

SOUTHWALL TECHNOLOGIES INC /DE/  
Form DEF 14A  
May 01, 2006

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934

Filed by the Registrant   
Filed by a Party other than the Registrant   
Check the appropriate box:

- Preliminary Proxy Statement  
 **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**  
 Definitive Proxy Statement  
 Definitive Additional Materials  
 Soliciting Material Pursuant to §240.14a-12

**SOUTHWALL TECHNOLOGIES INC.**  
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.  
 Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
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(4)

Date Filed:

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**SOUTHWALL TECHNOLOGIES INC.**  
**3975 East Bayshore Road**  
**Palo Alto, California 94303**

May 5, 2006

Dear Stockholder:

You are cordially invited to attend our Annual Meeting of Stockholders, which will be held on Monday, June 5, 2006, at 3:00 p.m. local time, at our principal executive offices at 3975 East Bayshore Road, Palo Alto, California.

The following Notice of Annual Meeting of Stockholders and Proxy Statement describe the items to be considered by the stockholders and contain certain information about us and our officers and directors.

Please sign and return the enclosed proxy card as soon as possible in the envelope provided, or vote by Internet or telephone, so that your shares can be voted at the meeting in accordance with your instructions. Even if you plan to attend the meeting, we urge you to sign and promptly return the proxy card, or vote by Internet or telephone. You may revoke it at any time before it is exercised at the meeting or vote your shares personally if you attend the meeting.

Thank you in advance for your participation and prompt attention. We look forward to seeing you.

Sincerely,  
Thomas G. Hood  
*President and Chief Executive Officer*

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**SOUTHWALL TECHNOLOGIES INC.**

3975 East Bayshore Road  
Palo Alto, California 94303

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**To Be Held on June 5, 2006**

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To the stockholders of Southwall Technologies Inc.:

The Board of Directors of Southwall Technologies Inc. has called an annual meeting to seek stockholder approval of the matters listed below.

Each of the matters submitted to our stockholders at the annual meeting is described in more detail in the accompanying proxy statement. We encourage you to read the proxy statement in its entirety. The details of the annual meeting are as follows:

Date: June 5, 2006.  
Time: 3:00 p.m., local time.  
Place: Our principal executive offices at 3975 East Bayshore Road, Palo Alto, California.  
Items of Business: At the annual meeting, you and our other stockholders will be asked to:

1. elect directors to serve for the ensuing year;
2. ratify the appointment of Burr, Pilger & Mayer LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2006; and
3. transact such other business as may properly come before the meeting or any adjournment.

Record Date: You may vote at the annual meeting if you were a stockholder of record at the close of business on April 21, 2006.

Proxy Voting: Your vote is important. You may vote on these matters in person or by proxy. We ask that you complete and return the enclosed proxy card promptly, whether or not you plan to attend the annual meeting, in the enclosed addressed, postage-paid envelope, or vote by Internet or telephone, so that your shares will be represented and voted at the annual meeting in accordance with your wishes. You can revoke your proxy at any time prior to its exercise by written notice received by us, by delivering to us a duly executed proxy bearing a later date, or by attending the annual meeting and voting your shares in person.

This notice, the attached proxy statement and form of proxy card are first being mailed to our stockholders beginning on or about May 5, 2006.

By Order of the Board of Directors

Sylvia Kamenski  
*Secretary*

Palo Alto, California  
May 5, 2006

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**PROXY STATEMENT  
FOR  
ANNUAL MEETING OF STOCKHOLDERS  
TO BE HELD ON June 5, 2006**

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**SOUTHWALL TECHNOLOGIES INC.  
3975 East Bayshore Road  
Palo, Alto, California 94303**

**PROXY STATEMENT  
FOR ANNUAL MEETING OF STOCKHOLDERS**

**To Be Held on June 5, 2006**

This proxy statement contains information about the 2006 Annual Meeting of Stockholders of Southwall Technologies Inc. The meeting will be held on Thursday, June 5, 2006, beginning at 3:00 p.m., local time, at our principal executive offices at 3975 East Bayshore Road, Palo Alto, California.

This proxy statement is furnished in connection with the solicitation of proxies by our Board of Directors for use at the annual meeting and at any adjournment of that meeting. All proxies will be voted in accordance with the instructions they contain. If no instruction is specified on a proxy, it will be voted in favor of Proposals 1 and 2 set forth in the notice of the meeting. A stockholder may revoke any proxy at any time before it is exercised by giving our corporate secretary written notice to that effect.

Our Annual Report to Stockholders for the fiscal year ended December 31, 2005 is being mailed to stockholders with the mailing of these proxy materials on or about May 5, 2006. The Annual Report does not constitute any part of this proxy statement.

**INFORMATION ABOUT THE ANNUAL MEETING AND VOTING**

*We have included the following discussion of the matters to be presented at the annual meeting to provide summary answers to some of the questions that you might have about the annual meeting and the proposals to be presented to our stockholders at the annual meeting. You are encouraged to read the entire proxy statement. The information below is qualified in its entirety by the full text of this proxy statement.*

**What is the purpose of the annual meeting?**

At the annual meeting, stockholders will consider and vote on the following matters:

1. The election of directors to serve for the ensuing year.
2. The ratification of the selection of Burr, Pilger & Mayer LLP as our independent registered public accounting firm for the year ending December 31, 2006.

The stockholders will also act on any other business that may properly come before the meeting.

**Who may vote at the annual meeting?**

Only holders of our common stock at the close of business on the record date, April 21, 2006, are entitled to receive notice of, and to vote their shares at, the annual meeting. As of the record date, there were issued and outstanding 26,900,091 shares of common stock. Shares of our Series A 10% Cumulative Preferred Stock, or the Series A shares, are not entitled to vote on the matters to be presented at the meeting.

**How many votes do I have?**

At the annual meeting, you will be entitled to one vote for each share of common stock you held on the record date.

**Is my vote important?**

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Your vote is important regardless of how many shares you own. Please take time to vote. Take a moment to read the instructions below.

### **How do I vote?**

You can vote your shares in four ways. You can vote by mail, over the Internet, by telephone, or in person at the meeting.

*You may vote by mail.* You may vote by completing and signing the proxy card that accompanies this proxy statement and promptly mailing it in the enclosed postage-prepaid envelope. You do not need to put a stamp on the enclosed envelope if you mail it in the United States. The shares you own will be voted according to the instructions on the proxy card you mail. If you return the proxy card but do not give any instructions on a particular matter described in this proxy statement, the shares you own will be voted in accordance with the recommendations of our Board of Directors. The Board of Directors recommends that you vote FOR Proposals 1 and 2.

*You may vote over the Internet.* If you have Internet access, you may vote your shares from any location in the world by following the "Vote by Internet" instructions set forth on the enclosed proxy card.

*You may vote by telephone.* You may vote your shares by following the "Vote by Phone" instructions set forth on the enclosed proxy card.

*You may vote in person.* If you attend the meeting, you may vote by delivering your completed proxy card in person or you can vote by completing a ballot. Ballots will be available at the meeting.

### **May I revoke my proxy?**

Yes. Even if you complete and return a proxy, you may revoke it at any time before it is exercised by taking one of the following actions:

- send written *notice* that you wish to revoke your proxy to Sylvia Kamenski, our corporate Secretary, at our address set forth in the Notice of Annual Meeting appearing before this proxy statement;
- send us *another* signed proxy with a later date; or
- attend the annual meeting, notify Ms. Kamenski that you are present, and then vote in person.

If, however, you elect to vote in person at the annual meeting and a broker or other nominee holds your shares, you must bring to the annual meeting a legal proxy from the broker or other nominee authorizing you to vote the shares.

### **What if a broker holds my shares in "street name"?**

If your shares are held in "street name" by a bank or other nominee, your bank or nominee, as the record holder of your shares, is required to vote your shares according to your instructions. You should instruct your broker or other nominee to vote your shares by following the procedure provided by your broker or other nominee. Even if you do not give your broker or other nominee instructions as to how to vote on the other proposals described in this proxy statement, your broker or other nominee may be entitled to use its discretion in voting your shares in accordance with industry practice and applicable law. You may also attend the annual meeting and vote in person. If you elect to vote in person, however, you must bring to the annual meeting a legal proxy from the broker or other nominee authorizing you to vote the shares.

**How many shares must be present in person or by proxy to transact business at the annual meeting?**

Our by-laws require that shares representing a majority of the votes entitled to be cast by the holders of common stock outstanding on the record date be present in person or by proxy at the annual meeting to constitute a quorum to transact business with regard to each of the proposals. Shares as to which holders abstain from voting as to a particular matter and broker non-votes will be counted in determining whether there is a quorum of stockholders present at the annual meeting.

