Hallwood Group Inc
Form 10-K
April 02, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(MARK ONE)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the year ended December 31, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
for the transition period from to

Commission file number: 1-8303

The Hallwood Group Incorporated

(Exact name of registrant as specified in its charter)

Delaware	**51-0261339**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification No.)**
3710 Rawlins, Suite 1500,	
Dallas, Texas	**75219**
(Address of principal executive offices)	**(Zip Code)**

(Registrant s telephone number, including area code)

214-528-5588

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Class	**Name of Exchange on Which Registered**
Common Stock ($0.10 par value)	**NYSE Amex**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in, definitive proxy or information statements incorporated by reference in part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The aggregate market value of the Common Stock, held by non-affiliates of the registrant as of June 30, 2011, the last business day of the registrant s most recently completed second fiscal quarter, based on the closing price of $19.00 per share on the NYSE Amex, was $9,751,000.

1,525,166 shares of Common Stock were outstanding at March 26, 2012.

DOCUMENTS INCORPORATED BY REFERENCE

The information called for by Part III of this Form 10-K is incorporated by reference to the definitive Proxy Statement for the Annual Meeting of Stockholders of the Company.

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THE HALLWOOD GROUP INCORPORATED

FORM 10-K

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Forward-Looking Statements

In the interest of providing stockholders with certain information regarding the Company and its subsidiaries future plans and operations, certain statements set forth in this report on Form 10-K relate to management s future plans, objectives and expectations. Such statements are forward-looking statements. Although any forward-looking statement expressed by or on behalf of the Company is, to the knowledge and in the judgment of the officers and directors, expected to prove true and come to pass, management is not able to predict the future with absolute certainty. Forward-looking statements involve known and unknown risks and uncertainties, which may cause the Company s actual performance and financial results in future periods to differ materially from any projection, estimate or forecasted result. Among others, these risks and uncertainties include those described in Item 1A.- Risk Factors to this report on Form 10-K. These risks and uncertainties are difficult or impossible to predict accurately and many are beyond the control of the Company. Other risks and uncertainties may be described, from time to time, in the Company s periodic reports and filings with the Securities and Exchange Commission.

PART I

Item 1. Business

The Hallwood Group Incorporated (the Company) (NYSE Amex: HWG) was incorporated in Delaware in 1981 and operates as a holding company. The Company operates its principal business in the textile products industry through its wholly owned subsidiary, Brookwood Companies Incorporated (Brookwood). Information contained herein includes references to the Company and its subsidiaries (collectively, the Hallwood Group).

***Textile Products*.** Textile products operations are conducted through Brookwood. Brookwood is an integrated textile firm that develops and produces innovative fabrics and related products through specialized finishing, treating and coating processes.

Organization. Brookwood principally operates as a converter, finisher and laminator in the textile industry, which processes fabrics at its plants, located in Rhode Island and Connecticut, or by contracting with independent finishers. Brookwood is one of the largest coaters of woven nylons in the United States of America. Brookwood is known for its extensive, in-house expertise in high-tech fabric development and is a major supplier of specialty fabric to U.S. military contractors. Brookwood produces fabrics that meet standards and specifications set by both government and private industry, which are used by military, consumer and industrial customers. Brookwood has two principal subsidiaries at December 31, 2011:

- Kenyon Industries, Inc. (Kenyon). Kenyon, located in Rhode Island, uses the latest technologies and processes in dyeing, finishing, coating and printing of woven synthetic products. Kenyon provides quality finishing services for fabrics used in a variety of markets, such as military, luggage and knapsacks, flag and banner, apparel, industrial and sailcloth.

- Brookwood Laminating Inc. (Brookwood Laminating). Brookwood Laminating, located in Connecticut, uses the latest in processing technology to provide quality laminating services for fabrics used in military clothing and equipment, sailcloth, medical equipment, industrial applications and consumer apparel. Up to five layers of textile materials can be processed using both wet and dry lamination techniques.

Raw Materials and Suppliers. The principal raw materials used by Brookwood include various untreated woven nylons, other fabrics, films, dyes and chemical compounds acquired primarily from U.S. suppliers.

Brookwood generally maintains relationships with a limited number of suppliers, however, Brookwood believes that these raw materials are available from alternative suppliers if a supplier cannot meet Brookwood s requirements. Some of Brookwood s significant suppliers include General Electric, Milliken & Company, Precision Fabrics Group, Inc., and Schneider Mills, Inc.

Sales and Distribution. Brookwood s products are sold through its internal sales force in New York, Connecticut and California and a minimal network of independent sales representatives.

Substantially all products are sold to U.S. organizations, including various customers holding or participating in military contracts.

Competition. The textile market remains highly competitive. Competition is principally based on product development, design, price, quality and service. Brookwood s ability to compete is enhanced by its in-house expertise and vertical integration of its product development, converting, finishing and laminating process.

Brookwood s competitive position varies by product line. There are several major domestic competitors in the synthetic fabrics business, none of which dominates the market. Brookwood believes, however, that it has a strong competitive position. In addition, Brookwood believes it is one of a few finishers successful in printing camouflage on nylon for sale to apparel suppliers of the U.S. government. Additional competitive strengths of Brookwood include: knowledge of its customers business needs; its ability to design and produce special fabrics such as textured blends; waterproof breathable fabrics; state of the art fabric finishing equipment at its facilities; and substantial vertical integration.

Seasonality and Backlog. The textile industry historically experiences cyclical swings. Brookwood has partially offset the effect of those swings by diversifying its product lines and business base. Brookwood has historically enjoyed a fairly steady base level stream of orders that comprise its backlog. However, the backlog is subject to market conditions and the timing of contracts granted to its prime government contractor customers. Management believes that Brookwood maintains a level of inventory adequate to leverage its sales requirements.

Patents and Trademarks. Brookwood has and continues to obtain various patents and trademarks. Brookwood has ongoing programs of research and development in all of its divisions adequate to maintain the exploration, development and production of innovative products and technologies.

