Table of Contents

Highlights for the Full Year 2009

- Revenue of $6.6 million for the year ended 31 December 2009 (2008: $8.6 million)
- Net Loss of $1.9 million for the year ended 31 December 2009 (2008 Net Income: $0.1 million)
- As at 31 December 2009, the Company had $17.3 million in cash and cash equivalents and cash and short-term investments held for property and equipment construction (2008: $23.3 million). Of that total, cash and cash equivalents not held for property and equipment construction was $8.4 million. The Company continues to be in a strong position for capacity expansion.
- Investment in labor force, the new building committed to in the previous year and stagnant sales in 2009 have resulted in gross margin for the year ended 31 December 2009 of -5% (2008: 20%). Strong cost cutting actions taken during 2009 to reverse this fall in margin going forward.
- New solar recharging product solutions and distribution partners for the golf cart, police and emergency responder, marina, and bus shelter lighting markets.
- The Company is expanding the distribution of its products by forming a strategic partnership with established industry leader SoundOff Signal to distribute globally to the police, emergency, fleets, RV and trucking markets. Also the strategic relationship with W.W. Grainger offers potentially significant global sales opportunities in the military and disaster relief (including FEMA) markets. Distribution in the U.S. was further expanded via the West Marine national retail chain.
- Progress continues to be made on operation of the meter-wide deposition machine and associated cost reduction technology. Yields, however, remain insufficient for manufacturing of commercial product at this time. The Company is working to complete the engineering modifications required to solve this.
- The Company is progressing with its objectives for producing building integrated solar panels and has installed its first building integrated solar installation on architectural fabric at the Furman Aquatic Center in Ames, with other demonstration projects in the pipe line for 2010.
- In 2009, as previously announced, the thin film electronics business of the Company, through its majority-owned subsidiary Phicot, Inc., was awarded additional funding in the amount of $1.375 million by the U.S. Army in a cooperative agreement for further development of a "Self Powered Flexible Display."
- Like most companies in 2009, PowerFilm suffered from a downturn in its OEM and consumer markets due to the slowdown of the global economy. Yet PowerFilm continues to have a good foundation for growth with its increasing market presence and continued strong cash position on its balance sheet.

Chairman and CEO's Statement

The year 2009 was a challenging year for the solar industry, including PowerFilm. Our focus is clearly on achieving the Company's technical goals to realize an industry-leading low-cost manufacturing position with the meter-wide technology, which is especially important for the building integrated market. An equal priority is to increase revenues significantly, return to our historical gross margin levels, and manage costs closely to return to profitability.

We continue to understand how essential the lower-cost meter-wide manufacturing technology and building integrated solar product development and third party certification are to PowerFilm and its shareholders. Achieving those important technical milestones are top Company priorities every day. We are making progress and we believe we will meet those milestones successfully. Status updates on each of those two priorities are detailed in their respective sections in this announcement.

Our investment over the years in developing rugged lightweight products for portable and remote use for the Military market has resulted in a growing market presence and the development of certain key relationships in the sector, which are expected to result in increased military product volumes and revenues in 2010.

The largest impact of the economic recession on us has been through our commercial customers, as they have reduced spending and investment wherever they can. They had been the largest part of our sales, but have dropped significantly. In a number of cases, their annual orders have been a small fraction of their earlier purchasing levels. We have worked to broaden our customer base in this segment to maintain total sales. We expect that, as the economy recovers, this broader base of customers will provide us with good growth in the segment.

Newly developed products and distribution relationships for the Commercial/Industrial markets should begin to deliver increased revenues this year. Those revenue opportunities include panels for electric golf carts, marinas, RVs, police and emergency vehicles, and bus shelters. Although consumer and commercial spending remains tentative, our portable chargers and OEM components for that market are well-positioned once consumer spending regains its strength.

PowerFilm is making real progress with establishing building integrated relationships with established roofing materials manufacturers. Those relationships, along with the expected success with the meter-wide technology and third-party certification, will help give the Company a robust position with much potential in the building integrated solar market.

The overall market environment for PV has changed radically in the past year as a combined result of the economic downturn and the accelerating entry of Chinese manufacturers into the market. The combined impact of these two forces have cut selling prices of large rigid PV panels in half. Continued government subsidies around the world have mitigated the impact of the economic recession on demand for grid connected PV panels, but the Chinese entry has introduced much higher capacity. While the Chinese manufacturers do not have products which compete directly with PowerFilm's flexible PV, they compete indirectly and they effect the attitudes of buyers to the price per Watt for PV. While the price drop occurred more suddenly than expected, we have anticipated this level of price competition and have been advancing the meter-wide and associated cost reduction technologies to be able to compete at these levels. This year's changes emphasize the importance of bringing these improvements on line and carefully planning our entry into the more price sensitive markets.

Our leading position continues in developing backplane drivers for flexible displays using a true roll-to-roll manufacturing process and a flexible plastic substrate.

We are in an industry with strong product demand prospects for the decades ahead given the expected increase in use of electricity globally, the depleting supply of fossil fuels, and a sustaining commitment to the use of cleaner energy technology.

We believe that our continued focus on our core goals of increased revenues and lower costs per unit will put PowerFilm on the path to profitability. Our strong balance sheet gives us added confidence in our ability get over the temporary hurdles the recession has put in our path to demonstrate our full potential as a company and an investment.

Merlin Hanson – Chairman
Frank R. Jeffrey – CEO

Operational Review

Meter-Wide and Building Integrated Solar Update

The Company is progressing with its objectives for producing building integrated solar panels and has installed its first building integrated solar installation on architectural fabric at the Furman Aquatic Center in Ames, with other demonstration projects in the pipe line for next year. However, a wider roll out of the building integrated products, particularly in the current market conditions, will require the lower cost production of the meter-wide processing machines along with third-party certification.

As announced at the time of the results for the first half of 2009, solar material that passes internal standard specifications has been made with the meter-wide metallization and silicon deposition equipment, but current yield levels remain insufficient for the product to be commercially saleable. The Company is working to complete the engineering modifications required to solve this. Once this is done, the second meter-wide equipment line is expected to come on line relatively quickly, and then the production capacity expansion program in the new building will be implemented carefully to be aligned with market demand. The Company has made important further technical progress in the past three months.

Building integrated products will require third-party certification, as well as continued cost reducing technology improvements, so these remain a top priority. It is standard practice in the market for building integrated solar products to have their 20-year lifetime performance validated by third-party independent laboratory certification. Building integrated strategic partnerships are being formalized with building materials manufacturers to supply the market with integrated solutions.

As was previously announced, PowerFilm has been awarded a $150,000 grant from the Iowa Demonstration Fund to support the commercialization of the Company's new building integrated solar products. The grant will fund a building integrated product demonstration exhibition area at the Company, as well as several loaner demonstration units.