**How many votes are required to approve the proposals?**

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The votes necessary to approve each of the proposals is as follows:

- *Election of Directors.* The seven nominees receiving the highest number of votes cast at the annual meeting will be elected, regardless of whether that number represents a majority of the votes cast.
  
- *Other Matters.* The affirmative vote of a majority of the total number of shares cast at the meeting is needed to approve other matters to be voted on at the meeting, including the ratification of the independent registered public accounting firm.

Abstentions and broker non-votes will not be counted as votes in favor of a proposal, and will also not be counted as votes cast or shares voting on such proposal. Accordingly, abstentions and broker non-votes will have no effect on the outcome of voting with respect to Proposal 1 (election of directors) or Proposal 2 (ratification of independent registered public accounting firm), because each of those proposals requires an affirmative vote of a plurality, in the case of Proposal 1, and a majority, in the case of Proposal 2, of the shares voting on such matter.

**Who will count the votes?**

The votes will be counted, tabulated and certified by our transfer agent and registrar, Computershare Trust Company, N.A. A representative of Computershare Trust Company, N.A. will serve as inspector of elections at the meeting.

**What if additional proposals are presented at the annual meeting?**

If other proposals are properly presented at the annual meeting for consideration, the persons named in the proxy card that accompanies this proxy statement will have the discretion to vote on those proposals for you. As of the date of the mailing of this proxy statement, we do not know of any other proposals to be presented at the annual meeting.

**Will any other business be conducted at the meeting or will other matters be voted on?**

The Board of Directors does not know of any other matters that may come before the meeting. If any matter properly comes before the meeting, the persons named in the proxy card that accompanies this proxy statement will exercise their judgment in deciding how to vote, or otherwise act, at the meeting with respect to that matter or proposal.

**Where can I find the voting results?**

We will report that voting results in our quarterly report on Form 10-Q for the second quarter of 2006, which we expect to file with the Securities and Exchange Commission, or the SEC, on or before August 14, 2006.

**How and when may I submit a stockholder proposal for the 2007 annual meeting?**

If you are interested in submitting a proposal for inclusion in the proxy statement for the 2007 annual meeting, you need to follow the procedures outlined in Rule 14a-8 of the Securities Exchange Act of 1934. To be eligible for inclusion, your stockholder proposal intended for inclusion in the proxy statement for the 2007 annual meeting of the stockholders must be received by us at our principal corporate offices in Palo Alto, California as set forth below no later than January 5, 2007.

If a stockholder wishes to present a proposal before the 2007 annual meeting of stockholders, but does not wish to have the proposal considered for inclusion in the proxy statement and proxy card, the stockholder must also give written notice to us at the address written below. If a stockholder fails to provide timely notice of a proposal to be presented at the 2007 annual meeting of stockholders by no later than March 21, 2007, the proxies designated by our

Board of Directors will have discretionary authority to vote on that proposal.

Any proposals or notices should be sent to:

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Southwall Technologies Inc.  
3975 East Bayshore Road  
Palo Alto, California 94303  
Attention: Secretary

**Who will bear the costs of soliciting these proxies?**

We will bear the costs of solicitation of proxies. Brokers, custodians and fiduciaries will be requested to forward proxy soliciting material to the owners of shares of our common stock they hold in their names. We will reimburse banks and brokers for their reasonable out-of-pocket expense incurred in connection with the distribution of proxy materials.

**How can I obtain an Annual Report on Form 10-K?**

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, is available on our website at [www.southwall.com](http://www.southwall.com). If you would like a copy of our Annual Report, we will send you one without charge. Please contact:

Southwall Technologies Inc.  
3975 East Bayshore Road  
Palo Alto, California 94303  
Attention: Investor Relations  
Telephone: (650) 962-9111 x1178

**Whom can I contact for more information regarding the proxy materials or voting my shares?**

If you have any additional questions about the proposals in this proxy statement, you should contact Sylvia Kamenski, our Vice President, Finance, by telephone at (650) 962-9111 or by e-mail to [skamenski@southwall.com](mailto:skamenski@southwall.com).

**Householding of Annual Meeting Materials**

Some banks, brokers and other nominee record holders may be participating in the practice of “householding” proxy statements and annual reports. This means that only one copy of our proxy statement and annual report to stockholders may have been sent to multiple stockholders in your household. We will promptly deliver a separate copy of either document to you if you contact us at the following address or telephone number: Investor Relations, Southwall Technologies Inc., 3975 East Bayshore Road, Palo Alto, California 94303, Telephone: (650) 962-9111 x1178. If you want to receive separate copies of the proxy statement or annual report to stockholders in the future, or if you are receiving multiple copies and would like to receive only one copy per household, you should contact your bank, broker or other nominee record holder, or you may contact us at the above address or telephone number.

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BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth material information regarding beneficial ownership of our common stock as of February 14, 2006, by:

- each person who we know to own beneficially more than 5% of our common stock;
- each of our executive officers, for whom compensation information is provided elsewhere in this proxy statement;
- each director and nominee for director; and
- all executive officers and directors as a group.

Except as noted below, the address of each person listed on the table is c/o Southwall Technologies Inc., 3975 East Bayshore Road, Palo Alto, California 94303, and each person has sole voting and investment power over the shares shown as beneficially owned, except to the extent authority is shared by spouses under applicable law. Beneficial ownership is determined in accordance with the rules of the SEC. The information below regarding persons beneficially owning more than 5% of our common stock is based solely on public filings made by such persons with the SEC through February 14, 2006.

<b><u>Name and Address</u></b>	<b>Common Stock Beneficially Owned</b>	<b>Percent of Outstanding Shares(1)</b>
Needham Investment Management, LLC(2) 445 Park Avenue New York, New York 10022	1,428,000	5.3%
Needham & Company, LLC 445 Park Avenue New York, New York 10022	2,009,807	7.5%
Needham Capital Management (Bermuda) L.L.C.(3) 445 Park Avenue New York, New York 10022	1,593,467	6.0%
Needham Capital Management, L.L.C.(4) 445 Park Avenue New York, New York 10022	9,550,838	35.7%
Dolphin Direct Equity Partners, L.P.(5) 129 East 17th Street New York, New York 10003	6,258,062	22.0%
William A. Berry(6)	52,876	*
George Boyadjieff(7)	381,250	1.4%
Jami K. Dover Nachtsheim(6)	50,906	*
Joseph B. Reagan(8)	182,662	*
Walter C. Sedgwick(9)	508,971	1.9%
Peter E. Salas	-	-
Andre R. Horn	50,000	*
R. Eugene Goodson	11,000	*
Thomas G. Hood(10)	842,130	3.1%

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Wolfgang Heinze(11)	313,929	1.2%
Dennis Capovilla(12)	300,000	1.1%
Neil Bergstrom(12)	96,429	*
Sicco W.T. Westra(13)	226,979	*
All current officers and directors as a group (14 persons)(14)	2,963,132	10.3%

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\* Less than 1%

(1) The number of shares of common stock deemed outstanding consists of (i) 26,792,681 shares of common stock outstanding as of February 14, 2006, and (ii) shares of common stock issuable pursuant to outstanding Series A shares, options or warrants held by the respective persons or group that are exercisable within 60 days of February 14, 2006, as set forth below.

