Westinghouse Solar, Inc.
Form 10-Q
October 31, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2012

or

o 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 001-33695

Westinghouse Solar, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	90-0181035 (I.R.S. Employer Identification No.)
1475 S. Bascom Ave. Suite 101, Campbell, CA (Address of principal executive offices)	95008 (Zip Code)

(408) 402-9400
(Registrant's telephone number, including area code)

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

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

As of October 29, 2012, 21,908,445 shares of the issuer's common stock, par value $0.001 per share, were outstanding (including non-vested restricted shares).

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

Westinghouse Solar, Inc.
Condensed Consolidated Balance Sheets

	September 30, 2012 (unaudited)	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$56,274	$ 1,346,777
Accounts receivable, net	309,898	1,096,580
Other receivables	67,474	469,469
Inventory, net	1,663,700	4,172,809
Prepaid expenses and other current assets, net	495,856	978,709
Assets of discontinued operations	11,254	87,455
Assets held for sale – discontinued operations	15,570	18,293
Total current assets	2,620,026	8,170,092
Property and equipment, net	76,373	196,718
Other assets, net	1,552,780	955,570
Assets of discontinued operations – long-term	200,000	209,913
Total assets	$4,449,179	$ 9,532,293
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$3,272,749	$ 3,865,039
Accrued liabilities	867,656	428,813
Accrued warranty	322,972	217,812
Common stock warrant liability	1,150	317,490
Credit facility	52,793	92,266
Capital lease obligations – current portion	4,512	4,699
Note payable – current portion	—	283,252
Liabilities of discontinued operations – short-term	1,085,959	1,308,820
Total current liabilities	5,607,791	6,518,191
Capital lease obligations, less current portion	1,398	4,713
Long-term liabilities of discontinued operations	—	10,200
Total liabilities	5,609,189	6,533,104
Commitments, contingencies and subsequent events (Notes 17 and 18)		
Stockholders' (deficit) equity:		
Convertible redeemable preferred stock, $0.001 par value, 1,000,000 shares authorized; 2,263 shares issued and outstanding on September 30, 2012 and December 31, 2011	747,872	751,223
Common stock, $0.001 par value; 100,000,000 shares authorized; 21,432,690 and 16,040,581 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively (Note 1)	21,433	16,041
Additional paid-in capital	75,926,613	72,683,781

Accumulated deficit	(77,855,928)	(70,451,856)
Total stockholders' (deficit) equity	(1,160,010)	2,999,189
Total liabilities and stockholders' (deficit) equity	$4,449,179	$9,532,293

The accompanying notes are an integral part of these condensed consolidated financial statements

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Westinghouse Solar, Inc.
Condensed Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net revenue	$838,446	$3,373,692	$4,469,997	$8,125,783
Cost of goods sold	1,063,538	3,090,257	4,486,541	7,370,662
Gross (loss) profit	(225,092)	283,435	(16,544)	755,121
Operating expenses				
Sales and marketing	536,463	560,034	1,627,166	1,606,465
General and administrative	1,458,468	1,325,166	5,185,762	4,468,380
Total operating expenses	1,994,931	1,885,200	6,812,928	6,074,845
Loss from continuing operations	(2,220,023)	(1,601,765)	(6,829,472)	(5,319,724)
Other income (expense)				
Interest (expense) income, net	(36,433)	49,869	(71,219)	(7,980)
Adjustment to the fair value of common stock warrants	8,972	849,121	(417,668)	1,980,110
Total other (expense) income	(27,461)	898,990	(488,887)	1,972,130
Loss before provision for income taxes and discontinued operations	(2,247,484)	(702,775)	(7,318,359)	(3,347,594)
Provision for income taxes	—	—	—	—
Net loss from continuing operations	(2,247,484)	(702,775)	(7,318,359)	(3,347,594)
Net income (loss) from discontinued operations, net of tax (Note 3)	8,932	(42,138)	31,905	(38,570)
Net loss	(2,238,552)	(744,913)	(7,286,454)	(3,386,164)
Preferred stock dividend	(75,331)	(77,788)	(117,618)	(77,788)
Preferred deemed dividend	—	—	—	(975,460)
Net loss attributable to common stockholders	$(2,313,883)	$(822,701)	$(7,404,072)	$(4,439,412)
Net loss attributable to common stockholders per common and common equivalent share (basic and diluted)	$(0.11)	$(0.06)	$(0.40)	$(0.37)
Weighted average shares used in computing loss per common share: (basic and diluted)	19,883,887	12,611,868	18,168,851	11,791,722

The accompanying notes are an integral part of these condensed consolidated financial statements.