The Company has made progress with establishing strategic relationships with established, industry-leading roofing materials manufacturers for building integrated solar products. Those additional relationships are currently being formalized.

Production Capacity Expansion

The current plan is to add production capacity incrementally after engineering sign-off on the meter-wide equipment and as the economy improves.

Addition of Tim Neugent

In early 2009 Tim Neugent joined PowerFilm as President and COO to bring a clearer focus to the Company's strategical planning in terms of marketing, research and development, operational, and financial goals. He brings extensive experience in developing and building entrepreneurial companies, which include his own companies, as well as serving as Chief Executive of a number of others. Previously he was Director at Pioneer Hi-Bred where he co-developed the added-value Specialty Plant Products Division, served as CEO of CST a Computer and Alcohol interlock device company, COO of JD Publishing and consulted numerous more companies in strategic planning and targeted focus.

Sales and Marketing Update

Importantly, during this global economic downturn, PowerFilm has continued to invest selectively in its target markets through its marketing and sales efforts—especially targeted tradeshows—and is now largely known in those target markets. The increased top-of-mind awareness and brand and product recall has been achieved with several years of investment in tradeshows and the development of relationships of key players in each target market.

One of PowerFilm's key strengths is its ability to develop and supply optimized customized product solutions for our customers. This is enabled by both the inherent low-cost of customization characteristics of our technology and manufactur-

Operational Review - cont.

ing process and our strong product development engineering team. Our highly experienced team of in-house electrical engineers, mechanical engineers, materials engineers, chemical engineers, physicists, and other technical experts give both the Company and its customers a distinct advantage in the market.

Military Products Update

PowerFilm sells its products directly to the U.S. military and its military allies. The Company also sells products to defense contractors to add solar power recharging capabilities to their systems.

As was previously announced in December 2009, the Company was awarded two contracts from the U.S. Army Soldier Systems Center of Natick, Massachusetts, which total $1.27 million. These contracts are to enhance further the Company's lightweight solar and portable battery recharging technology for additional use by individual soldiers.

The benefit to individual soldiers in the field will be:

- a lighter load since fewer batteries will need to be carried;
- a reduction in the use of generators and very costly fuel by integrating additional solar power into military tents;
- enhanced mission capabilities with additional portable and remote power; and
- increased sustainability.

Portable, Miniature Solar/Battery Microgrid Modules
The Company has entered into a contract with the U.S. military to develop a small, rugged, lightweight portable balance of system/microgrid to provide a versatile and reliable source of electrical power without adding excessive weight to the soldier's load. The microgrid system will be suitable for use with PowerFilm's portable flexible solar panels and typical soldier-carried BB2590 / BB390 batteries.

A combined battery charger/AC solar module will be developed so that a soldier can carry and utilize the output from various power sources in order to generate a low power 120 volt AC output. Additionally, a battery cradle will be developed that holds multiple batteries and is capable of generating a higher output level of AC power of approximately 1 kilowatt.

The proposed lightweight, portable microgrid will allow the soldier to directly recharge military BB2590 and BB30 batteries, charge other military equipment via the DC bus or via AC inverter output, and also provide direct AC power for smaller electrical loads. This will in turn reduce the number of batteries soldiers are required to carry (less weight and volume), provide a flexible capability to charge military batteries and other military devices in situ, and remove the need for a small generator and fuel that is typically required for remote power generation for these tasks.

Research and Development for Continued Performance Improvement in Flexible a-Si PV
This contract covers support for the Army's needs for solar power-integrated Tentage, Fabric Structures, and Wall Shelters. The purpose of this contract is to further develop a flexible, thin film photovoltaic material on plastic film that can be incorporated into the skins of military tents and into the BB2590 / BB330 battery charging systems. This project will further improve the current technology.

This contract is evidence of the strong collaborative relationship PowerFilm has with the U.S. Army to work together to develop and supply thin film solar technology products that meet the needs of deployed soldiers.

For several years PowerFilm has developed products for and sold products into the military market. There are recognized needs for rugged alternative renewable electric power—where and when needed—in remote military areas, especially in or near the field of operations, such as in Afghanistan. These products are to be aligned with the power needs of today's highly sophisticated and electronics-connected soldier. The Company is placing a growing emphasis on providing power solutions that include not only solar panels with an optimized power output and form factor but also balance of systems technology (inverters and batteries) that meet specific military power needs as stand-alone units, multiple units connected together, or as part of overall hybrid power systems.

Operational Review - cont.

The built-in ruggedness of PowerFilm solar panels is especially important for use by the military. PowerFilm solar panels continue to perform, even after they are riddled with bullets, because PowerFilm's proprietary printed interconnect is a massively parallel interconnect that safeguards the connections between cells.

Solutions for reducing the monetary and human costs of a long logistical tail for fuel for generators are of clear interest at many levels in the U.S. Department of Defense. Reducing the use of costly fuel for generators in remote areas such as Afghanistan will help decrease the cost of extended remote deployments and will also decrease convoys and, in turn, the risk of casualties with those convoys. Reducing the quantity of batteries needed in the field is also of interest. The use of PowerFilm solar panels helps address all of these issues.

Unlike copper indium gallium selenide (CIGS) technology, PowerFilm solar panels do not require light-soaking when removed from storage in order to make the panel useful. This ability for soldiers to use PowerFilm solar panels directly from storage in a rucksack, vehicle, or tent is an important technical and practical advantage in remote areas of deployment.

The Company supplies its 1-3 kW Powershade products that provides not only the solar power, but shade to the user. The Company also supplies solar panels to tent manufacturers for field shelters that integrate the solar panels with their field shelters. PowerFilm has developed balance of system (BOS) batteries and inverters that are used with the solar field shelters. The BOS provides AC and DC power management, stores solar power for 24/7 use, and connects power to DC and AC devices. These shelters can be used as one component of hybrid electric power systems, or independently as a single unit, or in multiples.

Other PowerFilm military products include solar quads which provide approximately 200 Watts of power and can be used for powering DC systems or in combination with balance of system (BOS) batteries and inverters. The solar quad products are lightweight and can be daisy chained together to produce additional power.

Some examples of the Company's portable solar chargers for the military include the following: foldable solar chargers of various and custom configuration and sizes, rollable solar chargers of various and custom configuration and sizes, AA chargers, and USB+AA chargers. These solar chargers can be used for recharging and powering military laptops, cell phones, satellite phones, PDA's, field communications systems, gps systems, medical refrigeration, bots, unmanned bomb sniffers, drones, lighting, ventilation, and other electric needs, depending upon the size of the power need and solar array.

The Company is expanding the distribution of its products by forming a strategic partnership with established industry leader SoundOff Signal to distribute globally to the police, emergency, fleets, RV and trucking markets. Also the strategic relationship with W.W. Grainger offers potentially significant global sales opportunities in the military and disaster relief (including FEMA) markets.

