

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 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

(State or other jurisdiction of
incorporation or organization)

51-0261339

(I.R.S. Employer
Identification No.)

3710 Rawlins, Suite 1500, Dallas, Texas

(Address of principal executive offices)

75219

(Zip Code)

214-528-5588

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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 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 No

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.

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class

Common Stock, \$0.10 par value per share

Outstanding at July 31, 2011

1,525,166 shares

THE HALLWOOD GROUP INCORPORATED AND SUBSIDIARIES

EXPLANATORY NOTE

This Form 10-Q/A amendment to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2011 is being filed for the sole purpose of furnishing Exhibit 101. Exhibit 101 to this report provides financial information formatted in Extensible Business Reporting Language (XBRL) in accordance with Rule 405 of Regulation S-T.

This Amendment No. 1 does not reflect any events occurring subsequent to the August 16, 2011 filing date of the original Form 10-Q for the quarter ended June 30, 2011 or in any way modify or update disclosures in the original Form 10-Q for the quarter ended June 30, 2011.

PART II — OTHER INFORMATION

Item 6. Exhibits

See Index to Exhibits beginning on page 4.

THE HALLWOOD GROUP INCORPORATED AND SUBSIDIARIES

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE HALLWOOD GROUP INCORPORATED

Dated: September 14, 2011

By: /s/ Richard Kelley
Richard Kelley, Vice President
(Duly Authorized Officer and
Principal Financial and
Accounting Officer)

THE HALLWOOD GROUP INCORPORATED AND SUBSIDIARIES

INDEX TO EXHIBITS

| Exhibit Number | Description |
|---------------------------|--|
| 31.1 | Certification of the Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.* |
| 31.2 | Certification of the Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. * |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. * |
| 101.INS | XBRL Instance Document** |
| 101.SCH | XBRL Taxonomy Extension Schema** |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase** |
| 101.DEF | XBRL Additional Taxonomy Extension Definition Linkbase** |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase** |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase** |

* Previously filed with The Hallwood Group Incorporated's Quarterly Report on Form 10-Q filed on August 16, 2011.

** Furnished electronically herewith. XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

<DOCUMENT>
<TYPE> EX-101.INS
<FILENAME> hwg-20110630.xml
<DESCRIPTION> EX-101 INSTANCE DOCUMENT
<DOCUMENT>
<TYPE> EX-101.SCH
<FILENAME> hwg-20110630.xsd
<DESCRIPTION> EX-101 SCHEMA DOCUMENT
<DOCUMENT>
<TYPE> EX-101.CAL
<FILENAME> hwg-20110630_cal.xml
<DESCRIPTION> EX-101 CALCULATION LINKBASE DOCUMENT
<DOCUMENT>
<TYPE> EX-101.LAB
<FILENAME> hwg-20110630_lab.xml
<DESCRIPTION> EX-101 LABELS LINKBASE DOCUMENT
<DOCUMENT>
<TYPE> EX-101.PRE
<FILENAME> hwg-20110630_pre.xml
<DESCRIPTION> EX-101 PRESENTATION LINKBASE DOCUMENT
<DOCUMENT>
<TYPE> EX-101.DEF
<FILENAME> hwg-20110630_def.xml
<DESCRIPTION> EX-101 DEFINITION LINKBASE DOCUMENT

| Document and Entity Information (USD \$) | 6 Months Ended | | |
|---|---------------------------|---------------|---------------|
| | Jun. 30, 2011 | Jul. 31, 2011 | Jun. 30, 2010 |
| Document and Entity Information [Abstract] | | | |
| Entity Registrant Name | Hallwood Group Inc | | |
| Entity Central Index Key | 0000355766 | | |
| Document Type | 10-Q | | |
| Document Period End Date | Jun. 30, 2011 | | |
| Amendment Flag | false | | |
| Document Fiscal Year Focus | 2011 | | |
| Document Fiscal Period Focus | Q2 | | |
| Current Fiscal Year End Date | --12-31 | | |
| Entity Well-known Seasoned Issuer | No | | |
| Entity Voluntary Filers | No | | |
| Entity Current Reporting Status | Yes | | |
| Entity Filer Category | Smaller Reporting Company | | |
| Entity Public Float | | | \$ 19,532,000 |
| Entity Common Stock, Shares Outstanding | | 1,525,166 | |

| Condensed Consolidated Balance Sheets (Unaudited) (USD \$) In Thousands | Jun. 30, 2011 | Dec. 31, 2010 |
|---|---------------|---------------|
| Current Assets | | |
| Cash and cash equivalents | \$ 9,930 | \$ 11,159 |
| Marketable securities - short-term investments | 10 | 7,490 |
| Accounts receivable, net | | |
| Factors | 16,929 | 14,043 |
| Trade and other | 8,568 | 8,916 |
| Related parties | 35 | 12 |
| Inventories, net | 27,478 | 19,136 |
| Deferred income tax, net | 4,222 | 1,597 |
| Prepays, deposits and other assets | 972 | 700 |
| Prepaid income taxes | 916 | 1,093 |
| Total current assets | 69,060 | 64,146 |
| Noncurrent Assets | | |
| Property, plant and equipment, net | 20,259 | 20,984 |
| Other assets | 165 | 147 |
| Investments in Hallwood Energy, net | 0 | 0 |
| Total noncurrent assets | 20,424 | 21,131 |
| Total Assets | 89,484 | 85,277 |
| Current Liabilities | | |
| Accounts payable | 8,984 | 7,996 |
| Accrued expenses and other current liabilities | 5,276 | 6,016 |
| Payable - Hallwood Energy matters | | |
| Litigation reserve | 7,500 | 0 |
| Contingent additional investment in Hallwood Energy | 3,201 | 3,201 |
| Income taxes payable | 9 | 27 |
| Total current liabilities | 24,970 | 17,240 |
| Noncurrent Liabilities | | |
| Long term portion of loans payable | 3,000 | 2,000 |
| Deferred income tax | 566 | 566 |
| Total noncurrent liabilities | 3,566 | 2,566 |

| | | |
|---|-----------|-----------|
| Total Liabilities | 28,536 | 19,806 |
| Contingencies and Commitments (Note 14) | | |
| Stockholders' Equity | | |
| Common stock, issued 2,396,105 shares for both periods; outstanding 1,525,166 shares for both periods | 240 | 240 |
| Additional paid-in capital | 51,700 | 51,700 |
| Retained earnings | 22,412 | 26,935 |
| Treasury stock, 870,939 shares for both periods; at cost | (13,404) | (13,404) |
| Total Stockholders' Equity | 60,948 | 65,471 |
| Total Liabilities and Stockholders' Equity | \$ 89,484 | \$ 85,277 |

| Condensed Consolidated Balance Sheets (Unaudited) (Parenthetical) | Jun. 30, 2011 | Dec. 31, 2010 |
|---|---------------|---------------|
| Stockholders' Equity | | |
| Common stock, shares issued | 2,396,105 | 2,396,105 |
| Common stock, shares outstanding | 1,525,166 | 1,525,166 |
| Treasury stock, shares | 870,939 | 870,939 |