New Revolving Credit Facility entered into in March 2012. On March 30, 2012, Brookwood and its subsidiaries entered into a loan agreement by and among Brookwood, its subsidiaries and Branch Banking and Trust Company (BB&T) (the New Revolving Credit Facility). The New Revolving Credit Facility replaces Brookwood s previous revolving credit facility with KeyBanc (the Working Capital Revolving Credit Facility).

The New Revolving Credit Facility provides for borrowings of up to $25,000,000 and is secured by a first lien on substantially all of the assets of Brookwood. The New Revolving Credit Facility has a maturity date of March 30, 2014. On April 2, 2012, Brookwood borrowed $2,000,000 under this new facility to repay outstanding amounts due under Brookwood s former Working Capital Revolving Credit Facility.

The interest rate payable on the New Revolving Credit Facility is dependent on a leverage ratio, as defined, and can vary from LIBOR plus 1.00% to 2.00%. If BB&T is not a primary factor of Brookwood, then the interest rates will be increased by 0.40%.

The terms of the New Revolving Credit Facility provide that the facility may be used for refinancing existing indebtedness, providing for working capital and financing on-going capital expenditures.

The New Revolving Credit Facility contains customary representations, warranties and affirmative covenants on behalf of Brookwood and also contains negative covenants that, among other things, prohibit Brookwood from, without obtaining prior BB&T written consent and with certain exceptions: (i) permitting liens (other than customary liens) to exist on any of its properties; (ii) incurring other debt other than accounts payable to trade creditors incurred in the ordinary course of business and factors; (iii) making capital expenditures in excess of $5,000,000 in any year; (iv) purchasing substantially all the assets of another entity; (v) entering into new leases except operating leases for machinery and equipment that do not in the aggregate require payments in excess of $250,000 in any year and real estate leases in the ordinary course of business; (vi) paying dividends, or acquiring any of its stock, other than (a) annual payments to the Company for tax sharing obligations, and (b) annual discretionary dividends to the Company not to exceed 50% of Brookwood s net income for such year; (vii) making loans or advances to, or guaranties for the benefit of, any person; and (viii) disposing of its assets or properties except in the ordinary course of its business.

The loan agreement also requires Brookwood to satisfy certain financial covenants on the last day of each fiscal quarter, including maintaining:

(i) a ratio of total current assets to the sum of total current liabilities and the outstanding loan balance of not less than 1.40 to 1.00.

(ii) a ratio of total liabilities to tangible net worth of not greater than 1.50 to 1.00. Tangible net worth is defined as net worth, plus obligations contractually subordinated to debts owed to BB&T, minus goodwill, contract rights, and assets representing claims on stockholders or affiliated entities.

(iii) a ratio of funded debt (as defined) to EBITDA (earnings before interest, taxes, depreciation and amortization) for the trailing four quarters of not greater than 2.75 to 1.00.

For the three years ended December 31, 2011, textile products operations accounted for all of Hallwood Group s operating revenues. For details regarding revenue, profit and total assets, see Note 17 to the Company s consolidated financial statements.

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Energy. The Company s prior investment in the energy segment was held through its ownership interest in Hallwood Energy, L.P. (Hallwood Energy) and Hallwood Energy Management, LLC, its general partner (HEM). Hallwood Energy was a privately held independent oil and gas limited partnership that operated as an upstream energy company engaged in the acquisition, development, exploration, production, and sale of hydrocarbons, with a primary focus on natural gas assets. The Company accounted for the investment in Hallwood Energy using the equity method of accounting, recording its pro rata share of Hallwood Energy s net income (loss), partners capital transactions and comprehensive income (loss), as appropriate.

Bankruptcy Reorganization by Hallwood Energy. In March 2009, Hallwood Energy, HEM and Hallwood Energy s subsidiaries filed petitions for relief under Chapter 11 of the United States Bankruptcy Code. The cases were adjudicated in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division, in *In re Hallwood Energy, L.P., et al Case No. 09-31253*. The Company was only an investor in and creditor of Hallwood Energy. The bankruptcy filing did not include the Company or Brookwood. In October 2009, the Bankruptcy Court confirmed a plan of reorganization of the debtors.

Litigation. As further discussed in Item 3. Legal Proceedings, in connection with Hallwood Energy s bankruptcy proceeding, Hallwood Energy and other parties filed a number of lawsuits against the Company, its directors and various other parties. One of the lawsuits involved an acquisition and farmout agreement entered into between Hallwood Energy and FEI Shale, L.P., a subsidiary of Talisman Energy, Inc. in June 2008 and a related equity support agreement executed by the Company (the Adversary Proceeding). The court in the Adversary Proceeding has issued Proposed Findings (as hereinafter defined) setting forth damages totaling approximately $18,700,000, plus prejudgment and postjudgment interest and attorneys fees as may be requested and awarded pursuant to a subsequent motion. Certain other lawsuits have been settled.

Refer also to Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Investments in Hallwood Energy for a further discussion of the Company s former energy investment, including the Adversary Proceeding.

***Investments in Financial Instruments*.** In the 2011 first quarter, the Company opened an investment account with UBS AG, a global financial services firm, and disclosed that it intended to transfer a significant portion of the cash it holds from time to time to the UBS account to be placed in various financial instruments and may borrow additional amounts from UBS to invest on a leveraged basis. As of March 30, 2012, no funds have been transferred into the UBS account. Because of the current pending Adversary Proceeding, the Company does not currently intend to transfer funds into the UBS account, but may reconsider this matter after the Adversary Proceeding is concluded.

Segment and Related Information. For details regarding revenue, profit (loss) and total assets, see Note 17 to the Company s consolidated financial statements.

Number of Employees

The Company and its wholly owned Brookwood subsidiary had 458 and 470 employees as of February 28, 2012 and 2011, respectively, comprised as follows:

	February 28,	
	2012	2011
Company	7	7
Brookwood	451	463
Total	458	470

In 2010, Kenyon entered into an agreement for a new three-year collective bargaining agreement with Local 1321T of the New England Joint Board of UNITE HERE! union, representing approximately 250 employees at its Rhode Island plant facility, effective from March 1, 2010 through February 28, 2013.