PowerFilm is now largely known within the military circles and is staged to fill the military and defense contractor's demands for alternative solar power as they deploy in 2010.

Operational Review - cont.

Commercial/Industrial Market Update

PowerFilm spent considerable energy in 2009 to develop product solutions and distribution partners outside of the military markets to diversify its customer mix, so as not to rely so heavily on just the military sector.

Much effort was spent in identifying key markets and creating products where competition is limited, margins can be maintained and distribution partners can be aligned to take PowerFilm's products through their own distribution system.

Some of these efforts include:

- **Golf Cart Peel & Stick Modules with Charge Controllers:**

  Discussions are being held with the leading battery manufacturer in this space along with the four major golf cart manufacturers. The plans are to roll this product out in 2010.

- **Police & Emergency Responder market with PowerFilm's patented Magnetic Module design:**

  Signed an exclusive marketing and distribution agreement with SoundOff Signal, who manufactures LED lights, including emergency light bars, amber lights for fleets, and LED lighting for school buses, trucks and others.

- **Power Pier for boat lifts and boat battery charging:**

  Design patent has been applied for and received, and the Company is in discussions with a strategic distributor(s) to market these products.

- **RV peel & stick solar module with charge controllers:**

  The Company is in discussions with a strategic distributor(s) to market these products.

These efforts and the significant progress attained in 2009, along with our ability to customize and tailor manufacture to customers' needs will help insure increased revenues in 2010 with excellent margins.

We are excited over our efforts and achievements and even more excited as we move into 2010.

Consumer Market Update

The timing of the Consumer market recovery remains difficult to predict. Once it does recover, the Company has attractive products for that market. Broader distribution of these products now includes the outdoor retailer REI, West Marine with its U.S. national retail chain of more than 300 stores, and Amazon.com.

PowerFilm penetrates consumer markets with OEM solar modules, finished consumer-ready products sold under its brand name PowerFilm Solar, and via select private labeling opportunities to gain additional market penetration.

The PowerFilm Solar branded portable solar charger product line includes the USB+AA Solar Charger, the AA Solar Charger, foldable chargers ranging from 5-60 Watts, and a line of rollable chargers ranging from 7-28 Watts. The products are sold via authorized resellers. An important new retail account win is the West Marine retail chain in the U.S. which has more than 300 marine retail stores nationally.

To expand sales to the outdoor youth market, the Company has obtained a license from the Boy Scouts of America to market AA portable solar chargers under the "Be Prepared" brand name. PowerFilm is sponsoring an essay contest for Scouts to support their activities and to raise product awareness and sales among that target group.

Marketing and sales team members are working the sales pipeline intensively, building relationships with strategic customers whose applications have high-volume sales potential once the economy picks up. A recent high-profile promotional activity in the consumer market was PowerFilm's sponsorship for the Fox Teen Choice Awards. For the awards program PowerFilm's

Operational Review - cont.

rollable solar charges were used to power lighting and fans and were featured prominently along the "green" carpet.

We have built a sales pipeline that is a sound foundation for generating increased revenues and profits. There is strong product interest, but product adoption and sales are tempered by reduced consumer spending. That will turn, and when it does we are ready to capitalize in the opportunities in this space.

Thin Film Electronics Update

PowerFilm, Inc., through its majority-owned subsidiary Phicot, Inc., continues its leading technology position in the development of backplane drivers for flexible displays.

PowerFilm and HP were awarded the 2010 FLEXI Award from the The FlexTech Alliance. The FLEXI Awards recognize significant accomplishments in R&D, product development, and leadership in education in the flexible, printed electronics and displays industries.

PowerFilm is leveraging its expertise in roll-to-roll semiconductor manufacturing with a flexible plastic substrate to produce thin film electronics. The company is advancing its development program for backplane drivers for flexible displays through its majority-owned subsidiary Phicot, Inc. Collaboration on this project with H-P continues. As was previously announced, PowerFilm has licensed self-aligning imprint lithography technology from H-P to augment PowerFilm's core technology for the development of low-cost truly roll-manufactured backplane drivers on a thin, flexible plastic substrate.

PowerFilm's initial focus is the development of a self-powered flexible display device for individual soldiers to use to improve their situational awareness. The Company has received funding for the first year and a contract has been awarded for the second year of the development program.

As was previously announced in August 2009, the Company announced that it had been awarded second year funding in the amount of $1.375 million by the U.S. Army in a cooperative agreement for further development of a "Self Powered Flexible Display."

This funding is part of the cooperative agreement among PowerFilm's majority-owned subsidiary Phicot, Inc., Hewlett-Packard, and the U.S. Army Research Laboratory (ARL) for the three-year development program that was announced on 06 October 2008. At that time the initial funding award of $1.4 million for the first year was announced.

The display is intended to improve the situational awareness of individual soldiers and will be based on the roll-to-roll based thin film electronics technology being developed by PowerFilm in cooperation with Hewlett-Packard Laboratories. The display will be powered by the Company's thin flexible solar panels.

This funding will support the second year of a three-year development program. Funding for the third year is dependent on availability of funds and progress on the development milestones. The development of a flexible display under this agreement is expected to have significant cross-over benefit in other applications and markets.

PowerFilm believes that it has a strong chance to receive ongoing external funding for the third year of funding for the self-powered display program for the U.S. Army, at or possibly exceeding its existing development funding level.

Financial Review

Financial Results

Revenue of $6,590,213 was realized for the year ended 31 December 2009, compared with $8,604,514 for the year ended 31 December 2008.

Gross Margin for the year ended 31 December 2009 was -5%, compared with 20% for the year ended 31 December 2008. The decrease in gross margin is attributable to higher cost of sales due primarily to higher depreciation expense for new machines and the new building which was placed in service February 2009, higher utility costs for the new building, and higher labor costs and fringe benefits during the first half of 2009. Employees had been added during the last half of 2008 in preparation for a manufacturing scale-up to meet growth expectations. When sales did not materialize as anticipated, the Company took measures to reduce labor cost during the second half of 2009 by implementing a company-wide two-week plant shutdown and the layoff of fifteen employees. While these actions reduced cost of sales for the second half of 2009, it was not enough to completely offset the impact of labor costs for the first half of 2009.

Net loss was $1,851,926 for the year ended 31 December 2009, compared with net income of $135,826 for the year ended 31 December 2008.

The Company's balance sheet as at 31 December 2009 includes cash and cash equivalents of $8,448,812 and cash and short-term investments (certificates of deposit with original maturities greater than three months) held for property and equipment construction of $8,830,000. These accounts total $17,278,812. The balance sheet shows a short term liability of $4,625,000 for the tax exempt industrial revenue bond issued by the Iowa Finance Authority.