Westinghouse Solar, Inc.
Condensed Consolidated Statements of Changes in Stockholders' (Deficit) Equity
(Unaudited)

	Convertible Redeemable Preferred Stock		Common Stock				
	Number of Shares	Amount	Number of Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Stockholders' Equity
Balance at January 1, 2012	2,273	$751,223	16,040,581	$16,041	$72,683,781	$(70,451,856)	$2,999,189
Issuance of common stock pursuant to a securities purchase agreement	—	—	2,000,000	2,000	498,000	—	500,000
Issuance of common stock for supply agreement	—	—	2,110,647	2,110	1,140,690	—	1,142,800
Preferred stock dividends paid in common stock	—	—	403,341	404	117,214	(117,618)	—
Conversion of convertible redeemable preferred stock to common stock	(10)	(3,351)	36,000	36	3,315	—	—
Reclassify fair value of common stock warrant liability upon exercise and modification	—	—	—	—	734,007	—	734,007
Exercise of warrants for common stock	—	—	472,222	472	282,862	—	283,334
Grants of restricted stock, net of forfeitures and repurchases for employee taxes	—	—	369,899	370	(12,904)	—	(12,534)
Stock-based compensation expense	—	—	—	—	570,402	—	570,402
Placement agent and registration fees and other direct costs	—	—	—	—	(90,754)	—	(90,754)
Net loss	—	—	—	—	—	(7,286,454)	(7,286,454)
Balance at September 30, 2012	2,263	$747,872	21,432,690	$21,433	$75,926,613	$(77,855,928)	$(1,160,010)

The accompanying notes are an integral part of these condensed consolidated financial statements.

Westinghouse Solar, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities		
Net loss	$(7,286,454)	$(3,386,164)
Adjustments to reconcile net loss to net cash used in operations:		
Depreciation	120,345	154,623
Amortization of patents	39,844	4,720
Bad debt expense	476,258	10,000
Inventory revaluation	271,269	—
Unrealized gain (loss) on fair value adjustment of common stock warrants	417,668	(1,980,110)
Non-cash stock-based compensation expense	570,402	842,216
Loss on assets held for sale	—	10,840
Changes in assets and liabilities:		
Accounts receivable	710,603	(141,673)
Other receivables	1,816	(460,550)
Inventory	2,335,640	1,015,452
Prepaid expenses and other current assets	482,851	(63,242)
Assets of discontinued operations – short term	76,203	519,252
Assets held for sale	2,723	36,504
Other assets	(637,054)	(344,700)
Assets of discontinued operations – long-term	9,913	(188,189)
Accounts payable	452,710	1,321,324
Accrued liabilities and accrued warranty	544,003	(22,942)
Liabilities of discontinued operations	(233,061)	(330,650)
Net cash used in operating activities	(1,644,321)	(3,003,289)
Cash flows from investing activities		
Acquisition of property and equipment	—	(51,417)
Proceeds from disposal of property and equipment	—	18,800
Proceeds from disposal of property and equipment from discontinued operations	—	234,692
Net cash provided by investing activities	—	202,075
Cash flows from financing activities		
Repayment of notes payable	(283,252)	(136,816)
Repayment (borrowing) on line of credit	(39,473)	(540,250)
Repayments on capital lease obligations	(3,502)	(2,305)
Repayments on capital lease obligations from discontinued operations	—	(5,910)
Restricted cash	—	540,250
Proceeds from stock offering	—	3,600,000
Proceeds from securities purchase agreement	500,000	1,400,000
Proceeds from exercise of warrants	283,334	—
Payment of placement agent and registration fees and other direct costs	(90,754)	(674,458)
Employee taxes paid for vesting of restricted stock	(12,535)	(24,048)
Net cash provided by financing activities	353,818	4,156,463
Net (decrease) increase in cash and cash equivalents	(1,290,503)	1,355,249