| Condensed Consolidated Statements of Operations (Unaudited) (USD \$) In Thousands, except Per Share data | 3 Months Ended | | 6 Months Ended | |
|--|----------------|---------------|----------------|---------------|
| | Jun. 30, 2011 | Jun. 30, 2010 | Jun. 30, 2011 | Jun. 30, 2010 |
| Revenues | | | | |
| Textile products sales | \$ 36,699 | \$ 47,927 | \$ 63,468 | \$ 95,077 |
| Expenses | | | | |
| Textile products cost of sales | 29,116 | 34,193 | 52,310 | 66,866 |
| Administrative and selling expenses | 5,331 | 6,157 | 10,477 | 12,453 |
| Litigation reserve - Hallwood Energy matters | 7,500 | | 7,500 | |
| Total expenses | 41,947 | 40,350 | 70,287 | 79,319 |
| Operating income (loss) | (5,248) | 7,577 | (6,819) | 15,758 |
| Other Income (Loss) | | | | |
| Interest expense | (23) | (57) | (49) | (118) |
| Interest and other income | 13 | 5 | 30 | 6 |
| Total other income (loss) | (10) | (52) | (19) | (112) |
| Income (loss) before income taxes | (5,258) | 7,525 | (6,838) | 15,646 |
| Income tax expense (benefit) | (1,731) | 2,729 | (2,315) | 5,600 |
| Net Income (Loss) | \$ (3,527) | \$ 4,796 | \$ (4,523) | \$ 10,046 |
| Net Income (Loss) Per Common Share | | | | |
| Basic | \$ (2.31) | \$ 3.14 | \$ (2.97) | \$ 6.59 |
| Diluted | \$ (2.31) | \$ 3.14 | \$ (2.97) | \$ 6.59 |
| Weighted Average Shares Outstanding | | | | |
| Basic | 1,525 | 1,525 | 1,525 | 1,525 |
| Diluted | 1,525 | 1,525 | 1,525 | 1,525 |

| Condensed Consolidated Statements of Comprehensive Income (Unaudited) (USD \$) In Thousands | 3 Months Ended | | 6 Months Ended | |
|---|----------------|---------------|----------------|---------------|
| | Jun. 30, 2011 | Jun. 30, 2010 | Jun. 30, 2011 | Jun. 30, 2010 |
| Condensed Consolidated Statements of Comprehensive Income [Abstract] | | | | |
| Net Income (Loss) | \$ (3,527) | \$ 4,796 | \$ (4,523) | \$ 10,046 |
| Other Comprehensive Income (Loss) | | | | |

| | | | | |
|-----------------------------|------------|----------|------------|-----------|
| None | | | | |
| Comprehensive Income (Loss) | \$ (3,257) | \$ 4,796 | \$ (4,523) | \$ 10,046 |

| Condensed Consolidated Statement of Changes in Stockholders' Equity (Unaudited) (USD \$) In Thousands | 6 Months Ended | | | | |
|---|----------------|----------------------------|-------------------|----------------|-----------|
| | Common Stock | Additional Paid-In Capital | Retained Earnings | Treasury Stock | Total |
| Balance, shares at Dec. 31, 2010 | 2,396 | | | 871 | |
| Balance at Dec. 31, 2010 | \$ 240 | \$ 51,700 | \$ 26,935 | \$ (13,404) | \$ 65,471 |
| Net loss | | | (4,523) | | (4,523) |
| Balance, shares at Jun. 30, 2011 | 2,396 | | | 871 | |
| Balance at Jun. 30, 2011 | \$ 240 | \$ 51,700 | \$ 22,412 | \$ (13,404) | \$ 60,948 |

| Condensed Consolidated Statements of Cash Flows (Unaudited) (USD \$) In Thousands | 6 Months Ended | |
|---|-----------------|------------------|
| | Jun. 30, 2011 | Jun. 30, 2010 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net Income (Loss) | \$ (4,523) | \$ 10,046 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Litigation reserve - Hallwood Energy matters | 7,500 | |
| Deferred tax expense (benefit) | (2,625) | |
| Depreciation, amortization and impairment | 1,282 | 1,172 |
| Provision for obsolete inventory | 57 | 268 |
| Provision for doubtful accounts and factor dilution | (85) | |
| Changes in assets and liabilities: | | |
| (Increase) decrease in inventories | (8,399) | 485 |
| (Increase) decrease in accounts receivable | (2,476) | 271 |
| Increase (decrease) in accounts payable | 1,513 | (611) |
| Increase (decrease) in accrued expenses and other current liabilities | (740) | (1,581) |
| Net change in other assets and liabilities | (290) | 88 |
| Net change in income taxes receivable/payable | 159 | 1,014 |
| Net cash provided by (used in) operating activities | (8,627) | 11,152 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from redemption of short-term investments | 7,480 | |
| Investments in property, plant and equipment, net | (1,082) | (5,144) |
| Net cash provided by (used in) investing activities | 6,398 | (5,144) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from revolving credit facility | 1,000 | 11,605 |
| Repayments of revolving credit facility | | (15,055) |
| Net cash provided by (used in) financing activities | 1,000 | (3,450) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (1,229) | 2,558 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 11,159 | 7,838 |
| CASH AND CASH EQUIVALENTS, END | \$ 9,930 | \$ 10,396 |

| Organization, Interim Condensed Consolidated Financial Statements and New Accounting Pronouncements | 6 Months Ended Jun. 30, 2011 |
|--|---------------------------------|
| Organization, Interim Condensed Consolidated Financial Statements and New Accounting Pronouncements [Abstract] | |

Organization, Interim Condensed Consolidated Financial Statements and New Accounting Pronouncements

Note 1 — Organization, Interim Condensed Consolidated Financial Statements and New Accounting Pronouncements

Organization. The Hallwood Group Incorporated (the “Company”) (NYSE Amex: HWG) was incorporated in Delaware in 1981. The Company 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”).

Interim Condensed Consolidated Financial Statements. The interim condensed consolidated financial statements of the Company and its subsidiaries (collectively, the “Hallwood Group”) have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America. Although condensed, in the opinion of management, all adjustments considered necessary for a fair presentation have been included. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related disclosures thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2010.

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. Brookwood has two principal subsidiaries at June 30, 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.

Textile products accounts for all of Hallwood Group’s operating revenues. See Note 4 for additional information on Brookwood.

Investments in Financial Instruments. In the 2011 first quarter, the Company opened an investment account with UBS AG, a global financial services firm, and intended to transfer a significant portion of the cash it holds from time to time to the UBS account to invest. As of August 15, 2011, no funds have been transferred into the UBS account. In connection with the Hallwood Energy litigation matters discussed in Note 14, on July 25, 2011, the Court issued Proposed Findings of Fact, Conclusions of Law and Judgment Awarding Various Monetary Damages (the “Proposed Findings”) in the Adversary proceedings. The Court proposed damage awards plus interest and attorney fees. The Company intends to object to the Proposed Findings and will vigorously defend against the entry of any final judgment. Until this matter is concluded, the Company does not intend to pursue its previously announced intention to transfer funds into the UBS account.

Energy. Prior to October 2009, the Company held an investment in Hallwood Energy, L.P. (“Hallwood Energy”). Hallwood Energy was a privately held independent oil and gas limited partnership and 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 further discussed in Note 5, Hallwood Energy filed for bankruptcy in March 2009. In connection with the confirmation of Hallwood Energy’s bankruptcy in October 2009, the Company’s ownership interest in Hallwood Energy was extinguished and the Company no longer

accounts for the investment in Hallwood Energy using the equity method of accounting.