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Available Information

The Company s Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), are available on its website at www.hallwood.com, as soon as reasonably practicable after such reports are electronically filed with the Securities and Exchange Commission (SEC). Additionally, the Company s Code of Business Conduct and Ethics, Whistle Blower Policy and Audit Committee Charter may be accessed through the website. The Company s website and the information contained therein or connected thereto shall not be deemed to be incorporated into this Annual Report.

Executive Officers of the Company

In addition to Anthony J. Gumbiner, age 67, who serves as Director, Chairman and Chief Executive Officer of the Company (see Item 10), the following individuals also serve as executive officers:

William L. Guzzetti, age 68, has served as President and Chief Operating Officer of the Company since March 2005 and as Executive Vice President from October 1989 to March 2005. He also served as President, Chief Operating Officer and a Director of HEM, the general partner of Hallwood Energy, and each of the former energy affiliates from their inception until June 2009. HEM, Hallwood Energy and its subsidiaries filed petitions for relief under Chapter 11 of the United States Bankruptcy Code on March 1, 2009. Mr. Guzzetti had served as President, Chief Operating Officer and a Director of Hallwood Energy Corporation, formerly based in Denver, Colorado and sold in May 2001, from December 1998 until May 2001 and of its predecessors since 1985. From 1990 until its sale in 2004, Mr. Guzzetti served as President, Chief Operating Officer and a Director of Hallwood Realty, LLC (Hallwood Realty) and Hallwood Commercial Real Estate, LLC, respectively. He had served as the President and a director of Hallwood Energy Corporation, formerly based in Cleburne, Texas and sold in December 2004, from December 2002 until December 2004. He is a member of the Florida Bar and the State Bar of Texas.

Richard Kelley, age 51, assumed the positions of Vice President, Chief Financial Officer and Secretary of the Company, in December 2008. Mr. Kelley has been with the Company, or one of the Company s affiliates, since 1985. Prior to his appointment, Mr. Kelley served as the Company s Director of Human Resources since July 2004. He served as the Manager of Financial & SEC Reporting for Hallwood Realty from May 1990 to July 2004. Mr. Kelley served as the Financial Reporting Accountant from June 1985 to March 1987 and as the Manager of Financial & SEC Reporting from March 1987 to May 1990 for Hallwood Energy Corporation.

Amber M. Brookman, age 69, has served as President, Chief Executive Officer and a Director of Brookwood since 1989. From July 2004 to April 2007, Ms. Brookman served as a director of Syms Corporation, a national clothing retailer with headquarters in Secaucus, New Jersey.

Item 1A. Risk Factors
Risks related to the Company

A significant stockholder has the ability to substantially influence the Company and it may conflict with or differ from other stockholders. Hallwood Financial Limited (Hallwood Financial), a corporation controlled by the Company s Chairman and Chief Executive Officer, Mr. Anthony J. Gumbiner and members of his family, owns approximately 66% of the Company s outstanding common stock as of March 30, 2012. Accordingly, Mr. Gumbiner can exert substantial influence over the affairs of the Company.

The Company s success is dependent upon retaining key management personnel whose continued service is not guaranteed. The Company is dependent upon its executive officers for strategic business direction and specialized industry experience. While the Company believes that it could find replacements for these key personnel, loss of their services could adversely affect the Company s operations.

Any failure by Brookwood to pay dividends or tax sharing payments to the Company could have a material adverse effect on the Company s financial position, results of operations and cash flows. As a holding company, the Company is dependent on Brookwood to receive the cash necessary to fund its ongoing operations and its obligations. At December 31, 2011, the Company had approximately $6,700,000 of cash and cash equivalents (of which $1,800,000 was used in February 2012 to settle the Hallwood Energy litigation, except the Adversary Proceeding, as discussed in Item 3. Legal Proceedings). Any failure to receive from Brookwood cash required by the Company, including cash required to pay or appeal any judgment or pay any settlement of the Adversary Proceeding, could have a material adverse effect on the Company s financial position, results of operations and cash flows. See *Litigation and costs related thereto could have a material adverse effect on the Company s financial position, results of operations and cash flows , below.*

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Brookwood s ability to pay dividends and tax sharing payments or make advances to the Company is contingent upon Brookwood s compliance with loan covenants and other factors. Brookwood s ability to pay dividends and tax sharing payments or make advances to the Company are contingent upon Brookwood s compliance with the loan covenants in the New Revolving Credit Facility with BB&T and are limited in amount by terms of the loan agreement. This limitation could adversely affect the Company if these payments were restricted. Additionally, any payment of a dividend, tax sharing payment or advance to the Company by Brookwood is dependent on a number of other factors, including approval of Brookwood s board of directors, Brookwood s ability to meet the requirements of the Delaware corporate laws for payment of dividends, and compliance with other applicable laws and requirements. In addition, a significant adverse judgment against Brookwood in the Nextec Applications, Inc. litigation matter (See Item 3. Legal Proceedings) could adversely affect Brookwood s ability to make payments or advances to the Company. As a result, no assurance can be given that these amounts will be available when needed or required.

Litigation and costs related thereto could have a material adverse effect on the Company s financial position, results of operations and cash flows. The Company is involved in certain litigation matters, as described in Item 3. Legal Proceedings, and the court in the Adversary Proceeding described in that Item has issued Proposed Findings proposing that the United States District Court award damages against the Company totaling approximately $18,700,000 plus prejudgment and postjudgment interest and attorneys fees as may be requested and awarded pursuant to a subsequent motion. The Proposed Findings (including the proposed monetary awards) are not final. The Company and each of the other parties has objected to various aspects of the Proposed Findings to the United States District Court, which will review the portions to which objections have been raised on a de novo basis. The Company intends to vigorously defend against the entry of any final judgment and would likely appeal any adverse final judgment to the extent it is able. The ability to appeal any adverse final judgment would be dependent on a number of factors, including the ability to post a bond in connection with the appeal of such judgment. See *--Any failure by Brookwood to pay dividends or tax sharing payments to the Company could have a material adverse effect on the Company s financial position, results of operations and cash flows*.