The Company has significant development contracts in place which support the majority of the research and development, thus reducing internally funded research and development. Internal research and development for 2009 was $105,100, compared to $40,027 for 2008. The increase in internal research and development in 2009 over 2008 was due to additional work on an R&D project beyond the funding of the contract. Selling, general and administrative expenses were $2,321,262 in 2009, compared to $1,686,903 for the previous year. The increase in expenses was due to higher professional and consulting fees, increased sales force, and an expanded trade show schedule and marketing expenses to target strategic markets for increasing future sales revenues.

Interest and dividend income for the year ended 31 December 2009 was $128,043, compared to $722,239 for the previous year. The Company's policy is to place its cash and short-term investments with high credit quality financial institutions in order to limit the amount of credit exposure. The decrease in interest and dividend income is due to the global reduction of interest rates, however during the second half of 2009, the Company did increase investments in higher yielding, secure certificates of deposit.

Accounts Audited

The information presented herein has been prepared on the basis of current US generally accepted accounting principles (US GAAP).

Independent Auditor's Report

McGladrey & Pullen
Certified Public Accountants

Independent Auditor's Report

The Board of Directors and Stockholders
PowerFilm, Inc.

We have audited the accompanying consolidated balance sheets of PowerFilm, Inc. and subsidiary as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders' equity, comprehensive (loss) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PowerFilm, Inc. and subsidiary as of December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

McGladrey & Pullen, LLP

Des Moines, Iowa
March 25, 2010

PowerFilm, Inc. and Subsidiary **Consolidated Balance Sheets**

31 December 2009 and 2008

	2009	2008
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents, net of cash held for property and equipment construction	**$ 8,448,812**	$ 11,584,345
Accounts receivable, less allowance for doubtful accounts 2009 $6,000; 2008 $11,213	**1,164,874**	1,557,265
Inventories	**3,294,266**	2,474,851
Prepaid expenses and other assets	**116,666**	122,929
Income tax receivable	**1,090,000**	103,000
Deferred income taxes	**237,000**	249,000
Total current assets	**14,351,618**	16,091,390
CASH AND SHORT-TERM INVESTMENTS HELD FOR PROPERTY AND EQUIPMENT CONSTRUCTION	**8,830,000**	11,730,000
PROPERTY AND EQUIPMENT		
Land	**972,432**	972,432
Building and improvements	**5,059,825**	-
Machinery and equipment	**8,361,317**	7,282,273
Leasehold improvements	**272,276**	272,276
Construction in progress	**4,833,835**	7,634,624
	19,499,685	16,161,605
Less accumulated depreciation	**(3,101,060)**	(2,104,017)
	16,398,625	14,057,588
OTHER ASSETS	**176,625**	184,427
	$ 39,756,868	$ 42,063,405

(Continued on next page)

See Notes to Consolidated Financial Statements

PowerFilm, Inc. and Subsidiary Consolidated Balance Sheets, cont.

31 December 2009 and 2008

	2009	2008
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current maturities of long-term debt	**$ 4,625,000**	$ 250,000
Trade accounts payable	**328,519**	514,107
Other payables and accrued expenses	**389,842**	624,402
Derivative financial instrument, interest rate swap	**341,294**	-
Total current liabilities	**5,684,655**	1,388,509
LONG-TERM LIABILITIES		
Revenue bonds payable, less current maturities	**-**	4,625,000
Derivative financial instrument, interest rate swap	**-**	757,224
Deferred income taxes	**787,000**	236,000
Total long-term liabilities	**787,000**	5,618,224
COMMITMENTS		
STOCKHOLDERS' EQUITY		
PowerFilm, Inc. and Subsidiary stockholders' equity:		
Common stock	**376,661**	373,717
Additional paid-in capital	**32,475,649**	32,329,012
Retained earnings	**1,143,066**	2,994,992
Treasury stock, at cost	**(488,675)**	(144,591)
Accumulated other comprehensive (loss)	**(225,254)**	(500,224)
Total PowerFilm Inc. and Subsidiary stockholders' equity	**33,281,447**	35,052,906
Noncontrolling interest	**3,766**	3,766
Total stockholders' equity	**33,285,213**	35,056,672
	$ 39,756,868	$ 42,063,405

See Notes to Consolidated Financial Statements

PowerFilm, Inc. and Subsidiary Consolidated Statements of Operations

Years Ended 31 December 2009 and 2008

	2009	2008
Operating revenues:		
Sales	$ 4,302,580	$ 5,742,166
Development contracts	2,287,633	2,862,348
	6,590,213	8,604,514
Cost of revenues	6,925,345	6,867,381
Gross profit (loss)	(335,132)	1,737,133
Operating expenses:		
Research and development	105,100	40,027
Selling, general and administrative	2,321,262	1,686,903
	2,426,362	1,726,930
Operating income (loss)	(2,761,494)	10,203
Other income (expense):		
Interest and dividend income	128,043	722,239
Interest (expense)	(63,124)	(187,839)
Other income (expense)	(48,351)	(265,401)
	16,568	268,999
Income (loss) before income taxes (benefit)	(2,744,926)	279,202
Income taxes (benefit)	(893,000)	144,000
Net income (loss)	(1,851,926)	135,202
Less: Net income (loss) attributable to the noncontrolling interest	-	(624)
Net income (loss) attributable to PowerFilm, Inc. and Subsidiary	$ (1,851,926)	$ 135,826
Basic earnings (loss) per share	$ (0.05)	$ 0.00
Diluted earnings (loss) per share	$ (0.05)	$ 0.00

See Notes to Consolidated Financial Statements

PowerFilm, Inc. and Subsidiary **Consolidated Statements of Stockholders' Equity**