Consolidation Policy. The Company's Brookwood subsidiary operates on a 5-4-4 accounting cycle with its months always ending on a Saturday for accounting purposes, while the Company operates on a traditional fiscal month accounting cycle. For purposes of the year-end financial statements the Brookwood cycle always ends on December 31, however, quarterly interim financial statements may not correspond to the fiscal quarter-end. Hallwood Group's condensed consolidated financial statements as of June 30, 2011 and 2010 include Brookwood's operations through July 2, 2011 and June 26, 2010, respectively. Estimated operating results of Brookwood for the intervening periods to June 30, 2011 and 2010, respectively, are provided below (in thousands):

| | Amounts in Intervening Periods Six Months Ended June 30, | |
|-------------------------------------|---|-----------------------|
| | 2011 | 2010 |
| | (one business day) | (three business days) |
| Textile products sales | \$211 | \$137 |
| Textile products costs of sales | 175 | 112 |
| Administrative and selling expenses | 131 | 297 |

New Accounting Pronouncements. In June 2011, the Financial Accounting Standards Board issued Accounting Standards Update No. 2011-05 (ASU 2011-05), *Presentation of Comprehensive Income*. This standard eliminates the current option to present other comprehensive income and its components in the statement of changes in equity. It will require companies to report the total of comprehensive income including the components of net income and the components of other comprehensive income in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Hallwood Group will adopt ASU 2011-05 in its annual financial statements for the year ended December 31, 2011. The adoption of ASU 2011-05 will not affect Hallwood Group's financial position, results of operations or cash flows.

| Cash, Cash Equivalents and Marketable Securities | 6 Months Ended Jun. 30, 2011 |
|--|---------------------------------|
| Cash, Cash Equivalents and Marketable Securities [Abstract] | |
| Cash, Cash Equivalents and Marketable Securities | |

Note 2 — Cash, Cash Equivalents and Marketable Securities

The following tables summarize the estimated fair value of Hallwood Group's cash, cash equivalents and marketable securities and the gross unrealized holding gains and losses (in thousands):

| | June 30, 2011 | | | |
|--|----------------|-------------------------------|------------------------------|----------------|
| | Cost | Gross Unrealized Losses | Gross Unrealized Gains | Fair Value |
| | | | | |
| Cash and Cash Equivalents | | | | |
| Cash | \$4,403 | \$ — | \$ — | \$4,403 |
| Available for-sale-securities: | | | | |
| Money market funds | <u>5,527</u> | <u>—</u> | <u>—</u> | <u>5,527</u> |
| Total cash and cash equivalents | <u>\$9,930</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$9,930</u> |

Marketable Securities

| | | | | |
|----------------------------|--------------|-------------|-------------|--------------|
| Short-term investments | | | | |
| Variable-rate demand notes | <u>\$ 10</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 10</u> |

| | December 31, 2010 | | | |
|--|-------------------|-------------------------------|------------------------------|-----------------|
| | Cost | Gross Unrealized Losses | Gross Unrealized Gains | Fair Value |
| | | | | |
| Cash and Cash Equivalents | | | | |
| Cash | \$ 5,909 | \$ — | \$ — | \$ 5,909 |
| Available for-sale-securities: | | | | |
| Money market funds | <u>5,250</u> | <u>—</u> | <u>—</u> | <u>5,250</u> |
| Total cash and cash equivalents | <u>\$11,159</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$11,159</u> |

Marketable Securities

Short-term investments

| | | | | |
|----------------------------|-----------------|-------------|-------------|-----------------|
| Variable-rate demand notes | <u>\$ 7,490</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 7,490</u> |
|----------------------------|-----------------|-------------|-------------|-----------------|

There are no unrealized gains or losses for the variable-rate demand notes because of the frequent resetting nature of such notes. Variable-rate demand notes are considered highly liquid and although the variable-rate demand notes have long-term nominal maturity dates, the interest rates generally reset weekly. Despite the long-term nature of the variable-rate demand notes, they are classified as short-term due to Hallwood Group's ability to quickly liquidate these securities at par plus accrued interest with seven-day notice. The variable-rate demand notes were sold at par principally during the 2011 second quarter in connection with Brookwood's recurring operations with the exception of \$10,000 which were sold in July 2011.

| Inventories | 6 Months Ended | |
|--|-----------------|---------------------|
| | Jun. 30, 2011 | |
| Inventories [Abstract] | | |
| Inventories | | |
| Note 3 — Inventories | | |
| All inventories relate to Brookwood. Inventories as of the balance sheet dates were as follows (in thousands): | | |
| | June 30, | December 31, |
| | 2011 | 2010 |
| Raw materials | \$ 8,152 | \$ 6,796 |
| Work in progress | 6,131 | 4,782 |
| Finished goods | 14,452 | 8,758 |
| | <u>28,735</u> | <u>20,336</u> |
| Less: Obsolescence reserve | (1,257) | (1,200) |
| Total | <u>\$27,478</u> | <u>\$ 19,136</u> |

| Operations of Brookwood Companies Incorporated | 6 Months Ended | |
|---|----------------|--|
| | Jun. 30, 2011 | |
| Operations of Brookwood Companies Incorporated [Abstract] | | |
| Operations of Brookwood Companies Incorporated | | |
| Note 4 — Operations of Brookwood Companies Incorporated | | |
| <p><i>Receivables.</i> 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. Factored receivables were \$16,929,000 and \$14,043,000 at June 30, 2011 and December 31, 2010, which were net of a returned good dilution allowance of \$84,000 and \$114,000, respectively.</p> <p>Brookwood monitors its factors and their ability to fulfill their obligations to Brookwood in a timely manner. As of August 15, 2011, all of Brookwood's factors were complying with payment terms in accordance with factor agreements.</p> <p>Trade receivables were \$8,261,000 and \$8,387,000 at June 30, 2011 and December 31, 2010, which were net of an allowance for doubtful accounts of \$74,000 and \$129,000, respectively. The trade receivable balance at June 30, 2011 and December 31, 2010 includes approximately \$1,639,000, which was the balance remaining related to fabric sold in two products to a Brookwood customer that supplies the U.S. military for which payment has been delayed due to a pending compliance issue (see also Note 14). Brookwood resolved the issue with respect to one of the products and received payment at full value in 2009. Additionally, resolution with respect to the second product with one of the procurement entities was achieved in 2010 and Brookwood received payment at full value of \$3,242,000 in October 2010. Although Brookwood is continuing efforts to structure a resolution with the final procurement entity, Brookwood has communicated to its supplier regarding satisfaction of the unpaid receivable. Brookwood believes it is likely to collect the balance due.</p> | | |

Sales Concentration. Brookwood has two customers who accounted for more than 10% of

Brookwood's sales. Sales to one Brookwood customer, Tennier Industries, Inc. ("Tennier"), accounted for more than 10% of Brookwood's sales during both the 2011 and 2010 periods. Brookwood's relationship with Tennier is ongoing. Sales to Tennier, which are included in military sales, were \$6,105,000 and \$6,395,000 in the 2011 second quarter and six month periods, respectively, compared to \$16,592,000 and \$35,769,000 in 2010. Sales to Tennier represented 16.6% and 34.6% of Brookwood's net sales in the 2011 and 2010 second quarters, respectively, and 10.1% and 37.6% in the 2011 and 2010 six month periods, respectively. Sales to another customer, ORC Industries, Inc. ("ORC"), accounted for more than 10% of Brookwood's sales in 2010. Brookwood's relationship with ORC is ongoing. Sales to ORC, which are included in military sales, were \$1,092,000 and \$1,092,000 in the 2011 second quarter and six month periods, respectively, compared to \$4,448,000 and \$10,079,000 in 2010. Sales to ORC represented 3.0% and 9.3% of Brookwood's net sales in the 2011 and 2010 second quarters, respectively, and 1.7% and 10.6% in the 2011 and 2010 six month periods, respectively. Brookwood received an increased level of military orders and sales in late March and into the 2011 second quarter that have been and will be processed in 2011, however not to the same level as the first half of 2010.

Military sales accounted for \$20,235,000 and \$30,411,000 in the 2011 second quarter and six month periods, respectively, compared to \$35,293,000 and \$69,950,000 in 2010. The military sales represented 55.1% and 73.6% of Brookwood's net sales in the 2011 and 2010 quarters, respectively, and 47.9% and 73.6% in the 2011 and 2010 six month periods, respectively.