Cash and cash equivalents		
Beginning of period	1,346,777	596,046
End of period	$56,274	$1,951,295

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	Nine Months Ended September 30,	
	2012	2011
Supplemental cash flows disclosures:		
Cash paid during the period for interest	$20,812	$16,328
Supplemental disclosure of non-cash financing activity:		
Fair value of warrants issued in stock offering	$—	$2,713,550
Conversion of preferred stock to common stock	$3,351	$—
Conversion of common stock warrant liability upon exercise of warrants	$252,765	$—
Common stock warrant liability issued in connection with agency placement fee	$—	$89,010
Reclassification of common stock liability upon modification of warrants	$481,242	$—
Preferred deemed dividend	$—	$975,460
Preferred stock dividends paid in common stock	$117,618	$77,788
Stock issued in satisfaction of accounts payable to investor supplier	$1,045,000	$—
Stock issued to procure inventory	$97,800	$51,158
Property and equipment acquired through capital lease	$—	$11,000

The accompanying notes are an integral part of these condensed consolidated financial statements.

Westinghouse Solar, Inc.
Notes to Condensed Consolidated Financial Statements
September 30, 2012
(Unaudited)

1. Basis of Presentation and Description of Business

Basis of Presentation — Interim Financial Information

The accompanying condensed consolidated financial statements are unaudited and have been prepared in accordance with generally accepted accounting principles for interim financial information. They should be read in conjunction with the financial statements and related notes to the financial statements of Westinghouse Solar, Inc. (“we”, “us”, “our” or the “Company”), formerly Akeena Solar, Inc., for the years ended December 31, 2011 and 2010 appearing in our Form 10-K. The September 30, 2012 unaudited interim consolidated financial statements included in this Quarterly Report on Form 10-Q have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and note disclosures normally included in annual financial statements filed with our Annual Report on Form 10-K have been condensed or omitted as permitted by those rules and regulations. In the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair statement of the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the entire year.

Reclassifications

Reverse Stock Split

On April 6, 2011, we filed a Certificate of Amendment to our Certificate of Incorporation with the Secretary of State of the State of Delaware to effect a reverse split of our common stock at a ratio of 1-for-4. The reverse stock split was effective at the close of business on April 13, 2011. All historical share and per share amounts have been adjusted to reflect the reverse stock split. Our par value was not changed by the reverse stock split.

Description of Business

We are a designer and manufacturer of solar power systems and solar panels with integrated microinverters (which we call AC solar panels). We design, market and sell these solar power systems to solar installers, trade workers and do-it-yourself customers through distribution partnerships, our dealer network and retail outlets. Our products are designed for use in solar power systems for residential and commercial rooftop customers. Prior to September 2010, we were also in the solar power installation business. We launched the distribution of our solar power systems in the second quarter of 2009.

On May 17, 2010, we entered into an exclusive worldwide agreement that permits us to manufacture, distribute and market our solar panels under the Westinghouse name. On July 22, 2010, we announced that we will operate under the name “Westinghouse Solar” and, effective July 23, 2010 at the opening of the market, our stock began trading under the stock symbol “WEST.”

At the Annual Meeting of Stockholders held on March 31, 2011, our stockholders approved an amendment to our Certificate of Incorporation to formally change the name of the company from “Akeena Solar, Inc.” to “Westinghouse Solar, Inc.”. The name change became effective on April 6, 2011.

On May 7, 2012, we entered into an Agreement and Plan of Merger, as amended from time to time (the "Merger Agreement"), with CBD Energy Limited, an Australian corporation ("CBD"), and CBD-WS Merger Sub, Inc., a Delaware corporation and a wholly owned subsidiary of CBD ("Merger Sub"). Under the terms of the Merger Agreement, Merger Sub will be merged with and into the Company, with the Company to be the surviving corporation and a wholly-owned subsidiary of CBD (the "Merger").