Years Ended 31 December 2009 and 2008

	Common Stock U.S. $	Additional Paid-In Capital U.S. $	Retained Earnings U.S. $	Treasury Stock U.S. $	Accumulated Other Comprehensive (Loss) U.S. $	Noncontrolling Interest U.S. $	**Total Equity** U.S. $
Balance, December 31, 2007	$ 365,404	$31,762,286	$ 2,859,166	$ -	$ (110,015)	$ -	$ 34,876,841
Capital contribution	-	-	-	-	-	4,390	4,390
Net income (loss)	-	-	135,826	-	-	(624)	135,202
Unrealized derivative loss, net of tax benefit of $200,000	-	-	-	-	(390,209)	-	(390,209)
Stock awards exercised for 434,933 common shares	4,350	56,758	-	-	-	-	61,108
Acquisition of 257,200 shares for the treasury	-	-	-	(144,591)	-	-	(144,591)
Stock-based compensation expense, including tax benefit of $7,302	-	157,025	-	-	-	-	157,025
Issuance of 32,694 common shares, including 7,046 committed shares to be issued from 2007 to directors as compensation, less tax expense of $14,165	327	50,746	-	-	-	-	51,073
Subordinated debentures converted to 363,615 common shares	3,636	296,364	-	-	-	-	300,000
3,437 committed shares to be issued	-	5,833	-	-	-	-	5,833
Balance, December 31, 2008	373,717	32,329,012	2,994,992	(144,591)	(500,224)	3,766	35,056,672
Net (loss)	-	-	(1,851,926)	-	-	-	(1,851,926)
Unrealized derivative gain, net of tax expense of $141,000	-	-	-	-	274,970	-	274,970
288,300 restricted shares awarded from treasury shares, net of forfeitures	-	(125,640)	-	125,640	-	-	-
Stock awards exercised for 193,929 common shares	1,939	14,061	-	-	-	-	16,000
Acquisition of 1,769,000 shares for the treasury	-	-	-	(469,724)	-	-	(469,724)
Stock-based compensation expense, including tax benefit of $8,000	-	209,304	-	-	-	-	209,304
Issuance of 100,476 common shares, including 3,437 committed shares to be issued from 2008 to directors as compensation, less tax expense of $23,000	1,005	43,495	-	-	-	-	44,500
13,309 committed shares to be issued	-	5,417	-	-	-	-	5,417
Balance, December 31, 2009	**$ 376,661**	**$32,475,649**	**$1,143,066**	**$ (488,675)**	**$ (225,254)**	**$ 3,766**	**$ 33,285,213**

See Notes to Consolidated Financial Statements

PowerFilm, Inc. and Subsidiary Consolidated Statements of Comprehensive (Loss)

Years Ended 31 December 2009 and 2008

	2009	2008
Net income (loss)	$ (1,851,926)	$ 135,202
Other comprehensive income (loss), unrealized derivative gain (loss), net of tax	274,970	(390,209)
Comprehensive (loss)	**(1,576,956)**	(255,007)
Comprehensive income attributable to the noncontrolling interest	-	624
Comprehensive (loss) attributable to PowerFilm, Inc. and Subsidiary	**$ (1,576,956)**	$ (254,383)

See Notes to Consolidated Financial Statements

PowerFilm, Inc. and Subsidiary Consolidated Statements of Cash Flows

Years Ended 31 December 2009 and 2008

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	**$ (1,851,926)**	$ 135,202
Adjustments to reconcile net income (loss) to net cash (used in) operating activities:		
Depreciation and amortization	**1,016,745**	649,930
Provision for doubtful accounts	**16,950**	57,295
Deferred taxes	**422,000**	60,000
Stock-based compensation expense	**251,221**	170,931
Tax benefit resulting from stock awards	**8,000**	43,000
Changes in working capital components		
(Increase) decrease in accounts receivable	**375,441**	(597,313)
(Increase) in inventories	**(819,415)**	(982,328)
(Increase) decrease in prepaid expenses	**6,263**	(48,374)
(Increase) decrease in income tax receivable	**(987,000)**	90,000
Increase (decrease) in trade accounts payable	**(185,588)**	8,439
Increase (decrease) in other payables and accrued expenses	**(234,520)**	93,259
Net cash (used in) operating activities	**(1,981,829)**	(319,959)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	**(3,338,080)**	(8,709,012)
Proceeds from sale of securities available for sale	**-**	12,650,000
Decrease in cash and short-term investments held for property and equipment construction	**2,900,000**	3,270,000
(Increase) in other assets	**(11,900)**	(26,413)
Net cash provided by (used in) investing activities	**(449,980)**	7,184,575
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on long-term debt	**(250,000)**	(125,000)
Acquisition of treasury stock	**(469,724)**	(144,591)
Proceeds from issuance of common stock, net	**16,000**	61,108
Net cash (used in) financing activities	**(703,724)**	(208,483)
Net increase (decrease) in cash and cash equivalents	**(3,135,533)**	6,656,133
CASH AND CASH EQUIVALENTS		
Beginning	**11,584,345**	4,928,212
Ending	**$ 8,448,812**	$ 11,584,345

(Continued on next page)

See Notes to Consolidated Financial Statements

PowerFilm, Inc. and Subsidiary Consolidated Statements of Cash Flows, cont.

Years Ended 31 December 2009 and 2008

		2009		2008
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION, cash payments (receipts) for:				
Interest paid	$	**189,074**	$	209,939
Income taxes		**(610,000)**		37,000
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES				
Conversion of subordinated debentures to common stock	$	**-**	$	300,000
Gain (loss) on interest rate swap agreement		**274,970**		(390,209)
Purchase of property and equipment on account		**-**		194,578
Restricted shares awarded from treasury shares		**125,640**		-

See Notes to Consolidated Financial Statements

PowerFilm, Inc. and Subsidiary **Notes to Consolidated Financial Statements**

Note 1. Summary of Significant Accounting Policies

Nature of business: PowerFilm, Inc. was incorporated on October 13, 1988, for the purpose of research and development of thin film technologies. PowerFilm, Inc.'s focus is now the use of such developed technologies to manufacture solar modules. PowerFilm, Inc. sells its solar modules throughout the world and continues to enter into research contracts to further develop the thin film technology for use in the manufacturing of solar cells. Phicot, Inc. was incorporated as a new subsidiary during 2008 for the purpose of conducting further research and development under these research contracts.

Principles of consolidation: The consolidated financial statements include the accounts of PowerFilm, Inc. and its 92% owned subsidiary, Phicot, Inc. (collectively, the Company). All intercompany balances and transactions have been eliminated in consolidation.

Effective January 1, 2009, the Company adopted new authoritative accounting guidance for noncontrolling interests in consolidated financial statements, which resulted in the reclassification of noncontrolling interests as a component of stockholders' equity. As a result to this adoption, the 2008 consolidated financial statements have been adjusted to make them comparable with the presentation required for the year ending December 31, 2009. Certain other amounts previously reported have also been reclassified to conform to the presentation in these consolidated financial statements. These other reclassifications did not affect previously reported net income or stockholders' equity.

Use of estimates: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair value measurements: The Company measures fair value of financial instruments in accordance with the *Fair Value Measurements and Disclosures* topic of the Accounting Standards Codification. In general, fair value measurements are based upon quoted market prices, where available. If quoted market prices are not available, fair value measurements are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and require some degree of judgment regarding interest rates, credit risk, prepayments and other factors. The use of different assumptions or estimation techniques may have a significant effect on the fair value amounts reported.

Cash and cash equivalents: The Company considers all cash accounts which are not subject to restrictions and all highly liquid investments with a maturity of three months or less to be cash equivalents. At December 31, 2009 and 2008, approximately $80,000 and $466,000, respectively, of cash is denominated in a foreign currency. During the years ended December 31, 2009 and 2008, approximately $62,000 of foreign currency gain and ($178,000) of foreign currency (loss), respectively, were recognized in other income (expense) on the consolidated statements of income.