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- (2) Consists of shares of common stock owned by private investment partnerships and registered investment companies with respect to which Needham Investment Management, LLC is a general partner or investment adviser and, therefore, may be deemed to own. Needham Investment Management, LLC disclaims beneficial ownership of these shares.
- (3) Consists of 804,063 shares of common stock and 332,704 shares of common stock issuable upon conversion of Series A shares owned by Needham Capital Partners III (Bermuda), L.P. and 323,045 shares of common stock and 133,655 shares of common stock issuable upon conversion of Series A shares owned by Needham Capital Partners II (Bermuda), L.P., with respect to which, in each case, Needham Capital Management (Bermuda) L.L.C. is a general partner and, therefore, may be deemed to own. Needham Capital Management (Bermuda) L.L.C. disclaims beneficial ownership of these shares.
- (4) Consists of 2,304,511 shares of common stock and 953,557 shares of common stock issuable upon conversion of Series A shares owned by Needham Capital Partners II, L.P.; 4,034,378 shares of common stock and 1,669,338 shares of common stock issuable upon conversion of Series A shares owned by Needham Capital Partners III, L.P.; and 416,652 shares of common stock and 172,402 shares of common stock issuable upon conversion of Series A shares owned by Needham Capital Partners IIIA, L.P., with respect to which, in each case, Needham Capital Management, L.L.C. is a general partner and, therefore, may be deemed to own. Needham Capital Management, L.L.C. disclaims beneficial ownership of these shares
- (5) Includes 1,630,883 shares of common stock issuable upon conversion of Series A shares that were issued pursuant to an investment agreement.
  - (6) Includes options to purchase 22,500 shares that are exercisable within 60 days of February 14, 2006.
  - (7) Includes options to purchase 281,250 shares that are exercisable within 60 days of February 14, 2006.
  - (8) Includes 31,067 shares held in a family limited partnership, and 59,850 shares held in trust.
- (9) Consists of 99,000 shares held by two public foundations of which Mr. Sedgwick is an officer, 17,272 shares held by his son, 273,929 shares held in a trust of which Mr. Sedgwick is a trustee and options to purchase 118,770 shares that are exercisable within 60 days of February 14, 2006.
- (10) Includes options to purchase 797,505 shares that are exercisable within 60 days of February 14, 2006, and 100 shares held by Mr. Hood's son and 100 shares held by Mr. Hood's daughter.
  - (11) Includes options to purchase 238,929 shares that are exercisable within 60 days of February 14, 2006.
  - (12) Consists of options that are exercisable within 60 days of February 14, 2006.
  - (13) Includes options to purchase 203,979 shares that are exercisable within 60 days of February 14, 2006.
- (14) Includes options to purchase an aggregate of 2,053,292 shares that are exercisable within 60 days of February 14, 2006, the shares held in a family limited partnership and trust described in note 8 above, the shares held by two public foundations, in trust and by Mr. Sedgwick's son described in note 9 above, and the shares held by Mr. Hood's son and daughter described in note 10 above.



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**PROPOSAL 1  
ELECTION OF DIRECTORS**

There are currently eight members of our Board of Directors. The Board has fixed the number of directors for the ensuing year at seven and has nominated for such positions the seven people listed below. Mr. Sedgwick and Dr. Reagan have decided not to stand for reelection to the Board of Directors. The persons named in the enclosed proxy card as proxies will vote to elect each of the nominees unless you withhold authority to vote for the election of one or more nominees by marking the proxy card to that effect. Each of the seven nominees has agreed to serve, but if any of them shall become unable or unwilling to serve, the proxies, unless authority has been withheld as to such nominee, may be voted for election of a substitute nominee designated by our Board of Directors or the Board may reduce the number of directors. Proxies may not be voted for more than seven persons.

There are no family relationships among any of our executive officers or directors.

The following information as of the date of this proxy statement is furnished with respect to each nominee for election as a director. The information presented includes information each director and nominee has given us about his or her age, all positions he or she holds with us, his or her principal occupation and business experience during the past five years, and the names of other publicly-held companies of which he or she serves as a director. Information about the number of shares of common stock and preferred stock beneficially owned by each director or nominee, directly and indirectly, as of February 14, 2006, appears above under the heading "Security Ownership of Certain Beneficial Owners and Management."

Name	Age
William A. Berry(1)	68
George Boyadjieff, Chairman(1)(2)	67
R. Eugene Goodson	71
Thomas G. Hood	50
Andre R. Horn(1)	77
Jami K. Dover Nachtsheim(2)(3)	47
Peter E. Salas(3)	51

(1) Member of the Audit Committee.

(2) Member of the Nominating and Corporate Governance Committee.

(3) Member of the Compensation Committee.

*Mr. Berry* has served on our Board of Directors since May 2003. Since April 1996, Mr. Berry retired from EPRI, the Electric Power Research Institute, a non-profit energy research organization providing science and technology-based solutions to global energy companies, in December 2003. While at EPRI, Mr. Berry served as Chief Financial Officer from April 1996 to July 2003. From August 2003 to December 2003, Mr. Berry served as Special Projects Manager. From 1992 to March 1996, Mr. Berry was the Senior Vice President and Chief Financial Officer of Compression Labs, Inc., a manufacturer of visual communications systems based on digital technology, and from 1989 to 1992 was the President of Optical Shields, Inc. Mr. Berry worked at Raychem Corporation from 1967 until 1988, where he was a Corporate Vice President and Chief Administrative Officer from 1985 to 1988. He is a director of FAFCO, Inc., a manufacturer of solar pool heating systems. Mr. Berry holds a BS in industrial engineering and an MBA from Stanford University.

*Mr. Boyadjieff* joined our Board of Directors as Chairman in December 2003. Mr. Boyadjieff was the Chief Executive Officer of Varco International, Inc., a diversified oil service company, from 1991 through 2002, and the chairman of

the Board of Directors of Varco from 1998 through 2003. Mr. Boyadjieff retired from active leadership of Varco in 2003. Mr. Boyadjieff holds a BS and an MS in mechanical engineering from the University of California at Berkeley.

*Dr. Goodson* joined our Board of Directors in April 2006. Dr. Goodson has been the Chief Executive Officer and President of Williams Controls Inc. (OTCBB: WMCO), a manufacturer of electronic throttle controls, from July 2002 until October 2004, and the Chairman of the Board of Williams Controls since October 2004. From 1990 to 1997, Dr. Goodson was the Chairman and Chief Executive Officer of Oshkosh Truck Corporation, a developer and producer of heavy-duty on and off road trucks. After retiring from Oshkosh in 1998, Dr. Goodson became an Adjunct Professor at the University of Michigan Business School, teaching operations management. He was a director of the Executive Officer Association of American Industrial Partners, a private equity firm, from 1998 to 2005.

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*Mr. Hood* has served as our President and Chief Executive Officer since July 1998 and as a member of our Board of Directors since March 1998. From March 1998 until July 1998, he served as Interim President and Chief Executive Officer. From July 1996 to March 1998, he served as Senior Vice President, General Manager, Energy Products Division. From January 1995 to July 1996, he was Vice President, General Manager, International Operations, and from October 1991 to January 1995, he was Vice President, Marketing and Sales. He is the inventor of record on ten of our patents. Mr. Hood has an MS degree in Mechanical Engineering from New Mexico State University and a BS in mechanical engineering from Union College.

*Mr. Horn* was appointed to our Board of Directors in February of 2006. Mr. Horn retired in 1985 as Chairman of Joy Manufacturing Co. in Pittsburgh, Pennsylvania, now known as Joy Global Inc., a manufacturer of heavy equipment. Mr. Horn served as the Chairman of Needham & Co., Inc. (“Needham”), from which position he retired in 1991, and was elected Chairman *Emeritus* of Needham. Needham and its affiliates are the beneficial owners of approximately 42.4% of the Company’s outstanding capital stock as set forth under the heading “Security Ownership of Certain Beneficial Owners and Management.” Mr. Horn is currently a director and Chairman of the Board of REMEC, Inc., a San Diego, California manufacturer of microwave components for communications and defense electronics, which is in the process of liquidation. Mr. Horn holds a BA in Mathematics from the University of Paris and is a graduate from the Ecole des Hautes Etudes Commerciales.

*Ms. Nachtsheim* has been a member of our Board of Directors since April 2003. Ms. Nachtsheim retired in June 2000 after 20 years with Intel Corporation, a semiconductor chipmaker. Ms. Nachtsheim served in a variety of positions at Intel, most recently as Corporate Vice President of the Sales and Marketing Group and Director of Worldwide Marketing, from 1998 until her retirement. From January 2003 to December 2003, Ms. Nachtsheim served on the Board of Directors of Vixel Corporation, a creator of disruptive storage networking technologies. Ms. Nachtsheim is a graduate of Arizona State University with a BA in Business Management.

*Mr. Salas* was appointed to our Board of Directors in November of 2005. Mr. Salas has been President of Dolphin Asset Management Corporation and its related companies (“Dolphin”) since he founded it in 1988. Dolphin and its affiliates are the beneficial owners of approximately 22.0% of the Company’s outstanding capital stock, as set forth under the heading “Security Ownership of Certain Beneficial Owners and Management.” Prior to founding Dolphin, he was with J.P. Morgan Investment Management, Inc. for ten years. Mr. Salas is currently a director and Chairman of the Board of both Tengasco, Inc. (AMEX: TGC), an independent oil and gas producer, and of ACT Teleconferencing, Inc. (OTC: ACTT), a global teleconferencing provider. He is also a director of Williams Controls, Inc. (OTCBB: WMCO), a manufacturer of electronic throttle controls, and Boston Restaurant Associates, Inc. (OTCBB: BRAI), a restaurant company in the New England. Mr. Salas received an A.B. degree from Harvard in 1978.