The Company does not currently have sufficient cash, directly or through Brookwood, to pay the amount of the damages proposed in the Proposed Findings. Payment by the Company of a significant judgment based on the Proposed Findings, if ultimately required, would have a material adverse effect on the Company, its financial position, results of operation and cash flows. The Company s insurance carrier for its directors and officers liability policy has also been released from any obligation it may have had to make any payments toward the resolution of the Adversary Proceeding. The Company s ability to meet in cash a final judgment arising out of the Proposed Findings, including any requirement to post any supersedeas bond to appeal any such judgment or any agreed to cash settlement, would be dependent on the Company s then available cash and its ability to receive cash dividends or other advances from Brookwood. See *Brookwood s ability to pay dividends and tax sharing payments or make advances to the Company is contingent upon Brookwood s compliance with loan covenants and other factors* above. To pay any such cash dividends or advances to the Company above the permitted annual discretionary dividend not to exceed 50% of Brookwood s net income, Brookwood has indicated that it would be required (pursuant to the terms of the New Revolving Credit Facility) to obtain consent from BB&T for such payments. The New Revolving Credit Facility provides for aggregate borrowings of up to $25,000,000, of which $2,121,000 was utilized at April 2, 2012. Brookwood has not requested BB&T to approve any such payments and does not intend to do so unless and until requested by the Company and approved by Brookwood s board of directors. Any such payments or advances would also be contingent upon Brookwood s ability to meet the requirements of the Delaware corporate laws for the payment of dividends and compliance with other applicable laws and requirements. If for any reason Brookwood is unable to pay a cash dividend or other advance to the Company, the Company would be required to seek alternative sources of funding. The Company has not yet determined what, if any, sources would be available to it, but will consider such alternatives as an additional or new facility or term loan and potential sales of assets or additional securities. No assurance can be given that any such additional sources of funding will be available to the Company.

Although the Company does not believe that the results of the other litigation matters, other than the Adversary Proceeding, are likely to have a material adverse effect on its financial position, results of operations or cash flows, it is possible that any of the litigation matters, could result in material liability.

Risks related to our Textile Products Business

The Company s textile products business may be affected by the following risk factors, each of which could adversely affect the Company.

Brookwood depends upon a limited number of third-party suppliers for raw materials. Brookwood purchases a significant

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amount of the fabric and other materials it processes and sells from a small number of suppliers. Brookwood believes that the loss of any one of its direct suppliers would not have a long-term adverse effect because other manufacturers with which Brookwood conducts business would be able to fulfill those requirements. However, the loss of certain of Brookwood s suppliers could, in the short term, adversely affect Brookwood s business until alternative supply arrangements were secured. In addition, there can be no assurance that any new supply arrangements would have terms as favorable as those contained in current supply arrangements. Some of Brookwood s suppliers are entering the military markets in competition to Brookwood, targeting specific military specifications. However, there has been no material effect upon Brookwood s business relationship to date. As of March 30, 2012, Brookwood has not experienced any significant disruptions in supply as a result of shortages in fabrics or other materials from its suppliers.

The loss of one or more of Brookwood s key customers could result in a significant loss of revenues. Brookwood has two customers who accounted for more than 10% of Brookwood s sales in one or more of the three years ended December 31, 2011. Sales to one Brookwood customer, Tennier Industries, Inc. (Tennier), accounted for more than 10% of Brookwood s sales in each of the three years ended December 31, 2011. Brookwood s relationship with Tennier is ongoing. Sales to Tennier, which are included in military sales, were $13,916,000, $51,637,000 and $60,994,000 in 2011, 2010 and 2009, respectively, which represented 10.0%, 30.7% and 34.0% of Brookwood s sales. Sales to another customer, ORC Industries, Inc. (ORC), accounted for more than 10% of Brookwood s sales in 2009. Brookwood s relationship with ORC is ongoing. Sales to ORC, which are also included in military sales, were $5,324,000, $14,375,000 and $24,598,000 in 2011, 2010 and 2009, respectively, which represented 3.8%, 8.5% and 13.7% of Brookwood s sales.

Military sales were $73,906,000, $114,266,000 and $130,103,000 in 2011, 2010 and 2009, respectively, which represented 53.0%, 67.9% and 72.5% of Brookwood s sales. Generally, military sales represent sales of a product to a customer (prime and sub-prime contractors) that will be incorporated into an end product that will be used to fulfill a U.S. or international military contract. While Brookwood has enjoyed substantial revenues from its military business, there is no assurance that such revenues will continue. Brookwood s sales to the customers from whom it derives its military business have been volatile and difficult to predict, a trend management believes will continue. In recent years, orders from the military for goods generally were significantly affected by the activity of the U.S. military. If activity changes, then orders from the military generally, including orders for Brookwood s products, may be similarly affected.

Changes in military procurement practices or regulations could adversely affect Brookwood s business. From time to time, the military limits orders for existing products and adopts revised specifications for new products to replace the products for which Brookwood s customers have been suppliers. The U.S. government released orders in recent years that include Brookwood s products, which resulted in significant military sales. Changes in specifications, procurement entity budgets, or orders present a potential opportunity for additional sales; however, it is a continuing challenge to adjust to changing specifications, budgetary and production requirements. Brookwood has regularly conducted research and development on various processes and products intended to comply with the revised specifications and participates in the bidding process for new military products. However, to the extent Brookwood s products are not included in future purchases by the U.S. government for any reason, Brookwood s sales could be adversely affected. A provision of U.S. federal law, known as the Berry Amendment, generally requires the Department of Defense to give preference in procurement to domestically produced products, including textiles. Brookwood s sales of products to the U.S. military market is highly dependent upon the continuing application and enforcement of the Berry Amendment by the U.S. government. In addition, the U.S. government is releasing contracts for shorter periods than in the past. Management acknowledges the unpredictability in revenues and margins due to military sales and is unable at this time to predict future sales trends.