Short-term investments: Short-term investments are recorded at cost and consist of certificates of deposit with maturities at date of purchase of more than three months. As of December 31, 2009, $8,000,000 of the certificates of deposit are in United States banks and are fully insured by the FDIC with maturities from April 2010 through December 2010. The remaining certificate of deposit is with a bank in the United Kingdom and matures in July 2010. The United Kingdom certificate is denominated in British Pounds with 50,000 British Pounds guaranteed by the United Kingdom Deposit Protection program. Interest income on these certificates is recorded on the accrual basis.

Accounts receivable: Accounts receivable are carried at original invoice amount less an estimate for doubtful receivables based on a review of outstanding amounts. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Inventories: Inventories are stated at the lower of cost or market, with cost determined on the first-in, first-out (FIFO) basis.

Property and equipment: Property and equipment is recorded at cost. Depreciation is provided using the straightline method over the estimated useful lives of the related assets. During 2009 and 2008, the Company capitalized interest totaling approximately $128,000 and none respectively related to construction in progress.

PowerFilm, Inc. and Subsidiary **Notes to Consolidated Financial Statements, cont.**

Revenue recognition: Revenue from product sales is recognized upon shipment of the product to the customer. Revenue from development contracts is recognized as services are performed. Shipping and handling charges to customers are included in operating revenue. Shipping and handling costs incurred by the Company are included in cost of revenues.

Foreign sales: During the years ended December 31, 2009 and 2008, sales to customers located in foreign countries (primarily Hong Kong and China during 2009 and Hong Kong during 2008) totaled approximately $958,000 and $2,064,000, respectively.

Concentration of credit risk: The Company's financial instruments that are subject to concentrations of credit risk consist primarily of cash, short-term investments and accounts receivable. The Company's policy is to place its cash and short-term investments with high credit quality financial institutions in order to limit the amount of credit exposure. The Company maintains cash in bank accounts and certificates of deposit that at times may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Cash and short-term investments held for equipment construction: The estimated amount of cash and short-term investments that will be used for construction of equipment has been classified as long term according to its estimated use.

Earnings (loss) per share: Basic earnings (loss) per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is calculated by dividing net income by the weighted average number of common shares and potential common shares outstanding during the period.

Stock-based compensation: Compensation cost for all stock-based awards is measured at fair value on the date of grant and recognition of compensation expense over the requisite service period for awards expected to vest. The Company's consolidated statements of income include stock-based compensation expense of approximately $251,000 and $171,000 for the years ended December 31, 2009 and 2008, respectively.

Income taxes: Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Company follows the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Company may recognize the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The guidance on accounts for uncertain in income taxes also addresses de-recognition, classification, interest and penalties on income taxes, and accounting in interim periods. The Company has evaluated their material tax positions and determined no effects on the financial statements related to uncertainty to income taxes. The Company is no longer subject to federal and state examinations by tax authorities for years before 2006.

Derivative financial instruments: The Company has adopted hedge accounting for an interest rate swap contract in connection with borrowings on variable rate long-term debt. On the date the contract was entered into, the Company designated the derivative as a hedge of the variability of cash flows to be received or paid related to a recognized liability ("cash flow" hedge). Changes in the fair value of a derivative that are highly effective and that are designated and qualify as a cash flow hedge are recorded in other comprehensive income (loss) until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate liability are recorded in earnings).

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedged transactions. This process includes linking all derivatives that are designated as cash flow hedges to specific liabilities on the balance sheet. The Company also formally

PowerFilm, Inc. and Subsidiary Notes to Consolidated Financial Statements, cont.

assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge, or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively. No ineffectiveness was recognized on the interest rate swap for the year ended December 31, 2009.

The fair value of the interest rate swap was a liability of approximately $341,000 and $757,000 respectively, at December 31, 2009 and 2008. The notional amount of the interest rate swap at December 31, 2009, is $4,625,000, and the interest rate swap agreement expires June 1, 2028. Under the swap agreement, the Company pays interest at a fixed rate of 3.6% and receives interest at a variable rate equal to 70% of 1-month LIBOR (approximately 0.16% at December 31, 2009). The interest rate swap liability as been classified as a currently liability in the consolidated balance sheets as of December 31, 2009, due to the covenant violations discussed in Note 3.

<u>Other comprehensive income:</u> Other comprehensive income consists of the effective portion of net gains or losses on derivative instruments designated as qualifying cash flow hedges.

<u>Operating segment:</u> The Company uses the "management approach" for reporting information in financial statements. The management approach is based on the way the chief operating decision maker organizes segments within a company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure and any other manner in which management disaggregates a company. Based on the management approach model, the Company has determined that its business is comprised of a single operating segment.

<u>Recent authoritative accounting guidance:</u> New authoritative guidance under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 105, *Generally Accepted Accounting Principles* establishes the ASC as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. All guidance contained in the ASC carries an equal level of authority. All non-grandfathered accounting literature not included in the ASC is superseded and deemed non-authoritative. ASC Topic 105 became effective for the Company's financial statements for the year ending December 31, 2009, and did not have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

New authoritative accounting guidance under ASC Topic 855, Subsequent Events, establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC Topic 855 defines (i) the period after the balance sheet date during which a reporting entity's management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and (iii) the disclosures an entity should make about events or transactions that occurred after the balance sheet date. The new authoritative accounting guidance under ASC Topic 855 became effective for the Company's financial statements for the year ending December 31, 2009, and did not have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

Note 2. Inventories

Inventories were composed of the following at December 31:

	2009	2008
Raw materials	**$ 993,987**	$ 1,076,961
Work in process	**1,424,883**	1,039,172
Finished products	**875,396**	358,718
	$ 3,294,266	$ 2,474,851

PowerFilm, Inc. and Subsidiary **Notes to Consolidated Financial Statements, cont.**

Note 3. Revenue Bonds Payable

The Company has $4,625,000 tax exempt industrial revenue bond issued by the Iowa Finance Authority. Interest payments, at a variable interest rate calculated weekly based on adjustable rates, are due monthly. Principal payments of $125,000 are due June 1 and December 1 of each year through June 1, 2028, when all remaining principal and interest are due.

The Bonds are secured by a first lien on real estate, including improvements thereon, together with the machinery and equipment purchased with the proceeds of the bond issue. Proceeds from the bond were restricted for use in construction of a new facility. As of December 31, 2008, all of the proceeds had been used for the new facility; therefore, no restriction remains on the balance sheet. To provide additional security for payment, the Company is required to maintain a letter of credit agreement with a bank in the amount of the outstanding principal and interest payable on the related bonds. The letter of credit requirement expires on December 15, 2010. No amounts are outstanding on the letter of credit as of December 31, 2009 or 2008.