**The Board of Directors recommends a vote “FOR” the election of all of the above nominees that are nominated for election as directors.**

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**CORPORATE GOVERNANCE**

***General***

We believe that good corporate governance is important to ensure that Southwall is managed for the long-term benefit of its stockholders and are committed to having sound corporate governance principles. During the past year, we continued to review our corporate governance policies and practices and to compare them to those suggested by various authorities in corporate governance and the practices of other public companies. We have also continued to review the provisions of the Sarbanes-Oxley Act of 2002, the new and proposed rules of the SEC and the Nasdaq listing standards. As noted below, we have attempted to continue to comply with Nasdaq listing standards relating to corporate governance even though we are no longer listed on Nasdaq.

You can request copies of the current charters of our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee, as well as our Corporate Governance Guidelines and Code of Business Conduct and Ethics, by writing to:

Thomas G. Hood  
President and Chief Executive Officer  
c/o Southwall Technologies Inc.  
3975 East Bayshore Road  
Palo Alto, CA 94303  
Phone: (650) 962-9111

***Determination of Independence***

Our Board of Directors has determined that none of Messrs. Berry, Boyadjieff, Horn or Salas, Dr. Goodson or Ms. Nachtsheim has a material relationship with us (either directly or as a partner, shareholder or officer of an organization that has a relationship with us) and that each of these directors is “independent” within the meaning of Nasdaq’s director independence standards. In addition, our Board of Directors has determined that each of the members of each of our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee has no material relationship with us (either directly or as a partner, shareholder or officer of an organization that has a relationship with us) and is “independent” within the meaning of Nasdaq’s director independence standards.

***Director Candidates***

Our stockholders may recommend director candidates for inclusion by the Board of Directors in the slate of nominees that the Board recommends to our stockholders for election. The qualifications of recommended candidates will be reviewed by our Nominating and Corporate Governance Committee. If the Board determines to nominate a stockholder-recommended candidate and recommends his or her election as a director by the stockholders, the name will be included in our proxy card for the stockholders meeting at which his or her election is recommended.

Stockholders may recommend individuals for the Nominating and Corporate Governance Committee to consider as potential director candidates by submitting their names and background to the “Southwall Technologies Inc. Nominating and Corporate Governance Committee” c/o Southwall Technologies Inc., 3975 East Bayshore Road, Palo Alto, California 94303, Attention: Secretary. The Nominating and Corporate Governance Committee will consider a recommendation only if appropriate biographical information and background material is provided on a timely basis. The process followed by the Nominating and Corporate Governance Committee to identify and evaluate candidates includes requests to Board members and others for recommendations, meetings from time to time to evaluate

biographical information and background material relating to potential candidates and interviews of selected candidates by members of the Nominating and Corporate Governance Committee and the Board. Assuming that appropriate biographical and background material is provided for candidates recommended by stockholders, the Nominating and Corporate Governance Committee will evaluate those candidates by following substantially the same process, and applying substantially the same criteria, as for candidates submitted by Board members.

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In considering whether to recommend any candidate for inclusion in the Board's slate of recommended director nominees, including candidates recommended by stockholders, the Nominating and Corporate Governance Committee will apply the criteria set forth in Southwall's Corporate Governance Guidelines. These criteria include the candidate's integrity, business acumen, age, experience, commitment, diligence, conflicts of interest and the ability to act in the interest of all stockholders. The Nominating and Corporate Governance Committee does not assign specific weights to particular criteria and no particular criterion is necessarily applicable to all prospective nominees. We believe that the backgrounds and qualifications of the directors, considered as a group, should provide a significant composite mix of experience, knowledge and abilities that will allow the Board to fulfill its responsibilities. We have not paid, to date, any third party a fee to assist in evaluating and identifying nominees. During 2005, Messrs. Horn and Salas were recommended to us as candidates for the Board by Needham and Dolphin, respectively. Needham and Dolphin are each beneficial owners of more than 5% of our common stock.

***Communications from Stockholders and Other Interested Parties with the Board***

The Board of Directors will give appropriate attention to written communications on issues that are submitted by stockholders and other interested parties, and will respond if and as appropriate. Absent unusual circumstances or as contemplated by committee charters, the Chairman of the Nominating and Corporate Governance Committee will, with the assistance of our legal counsel, (1) be primarily responsible for monitoring communications from stockholders and other interested parties and (2) provide copies or summaries of such communications to the other directors as he or she considers appropriate.

Communications will be forwarded to all directors if they relate to substantive matters and include suggestions or comments that the Chairman of the Nominating and Corporate Governance Committee considers to be important for the directors to know. In general, communications relating to corporate governance and long-term corporate strategy are more likely to be forwarded than communications relating to personal grievances and matters as to which we tend to receive repetitive or duplicative communications. Stockholders and other interested parties who wish to send communications on any topic to the Board should address such communications to:

Ms. Jami K. Dover Nachtsheim  
Chair of the Nominating and Corporate Governance Committee  
c/o Secretary  
c/o Southwall Technologies Inc.  
3975 East Bayshore Road  
Palo Alto, CA 94303

***Board of Directors Meetings and Committees***

The Board of Directors has responsibility for establishing broad corporate policies and reviewing our overall performance rather than day-to-day operations. The Board's primary responsibility is to oversee the management of the company and, in so doing, serve the best interests of the company and its stockholders. The Board selects, evaluates and provides for the succession of executive officers and, subject to stockholder election, directors. It reviews and approves corporate objectives and strategies, and evaluates significant policies and proposed major commitments of corporate resources. It participates in decisions that have a potential major economic impact on us. Management keeps the directors informed of company activity through regular written reports and presentations at Board and committee meetings.

The Board of Directors met six times in 2005. During 2005, each of our directors attended 75% or more of the total number of meetings of the Board of Directors and the committees of which such director was a member. The Board has standing Audit, Compensation and Nominating and Corporate Governance Committees. Each committee has a

charter that has been approved by the Board. Each committee must review the appropriateness of its charter and perform a self-evaluation at least annually. Mr. Hood is the only director who is also an employee of Southwall. He does not participate in any meetings at which his compensation is evaluated. All members of all committees are non-employee directors.

Executive sessions of non-management directors will be held at least three times per year, and during 2005, there were six such sessions. The sessions are scheduled and chaired by Mr. Boyadjieff. Any non-management director can request that an additional executive session be scheduled.

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It is our current policy to have the Chairman of the Board and the Chief Executive Officer attend the annual meetings of stockholders. Two of our directors, the Chairman and the Chief Executive Officer, attended the 2005 annual meeting of stockholders.

*Audit Committee*

The current members of our Audit Committee are Messrs. Berry (Chairman), Boyadjieff and Horn and Dr. Reagan. Dr. Reagan has decided not to stand for reelection to the Board of Directors and, therefore, will no longer be a member of the Audit Committee following the 2006 annual meeting. Each of Messrs. Berry, Boyadjieff and Horn and Dr. Reagan qualifies as an “audit committee financial expert” under SEC rules. Each of Messrs. Berry, Boyadjieff and Horn and Dr. Reagan is an “independent director” under the Nasdaq rules governing the qualifications of the members of audit committees. In addition, our Board of Directors has determined that each member of the Audit Committee is financially literate. None of Messrs. Berry, Boyadjieff and Horn serve on the audit committees of more than two other public companies. The Audit Committee, of which Mr. Horn was not a member during 2005, met four times during 2005. The responsibilities of our Audit Committee and its activities during 2005 are described in the Report of the Audit Committee contained below in this proxy statement.

*Compensation Committee*

The current members of the Compensation Committee are Dr. Reagan (Chairman), Ms. Nachtsheim and Messrs. Salas and Sedgwick. Dr. Reagan and Mr. Sedgwick have decided not to stand for reelection to the Board of Directors and, therefore, will no longer be members of the Compensation Committee following the 2006 annual meeting. In addition, the Board expects that, following the 2006 annual meeting, Ms. Nachtsheim will cease to serve on the Compensation Committee and Dr. Goodson will be appointed. The Board has determined that each of Drs. Reagan and Goodson, Ms. Nachtsheim and Messrs. Salas and Sedgwick is independent as defined under Nasdaq rules. Our Compensation Committee held eight meetings during 2005. The Compensation Committee evaluates and sets the compensation of our Chief Executive Officer and makes recommendations to our Board of Directors regarding the salaries and bonuses of our other executive officers. The Compensation Committee also oversees the evaluation of management by the Board of Directors. The Compensation Committee also grants stock options and other stock incentives (within guidelines established by our Board of Directors) to our officers and employees. The responsibilities of our Compensation Committee and its activities during 2005 are described in the Report of the Compensation Committee on Executive Compensation contained below in this proxy statement.