Flood at Kenyon Facility. On March 31, 2010, Kenyon was affected by the general flooding that took place in the State of Rhode Island and in particular from the Pawcatuck River. Kenyon was closed for a period of seven days after which it reinstated production of unaffected production lines. Only certain production lines were affected and production capacity was restored within a few weeks. Brookwood filed claims with its insurance carriers, through its Kenyon subsidiary. Brookwood recognized the \$100,000 insurance policy deductible in the 2010 second quarter and has received from its carriers \$1,235,000 for its building and contents claims, including \$229,000 received in the 2011 first quarter. No additional amounts are due. Brookwood also filed a claim under its business interruption insurance policy and received \$150,000 in July 2011 from its carrier in satisfaction of its claim, which was recognized as a recovery in the 2011 second quarter.

Stockholders' Equity. The Company is the holder of all of Brookwood's outstanding \$13,500,000 Series A, \$13.50 annual dividend per share, redeemable preferred stock and all of its 10,000,000 outstanding shares of common stock. The preferred stock has a liquidation preference of \$13,500,000 plus accrued but unpaid dividends. At June 30, 2011, cumulative dividends in arrears on the preferred stock amounted to approximately \$456,000.

2005 Long-Term Incentive Plan for Brookwood. In December 2005, the Company adopted The Hallwood Group Incorporated 2005 Long-Term Incentive Plan for Brookwood Companies Incorporated (the "2005 Long-Term Incentive Plan for Brookwood") to encourage employees of Brookwood to increase the value of Brookwood and to be employed by Brookwood. The terms of the incentive plan provide for a total award amount to participants equal to 15% of the fair market value of consideration received by the Company in a change of control transaction, as defined, in excess of the sum of the liquidation preference plus accrued unpaid dividends on the Brookwood preferred stock (approximately \$13,956,000 at June 30, 2011). The base amount will fluctuate in accordance with a formula that increases by the amount of the annual dividend on the preferred stock, currently \$1,823,000, and decreases by the amount of the actual preferred dividends paid by Brookwood to the Company. The plan generally defines a change of control transaction as a transaction approved by the Company's board of directors or by the holders of at least 50% of the voting capital stock of the Company that results in: (i) a change in beneficial ownership of the Company or Brookwood of 50% or more of the combined voting power, (ii) the sale of all or substantially all of the assets of Brookwood, or (iii) any other transaction that, in the Company's board of directors discretion, has substantially the same effect of item (i) or (ii). Certain transfers, generally among existing stockholders and their related parties, are exempted from the definition.

However, if the Company's board of directors determines that certain specified Brookwood officers, or other persons performing similar functions do not have, prior to the change of control transaction, in the aggregate an equity or debt interest of at least two percent in the entity with whom the change of control transaction is completed, then the minimum amount to be awarded under the plan shall be \$2,000,000. In addition, the Company agreed that, if members of Brookwood's senior management do not have, prior to a change of control transaction in the aggregate an equity or debt interest of at least two percent in the entity with whom the change of control transaction is completed (exclusive of any such interest any such individual receives with respect to his or her employment following the change of control transaction), then the Company will be obligated to pay an additional \$2,600,000.

| | |
|--|----------------|
| Investments in Hallwood Energy, L.P. | 6 Months Ended |
| Investments in Hallwood Energy, L.P. [Abstract] | Jun. 30, 2011 |
| Investments in Hallwood Energy, L.P. | |

Note 5 — Investments in Hallwood Energy, L.P.

Hallwood Energy was a privately held independent oil and gas limited partnership and 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 had invested \$75,401,000 in Hallwood Energy comprised of a general partnership interest, Class A and Class C limited partnership interests and convertible notes.

Prior to the confirmation of Hallwood Energy’s plan of reorganization in Bankruptcy Court in October 2009 (discussed below), the Company accounted for the investment in Hallwood Energy using the equity method of accounting and recorded its pro rata share of Hallwood Energy’s net income (loss), partner capital transactions and comprehensive income (loss), as appropriate. In connection with Hallwood Energy’s bankruptcy reorganization, the Company’s general and limited partnership interests in Hallwood Energy were extinguished and the Company no longer accounts for the investment in Hallwood Energy using the equity method of accounting.

Bankruptcy Reorganization by Hallwood Energy. In March 2009, Hallwood Energy, Hallwood Energy Management, LLC (the general partner of 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 any other of its assets.

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. In addition, Hallwood Energy’s convertible notes, including those held by the Company, are subordinated to recovery in favor of Hall Phoenix/Inwood, Ltd. (“HPI”), the secured lender to Hallwood Energy. As a result of these developments, the Company does not anticipate that it will recover any of its investments in Hallwood Energy.

Contingent Commitment to Invest Additional Funds. In connection with the then ongoing efforts to complete a transaction to raise additional capital by entering into an agreement for the sale and farmout of an undivided interest in up to 33.33% of substantially all of its assets to FEI Shale, L.P. (“FEI”), a subsidiary of Talisman Energy, Inc. (the “Talisman Energy Transaction”), the Company loaned Hallwood Energy \$2,961,000 in May 2008. Concurrent with the completion of the Talisman Energy Transaction in June 2008, the Company entered into an equity support agreement (the “Equity Support Agreement”) with Hallwood Energy under which the Company committed, under certain conditions, to contribute equity or debt capital to Hallwood Energy to maintain a reasonable liquidity position for Hallwood Energy or prevent or cure any default under Hallwood Energy’s credit facilities with respect to interest payments, up to a maximum amount of \$12,500,000. The Company contributed \$2,039,000 at the completion date (for a total amount of \$5,000,000) to Hallwood Energy and committed to provide an additional amount of up to \$7,500,000 in certain circumstances under the terms of a \$12,500,000 convertible subordinated note agreement that was issued by Hallwood Energy in May 2008 and underwritten by the Company. In September 2008, the Company loaned an additional \$4,300,000 to Hallwood Energy under the Equity Support Agreement.

An obligation and related additional equity loss were recorded in 2008 to the extent of the Company’s contingent commitment to provide additional financial support to Hallwood Energy pursuant to the Equity Support Agreement, in accordance with generally accepted accounting principles. The Equity Support Agreement terminated not later than October 2009 in connection with the confirmation of Hallwood Energy’s plan of reorganization. The Equity Support Agreement is no longer in effect, although (as previously discussed) the obligation, subject to certain defenses raised by the Company, to pay the remaining contingent commitment amount of \$3,201,000 is at issue in the pending adversary proceeding against the Company. The \$3,201,000 amount is included in the “Payable — Hallwood Energy matters” reported on Hallwood Group’s consolidated balance sheets.

Litigation. In connection with Hallwood Energy’s bankruptcy proceeding, Hallwood Energy and other parties have filed lawsuits and threatened to assert additional claims against the Company and certain related parties alleging actual, compensatory and exemplary damages in excess of \$200,000,000, based on purported breach of contract, fraud, breach of fiduciary duties, neglect, negligence and various misleading statements, omissions and misrepresentations. See Note 14.