In connection with the bond agreement and letter of credit, the Company is required to maintain certain financial covenants. At December 31, 2009, the Company was in violation of these financial covenants which constitutes an event of default under the terms of the bond agreement. Due to the event of default, the Iowa Finance Authority has the ability to demand payment of the entire outstanding balance at any time. Accordingly, the outstanding balances of the bond and interest rate swap have been classified as a current liability at December 31, 2009.

The Company is continuing to negotiate a waiver of the covenant violations with the bank which issued the letter of credit, however, there can be no assurances that such a waiver will be obtained. In the event that a waiver cannot be obtained, the Company will attempt to obtain an alternate letter of credit from another bank. In the event that a waiver or alternate letter of credit cannot be obtained, the Company will pay the outstanding principal and interest balance on the revenue bond as well as the outstanding interest rate swap liability using cash on hand. Use of cash on hand to pay these amounts is not expected to have a significant impact on the Company's operations.

Note 4. Income Taxes

Income tax expense (benefit) consists of the following for the years ended December 31, 2009 and 2008:

	2009	2008
Current expense (benefit)	**$ (1,315,000)**	$ 84,000
Deferred expense	**422,000**	60,000
	$ (893,000)	$ 144,000

Income tax expense (benefit) differs from the amount expected by applying the statutory federal tax rate to income before taxes as a result of the following:

	2009	2008
Tax expense (benefit) at the statutory tax rate	**$ (934,000)**	$ 95,000
Increase in tax resulting from:		
Nondeductible incentive stock option expense	**33,000**	33,000
Other, net	**8,000**	16,000
Tax expense (benefit) at effective tax rate	**$ 893,000**	$ 144,000

The tax effects of significant items comprising the Company's net deferred tax assets (liabilities) as of December 31, 2009 and 2008 are as follows:

	2009	2008
Deferred tax assets:		
Interest rate swap agreements	**$ 116,000**	$ 257,000
Restricted stock grants	**24,000**	19,000
Accrued expenses	**59,000**	44,000
Foreign currency	**59,000**	38,000
Inventory	**-**	112,000
Other	**3,000**	56,000
	261,000	526,000
Deferred tax liabilities:		
Property and equipment	**(811,000)**	(513,000)
Net deferred tax assets (liabilities)	**$ (550,000)**	$ 13,000

Note 5. Leases

The Company leases its offices and manufacturing facility from a stockholder under a five-year operating lease that runs through January 1, 2010, with monthly lease payments of $7,500. Rent expense under this lease totaled $90,000 for each of the years ended December 31, 2009 and 2008.

Note 6. 401(k) Plan

The Company has a 401(k) profit sharing plan which covers substantially all employees of the Company. The Company may make annual contributions to the plan at the discretion of the Board of Directors. The Company contributed approximately $153,000 and $340,000 during the years ended December 31, 2009 and 2008, respectively.

Note 7. Major Customers

Net sales for the years ended December 31, 2009 and 2008, include sales to the following major customers, together with the approximate accounts receivable due from those customers:

	Net Sales December 31,		Accounts Receivable December 31,	
	2009	2008	**2009**	2008
Customer A	**37%**	36%	**$ 654,000**	$ 523,000
Customer B*	**4%**	17%	**-**	307,000

* These sales are to customers located in foreign countries

PowerFilm, Inc. and Subsidiary **Notes to Consolidated Financial Statements, cont.**

Note 8. Components of Common Stock

Information regarding components of $0.01 par value common stock at December 31, 2009 and 2008, is as follows:

	Authorized Share	Issued Shares	Outstanding Shares	Committed to be Issued Shares
2009	**60,000,000**	**37,666,099**	**35,928,199**	**13,309**
2008	60,000,000	37,371,694	37,114,494	3,437

During the years ended December 31, 2009 and 2008, the Company acquired 1,769,000 and 248,000 treasury shares at a cost of approximately $470,000 and $145,000, respectively. An additional 36,700 and 9,200 shares previously issued under the restricted stock plans discussed in Note 10 were forfeited during 2009 and 2008, respectively, prior to vesting. Per the terms of the restricted stock plan, these shares are to be held in treasury and are available for future grant under the plans. During 2009 the Company granted 325,000 restricted shares under the 2009 restricted stock plan discussed in Note 10.

As of December 31, 2009, there were 129,808 issued shares held in an escrow account subject to certain restrictions as discussed in Note 10.

Note 9. Commitments

The Company has historically entered into research and development contracts, for further development of the Company's technology, which are funded directly and indirectly through governmental agencies. The contract terms range from actual cost to cost plus a 5% fee. Revenue is earned as cost is incurred. Costs and any related fees included under such contracts are billed monthly for the costs incurred for the current month ending.

As of December 31, 2009, the Company had future research and development contractual commitments of approximately $2,403,000.

Note 10. Stock-Based Compensation

2005 Plan

The Company's Board of Directors adopted the 2005 Incentive Stock Option Plan (2005 Plan) during October 2005. Under the 2005 Plan, options may be granted to officers, directors and employees to purchase up to an aggregate of 3,030,150 shares of the Company's common stock. Option awards are granted with an exercise price equal to the market price of the Company's stock at the date of grant. Under the 2005 Plan, the term of the options may not exceed ten years. Incentive stock options granted under the 2005 Plan vest 20% immediately and then 20% annually thereafter for the following four years. At December 31, 2009, there were 339,383 common shares available for future grant under the 2005 Plan. No option awards were granted during the years ended December 31, 2009 and 2008.

The following table summarizes stock option activity for the year ended December 31, 2009:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Outstanding options, December 31, 2008	1,321,982	$ 0.70	
Exercised	(193,929)	0.08	
Forfeited	(48,482)	0.08	
Outstanding options, December 31, 2009	1 ,079,571	$ 0.84	6 years
Exercisable at December 31, 2009	1,001,998	$ 0.69	6 years

The intrinsic value of options exercised during the years ended December 31, 2009 and 2008, totaled approximately $62,000 and $1,088,000, respectively.

Cash received for option exercises for the years ended December 31, 2009 and 2008, totaled $16,000 and $61,000, respectively.

As of December 31, 2009, unrecognized compensation cost for stock options, net of forfeitures, totaled approximately $58,000, which is expected for be recognized during the year ended December 31, 2010.

2007 Plan

The Company's Board of Directors adopted the 2007 Restricted Stock Plan (2007 Plan) during October 2007. Under the 2007 Plan, restricted shares may be granted to any full-time employee of the Company, except officers and directors. Common shares issued under the 2007 Plan may not be sold or otherwise transferred until restrictions have lapsed. During the vesting period, participants have voting rights and receive dividends on the restricted shares. The 2007 Plan authorized a total of 100,000 shares to be available for grant. Awards that are forfeited prior to vesting are held in treasury and are available for future grant. At December 31, 2009, there were 55,200 common shares available for future grant under the 2007 Plan. There were no share awards granted under the 2007 Plan during the year ended December 31, 2009.