*Nominating and Corporate Governance Committee*

The current members of the Nominating and Corporate Governance Committee are Ms. Nachtsheim (Chair) and Messrs. Boyadjieff and Sedgwick. Mr. Sedgwick has decided not to stand for reelection to the Board of Directors and, therefore, will no longer be a member of the Nominating and Corporate Governance Committee following the 2006 annual meeting. In addition, the Board expects that, following the 2006 annual meeting, Mr. Boyadjieff will cease to serve on the Nominating and Corporate Governance Committee and Messrs. Horn and Salas will be appointed. The Board has determined that each of Ms. Nachtsheim and Messrs. Boyadjieff, Horn, Salas and Sedgwick is independent as defined under Nasdaq rules. The purpose of the Nominating and Corporate Governance Committee is to identify individuals qualified to become Board members, recommend to the Board the persons to be nominated by the Board for election as directors at the annual meeting of stockholders, develop and recommend to the Board a set of corporate governance principles and oversee the evaluation of the Board. The Nominating and Corporate Governance Committee is authorized to retain any such advisers or consultants. For information relating to nominations of directors by our stockholders, see “—Director Candidates” above. Our Nominating and Corporate Governance Committee met six times in 2005.



***Audit Committee's Pre-approval Policy and Procedures***

Our Audit Committee pre-approves all services, including both audit and non-audit services, provided by our independent registered public accounting firm for the purpose of maintaining the independence of our independent registered public accounting firm. For audit services, each year the independent registered public accounting firm provides us with an engagement letter outlining the scope of the audit services proposed to be performed during the year, which must be formally accepted by the Audit Committee before the audit commences. The independent registered public accounting firm also submits an audit services fee proposal, which also must be approved by the Audit Committee before the audit commences.

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Each year, management also submits to the Audit Committee a list of non-audit services that it recommends the independent registered public accounting firm be engaged to provide and an estimate of the fees to be paid for each. Management and the independent registered public accounting firm must each confirm to the Audit Committee that the performance of the non-audit services on the list would not compromise the independence of the independent registered public accounting firm and would be permissible under all applicable legal requirements. The Audit Committee must approve both the list of non-audit services and the budget for each such service before commencement of the work. Management and the independent registered public accounting firm report to the Audit Committee at each of its regularly scheduled meetings as to the non-audit services actually provided by the independent registered public accounting firm and the approximate fees incurred by us for those services.

During 2005, no services were provided to us by Burr, Pilger & Mayer LLP, our independent registered public accounting firm, or any other accounting firm other than in accordance with the pre-approval policies and procedures described above.

### **DIRECTOR COMPENSATION**

During 2005, we paid each of our non-employee directors a retainer for his or her services. Mr. Sedgwick was paid a retainer of \$12,000 for his service as a director during 2005. Mr. Salas was paid a retainer of \$3,000 for his service as a director from October 2005 through December 2005. As chairman of the Board, Mr. Boyadjieff was paid a retainer of \$30,000. As chairman of the Audit Committee, Mr. Berry was paid a retainer of \$18,000. As chairpersons of the Compensation and Corporate Governance Committees, Dr. Reagan and Ms. Nachtsheim, respectively, were each paid a retainer of \$15,000. In addition, each non-employee director received \$1,000 plus expenses for each Board meeting attended and a fee of \$500 for each Board meeting held via teleconference. In 2005, non-employee directors who served on committees of the Board also received \$750 for each committee meeting attended.

Directors may also from time to time be granted options to purchase shares of common stock under our 1997 Stock Incentive Plan. During 2005, the non-employee directors received options to purchase the following number of shares, all at an exercise price of \$1.28 per share: Mr. Boyadjieff—30,000 shares; Mr. Berry—20,000 shares; Ms. Nachtsheim—20,000 shares; Dr. Reagan—20,000 shares; and Mr. Sedgwick—20,000 shares. Of these options, 25% become vested six months from the grant date. Thereafter, the remainder of these options vest in 36 equal monthly installments. For a summary of option grants we made to Mr. Hood in 2005, please see “Executive Officer Compensation—Option Grants in Last Fiscal Year” below.

Assuming the election of the director candidates presented pursuant to Proposal 1, the non-employee directors’ annual fees for 2006 are as follows: Mr. Boyadjieff—\$30,000; Mr. Berry—\$18,000; Dr. Goodson—\$7,500; Mr. Horn—\$12,000; Ms. Nachtsheim—\$15,000; and Mr. Salas—\$12,000. In addition, each non-employee director will receive \$1,000 plus expenses for each Board meeting attended. Non-employee directors also receive a fee of \$500 for each Board meeting held via teleconference. Non-employee directors who serve on committees of the Board receive \$750 for each committee meeting attended in person or \$500 for each committee meeting held via teleconference. For service in 2006, Mr. Boyadjieff received options to purchase 30,000 shares, and Mr. Berry, Dr. Reagan, Mr. Sedgwick and Ms. Nachtsheim each received options to purchase 20,000 shares, all at an exercise price of \$0.68 per share. Messrs. Horn and Salas each received option to purchase 40,000 shares at an exercise price of \$.68 per share.

### **CERTAIN RELATIONSHIPS AND OTHER TRANSACTIONS**

There were no transactions during 2005 required to be disclosed pursuant to Item 404 of Regulation SK promulgated by the Securities and Exchange Commission. Future transactions, if any, with our executive officers, directors and affiliates will be on terms no less favorable to us than could be obtained from unrelated third parties and will be approved by a majority of the Board of Directors and by a majority of our disinterested directors.



Table of Contents**EXECUTIVE OFFICER COMPENSATION**

The following table sets forth information required under applicable SEC rules about the compensation for each of the last three fiscal years of our Chief Executive Officer and our four most highly compensated other executive officers who were serving as officers on December 31, 2005.

Name and Principal Position	Year	Annual Compensation(1)		Long-Term Compensation Awards	
		Salary(2)	Bonus(2)	Securities Underlying Options	All Other Compensation
Thomas G. Hood	2005	\$ 295,385	\$ 142,018	250,000	\$ 17,700(3)
President and Chief Executive Officer	2004	270,000	27,000	520,000	23,291(4)
	2003	274,154	130,731	60,000	17,200
Wolfgang Heinze	2005	299,765	70,303	150,000	16,481(5)
Vice-President, General Manager Dresden Operations	2004	246,717	26,042	195,000	—
	2003	221,224	28,482	10,000	—
Dennis Capovilla(6)	2005	222,039	179,043	150,000	12,566(7)
Vice President, Sales and Marketing	2004	301,538(8)	—	250,000	1000(9)
	2003	87,692	—	100,000	5,750
Sicco W. T. Westra	2005	203,255	48,464	150,000	12,806(10)
Senior Vice-President, Business Development	2004	195,000	19,500	125,000	516(11)
	2003	211,650	—	15,000	529
Neil Bergstrom(12)	2005	134,615	38,463	475,000	7,200(13)
Senior Vice President and Chief Technology Officer	2004	-	-	-	-
	2003	-	-	-	-

(1) In accordance with the rules of the SEC, other compensation in the form of perquisites and other personal benefits has been omitted because the aggregate amount of such perquisites and other personal benefits constituted less than the lesser of \$50,000 or 10% of the total of annual salary and bonuses for each of the Named Executive Officers for 2005, 2004 and 2003.

(2) The amounts listed under Salary and Bonus include amounts deferred pursuant to our 401(k) Plan.

(3) Includes \$16,200 for car allowance and \$1,500 of matching contributions under our 401(k) Plan.

(4) Consists of \$1,000 of our matching contributions under our 401(k) Plan and a vacation accrual cash payout of \$22,291.

(5) Consists of a car allowance.

(6) Mr. Capovilla joined Southwall in July 2003.

(7) Consists of \$11,400 of car allowance, and \$1,167 of matching contributions under our 401(k) Plan.

(8) Includes \$101,538 of sales commission.

(9) Consists of \$1,000 of matching contributions under our 401(k) Plan.

(10) Consists of \$11,400 of car allowance and \$1,406 of matching contributions under our 401(k) Plan.

(11) For 2004, consists of our matching contributions under our 401(k) Plan.

(12)

Mr. Bergstrom joined Southwall in June 2005.