Other. For further information on Hallwood Energy’s activities, including its bankruptcy reorganization, refer to the Company’s annual report on Form 10-K for the year ended December 31, 2010.

| Loans Payable | 6 Months Ended | |
|--------------------------|----------------|--|
| | Jun. 30, 2011 | |
| Loans Payable [Abstract] | | |
| Loans Payable | | |

Note 6 — Loans Payable

Loans payable, all of which relate to Brookwood, at the balance sheet dates were as follows (in thousands):

| | June 30, 2011 | December 31, 2010 |
|---|------------------|----------------------|
| Working Capital Revolving Credit Facility; due January 2014 | \$ 3,000 | \$ 2,000 |
| Current portion | — | — |
| Noncurrent portion | <u>\$ 3,000</u> | <u>\$ 2,000</u> |

Working Capital Revolving Credit Facility. The Company’s Brookwood subsidiary has a revolving credit facility in an amount up to \$25,000,000 with KeyBanc (the “Working Capital Revolving Credit Facility”). Borrowings are collateralized by all accounts receivable, certain finished goods inventory, machinery and equipment and all of the issued and outstanding capital stock of Brookwood and its subsidiaries. The interest rate was a blended rate of 1.69% and 3.02% at June 30, 2011 and December 31, 2010, respectively. The outstanding balance was \$3,000,000 at June 30, 2011 and Brookwood had \$21,879,000 of borrowing availability under this facility, which is net of a standby letter of credit for \$121,000.

Renewal of Credit Facility. In September 2010, Brookwood entered into an amendment of the Working Capital Revolving Credit Facility, to extend the term to January 31, 2014. The interest rate payable on the facility is dependent on the leverage ratio, as defined, and can vary from LIBOR + 1.50% — 2.00% and KeyBanc’s Base Rate, typically prime rate + 0.50% — 1.00%, at Brookwood’s option. The principal amount of \$25,000,000 and the loan covenants were not changed.

Loan Covenants. The Working Capital Revolving Credit Facility provides for a maximum total debt to tangible net worth ratio of 1.50 and a covenant that Brookwood shall maintain a quarterly minimum income before taxes of not less than one dollar. In October 2009, an additional covenant was added that provides for a total funded debt to EBITDA (earnings before interest, taxes, depreciation and amortization) ratio, for the trailing four quarters, of not greater than 2.00 to be calculated on a quarterly basis, commencing December 31, 2009.

As of December 31, 2010 and for all interim periods in 2010 Brookwood was in compliance with its loan covenants. 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 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. Future compliance with the covenants under its Working Capital Revolving Credit Facility depends on Brookwood’s military orders increasing from the levels in the 2010 fourth quarter and 2011 first quarter. Brookwood received an increased level of military orders in late March and into the 2011 second quarter, and reported income before taxes of \$3,304,000 in the 2011 second quarter and was in compliance with its loan covenants for the 2011 second quarter.

Payments of Dividends. Brookwood submits a quarterly loan compliance certificate to KeyBanc and concurrently requests the bank’s consent to pay cash dividends and tax sharing payments to the Company. Brookwood paid to the Company dividends of \$1,000,000 in February 2011 and May 2011. Brookwood anticipates requesting from KeyBanc the ability to borrow additional amounts from its Working Capital Revolving Credit Facility to pay cash dividends or to make advances to the Company to enable the Company to receive not only its quarterly cash dividends but an undetermined portion (in excess of the cash currently held by the Company) of its potential obligations relating to the Hallwood Energy litigation. KeyBanc has not yet agreed to allow Brookwood to borrow funds to pay any such cash dividend or other advance to the Company and has indicated that it will only agree to a limited amount to be determined depending on additional financial information to be supplied by Brookwood.

If for any reason Brookwood is unable to draw upon additional borrowings under its Working Capital Credit Facility or otherwise advance funds 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.

Additionally, any payment of a dividend 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. As a result, no assurance can be given that these amounts will be available when needed or required.

Restricted Net Assets. Cash dividends and tax sharing payments by Brookwood to the Company are contingent upon compliance with the KeyBanc loan covenants and the other restrictions described above. This limitation on the transferability of assets constitutes a restriction of Brookwood's net assets, which were \$60,519,000 and \$60,596,000 as of June 30, 2011 and December 31, 2010, respectively.

| Redeemable Preferred Stock | 6 Months Ended | |
|--|----------------|--|
| | Jun. 30, 2011 | |
| Redeemable Preferred Stock and Stockholders' Equity [Abstract] | | |
| Redeemable Preferred Stock | | |
| <p>Note 7 — Redeemable Preferred Stock</p> <p>The Company completed the redemption of its Series B Preferred Stock, at \$4.00 per share on July 20, 2010, the mandatory redemption date, in the total amount of \$1,000,000 and the Series B Preferred Stock was cancelled on the stock records of the Company.</p> | | |

| Stockholders' Equity | 6 Months Ended | |
|--|----------------|--|
| | Jun. 30, 2011 | |
| Redeemable Preferred Stock and Stockholders' Equity [Abstract] | | |
| Stockholders' Equity | | |
| <p>Note 8 — Stockholders' Equity</p> <p><i>Stock Options.</i> At June 30, 2011, there were no outstanding stock options. The Company's former stock option plan terminated in 2005 and no stock options are available for issuance.</p> | | |

| Income Taxes | 6 Months Ended | | | |
|--|--------------------|---------|------------------|---------|
| | Jun. 30, 2011 | | | |
| Income Taxes [Abstract] | | | | |
| Income Taxes | | | | |
| <p>Note 9 — Income Taxes</p> <p>Following is a schedule of the income tax expense (in thousands):</p> | | | | |
| | Three Months Ended | | Six Months Ended | |
| | June 30, | | June 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Federal | | | | |
| Current | \$ 780 | \$2,447 | \$ 190 | \$5,005 |
| Deferred | (2,625) | — | (2,625) | — |
| Sub-total | (1,845) | 2,447 | (2,435) | 5,005 |
| State | | | | |

| | | | | |
|-----------|------------------|----------------|------------------|----------------|
| Current | 114 | 282 | 120 | 595 |
| Deferred | — | — | — | — |
| Sub-total | <u>114</u> | <u>282</u> | <u>120</u> | <u>595</u> |
| Total | <u>\$(1,731)</u> | <u>\$2,729</u> | <u>\$(2,315)</u> | <u>\$5,600</u> |

The net deferred tax asset was \$3,656,000 and \$1,031,000 at June 30, 2011 and December 31, 2010, respectively. The deferred tax asset at June 30, 2011 was comprised of \$3,656,000 attributable to temporary differences, including \$2,625,000 for a litigation reserve and \$1,120,000 associated with the Company's investment in Hallwood Energy. The deferred tax asset at December 31, 2010 was comprised of \$1,031,000 attributable to temporary differences, including \$1,120,000 associated with the Company's investment in Hallwood Energy. The statutory federal tax rate in both periods was 35%, while state taxes were determined based upon taxable income apportioned to those states in which the Company does business at their respective tax rates.

Hallwood Group had a federal income tax receivable of \$283,000 and \$473,000 at June 30, 2011 and December 31, 2010, respectively, and net state tax receivable of \$624,000 and \$593,000, at June 30, 2011 and December 31, 2010, respectively.

| Fair Value of Financial Instruments [Abstract] | 6 Months Ended Jun. 30, 2011 | | |
|---|---|----------------|----------------|
| | Level 1 | Level 2 | Level 3 |
| Note 10 — Fair Value of Financial Instruments | | | |
| The following table summarizes the valuation of the Company's financial instruments based upon the inputs used to measure fair value in the three levels of the fair value hierarchy as of June 30, 2011 and December 31, 2010. | | | |
| | <ul style="list-style-type: none"> Level 1 — Quoted market prices in active markets for identical assets or liabilities Level 2 — Quoted prices for similar assets or liabilities in active markets or inputs that are observable Level 3 — Inputs that are unobservable | | |
| | June 30, 2011 | | |
| Cash Equivalents | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
| Money market funds | \$5,527 | \$ — | \$ — |
| Marketable Securities | | | |
| Short-term investments | | | |
| Variable-rate demand notes | — | 10 | — |
| Total | <u>\$5,527</u> | <u>\$ 10</u> | <u>\$ —</u> |
| | December 31, 2010 | | |
| Cash Equivalents | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
| Money market funds | \$5,250 | \$ — | \$ — |
| Marketable Securities | | | |
| Short-term investments | | | |
| Variable-rate demand notes | — | 7,490 | — |
| Total | <u>\$5,250</u> | <u>\$7,490</u> | <u>\$ —</u> |

Money market funds are classified as Level 1 instruments as they are traded in active markets with sufficient volume and frequency of transactions.