PowerFilm, Inc. and Subsidiary **Notes to Consolidated Financial Statements, cont.**

The following table presents information regarding the Company's 2007 restricted stock plan as of December 31, 2009:

	Number of Shares	Weighted Average Grant Date Fair Value
Restricted stock, beginning of year	40,585	$ 4.20
Vested	(8,577)	4.20
Forfeited	(13,500)	4.23
Restricted stock, end of year	18,508	$ 4.20

As of December 31, 2009, unrecognized compensation cost for the 2007 plan totaled approximately $78,000, which is expected to be recognized over a weighted average remaining period of 2.7 years.

2009 Plan

The Company's Board of Directors adopted the 2009 Restricted Stock Plan (2009 Plan) during January 2009. Under the 2009 Plan, restricted shares may be granted to any full-time employee of the Company, except officers and directors. Common shares issued under the 2009 Plan may not be sold or otherwise transferred until restrictions have lapsed. During the vesting period, participants have voting rights and receive dividends on the restricted shares. The 2009 Plan authorized a total of 325,000 shares to be available for grant. Awards that are forfeited prior to vesting are held in treasury and are available for future grant. At December 31, 2009, there were 23,200 shares available for future grant under the 2009 Plan.

The following table presents information regarding the Company's 2009 restricted stock plan as of December 31, 2009:

	Number of Shares	Weighted Average Grant Date Fair Value
Restricted stock, beginning of year	-	
Granted	325,000	0.36
Vested	(190,500)	0.36
Forfeited	(23,200)	0.36
Restricted stock, end of year	111,300	$ 0.36

As of December 31, 2009, unrecognized compensation cost for restricted stock totaled approximately $41,000, which is expected to be recognized over a weighted average remaining period of 3.2 years.

The fair value of restricted stock awards, based on the fair value of the Company's common stock on the date of grant, is being amortized as compensation expense on a straight-line basis over the period restrictions lapse. Compensation expense related to restricted share awards of approximately $105,000 and $52,000 is included in selling, general and administrative expenses on the consolidated statements of operations for the years ended December 31, 2009 and 2008, respectively.

PowerFilm, Inc. and Subsidiary **Notes to Consolidated Financial Statements, cont.**

Note 11. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2009 and 2008:

	2009	2008
Net income (loss) , basic and diluted, attributable to PowerFilm, Inc. and Subsidiary	$ (1,851,926)	$ 135,826
Average outstanding shares - basic	36,572,467	37,153,995
Add: effect of dilutive stock options	-	1,028,362
Average outstanding shares - diluted	36,572,467	38,182,357
Basic earnings (loss) per share	$ (0.05)	$ -
Diluted earnings (loss) per share	$ (0.05)	$ -

There were 1,209,379 and 393,218, for the years ended December 31, 2009 and 2008, respectively, of antidilutive stock options and restricted stock outstanding. Accordingly, the dilutive effect of these options and restricted shares has been excluded from the calculation of diluted earnings per share above.

Note 12. Fair Value Measurements

The Company measures fair value in accordance with the *Fair Value Measurements and Disclosures* topic of the Accounting Standards Codification. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The accounting standard requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In the regard, the standard establishes a fair value hierarchy for valuation inputs that give the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

PowerFilm, Inc. and Subsidiary Notes to Consolidated Financial Statements, cont.

Financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2009 and 2008, are as follows:

2009 **Description**	**Total**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Liabilities, interest rate swap agreement	**$ 341,294**	**$ -**	**$ 341,294**	**$ -**

2008 Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities, interest rate swap agreement	$ 757,224	$ -	$ 757,224	$ -

<u>Interest rate swap agreement:</u> The interest rate swap is valued using a discounted cash flow model that uses verifiable yield curve inputs to calculate the fair value and is classified within Level 2 of the valuation hierarchy. This method is not dependent on the input of any significant judgments for assumptions by management.

Accounting standards also require disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. Fair value is determined under the framework established above. Certain financial instruments, and all nonfinancial instruments, are excluded from these disclosure requirements. The Company's financial instruments consist primarily of cash and cash equivalents, short-term investments, accounts receivable, trade accounts payable, revenue bonds payable and an interest rate swap. The carrying amounts of cash and cash equivalents, accounts receivable and trade accounts payable approximate fair value due to the short maturities of those instruments. The carrying values of revenue bonds payable approximate fair values since they include variable interest rates which are not significantly different than current market rates. The fair value of the interest rate swap is estimated as described above. The fair value of short-term investments as of December 31, 2009, is approximately $8,855,000 estimated using market rates currently offered for certificates of deposit with similar remaining maturities.

Note 13. Subsequent Events

Subsequent events have been evaluated for potential recognition and disclosure through March 25, 2010, the date the financial statements were issued. Through that date, there were no events requiring recognition and no events requiring disclosure, except as described below.

On January 1, 2010, the Company renewed the operating lease on its offices and manufacturing facility disclosed in Note 5. The new lease agreement expires December 31, 2014, and requires future payments of $90,000 per year.

Notice of Annual General Meeting

TO THE STOCKHOLDERS OF POWERFILM, INC.:

Notice is hereby given of the Annual Meeting of Stockholders of PowerFilm, Inc. (the "Company") which will be held at 1287 XE Place, Ames, Iowa, 50014, USA, on May 21, 2010, commencing at 3:00 p.m. Central Time (US) for the following purposes:

1. To elect the Board of Directors to serve for a term ending at the Annual Meeting in 2011 and until their successors have been elected and qualified;

2. To ratify the appointment of McGladrey & Pullen, LLP as our independent registered public accounting firm for the year ending December 31, 2010;

3. To transact such other business as may properly come before the Annual Meeting or any adjournment or postponement thereof.

Notes:

1. The record date for determining those stockholders, who will be entitled to notice of, and vote at, the Annual Meeting, or any adjournment thereof, is April 15, 2010. The stock transfer books of the Company will not be closed between the record date and the date of the Annual Meeting. A list of stockholders entitled to vote at the Annual Meeting will be available for inspection at the offices of the Company.

2. You are cordially invited to attend the meeting in person. Whether or not you plan to attend the meeting, please execute the enclosed proxy and mail it promptly. Should you attend the meeting, you may revoke your proxy and vote in person. A return envelope, which requires no postage, if mailed in the United States, is enclosed for your convenience.

POWERFILM, INC.

By:

Frank R. Jeffrey
Chief Executive Officer
Ames, Iowa