Under the Merger Agreement, our stockholders would receive shares of CBD in exchange for their shares. Our common stockholders are to receive approximately 3.7 CBD common shares for each common share held and our preferred stockholders will receive CBD preferred shares which will be convertible into CBD common shares. On an as-converted basis, the holders of our common stock and holders of our Series B preferred stock would collectively hold approximately 15% of the outstanding CBD common shares, calculated as if the Merger was consummated on the signing date. The Merger will not qualify as a "tax free reorganization" for U.S. federal income tax purposes. CBD has applied for listing on the Nasdaq Stock Market, with listing to be effective on or before consummation of the Merger. Completion of the Merger is subject to customary conditions, including (i) the adoption of the Merger Agreement by the required vote of the holders of our outstanding common stock, (ii) the Securities and Exchange Commission (the "SEC") has declared effective a Registration Statement registering the CBD common shares under the Securities Act of 1933, as amended, (iii) the approval and adoption by the holders of outstanding CBD common shares of the Merger Agreement and the issuance of additional CBD common shares as consideration in the Merger, and (iv) the approval by the Australian Securities Exchange (the "ASX") and the holders of outstanding CBD common shares of the delisting of the CBD common shares from the ASX. In conjunction with the execution of the Merger Agreement, the holders of a majority of our outstanding Company Series B preferred stock entered into a Waiver and Agreement in substantially the form attached as Exhibit D to the Merger Agreement (and included in Exhibit 2.1 to the Current Report on Form 8-K filed with the SEC on May 9, 2012).

On August 17, 2012, we received written notification from the Listing Qualifications Department of the NASDAQ Stock Market ("NASDAQ") indicating that we failed to comply with the minimum stockholders' equity requirement of $2,500,000 for continued listing on the NASDAQ Capital Market set forth in NASDAQ Listing Rule 5550(b)(1). On September 6, 2012, our shares began trading on the OTCQB Marketplace under the symbol "WEST."

Our Corporate headquarters is located at 1475 S. Bascom Ave., Campbell, CA 95008. Our telephone number is (408) 402-9400. Additional information about Westinghouse Solar is available on our website at http://www.westinghousesolar.com. The information on our web site is not incorporated herein by reference.

2. Significant Accounting Policies

Liquidity and Financial Position

For the nine months ending September 30, 2012, and for each of the two years in the period ending December 31, 2011, we have incurred net losses and negative cash flows from operations. As of September 30, 2012, our stockholders' equity is a deficit of approximately $1.2 million. In addition, we expect to incur a net loss from operations for our year ending December 31, 2012. During recent years, we have undertaken several equity financing transactions to provide the capital needed to sustain and to grow our business. Based on current cash projections for 2012, we are addressing or intend to address ongoing working capital needs through cost reduction measures recently implemented and utilization of existing inventory, along with utilizing our available credit facility and raising additional equity. In the event that revenue is lower than anticipated, further staffing reductions and expense cuts could occur.

As of September 30, 2012, we had approximately $56,000 in cash on hand and $697,000 available under our credit facility. As an additional source of capital, outstanding warrants provide the possibility to receive additional proceeds upon exercise, depending on market conditions (See "Stock Warrants and Warrant Liability"). During the three months ending March 31, 2012, warrants to purchase 472,222 shares of common stock with an exercise price of $0.60 per share were exercised, resulting in approximately $283,000 in proceeds. On October 18, 2012, we closed a financing resulting in initial proceeds of $750,000 under a securities purchase agreement that allows us to obtain up to an additional $495,000 of proceeds through subsequent "draw-downs" through December 31, 2012. (See Note 18 "Subsequent Events").

The accompanying consolidated financial statements have been prepared assuming we will continue as a going concern. Our significant operating losses, negative cash flow from operations and our deficit in stockholders' equity raise substantial doubt about our ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty and contemplate the realization of assets and the settlement of liabilities and commitments in the normal course of business. We believe our current cash balance, projected financial results and the amounts that should be available through debt and equity financing provide sufficient resources and operating flexibility through at least the next 12 months, however, there can be no assurance that we will be able to raise additional funds on commercially reasonable terms, if at all.

Use of Estimates

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

Revenue Recognition

Revenue from sales of products is recognized when: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the sale price is fixed or determinable, and (4) collection of the related receivable is reasonably assured. We recognize revenue when the solar power systems are shipped to the customer.

Cash and Cash Equivalents

We consider all highly liquid investments with maturities of three months or less, when purchased, to be cash equivalents. We maintain cash and cash equivalents which consist principally of demand deposits with high credit quality financial institutions. At certain times, such amounts exceed FDIC insurance limits. We have not experienced any losses on these investments.