The variable-rate demand notes are classified as Level 2 instruments. Their fair values are based on quoted prices for similar assets or liabilities or determined using inputs that use readily observable market data that are actively quoted and can be validated through external sources, including third-

party pricing services, brokers and market transactions.

The fair value of financial instruments that are short-term or reprice frequently and have a history of negligible credit losses are considered to approximate their carrying value. These include cash, short term receivables, accounts payable and other liabilities.

| Supplemental Disclosures to the Condensed Consolidated Statements of Cash Flows | 6 Months Ended | |
|---|---|--------------------------------------|
| | Jun. 30, 2011 | |
| Supplemental Disclosures to the Condensed Consolidated Statements of Cash Flows [Abstract] | | |
| Supplemental Disclosures to the Condensed Consolidated Statements of Cash Flows | Note 11 — Supplemental Disclosures to the Condensed Consolidated Statements of Cash Flows | |
| | The following transactions affected recognized assets or liabilities but did not result in cash receipts or cash payments (in thousands): | |
| | <i>Supplemental schedule of non-cash investing and financing activities:</i> | |
| | | Six Months Ended June 30, |
| | Description | 2011 |
| | | 2010 |
| | Accrued capital expenditures in accounts payable and accrued expenses: | |
| | Amount at end of period | <u>\$ 19</u> |
| | | <u>\$ 196</u> |
| | <i>Supplemental disclosures of cash payments:</i> | |
| | Income taxes paid | \$ 154 |
| | Interest paid | \$ 4,585 |
| | | 51 |
| | | 94 |

| Computation of Income (Loss) Per Common Share | 6 Months Ended | | | | |
|---|--|--|----------------|--------------------------------------|-----------------|
| | Jun. 30, 2011 | | | | |
| Earnings Per Share [Abstract] | | | | | |
| Computation of Income (Loss) Per Common Share | Note 12 — Computation of Income (Loss) Per Common Share | | | | |
| | The following table reconciles weighted average shares outstanding from basic to diluted methods and reconciles net income (loss) used in the computation of income (loss) per share for the basic and diluted methods (in thousands): | | | | |
| | | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | Description | 2011 | 2010 | 2011 | 2010 |
| | Weighted Average Shares Outstanding | | | | |
| | Basic and diluted | <u>1,525</u> | <u>1,525</u> | <u>1,525</u> | <u>1,525</u> |
| | Net Income (Loss) | | | | |
| | Basic and diluted | <u>\$(3,527)</u> | <u>\$4,796</u> | <u>\$(4,523)</u> | <u>\$10,046</u> |
| | For the three months and six months ended June 30, 2011 and 2010, there were no outstanding stock options. No shares were excluded from the calculation of diluted earnings per share. | | | | |

| Related Party Transactions | 6 Months Ended | |
|--|---|--|
| | Jun. 30, 2011 | |
| Related Party Transactions [Abstract] | | |
| Related Party Transactions | Note 13 — Related Party Transactions | |

Hallwood Investments Limited. The Company has entered into a financial consulting contract with Hallwood Investments Limited (“HIL”), a corporation associated with Mr. Anthony J. Gumbiner, the Company’s chairman and principal stockholder. The contract provides for HIL to furnish and perform international consulting and advisory services to the Company and its subsidiaries, including strategic planning and merger activities, for annual compensation of \$996,000. The annual amount is payable in monthly installments. The contract automatically renews for one-year periods if not terminated by the parties beforehand. Additionally, HIL and Mr. Gumbiner are also eligible for bonuses from the Company or its subsidiaries, subject to approval by the Company’s or its subsidiaries’ board of directors. The Company also reimburses HIL for reasonable expenses in providing office space and administrative services in Europe in connection with HIL’s services to the Company pursuant to the financial consulting contract and for travel and related expenses to between Europe and the Company’s locations in the United States and health insurance premiums.

A summary of the fees and expenses related to HIL and Mr. Gumbiner are detailed below (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------------|------------------------------|---------------|
| | 2011 | 2010 | 2011 | 2010 |
| Consulting fees | \$ 249 | \$ 249 | \$ 498 | \$ 498 |
| Office space and administrative services | 93 | 57 | 166 | 130 |
| Travel and other expenses | 63 | 72 | 80 | 90 |
| Total | <u>\$ 405</u> | <u>\$ 378</u> | <u>\$ 744</u> | <u>\$ 718</u> |

In addition, from time to time, HIL and Mr. Gumbiner have performed services for certain affiliated entities that are not subsidiaries of the Company, for which they receive consulting fees, bonuses, stock options, profit interests or other forms of compensation and expenses. The Company recognizes a proportionate share of such compensation and expenses, based upon its ownership percentage in the affiliated entities, through the utilization of the equity method of accounting. HIL or Mr. Gumbiner received no compensation from these affiliated entities during 2011 or 2010.

HIL and certain of its affiliates in which Mr. Gumbiner has an indirect financial interest share common offices, facilities and certain staff in the Company’s Dallas office for which these companies reimburse the Company. Certain individuals employed by the Company, in addition to their services provided to the Company, perform services on behalf of the HIL-related affiliates. In addition, HIL utilizes some of the office space for purposes unrelated to the Company’s business. The Company pays certain common general and administrative expenses for salaries, rent and other offices expenses and charges the HIL-related companies an overhead reimbursement fee for the share of the expenses allocable to these companies. For the three months ended June 30, 2011 and 2010, these companies reimbursed the Company \$23,000 and \$26,000, respectively, for such expenses. For the six months ended June 30, 2011 and 2010, these companies reimbursed the Company \$47,000 and \$54,000, respectively.

| Litigation, Contingencies and Commitments | 6 Months Ended |
|--|----------------|
| | Jun. 30, 2011 |
| Litigation, Contingencies and Commitments [Abstract] | |
| Litigation, Contingencies and Commitments | |

Note 14 — Litigation, Contingencies and Commitments

Reference is made to Note 16 to the consolidated financial statements contained in the Company’s annual report on Form 10-K for the year ended December 31, 2010.

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. The Company and its subsidiaries are involved in a number of litigation matters. As discussed below, in the Hallwood Energy litigation, the court’s proposal awarded damages of \$18.7 million plus interest and attorney fees. The Company does not currently have sufficient cash, directly or through Brookwood, to make a cash payment of these amounts, if ultimately required to do so, and payment of a significant judgment based on the Proposed Findings would have a material adverse effect on the Company’s financial position, results of operations or cash flows. The Company does not believe that the results of any other litigation matters would have a material adverse effect on the Company’s financial position, results of operations or cash flows. In addition, the Company has

spent and will likely continue to spend significant amounts in professional fees in connection with its defense of its pending litigation matters. The Company 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 the defendants infringed five United States patents. In October 2007, The Hallwood Group Incorporated was dismissed without prejudice on stipulation from the lawsuit. Nextec later added additional patents to the lawsuit. On March 31, 2010, the Court issued its Order on various motions for summary judgment, which in part dismissed Nextec's infringement claims as to two of the four remaining patents in the case. Brookwood then requested reconsideration of certain of the Court's ruling with respect to the two remaining patents. On June 8, 2010, the Court denied Brookwood's request with respect to one of the remaining patents, but granted Brookwood leave to renew its motion for summary judgment for the second remaining patent. Brookwood filed a renewed motion for summary judgment of patent invalidity for the second remaining patent, which motion was later denied on March 8, 2011 due to a disputed issue of fact. Brookwood intends to vigorously defend against any remaining claims. Trial on this matter is currently scheduled to begin on October 31, 2011. 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 any other of its assets.