(13)

Consists of \$6,650 of car allowance and \$550 of matching contributions under our 401(k) Plan.

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The following table contains information concerning each stock option we granted to the named executive officers during 2005.

Name	Number of Securities Underlying Options Granted (1)	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price (\$/Sh)	Expiration Date	Annual Rates of Stock Price Appreciation for Option Terms(2)	
					5%	10%
Thomas G. Hood	250,000	10.75%	\$ 0.58	12/9/2015	\$ 91,190	\$ 231,093
Wolfgang Heinze	150,000	6.45%	\$ 0.58	12/9/2015	\$ 54,714	\$ 138,656
Sicco W.T. Westra	150,000	6.45%	\$ 0.58	12/9/2015	\$ 54,714	\$ 138,656
Dennis Capovilla	150,000	6.45%	\$ 0.58	12/9/2015	\$ 54,714	\$ 138,656
Neil Bergstrom	175,000	7.52%	\$ 0.58	12/9/2015	\$ 63,833	\$ 161,765
	300,000	12.90%	\$ 1.20	7/7/2015	\$ 99,461	\$ 219,784

(1) Option grants were made under our 1997 Stock Incentive Plan. Of these options, 25% become vested six months from the date of grant. Thereafter, the remainder of these options vest in 36 equal monthly installments. In the event of certain corporate transactions such as an acquisition or sale of our assets, the outstanding options of the named executive officers will become immediately exercisable for fully vested shares of common stock, unless the options are assumed or substituted with a comparable option by the acquiring company or its parent. In any event, our Compensation Committee may accelerate the vesting of outstanding options upon certain corporate transactions or involuntary terminations following a corporate transaction.

(2) The potential realizable values at assumed 5% and 10% annual rates of compounded stock price appreciation for the terms of the options are based on the fair market value or deemed fair market value of the common stock used by us for accounting purposes, as applicable, and do not represent our estimates or projections of its future stock prices. Actual gains, if any, on stock option exercises will be dependent on the future performance of our common stock.

**Fiscal Year-End Option Values**

The following table sets forth information required under applicable SEC rules concerning the number and value of unexercised stock options held as of December 31, 2005, by each of the named executive officers. None of the named executive officers exercised any options in 2005. We determined the value of unexercised in-the-money options by calculating the difference between the exercise price per share payable upon exercise of these options and the closing price of our common stock on the Over-the-Counter Bulletin Board Market at December 31, 2005, which was \$0.61 per share.

Number of Securities Underlying Unexercised Options at Fiscal Year-End	In-the-Money Options at Fiscal Year-End
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<b>Name</b>	<b>Exercisable</b>	<b>Unexercisable</b>	<b>Exercisable</b>	<b>Unexercisable</b>
Thomas G. Hood	584,145	431,071	\$ 302,500	\$ 277,500
Wolfgang Heinze	198,572	201,428	\$ 137,500	\$ 162,500
Dennis Capovilla	258,334	241,666	\$ 183,334	\$ 166,666
Sicco W.T. Westra	163,040	189,760	\$ 91,668	\$ 158,332
Neil Bergstrom	75,000	400,000	-	\$ 175,000

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The following table sets forth information as of March 15, 2006 regarding our 1997 Stock Incentive Plan, 1998 Stock Option Plan for Employees and Consultants, and 1997 Employee Stock Purchase Plan. Our stockholders previously approved each of these plans and all amendments that were subject to stockholder approval. We have no other equity compensation plans that have not been approved by stockholders.

	<b>Number of Shares of Common Stock to be Issued Upon Exercise of Outstanding Stock Options (a)</b>	<b>Weighted-Average Exercise Price of Outstanding Stock Options (b)</b>	<b>Number of Shares of Common Stock Remaining Available for Future Issuance (excluding those in column (a)) Under the Stock Option Plans (c)</b>
1997 Stock Incentive Plan (1)	4,149,183	\$ 1.40	1,718,740
1997 Employee Stock Purchase Plan (2)		Not applicable	
1998 Stock Option Plan for Employees and Consultants (1)	1,535,147	\$ 1.64	747,251
<b>Total</b>	<b>5,684,330</b>	<b>\$ 1.52</b>	<b>2,465,991</b>

(1) In addition to the issuance of stock options, each of the 1997 Plan and the 1998 Plan allows for the issuance of stock and restricted stock.

(2) A total of 325,000 shares of common stock are reserved for issuance under the 1997 Employee Stock Purchase Plan. Through March 15, 2006, we had issued 1,535,147 shares under the 1997 Employee Stock Purchase Plan. In addition, an offering period under the Plan is currently in effect and scheduled to expire on May 31, 2006, on which date we will issue an additional number of shares to be determined at such time.

**Severance Agreements**

We have a severance policy that covers all of our officers, including the named executive officers, and some of our key employees, under which they may become entitled to annual benefits in connection with certain changes in control of Southwall affected by merger, liquidation or tender offer. Under the policy, each participant may become entitled to a lump sum severance payment upon his or her involuntary termination within 24 months after a change in control. The cash payment will be equal to (i) in the case of our chief executive officer, two times the sum of the chief executive officer's annual rate of base salary in effect at the time of his or her involuntary termination plus the bonuses earned by him or her for the immediately preceding fiscal year and (ii) in the case of each other participant, between one and one and one-half times, as determined by our Board of Directors, the sum of the participant's annual rate of base salary in effect at the time of his or her involuntary termination plus the bonuses earned by him or her for the immediately preceding fiscal year. In addition, the amount paid to each participant will be grossed up if the amount received by the participant is subject to federal excise tax as an "excess parachute payment."

If benefits had become due as of December 31, 2005, under the severance policy, the maximum cash amounts payable to each of the named executive officers would be as follows: Mr. Hood, \$600,000; Mr. Heinze, \$449,648; Mr. Bergstrom, \$500,000; Mr. Westra, \$304,883; and Mr. Capovilla, \$334,470.





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**REPORT OF THE COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION**

It is the duty of the members of the Board of Directors to set the base salary of certain executive officers and to administer our benefit plans. In addition, the Board approves the individual bonus programs to be in effect for certain executive officers each fiscal year. The Board acts pursuant to recommendations of our Compensation Committee. The Compensation Committee administers the 1997 Plan, under which stock option grants may be made to such officers and other key employees. The Compensation Committee held eight meetings during 2005. During 2005, the Compensation Committee consisted of three members, Dr. Reagan, Ms. Nachtsheim and Mr. Sedgwick. Mr. Salas was added to the Compensation Committee in March 2006. Dr. Reagan and Mr. Sedgwick have decided not to stand for reelection to the Board of Directors and, therefore, will no longer be members of the Compensation Committee after the 2006 annual meeting.

For 2005, the Board established the compensation payable to Mr. Hood, President and Chief Executive Officer, and all other of our executive officers.

**General Compensation Policy.** Our executive compensation policy is competitive in order to recruit, retain and motivate people of needed capabilities. For executives, we strive to link total compensation to performance. Base compensation, benefits and perquisites are intended to be competitive. Incentive compensation is provided in the form of cash bonuses and stock options. We anticipate that the compensation levels of our executive officers will generally be reviewed in the early part of each fiscal year.

**Factors.** Several of the more important factors that were considered in establishing the components of each executive officer's compensation package for 2005 are summarized below.

*Base Salary.* The base salary for each executive officer is set on the basis of personal performance and salary levels for comparable positions at companies with revenue levels comparable to that of Southwall. Information regarding comparable salary levels is obtained from published surveys of companies that may or may not be in industries comparable to that of Southwall. Generally, we target base salaries at the mid-point of such market data.

*Annual Incentive Compensation.* The annual pool of bonuses for executive officers is determined solely on the basis of our achievement of the financial performance targets established at the start of the fiscal year. Actual bonuses paid reflect an individual's accomplishment of both corporate and functional objectives, with substantially greater weight being given to achievement of corporate rather than functional objectives. In particular, approximately 70% of an executive's target bonus is based on achieving corporate objectives and the balance on achieving the executive's functional objectives, such as profitability improvement, asset management, market position, product leadership and key projects. These factors are evaluated on a subjective basis without specific weighting.