Global capital and credit market conditions could have an adverse effect on Brookwood s business, operating results and financial condition. Brookwood maintains factoring agreements with several factors, which provide that receivables resulting from credit sales to customers, excluding the U.S. government, may be sold to the factor, subject to a commission and the factor s prior approval. The amount of receivables that Brookwood can factor is subject to certain limitations as specified in individual factoring agreements. The factoring agreements expose Brookwood to credit risk if any of the factors fail to meet their obligations. Brookwood seeks to manage this risk by conducting business with a number of reputable factors and monitoring the factors performance under their agreements. Brookwood continues to monitor its factors and their ability to fulfill their obligations to Brookwood in a timely manner. As of March 30, 2012, all of Brookwood s factors were complying with payment terms in accordance with factor agreements.

Brookwood s ability to comply with its New Revolving Credit Facility is subject to future performance and other factors. Brookwood s New Revolving Credit Facility with BB&T, entered into on March 30, 2012, requires compliance with various loan covenants and financial ratios on a quarterly basis, principally (i) a ratio of total current assets to the sum of total current liabilities and the outstanding loan balance of not less than 1.40 to 1.00; (ii) a ratio of total liabilities to tangible net worth of not greater than 1.50 to 1.00; and (iii) a ratio of funded debt (as defined) to EBITDA (earnings before interest, taxes, depreciation and amortization) for the trailing four quarters of not greater than 2.75 to 1.00.

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Brookwood was in compliance with its principal loan covenants on its former Working Capital Revolving Credit Facility as of December 31, 2011, 2010 and 2009 and for all interim periods, except one as discussed below, during those years.

Due to a decline in military sales for the 2011 first quarter, Brookwood was unable to meet the financial covenant that requires income before taxes of at least $1 in each quarter. Brookwood s unaudited loss before taxes for the 2011 first quarter was $299,000. Accordingly, in May 2011, Brookwood requested and received a waiver from KeyBanc for the income covenant for the 2011 first quarter. Brookwood received an increased level of military orders in late March 2011 and into the subsequent 2011 periods, and reported income before taxes in excess of $1 in the 2011 second quarter, third quarter and fourth quarter, respectively, and was in compliance with its loan covenants for the three remaining 2011 quarters.

If Brookwood does not comply with its loan covenants for any quarter, under the New Revolving Credit Facility, the bank may require payment of outstanding amounts and prohibit cash dividends and tax sharing payments by Brookwood to the Company. Brookwood would have been in compliance with the loan covenants of the New Revolving Credit Facility at December 31, 2011, if they had been in effect at such date.

Brookwood is subject to many environmental regulations that may result in significant costs or liabilities or cause interruptions in its operations. Kenyon and Brookwood Laminating are subject to a broad range of federal, state and local laws and regulations relating to the pollution and protection of the environment. Among the many environmental requirements applicable to Kenyon and Brookwood Laminating are laws relating to air emissions, ozone depletion, wastewater discharges and the handling, disposal and release of solid and hazardous substances and wastes. Based on continuing internal review and advice from independent consultants, Kenyon and Brookwood Laminating believe that they are currently in substantial compliance with applicable environmental requirements. Kenyon and Brookwood Laminating are also subject to such laws as the Comprehensive Environmental Response Compensation and Liability Act (CERCLA), that may impose liability retroactively and without fault for releases or threatened releases of hazardous substances at on-site or off-site locations. Kenyon and Brookwood Laminating are not aware of any releases for which they may be liable under CERCLA or any analogous provision. Actions by federal, state and local governments concerning environmental matters could result in laws or regulations that could increase the cost of producing the products manufactured by Kenyon and Brookwood Laminating or otherwise adversely affect demand for their products. Widespread adoption of any prohibitions or restrictions could adversely affect the cost and/or the ability to produce products and thereby have a material adverse effect upon Kenyon, Brookwood Laminating or Brookwood.

Brookwood does not currently anticipate any material adverse effect on its business, results of operations, financial condition or competitive position as a result of its efforts to comply with environmental requirements. Some risk of environmental liability is inherent, however, in the nature of Brookwood s business. There can be no assurance that material environmental liabilities will not arise. It is also possible that future developments in environmental regulation could lead to material environmental compliance or cleanup costs.

Brookwood s business could lose a significant competitive advantage if it fails to adequately protect its intellectual property rights. Brookwood considers its patents and trademarks, in the aggregate, to be important to its business and seeks to protect this proprietary know-how in part through U. S. patent and trademark registrations. No assurance can be given, however, that such protection will give Brookwood any material competitive advantage. In addition, Brookwood maintains certain trade secrets for which, in order to maintain the confidentiality of such trade secrets, it has not sought patent or trademark protection. As a result, such trade secrets could be infringed upon and such infringement could have a material adverse effect on its business, results of operations, financial condition or competitive position.

In July 2007, Nextec Applications Inc. filed a lawsuit in the United States District Court for the Southern District of New York claiming that Brookwood infringed five United States patents pertaining to internally-coated webs. Nextec later added additional patents to the lawsuit. After a number of motions, only two patents remain in the action and are being asserted against the process and machine for making certain fabrics. Brookwood intends to vigorously defend against all remaining claims. Trial on this matter is currently scheduled to begin on April 30, 2012. Refer to Item 3. Legal Proceedings for a further description of this lawsuit.

The strength of Brookwood s competitors may impact its ability to maintain and grow sales, which could decrease revenues. The cyclical nature of the textile and apparel industries, characterized by rapid shifts in military procurement, fashion and consumer demand and competitive pressures, results in both price and demand volatility. The demand for any particular product varies from time to time based largely upon changes in military specifications, consumer and industrial preferences, and general economic conditions affecting the textile and apparel industries, such as consumer expenditures for non-durable goods. The textile and apparel industries are also cyclical because the supply of particular products changes as competitors enter or leave the market.

Brookwood sells primarily to domestic manufacturers, some of which operate offshore sewing operations. Some of

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Brookwood s customers have moved their business offshore. Brookwood has responded by shipping fabric Asia to Asia and also by supplying finished products directly to manufacturers. Brookwood competes with numerous domestic and foreign fabric manufacturers, including companies larger in size and having greater financial resources than Brookwood. The principal competitive factors in the woven fabrics markets are price, service, delivery time, quality and flexibility, with the relative importance of each factor depending upon the needs of particular customers and the specific product offering. Brookwood s management believes that Brookwood maintains its ability to compete effectively by providing its customers with a broad array of high-quality fabrics at competitive prices on a timely basis.