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, are subordinated to recovery in favor of HPI. As a result of these developments, the Company does not anticipate that it will recover any of its investments in Hallwood Energy.

The confirmed plan of reorganization in the Hallwood Energy bankruptcy proceeding also provides that a creditors' trust created by the plan will 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.

In connection with an Acquisition and Farmout Agreement entered into between Hallwood Energy and FEI Shale, L.P. ("FEI"), 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 additional \$3,200,000, which the Company has not done. On March 30, 2009, Hallwood Energy filed an adversary proceeding against the Company seeking a judgment for the additional \$3,200,000. The case was originally styled *Hallwood Energy, L.P. v. The Hallwood Group Incorporated, Adversary No. 09-03082*, and is pending in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division.

HPI and FEI intervened in the lawsuit and filed their respective complaints in intervention. Among the arguments advanced in the complaints in intervention is 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 generally claims 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 seeks approximately \$38,000,000 in additional damages. In their second amended complaint, HPI and the trustee for the creditors' trust contend that the additional damage is at least \$20,000,000 because they allege that the failure of the Company to fund the \$3,200,000 caused FEI to not fund \$20,000,000 due under the Farmout Agreement between Hallwood Energy and FEI. HPI and the trustee also assert that the Company is 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. Also 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 the remedy of substantive consolidation. On May 5, 2010, the Court dismissed with prejudice the substantive consolidation and abuse of the bankruptcy process claims 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 is 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 parties participated in a Court-ordered mediation, held on July 8, 2010, but the parties were unable to reach a settlement of all or part of the lawsuit. The trial took place over a 13 day period from October 2010 to December 2010 and was followed up with the 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") in the matter. The court proposed that the United States District Court award damages of \$3,200,000 for the Company's knowing 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 tortious interference with the Farmout Agreement, and, in the alternative, for the Company's fraud in failing to disclose to FEI that the Company did not intend to fund the remaining obligation under the Equity Support Agreement, plus in each case prejudgment and postjudgment interest and attorneys' fees as may be requested and awarded pursuant to a subsequent motion. With respect to the issue of fraud by nondisclosure, the court proposed a finding that the Company (i) failed to disclose its belief that the Equity Support Agreement could legally be treated as terminated, (ii) failed to disclose that it had no intention to fund the final \$3.2 million under the Equity Support Agreement and (iii) orchestrated a misimpression that Hallwood Energy was not contemplating bankruptcy while, meanwhile, plotting Hallwood Energy's bankruptcy and plotting how FEI's funding could be used in a Hallwood Energy bankruptcy against FEI's wishes. The court also proposed that HPI's 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 be rejected, and that none of the plaintiffs be awarded exemplary or punitive damages. The Proposed Findings (including the awards) are not final. Any of the parties may object to the Proposed Findings to the United States District Court, which will then review the portions to which objections have been raised on a de novo basis. The Company intends to object to the Proposed Findings and will vigorously defend against the entry of any final judgment. The Company's board of directors has 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 the Hallwood Energy bankruptcy. In addition, the Company's board of directors has authorized the Audit Committee to hire, at the Company's expense, independent counsel and other advisors to assist the Audit Committee with such investigation.

As a result of Proposed Findings, 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 available objections to the Proposed Findings, the Company has reserved \$7,500,000 at June 30, 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 June 30, 2011. This reserve amount has been established in consultation with the Company's litigation counsel in the Hallwood Energy litigation, based on their best judgment of the probabilities of success related to, among other factors, the potential objections to the Proposed Findings. However, the actual results of litigation cannot be predicted with any certainty and the amount of liability to the Company may exceed any estimates or reserves.

On August 3, 2009, the Company was served with a complaint in *Hall Phoenix/Inwood Ltd. and Hall Performance Energy Partners 4, Ltd. v. The Hallwood Group Incorporated, et al.* filed in the 298th District of Texas, No. 09-09551. The other defendants include Anthony J. Gumbiner, the Chairman and Chief Executive Officer of the Company, Bill Guzzetti, the President of the Company, certain affiliates of Mr. Gumbiner and certain officers of Hallwood Energy. The complaint alleges that the defendants defrauded plaintiffs in connection with plaintiffs acquiring interests in and providing loans to Hallwood Energy and seeks actual and exemplary damages. On September 15, 2010, Ray Balestri, Trustee of the Hallwood Energy I Creditors Trust, intervened in this proceeding and added certain of the Company's officers, directors, and an employee as defendants. The new complaint alleges, among other things, claims against the defendants for breach of fiduciary duties, gross negligence and willful misconduct and seeks indeterminable actual and exemplary damages. The Company believes that the allegations and claims are without merit and intends to defend the lawsuit and any future claims vigorously. On November 5, 2010, this case was removed to the United States Bankruptcy Court for the Northern District of Texas, Dallas Division, Adversary No. 10-03358, but is subject to a pending motion to remand filed by the plaintiff.

On July 30, 2010, Hallwood Energy's trustee filed a complaint captioned *Ray Balestri, Trustee of the Hallwood Energy I Creditor's Trust v. Anthony J. Gumbiner, et al* in the Dallas County Court at Law No. 4, No. CC-10-05212D. The other defendants include certain current and former directors,

officers and employees of the Company, certain of Hallwood Energy's former officers and directors, as well as outside legal counsel. The complaint alleges, among other things, claims against the defendants for breach of fiduciary duties, gross negligence and willful misconduct and seeks indeterminable actual and exemplary damages. The Company believes that the allegations and claims are without merit and intends to defend the lawsuit and any future claims vigorously. This case has been removed to the United States Bankruptcy Court for the Northern District of Texas, Dallas Division, Adversary No. 10-03263, but is subject to a pending motion to remand filed by the plaintiff.

Following a hearing on August 4, 2011, the Bankruptcy Court ordered that the two matters that were removed to that court continue to be subject to a stay prohibiting further activities in those matters, other than dismissals of any parties, and that various parties, including the Company and its directors, HPI, FEI Shale, Hallwood Energy, Hallwood Energy's former counsel, and Hallwood Energy's former directors, participate in a series of mediations to take place in September and October 2011.

The allegations in these two later actions involve different actions and different time periods and allege different causes of action than those involved in the Proposed Findings. The Company is unable to estimate a possible loss, if any, in these two actions.

Claim Filed by Company with Insurance Carrier for Directors' and Officers' Liability Insurance Policy. The Company has incurred significant legal fees and associated costs in connection with these actions. The Company has filed claims with the carrier for a directors' and officers' liability insurance policies maintained by the Company. The policy has an aggregate limit of liability of \$10,000,000 per annual policy period. In September 2009, the Company's insurance carrier indicated that it would reimburse the Company pursuant to the terms of its directors' and officers' liability insurance policy for a portion of these expenses, subject to a reservation of rights. The Company received reimbursement of legal fees and associated costs of approximately \$820,000 in the nine month period ended September 30, 2010, which were recorded as expense recoveries in administrative and selling expenses. Additionally, through September 30, 2010, the insurance carrier also paid approximately \$1,120,000 in reimbursement of legal fees and associated costs on behalf of other defendants in connection with the *Hall Phoenix/Inwood Ltd. and Hall Performance Energy Partners 4 Ltd v The Hallwood Group Incorporated, et al* matter. The insurance carrier had indicated that it would pay future legal fees and associated costs incurred on behalf of the Company directly to the service providers.