*Long-Term Incentive Compensation.* In 2005, the Compensation Committee approved stock option grants to each of the named executive officers under our 1997 Plan. The grants are designed to align the interests of each of the named executive officers with those of the stockholders and provide each such individual with a significant incentive to manage Southwall from the perspective of an owner with an equity stake in Southwall. The decision to award options to certain officers and the number of shares subject to each such option grant was based upon the officer's type and level of function, criticality of function, contribution and performance against objectives as described above. The Committee considers the number of options already held by executives when approving new options to executives. Each option grant allows the officer to acquire shares of common stock at a fixed price per share (the market price on the grant date) over a specified period of time (up to seven years). Accordingly, the option will provide a return to the executive officer only if the market price of the common stock appreciates over the option term.

**CEO Compensation.** The annual base salary for 2005 for our President and Chief Executive Officer, Mr. Hood, was established primarily on the basis of Mr. Hood's personal performance and the range of base salaries paid to the chief executive officers of companies with comparable revenue levels. Mr. Hood's 2005 salary was within the range of base salaries paid to the chief executive officers of comparable companies. The option grants made to Mr. Hood that were based upon his position and a subjective evaluation of his performance, were intended to place a significant portion of his total compensation at risk, since the options will have no value unless there is appreciation in the value of the common stock over the option term.

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**Deduction Limit for Executive Compensation.** Section 162(m) of the Internal Revenue Code of 1986, as amended, limits federal income tax deductions for compensation paid after 1993 to the chief executive officer and the four other most highly compensated officers of a public company to \$1 million per year, but contains an exception for performance-based compensation that satisfies certain conditions. We do not believe that the components of our compensation will be likely to exceed \$1 million per year for any executive officer in the foreseeable future and, therefore, concluded that no further action with respect to qualifying such compensation for federal income tax deductibility was necessary at this time. In the future, we will continue to evaluate the advisability of qualifying its executive compensation for such deductibility. Our policy is to qualify its executive compensation for deductibility under applicable tax laws as practicable.

The Compensation Committee

Joseph B. Reagan, Chairman

Jami K. Dover Nachtsheim

Walter C. Sedgwick

Peter E. Salas

**COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

Our Compensation Committee is composed of Joseph B. Reagan, Jami K. Dover Nachtsheim, Peter E. Salas and Walter C. Sedgwick. Neither Dr. Reagan, Ms. Nachtsheim, Mr. Salas, nor Mr. Sedgwick has at any time since our formation been an officer or employee of Southwall. None of our executive officers currently serves, or in the past has served as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving on our Board of Directors or Compensation Committee.

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**REPORT OF THE AUDIT COMMITTEE**

The Audit Committee oversees our financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and the reporting process including the systems of internal controls. The primary duties and responsibilities of the Audit Committee are to: (1) select and approve our independent registered public accounting firm; (2) serve as an independent and objective party to monitor our financial reporting process and internal control systems; (3) review and appraise the audit efforts of our independent registered public accounting firm and internal audit department; (4) review the independent registered public accounting firm's fee; and (5) provide an open avenue of communication among the independent registered public accounting firm, financial and senior management and the Board of Directors.

During 2005, the Audit Committee consisted of three members, Messrs. Boyadjieff and Berry and Dr. Reagan. Mr. Horn was added to the Audit Committee in March of 2006. Dr. Reagan has decided not to stand for reelection to the Board of Directors and, therefore, will no longer be a member of the Audit Committee following the 2006 annual meeting. Each of Messrs. Boyadjieff, Berry and Horn and Dr. Reagan is independent (as defined by listing standards that govern companies, the shares of which are listed on Nasdaq). The Board of Directors has determined that the members of the Audit Committee satisfy the requirements of Nasdaq as to independence, financial literacy and expertise. In addition, the Board of Directors has determined that Mr. Berry is an audit committee financial expert as defined by the SEC and has the requisite financial sophistication to satisfy the requirements of Nasdaq. The Audit Committee operates under a written charter, approved by the Board of Directors, which was last amended in April 2004.

In fulfilling its oversight responsibilities regarding the 2005 financial statements, the Audit Committee reviewed with management the audited financial statements in the Annual Report, including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements. The Audit Committee's review included discussion with the independent registered public accounting firm of matters required to be discussed pursuant to Statement of Auditing Standards No. 61 (Codification of Statements on Auditing Standards), including the process used by management in formulating particularly sensitive accounting estimates and the basis for the conclusions of the independent registered public accounting firm regarding the reasonableness of those estimates.

The Audit Committee reviewed with the independent registered public accounting firm, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgment as to the quality, not just the acceptability, of Southwall's accounting principles and such other matters as are required to be discussed with the Audit Committee under generally accepted auditing standards. In addition, the Audit Committee has discussed with the independent registered public accounting firm their independence from management and Southwall, including the matters in the written disclosures required by the Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and received by the Committee.

The Audit Committee discussed with Southwall's independent registered public accounting firm the overall scope and plans for their audits in 2006. The Audit Committee meets with the independent registered public accounting firm, with and without management present, to discuss the results of their examinations, the evaluations of Southwall's internal controls, and the overall quality of Southwall's financial reporting. The Audit Committee held four meetings during 2005.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors, and the Board has approved, that the audited financial statements be included in the Annual Report on Form 10-K for the year ended December 31, 2005, for filing with the SEC.

The Audit Committee

William A. Berry (Chairman)

George Boyadjieff

Joseph B. Reagan

Andre R. Horn

Table of Contents**COMPARISON OF CUMULATIVE TOTAL STOCKHOLDER RETURN**

The following performance graph assumes an investment of \$100 on December 31, 2000 and compares the changes thereafter in the market price of our common stock with a broad market index Hemscott Market Index—Composite Market Value and an industry index Hemscott Industry Index—General Building Materials. These indices are the same as those we have used in proxy statements for previous years; however, the provider of these indices Hemscott, Inc., formerly known as Coredata, Inc., has changed its corporate name and the titles of its indices. We paid no dividends during the periods shown; the performance of the indexes is shown on a total return (dividend reinvestment) basis. The graph lines merely connect fiscal year-end dates and do not reflect fluctuations between those dates.

Company / Index	December 31,					
	2000	2001	2002	2003	2004	2005
SOUTHWALL TECHNOLOGIES INC.	100.00	248.70	108.87	33.39	59.83	21.22
HEMSCOTT GROUP INDEX	100.00	109.35	106.14	143.74	177.67	190.09
HEMSCOTT MARKET INDEX	100.00	88.54	70.33	93.63	105.02	112.46

**The Compensation Committee Report on Executive Compensation, the Report of the Audit Committee and the Comparison of Cumulative Total Stockholder Return information above shall not be deemed “soliciting material” or incorporated by reference into any of our filings with the SEC by implication or by any reference in any such filing to this proxy statement.**

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**PROPOSAL 2**  
**RATIFICATION OF THE SELECTION OF INDEPENDENT**  
**REGISTERED PUBLIC ACCOUNTING FIRM**

Our Audit Committee has selected Burr, Pilger & Mayer LLP, or BPM, an independent registered public accounting firm, to audit our financial statements for the fiscal year ending December 31, 2006. BPM audited our financial statements for the fiscal year ended December 31, 2005. Although stockholder approval of the selection of BPM is not required by law, our Board of Directors believe that it is advisable to give stockholders the opportunity to ratify this selection. We expect that representatives of BPM will be present at the 2006 annual meeting, with the opportunity to make a statement if they so desire, and will be available to respond to appropriate questions from stockholders.

**The Board of Directors recommends that you vote “FOR” the ratification of the selection of BPM as our independent registered public accounting firm, and proxies solicited by the Board will be voted in favor thereof unless a stockholder has indicated otherwise on the proxy.**

**PRINCIPAL INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FEES AND SERVICES**

The following table shows the fees paid or accrued by us for the audit and other services provided by our principal independent registered public accounting firms for 2005 and 2004.

	2004	2005
Audit fees(1)	\$ 455,280	\$ 237,620
Tax fees(2)	27,570	—
All other fees	—	—
Total	\$ 482,850	\$ 237,620

- (1) Audit fees represent:
- fees (in the amount of \$266,700 with respect to 2004) for professional services provided by PricewaterhouseCoopers LLP in connection with reviews of quarterly reports on Form 10-Q filed during 2004; and
  - fees (in the amount of \$188,580 with respect to 2004 and \$237,620 with respect to 2005) for professional services provided by Burr, Pilger & Mayer LLP in connection with the audit of our financial statements for the fiscal years ended December 31, 2004 and December 31, 2005, and the review of quarterly reports on Form 10-Q filed during 2004 and 2005.

- (2) Tax fees consisting of fees for tax compliance, tax advice and tax planning were paid to Burr, Pilger & Mayer LLP.