There are an increasing number of competitors entering the military market. These competitors vary and include converters from other market segments, as well as major mills, some of which are Brookwood suppliers, who are selectively targeting specific military specifications. As these companies enter the military market, the competitive pressures may result in further price and demand volatility.

Changes in the trade regulatory environment could weaken Brookwood s competitive position and have a material adverse effect on its business, net sales and profitability. Imports of foreign-made textile and apparel products are a significant source of competition for most sectors of the domestic textile industry. The U.S. government has attempted to regulate the growth of certain textile and apparel imports through tariffs and bilateral agreements, which establish quotas on imports from lesser-developed countries that historically account for significant shares of U.S. imports. Despite these efforts, imported apparel, which represents the area of heaviest import penetration, is estimated to represent in excess of 90% of the U.S. market.

The U.S. textile industry has been and continues to be negatively impacted by existing worldwide trade practices, including the North American Free Trade Agreement (NAFTA), the Central American Free Trade Agreement (CAFTA), anti-dumping and duty enforcement activities by the U.S. government and by the value of the U.S. dollar in relation to other currencies. The establishment of the World Trade Organization (WTO) in 1995 has resulted in the phase out of quotas on textiles and apparel, effective January 1, 2005.

Under NAFTA and CAFTA there are no textile and apparel quotas between the U.S. and the other parties for products that meet certain origin criteria. Tariffs among the countries are either already zero or are being phased out. Although these actions have the effect of exposing Brookwood s market to the lower price structures of the other countries and, therefore, continuing to increase competitive pressures, management is not able to predict their specific impact.

Accordingly, Brookwood believes it must fully utilize other competitive strategies to replace sales lost to importers. One strategy is to identify new market niches. In addition to its existing products and proprietary technologies, Brookwood has developed advanced breathable, waterproof laminate and other materials, which have been well received by its customers. Continued development of these fabrics for military, industrial and consumer application is a key element of Brookwood s business plan.

The U.S. government is engaged in discussions with a number of countries or trading blocs with the intent of further liberalizing trade. Authority to negotiate new fast track agreements has been granted by Congress, making new agreements in this field more likely.

Any employee slowdown or strike or the failure to renew the collective bargaining agreement could disrupt Brookwood s business. Although, in 2010, Kenyon entered into an agreement for a new three-year collective bargaining agreement with Local 1321T of the New England Joint Board of UNITE HERE! union, representing approximately 250 employees at its Rhode Island plant facility, effective from March 1, 2010 through February 28, 2013, any employee slowdown or strike or failure to renew the collective bargaining agreement in 2013 could adversely affect Brookwood s operations.

Brookwood s success is dependent upon retaining key management personnel whose continued service is not guaranteed. Brookwood is dependent upon its executive officers for strategic business direction and specialized industry experience. While the Company believes that it could find replacements for these key personnel, the loss of their services could adversely affect Brookwood s operations.

Risks Related to Investments in Financial Instruments

Hallwood Group invests in cash equivalents and marketable securities that carry investment risk and may incur loss. As of December 31, 2011, cash is held in demand deposit accounts or is invested in a variety of highly liquid cash equivalents, principally money market funds. At December 31, 2010, marketable securities included variable-rate demand notes, which have long-term nominal maturity dates with interest rates that generally reset weekly. Despite the long-term nature of the variable rate demand

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notes, management believes that it has the ability to quickly liquidate these securities, which have an embedded put option that allows the bondholder to sell the security at par plus accrued interest. Neither the Company or Brookwood held any variable-rate demand notes at December 31, 2011. While management believes the investments in demand deposits, cash equivalents and marketable securities at December 31, 2011 carry limited risk, no guarantee is made that the investments will be recovered at their full value.

As previously discussed, the Company opened an investment account with UBS AG in the 2011 first quarter. The Company intended to transfer a significant portion of the cash it holds from time to time to the UBS account to be invested in various instruments, including equity and debt that is publicly traded or is issued by United States and foreign publicly traded companies, financial institutions, mutual funds and exchange traded funds. Because of the current pending Adversary Proceeding, the Company does not currently intend to transfer funds into the UBS account, but may reconsider this matter after the Adversary Proceeding is concluded. Risk factors related to the Company s investment account at UBS are not provided as such activities have not commenced, nor is it determinable when such activities will occur.

Risks Related to our Energy Business

Risk factors for the Company s energy business are not provided as the Company s involvement in the energy business ceased in 2009 following the bankruptcy reorganization of its former energy affiliate, Hallwood Energy. In October 2009, the Bankruptcy Court confirmed a plan of reorganization of the debtors that, among other things, extinguished Hallwood Energy s general partnership and limited partnership interests, including those held by the Company.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

Real Properties

The general character, location and nature of the significant real properties owned by the Company and its subsidiaries and the encumbrances against such properties are described below.

Cost of real estate owned by property type, segment and location as of December 31, 2011 (in thousands):

Property Type	Segment	Location	Cost
Dyeing and finishing plant (Kenyon)	Textile	Rhode Island	$ 9,059
Production facility (Plainfield)	Textile	Connecticut	5,400
Undeveloped land	Other	Texas	46
Total			$ 14,505

The Kenyon dyeing and finishing plant is a multi-shift facility well-suited for that particular business. The development of new products and varying levels of utilization require the plant to be regularly upgraded. The Brookwood capital stock was and is pledged as collateral under Brookwood s former Working Capital Revolving Credit Facility and under its New Revolving Credit Facility, and the plant is encumbered by a negative pledge under the New Revolving Credit Facility. In addition, the New Revolving Credit Facility also contains a covenant to reasonably maintain property and equipment.

Brookwood Laminating has occupied its facility since 2006 and purchased it in May 2010 pursuant to a lease purchase option. Brookwood Laminating has updated and customized the facility with building improvements and equipment to develop new products and enhance production efficiencies. Similar to the Kenyon plant, the Brookwood capital stock is pledged under the New Revolving Credit Facility and the plant is encumbered by a negative pledge.