In August 2010, the insurance carrier informed the Company of a change in its coverage position whereby coverage was denied in reliance on the "insured vs. insured" exclusion in the policy. The Company believes it has demonstrated that the exclusion does not apply and made demand that the insurance carrier provide coverage for these actions. In November 2010, the insurance carrier informally agreed to pay the previously unreimbursed defense costs of the Company and another insured party, in exchange for an agreement not to initiate a coverage lawsuit if the carrier performed promptly. In December 2010, the Company received additional reimbursement from the insurance carrier of legal fees and associated costs of approximately \$553,000. Additionally, in December 2010, the insurance carrier also paid \$1,288,000 of legal fees and associated costs on behalf of other defendants. In April 2011, the insurance carrier reimbursed the Company \$110,000 of legal fees and associated costs and paid a currently undetermined amount of legal fees and costs on behalf of other defendants.

Significant additional costs in excess of insurance reimbursements have been incurred by the Company and on behalf of other defendants. The Company continues to incur substantial litigation-related costs on these matters and the insurance carrier periodically processes claims for the reimbursement of such eligible and covered costs.

Environmental Contingencies. A number of jurisdictions in which the Company or its subsidiaries operate have adopted laws and regulations relating to environmental matters. Such laws and regulations may require the Company to secure governmental permits and approvals and undertake measures to comply therewith. Compliance with the requirements imposed may be time-consuming and costly. While environmental considerations, by themselves, have not significantly affected the Company's or its subsidiaries' business to date, it is possible that such considerations may have a significant and adverse impact in the future. The Company and its subsidiaries actively monitor their environmental compliance and while certain matters currently exist, management is not aware of any compliance issues which will significantly impact the financial position, results of operations or cash flows of the Company or its subsidiaries.

Brookwood and its subsidiaries are subject to a number of environmental laws, regulations, licenses and permits and have ongoing discussions with environmental regulatory authorities, including the U.S. Environmental Protection Agency (the "EPA"), the Rhode Island Department of Health ("RIDOH"), the Rhode Island Department of Environmental Management ("RIDEM") and the Connecticut Department of Environmental Protection ("CTDEP") on a number of matters, including compliance with safe drinking water rules and wastewater discharge and treatment regulations, the control of

chemicals used in the companies' coating operations that are classified as air pollutants, the presence of groundwater and soil contaminants at the companies' facilities, the removal of underground storage tanks, and hazardous waste management.

From time to time Brookwood and its subsidiaries have paid fines or penalties for alleged failure to comply with certain environmental requirements, which did not exceed \$100,000 in the aggregate during the three years ended December 31, 2010 and the six months ended June 30, 2011. In addition, Brookwood and its subsidiaries have entered into various settlements and agreements with the regulatory authorities requiring the companies to perform certain tests, undertake certain studies, and install remedial facilities. Brookwood and its subsidiaries incurred capital expenditures to comply with environmental regulations of approximately \$488,000 in the year ended December 31, 2010 and \$79,000 during the six months ended June 30, 2011. In addition, Brookwood and its subsidiaries regularly incur expenses associated with various studies and tests to monitor and maintain compliance with diverse environmental requirements.

Other Contingencies. In May 2009, one of Brookwood's suppliers advised Brookwood that shipments to Brookwood during the period from September 2008 to April 2009 of a quantity of greige fabric from the supplier incorporated some fiber that was not of domestic origin in some yarn from the vendor. The fabric in question was ordered to fill contracts in support of the United States military, was required to be domestic and is subject to the preference for domestic source required flow down provisions of the Department of Defense Supplement to the Federal Acquisition Regulations implementing the provisions of 10 USC 2533a. Brookwood's suppliers have advised that the greige fabric containing the non-compliant yarn was supplied inadvertently to Brookwood in limited quantity. Brookwood has determined that this yarn affects two of their greige products. Brookwood advised its affected customers and the United States military of this circumstance. Brookwood resolved the issue with respect to one of the products and received payment at full value in 2009. Additionally, resolution on the second product with one of the procurement entities was achieved in July 2010 and Brookwood received payment at full value of \$3,242,000 in October 2010. Although Brookwood is continuing efforts to structure a resolution with the final procurement entity, Brookwood has communicated to its supplier regarding satisfaction of the unpaid receivable. Brookwood believes it is likely to collect the remaining amount due. The trade receivable balance at June 30, 2011 and December 31, 2010 includes \$1,639,000.

| Segments and Related Information | 6 Months Ended | | |
|--|-----------------------------|------------------|---------------------|
| Segments and Related Information [Abstract] | Jun. 30, 2011 | | |
| Segments and Related Information | | | |
| Note 15 — Segments and Related Information | | | |
| The following represents Hallwood Group's reportable segment operations for the three months and six months ended June 30, 2011 and 2010, respectively (in thousands): | | | |
| | <u>Textile Products</u> | <u>Other</u> | <u>Consolidated</u> |
| Three months ended June 30, 2011 | | | |
| Total revenue from external sources | \$36,699 | | \$ 36,699 |
| Operating income (loss) | \$ 3,316 | \$(8,564) | \$ (5,248) |
| Other income (loss), net | (11) | 1 | (10) |
| Income (loss) before income taxes | <u>\$ 3,305</u> | <u>\$(8,563)</u> | <u>\$ (5,258)</u> |
| Three months ended June 30, 2010 | | | |
| Total revenue from external sources | \$47,927 | | \$ 47,927 |
| Operating income (loss) | \$ 8,975 | \$(1,398) | \$ 7,577 |
| Other income (loss), net | (57) | 5 | (52) |
| Income (loss) before income taxes | <u>\$ 8,918</u> | <u>\$(1,393)</u> | <u>\$ 7,525</u> |
| Six months ended June 30, 2011 | | | |
| Total revenue from external sources | \$63,468 | | \$ 63,468 |

| | | | |
|-----------------------------------|-----------------|------------------|-------------------|
| Operating income (loss) | \$ 3,027 | \$(9,846) | \$ (6,819) |
| Other income (loss), net | (22) | 3 | (19) |
| Income (loss) before income taxes | <u>\$ 3,005</u> | <u>\$(9,843)</u> | <u>\$ (6,838)</u> |

Six months ended June 30, 2010

| | | | |
|-------------------------------------|-----------------|--|------------------|
| Total revenue from external sources | <u>\$95,077</u> | | <u>\$ 95,077</u> |
|-------------------------------------|-----------------|--|------------------|

| | | | |
|-----------------------------------|-----------------|------------------|------------------|
| Operating income (loss) | \$19,001 | \$(3,243) | \$ 15,758 |
| Other income (loss), net | (118) | 6 | (112) |
| Income (loss) before income taxes | <u>\$18,883</u> | <u>\$(3,237)</u> | <u>\$ 15,646</u> |

No differences have occurred in the basis or methodologies used in the preparation of this interim segment information from those used in the Company's annual report on Form 10-K for the year ended December 31, 2010. The total assets for Hallwood Group's operating segments have not materially changed since the Company's annual report on Form 10-K for the year ended December 31, 2010.

| Subsequent Events | 6 Months Ended |
|-------------------------------------|--|
| | Jun. 30, 2011 |
| Subsequent Events [Abstract] | |
| Subsequent Events | |
| | Note 16 — Subsequent Events |
| | In connection with the Hallwood Energy litigation matters discussed in Note 14, on July 25, 2011, the Court issued the Proposed Findings in the Adversary proceeding. Information contained in the Proposed Findings has been reflected in the results and disclosures reported in this quarterly report on Form 10-Q. |