All audit and non-audit services provided by our independent registered public accounting firm are approved by the Audit Committee, which considers whether the provision of non-audit services is compatible with maintaining the independent registered public accounting firm’s independence.

On August 16, 2004, PricewaterhouseCoopers LLP, or PwC, was dismissed as our independent registered public accounting firm with the approval of our Audit Committee, and, with the approval of our Audit Committee, we engaged Burr, Pilger & Mayer LLP to audit our financial statements for the year ending December 31, 2004.

PwC’s reports on our financial statements as of and for the years ended December 31, 2002 and 2003 included an explanatory paragraph regarding uncertainty. These explanatory paragraphs noted our incurrence of net losses and negative cash flows from operating activities during each fiscal year and our significant debt service and other contractual obligations at the end of each fiscal year. These factors raised a substantial doubt about our ability to continue as a going concern. Other than these explanatory paragraphs, the reports of PwC on the financial statements



as of and for the years ended on or about December 31, 2002 and 2003 contained no adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principle.

During the years ended on or about December 31, 2002 and 2003 and through August 16, 2004, there were no disagreements between us and PwC on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of PwC, would have caused PwC to make reference thereto in its reports on our financial statements for such years.

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During the years ended on or about December 31, 2002 and 2003 and through August 16, 2004, there were no reportable events (as defined in Item 304(a)(1)(v) of Regulation S-K promulgated by the SEC), except that, as detailed in our annual reports on Form 10-K for the years ended on or about December 31, 2002 and 2003, material weaknesses in our internal control environment were identified. These material weaknesses were caused by a reduction in force that occurred during 2002 and 2003 and related to the inadequacy of review and supervision of the preparation of accounting records and the untimely reconciliation of certain accounts. The Audit Committee discussed these material weaknesses with PwC. We have taken steps to attempt to improve our internal controls and our control environment. We have hired a new Corporate Controller, a new Director of Financial Planning and Analysis, a new Senior Cost Accountant, and a new Senior Accountant for our German subsidiary; appointed a new Plant Manager for our U.S. manufacturing operations; initiated re-training of personnel on the correct use of our new ERP system; initiated procedures to attempt to ensure all accounts are reconciled and reviewed on a timely basis; and are in the process of documenting our procedures and reviewing our internal controls to ensure compliance under section 404 of the Sarbanes-Oxley Act. We have authorized PwC to respond fully to inquiries of successor independent accountants concerning such material weaknesses.

Prior to engaging BPM as our new independent registered public accounting firm on August 16, 2004, we did not consult with BPM regarding any matter that was a reportable event or the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on our financial statements, with respect to which a written report or oral advice was provided to us that BPM concluded was an important factor considered by us in reaching a decision as to the accounting, auditing or financial reporting issue.

**SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, requires our officers and directors and persons who own more than ten percent of our common stock to file reports with the SEC disclosing their ownership of stock in Southwall and changes in such ownership. Officers, directors and 10% stockholders are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file. Based solely on a review of the copies of such reports received by us and the written representations received from one or more such persons, we believe that during 2005 all such filing requirements were complied with in a timely fashion, except that Forms 4 were filed late in connection with single grants of stock options to each of Thomas Hood, Dennis Capovilla, Wolfgang Heinze, Sicco W.T. Westra, Neil Bergstrom and Sylvia Kamenski.

**OTHER BUSINESS**

We know of no other business that may be presented for consideration at the 2006 annual meeting. If any other matters are properly presented to the annual meeting, however, it is the intention of the persons named in the accompanying proxy card to vote, or otherwise to act, in accordance with their best judgment on such matters.

The Board hopes that stockholders will attend the annual meeting. **Whether or not you plan to attend, you are urged to complete, sign and return the enclosed proxy in the accompanying envelope, or vote by Internet or telephone.** A prompt response will greatly facilitate arrangements for the meeting, and your cooperation will be appreciated. Stockholders who attend the annual meeting may vote their shares personally even though they have sent in their proxies.

By Order of the Board of Directors  
Sylvia Kamenski  
*Secretary*

Palo Alto, California  
May 5, 2006

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**SOUTHWALL TECHNOLOGIES, INC.  
3975 BAYSHORE ROAD  
PALO ALTO, CA 94303**

**VOTE BY INTERNET - [www.proxyvote.com](http://www.proxyvote.com)**

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

**ELECTRONIC DELIVERY OF FUTURE STOCKHOLDER COMMUNICATIONS**

If you would like to reduce the costs incurred by Southwall Technologies, Inc. in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access stockholder communications electronically in future years.

**VOTE BY PHONE - 1-800-690-6903**

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

**VOTE BY MAIL**

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Southwall Technologies, Inc. , c / o ADP, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS STHWA1      KEEP THIS PORTION FOR  
FOLLOWS:      YOUR RECORDS

DETACH AND RETURN THIS PORTION ONLY

**THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.**

**SOUTHWALL TECHNOLOGIES, INC.**

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE**

**“FOR” THE NOMINEES FOR DIRECTORS LISTED**

<b>BELOW AND “FOR” PROPOSAL</b>	<b>For</b>	<b>Withhold</b>	<b>For All</b>	To withhold authority to vote for any individual nominee, mark "For All Except" and write the nominee's name on the line below.
<b>2.</b>	<b>All</b>	<b>All</b>	<b>Except</b>	

Vote on Directors

1. Election of Directors to hold office until the 2007 Annual Meeting of Stockholders and until

their successors are elected.

Nominees:

- |      |                          |                        |
|------|--------------------------|------------------------|
| (01) | William A. Berry         | (05) Peter E. Salas    |
| (02) | Jami K. Dover Nachtsheim | (06) Thomas G. Hood    |
| (03) | R. Eugene Goodson        | (07) George Boyadjieff |
| (04) | Andre R. Horn            |                        |

**Vote on Proposals**

**For Against Abstain**

2. To ratify the selection of Burr, Pilger & Mayer LLP as our independent registered public accounting firm for the year ending 31, 2006.

3. In their discretion, the proxies are authorized to vote upon such other business as may properly come before the Annual Meeting and at any adjournment or postponement thereof.

Please sign exactly as your name appears hereon. If the stock is registered in the names of two or more persons, each should sign. If signer is a corporation, please give full corporate name and have a duly authorized officer sign stating title. If signer is a partnership, please sign in partnership name by authorized person.

For address changes and/or comments please check this box and write them on the back where indicated.

**YesNo**

Please indicate if you    
plan to attend this  
meeting.

**HOUSEHOLDING**

**ELECTION** - Please indicate if you consent to receive certain future investorcommunications in a single package per household.

Signature [PLEASE SIGN WITHIN BOX]      Date

Signature (Joint Owners)      Date

**PROXY SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS**

**SOUTHWALL TECHNOLOGIES INC.**

**Annual Meeting of Stockholders**

**June 5, 2006**

The undersigned hereby appoints Thomas G. Hood and Sylvia Kamenski, and each of them, as attorneys and proxies of the undersigned, with power of substitution, to vote all of the shares of stock of Southwall Technologies Inc. (the "Company") which the undersigned may be entitled to vote at the Annual Meeting of Stockholders of the Company to be held at the Company's principal executive offices at 3975 East Bayshore Road, Palo Alto, California on Monday, June 5, 2006 at 3:00 p.m., local time, and at all continuations, and adjournments or postponements thereof, with all of the powers the undersigned would possess if personally present, upon and in respect of the matters as listed on the reverse side and in accordance with the instructions designated on the reverse side, with the discretionary authority as to all other matters that may properly come before the meeting.

Receipt is hereby acknowledged of the Notice of Annual Meeting of Stockholders and Proxy Statement dated May 5, 2006 (the "Proxy Statement").

**UNLESS A CONTRARY DIRECTION IS INDICATED, THIS PROXY WILL BE VOTED FOR ALL NOMINEES LISTED IN PROPOSAL 1 AND FOR PROPOSAL 2 AS MORE SPECIFICALLY SET FORTH IN THE PROXY STATEMENT. IF SPECIFIC INSTRUCTIONS ARE INDICATED, THIS PROXY WILL BE VOTED IN ACCORDANCE THEREWITH.**

**PLEASE VOTE, DATE, SIGN, AND PROMPTLY RETURN THIS PROXY CARD USING THE ENCLOSED POSTAGE-PAID ENVELOPE.**

<b>Address Changes/Comments:</b>

(If you noted any Address Changes/Comments above, please mark corresponding box on the reverse side.)

**SEE REVERSE SIDE**

**CONTINUED AND TO BE SIGNED  
ON REVERSE SIDE**

**SEE REVERSE SIDE**