Leased Facilities

The Company has a lease obligation for office space in Dallas, Texas, which expires in November 2015 and includes a one-time option for the Company to terminate the lease in November 2012. Since January 2005, the Company shares its Dallas office space with Hallwood Investments Limited (HIL), a corporation associated with Mr. Anthony J. Gumbiner, the Company s Chairman, Chief Executive Officer and principal stockholder, and certain of HIL s affiliates. In addition, from August 2005 until July 2009, the Company shared its Dallas office space with Hallwood Energy. HIL and certain of its affiliates reimburse the Company and Hallwood Energy, until July 2009, reimbursed the Company for a pro-rata share of their lease and other office-related costs. Hallwood Energy completed its move from the office space by July 31, 2009 and no longer shares such expenses.

Brookwood leases office space for its corporate headquarters in New York City, which expires in August 2016. Brookwood also leases two apartments in New York City for business purposes and office space in Connecticut. The apartment leases became effective in May 2009 and April 2011, both of which expire in May 2013. The Connecticut office space lease became effective in October 2010 and expires in September 2013, with a two-year renewal option.

Brookwood Roll Goods, a division of Brookwood, leases warehouse space in Gardena, California, which expires in April 2015.

Item 3. Legal Proceedings

Litigation. From time to time, the Company, its subsidiaries, certain of its affiliates and others have been named as defendants in lawsuits relating to various transactions in which it or its affiliated entities participated. Although the Company does not believe that the results of any of these matters are likely to have a material adverse effect on its financial position, results of operations or cash flows, except as described below, it is possible that any of the matters could result in a material liability. In addition, Hallwood Group has spent and will likely continue to spend significant amounts in professional fees and other associated costs in connection with these matters. Hallwood Group expenses professional fees and other costs associated with litigation matters as incurred.

In July 2007, Nextec Applications, Inc. filed *Nextec Applications, Inc. v. Brookwood Companies Incorporated and The Hallwood Group Incorporated* in the United States District Court for the Southern District of New York (SDNY No. CV 07-6901) claiming that Brookwood infringed five United States patents pertaining to internally-coated webs. In October 2007, The Hallwood Group Incorporated was dismissed from the lawsuit. Nextec later added additional patents to the lawsuit. After a number of motions, only two patents remain in the action and are being asserted against the process and machine for making defendants

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Agility Storm-Tec X-Treme and Eclipse Storm-Tec X-Treme fabrics, which constitute two levels of the Military s Extended Cold Weather Clothing System. Nextec is seeking a permanent injunction as well as damages in an amount to be determined at trial. Separately, Brookwood filed requests for reexamination by the United States Patent and Trademark Office of the remaining patent claims at issue in the litigation. The United States Patent and Trademark Office has granted the reexamination requests and issued first office actions rejecting all the reexamined patent claims as unpatentable over the prior art of record. Nextec will have an opportunity to respond to the Patent Office and eventually to appeal any final decision by the Patent Office. Brookwood intends to vigorously defend against all remaining claims. Trial on this matter is currently scheduled to begin on April 30, 2012. While Brookwood believes it possesses valid defenses to these claims, due to the nature of litigation, the ultimate outcome of this case is indeterminable at this time.

Hallwood Energy. In March 2009, Hallwood Energy, HEM (the general partner of Hallwood Energy) and Hallwood Energy s subsidiaries, filed petitions for relief under Chapter 11 of the United States Bankruptcy Code. The cases were adjudicated in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division, in *In re Hallwood Energy, L.P., et al Case No. 09-31253*. The Company was only an investor in and creditor of Hallwood Energy. The bankruptcy filing did not include the Company or Brookwood.

In October 2009, the Bankruptcy Court confirmed a plan of reorganization of the debtors that, among other things, extinguished the Company s interest in Hallwood Energy s general partnership and limited partnership interests. In addition, Hallwood Energy s convertible notes, including those held by the Company, were subordinated to recovery in favor of Hall Phoenix/Inwood, Ltd (HPI), the secured lender to and an investor in Hallwood Energy.

The confirmed plan of reorganization in the Hallwood Energy bankruptcy proceeding also created a creditors trust that was authorized to pursue various claims against the Company, its officers, directors and affiliates and Hallwood Energy s officers and directors, including claims assigned to the creditors trust by HPI.

Adversary Proceeding. On March 30, 2009, Hallwood Energy filed an adversary proceeding against the Company seeking a judgment for $3,200,000. The case was originally styled as *Hallwood Energy, L.P. v. The Hallwood Group Incorporated, Adversary No. 09-03082,* and was brought in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division. This dispute arose in connection with an Acquisition and Farmout Agreement entered into between Hallwood Energy and FEI Shale, L.P. (FEI), a subsidiary of Talisman Energy, Inc., in June 2008. The Company and Hallwood Energy entered into an Equity Support Agreement dated June 9, 2008 under which the Company agreed, under certain conditions, to contribute to Hallwood Energy up to $12,500,000, in consideration for which the Company would receive equity or debt securities of Hallwood Energy. As of February 25, 2009, the Company had contributed $9,300,000 to Hallwood Energy pursuant to the Equity Support Agreement. On that date, Hallwood Energy demanded that the Company fund the $3,200,000, which the Company did not do.