Accounts Receivable

Accounts receivable consist of trade receivables. We regularly evaluate the collectability of our accounts receivable. An allowance for doubtful accounts is maintained for estimated credit losses, and such losses have historically been minimal and within our expectations. We consider a number of factors when estimating credit losses, including the aging of a customer's account, creditworthiness of specific customers, historical trends and other information.

Discontinued operations

Discontinued operations are presented and accounted for in accordance with Accounting Standards Codification (ASC) 360, "Impairment or Disposal of Long-Lived Assets," (ASC 360). When a qualifying component of the Company is disposed of or has been classified as held for sale, the operating results of that component are removed from continuing operations for all periods presented and displayed as discontinued operations if: (a) elimination of the component's operations and cash flows from the Company's ongoing operations has occurred (or will occur) and (b) significant continuing involvement by the Company in the component's operations does not exist after the disposal transaction.

On September 10, 2010, we announced that we were exiting the solar panel installation business. The exit from the installation business was essentially completed by the end of 2010, other than potential warranty payments related to past installations. (See "Manufacturer and Installation Warranties"). The exit from the installation business was therefore classified as discontinued operations for all periods presented under the requirements of ASC 360.

Manufacturer and Installation Warranties

The manufacturer directly warrants the solar panels and inverters for a range from 15 to 25 years. We warrant the balance of system components of our products against defects in material and workmanship for five years. We assist our customers in the event of a claim under the manufacturer warranty to replace a defective solar panel or inverter. The warranty liability for the material and the workmanship of the balance of system components of approximately $323,000 at September 30, 2012 and $218,000 at December 31, 2011, is included within "Accrued warranty" in the accompanying condensed consolidated balance sheets.

The liability for our manufacturing warranty consists of the following:

	September 30, 2012 (Unaudited)	December 31, 2011
Beginning accrued warranty balance (January 1)	$ 217,812	$51,860
Reduction for labor payments and claims made under the warranty	(1,535)	—
Accruals related to warranties issued during the period	106,695	165,952
Ending accrued warranty balance	$ 322,972	$217,812

We previously recorded a provision for warranty liability related to our discontinued installation operations. We provided for a 5-year or a 10-year warranty on the installation of a system and all equipment and incidental supplies other than solar panels and inverters that are covered under the manufacturer warranty. The liability for the installation warranty of approximately $1.1 million at September 30, 2012 and December 31, 2011 is included within "Liabilities of Discontinued Operations" in the accompanying condensed consolidated balance sheets. Defective solar panels or inverters are covered under the manufacturer warranty. In the event that a panel or inverter needs to be replaced, we will replace the defective item within the manufacturer's warranty period (between 5-25 years).

Patent Costs

We capitalize external legal costs and filing fees associated with obtaining or defending our patents. Upon issuance of new patents or successful defense of existing patents, we amortize these costs using the straight line method over the shorter of the legal life of the patent or its economic life. We believe the remaining useful life we assign to these patents, approximately 12.25 years as of September 30, 2012, is reasonable. As a result of the settlement of various legal disputes with Zep Solar, Inc., (Zep) (see "Commitments and Contingencies") during the quarter ended September 30, 2012, we reclassified approximately $1.3 million in legal costs from other long-term assets to patents, both included in "other assets, net" in the accompanying balance sheets, which is being amortized over 12.25 years. We periodically review our patents to determine whether any such cost have been impaired and are no longer being used. To the extent we are no longer using certain patents, the associated costs will be written off at that time.

Common Stock Warrant Liabilities

In March 2009 and February 2011, we issued warrants to purchase shares of our common stock in connection with certain capital financing transactions. The terms of the March 2009 warrant agreements include a cash-out provision which may be triggered at the option of the warrant holders if the Company "goes private," is acquired for all cash or upon the occurrence of certain other fundamental transactions involving the Company. Under the Financial Accounting Standards Board ("FASB") Topic 480, Distinguishing Liabilities from Equity ("ASC 480"), financial instruments that may require the issuer to settle the obligation by transferring assets or to reduce the exercise price of its warrants to purchase shares of its common stock are classified as a liability. Therefore, we classified these warrants as liabilities and we record mark-to-market adjustments to reflect the fair value at each period-end. On March 30, 2012, the February 2011 warrants were amended to remove any future price adjustment to the exercise price. (See "Stock Warrants" relating to the accounting treatment of the Series E and K warrants).