Following the commencement of litigation, HPI and FEI intervened in the lawsuit and filed their respective complaints in intervention. In their complaints, they alleged that the Company s failure to fund $3,200,000 under the Equity Support Agreement damaged Hallwood Energy in an amount in excess of $3,200,000. FEI claimed that, in addition to not paying the $3,200,000, the Company defrauded FEI and tortiously interfered with its rights under the Acquisition and Farmout Agreement, and it sought approximately $38,000,000 in additional damages. In their second amended complaint, HPI and the trustee for the creditors trust contended that the additional damage was at least $20,000,000 based on the alleged failure of the Company to fund the $3,200,000, which allegedly caused FEI to not fund $20,000,000 due under the Farmout Agreement between Hallwood Energy and FEI. HPI and the trustee also asserted that the Company was liable for exemplary damages of $100,000,000 on account of its failure to fund the last $3,200,000 under the Equity Support Agreement. In the second amended complaint, HPI and the trustee had named as additional defendants Hallwood Family (BVI) L.P., Hallwood Investments Limited, Hallwood Company Limited, the Hallwood Trust, Hallwood Financial Limited and Brookwood Companies Incorporated contending that the additional defendants are liable to the plaintiffs under allegations requesting the remedy of substantive consolidation. On May 5, 2010, the Court dismissed with prejudice the substantive consolidation claim and abuse of the bankruptcy process against all parties, resulting in the Company remaining as the sole Defendant. In light of the Court s disposition of the theories advanced in the second amended complaint, the adversary proceeding was now styled as *Ray Balestri, Trustee of the Hallwood Energy I Creditors Trust, as successor in interest to Hallwood Energy, L.P., Plaintiffs and FEI Shale L.P. and Hall Phoenix/Inwood Ltd., Plaintiffs in Intervention vs. The Hallwood Group Incorporated, Defendant; Adversary No. 09-03082-SGJ* (the Adversary Proceeding). The trial took place over a 13 day period from October 2010 to December 2010 and was followed with the Bankruptcy Court s proposed findings in July 2011.

On July 25, 2011, the Bankruptcy Court issued the Proposed Findings of Fact, Conclusions of Law and Judgment Awarding Various Monetary Damages (the Proposed Findings). The court proposed that the United States District Court award damages of $3,200,000 for the Company s alleged breach of the Equity Support Agreement, to be allocated among the three plaintiffs and damages of $15,485,714 to FEI, for the Company s alleged tortious interference with the Farmout Agreement, and, in the alternative, for the Company s alleged fraud in failing to disclose to FEI that the Company allegedly did not intend to fund the

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remaining obligation under the Equity Support Agreement, plus prejudgment and postjudgment interest and attorneys fees as may be requested and awarded pursuant to subsequent motions and hearings. With respect to the issue of fraud by nondisclosure, the Bankruptcy Court proposed a finding that the Company (i) failed to disclose a belief that the Equity Support Agreement could legally be treated as terminated, (ii) failed to disclose its alleged intention not to fund the final $3,200,000 under the Equity Support Agreement and (iii) orchestrated an alleged misimpression that Hallwood Energy was not contemplating bankruptcy while planning Hallwood Energy s bankruptcy and how to use FEI s funding in a Hallwood Energy bankruptcy against FEI s wishes. The court also proposed that the District Court reject HPI and the trustee s claim that the Company s failure to fund the $3,200,000 caused FEI to not fund $20,000,000 under the Farmout Agreement, that the District Court reject HPI and the trustee s claim that the Company tortiously interfered with certain contractual rights, and that the District Court reject HPI and the trustee s claim for exemplary or punitive damages. The Bankruptcy Court s Proposed Findings (including the proposed monetary awards) are not final. The United States District Court is reviewing the objections that have been filed by all parties in the case on a de novo basis and will eventually accept the Proposed Findings, decline to adopt the Proposed Findings and issue its own findings, or accept some of the Proposed Findings while declining to adopt the remaining Proposed Findings and issuing its own findings in their place. The District Court may also revise the damage awards. The Company does not know when the United States District Court will issue its decision or enter a final judgment.

In August 2011, the Company s board of directors authorized the Audit Committee, consisting solely of independent directors of the Company, to investigate the facts giving rise to the Proposed Findings and various allegations that have been made arising out of Hallwood Energy s bankruptcy. In addition, the Company s board of directors authorized the Audit Committee to hire, at the Company s expense, independent counsel and other advisors to assist the Audit Committee with such investigation. The Audit Committee focused its investigation on whether there were any violations of the Company s Code of Business Conduct and Ethics by management in connection with the matters addressed in the Proposed Findings, including, among other actions, the alleged nondisclosure by management to FEI of the potential bankruptcy of Hallwood Energy and the Company s purported intent not to fund the remaining $3,200,000 under the Equity Support Agreement, various changes in testimony by management, the payment of the cash dividend to the Company s stockholders in alleged violation of the Equity Support Agreement and the delivery by Hallwood Energy to FEI of a request for funding without any alleged disclosure of the potential bankruptcy of Hallwood Energy. In March 2012, the investigation was concluded and the Audit Committee reported its conclusions to the full board of directors. The Audit Committee indicated in its presentation to the board of directors that, based on its investigation, it believes that, with respect to the matters investigated, management did not act unreasonably or in violation of the Code of Business Conduct and Ethics. The Audit Committee also made various preliminary recommendations to the board of directors intended to assist the Board of Directors in monitoring and assessing risks to the Company from the activities and investments of the Company and its management. After discussion with and input from management and discussions with members of the Board concerning the nature of Mr. Gumbiner s historic and existing investments, the Audit Committee determined that it was in the best interests of the Company and its stockholders that (i) the Company adopt a new policy requiring management to provide complete disclosure of any potential risks and any potential exposure in connection with the Company s acquisition of ownership interests in other entities, including joint ventures; various communication improvements regarding the Adversary Proceeding and future litigation; (ii) at least annually or in connection with entering into any new outside business activities, the members of management of the Company disclose to the Audit Committee all outside business activities, including the nomenclature used or to be used in connection therewith, in which they are engaged including sufficient information to enable the Audit Committee to assess any potential risks and any potential exposure to the Company s business operations, reputation or financial condition that may result from those activities; and (iii) the Audit Committee review with management of the status and role of the Company s outside advisors.

As a result of Proposed Findings in the Adversary Proceeding, the Company believes that for accounting purposes it is probable that a liability has been incurred and that an estimate of the amount of the loss for accounting purposes may be made. Accordingly, taking into consideration the Company s objections to the Proposed Findings, the Company reserved $7,500,000 at June 30, 2011. As no new information has become available regarding the outcome of the litigation, the Company does not believe the reserve related to the Adversary Proceeding should be changed at December 31, 2011. This noncash, accrued reserve of $7,500,000 is reported in the Company s balance sheet under Hallwood Energy matters Litigation reserve , in addition to the $3,201,000 that was previously recorded in connection with the Equity Support Agreement, for a total reserve of $10,701,000 at December 31, 2011 for the Adversary Proceeding. This reserve amount has been established in consultation with the Company&#146