Significant Accounting Policies and Estimates

There have been no material developments or changes to the significant accounting policies discussed in our 2011 Annual Report on Form 10-K or accounting pronouncements issued or adopted, except as described below.

Recently Adopted Accounting Standards

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income (ASU No. 2011-05). ASU No. 2011-05 requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements, eliminating the option to present other comprehensive income in the statement of changes in equity. Under either choice, items that are reclassified from other comprehensive income to net income are required to be presented on the face of the financial statements where the components of net income and the components of other comprehensive income are presented. We adopted ASU No. 2011-05 on January 1, 2012 and the adoption of this guidance did not have a material impact on our financial position, results of operations or cash flows.

3. Discontinued Operations

On September 10, 2010, we announced that we were exiting the solar panel installation business and we were expanding our distribution business to include sales of our Westinghouse Solar Power Systems directly to dealers in California. The exit from the installation business was essentially completed by the end of 2010. During the nine months ended September 30, 2012, we recorded a gain from discontinued operations of approximately $32,000 compared to a loss from discontinued operations of approximately $39,000 during the nine months ended September 30, 2011. The assets and liabilities of discontinued operations are presented separately under the captions “Assets of discontinued operations,” “Liabilities of discontinued operations” and “Long-term liabilities of discontinued operations,” respectively, in the accompanying condensed consolidated balance sheets at September 30, 2012 and December 31, 2011, and consist of the following:

Assets of discontinued operations:	September 30, 2012 (unaudited)	December 31, 2011
Accounts receivable and other receivables	$ 1,340	$ 41,762
Prepaid expenses and other current assets	—	34,415
Other assets	9,914	11,278
Total current assets of discontinued operations	11,254	87,455
Security deposits on operating leases	—	9,913
Security deposit – escrow account for installation jobs	200,000	200,000
Total assets of discontinued operations	$ 211,254	$ 297,368

Liabilities of discontinued operations:	September 30, 2012 (unaudited)	December 31, 2011
Accrued liabilities	$ 20,034	$ 124,751
Accrued warranty	1,065,925	1,133,549
Deferred revenue	—	50,520
Total current liabilities	1,085,959	1,308,820
Other long-term liabilities	—	10,200
Total discontinued operations liabilities	$ 1,085,959	$ 1,319,020

We entered into a Supply and Warranty Agreement and Master Assignment Agreement with Real Goods Solar, Inc. (Real Goods), pursuant to which Real Goods has agreed to perform certain warranty work. The terms of the agreement provide that an escrow account be established as a source of funds from which to satisfy our obligation to pay Real Goods for its fees and reimburse it for its expenses for this warranty work. In March 2011, we entered into an Escrow Agreement with Real Goods and deposited $200,000 into an escrow account. The amount is reflected in long-term assets of discontinued operations in the balance sheet. The escrow deposit will be released to us in the amount of $40,000, or one-fifth of the remaining escrow funds, per year after each of the fifth through the ninth anniversary of the escrow agreement.

In connection with the announcement of our exit from the solar panel installation business, we reclassified certain assets as “Assets held for sale,” in the accompanying condensed consolidated balance sheets at September 30, 2012 and December 31, 2011, which consists of inventory of solar inverters of approximately $16,000 and $18,000, respectively.

4. Accounts Receivable

Accounts receivable consists of the following:

	September 30, 2012 (Unaudited)	December 31, 2011
Trade accounts	$ 427,346	$ 1,230,895
Less: Allowance for bad debts	(103,750)	(39,000)
Less: Allowance for returns	(13,698)	(95,315)
	$ 309,898	$ 1,096,580

The following table summarizes the allowance for doubtful accounts as of September 30, 2012 and December 31, 2011:

	Balance at Beginning of Period	Provisions, net	Write-Off/ Recovery	Balance at End of Period
Nine months ended September 30, 2012	$ 39,000	$ 102,000	$ (37,250)	$ 103,750
Year ended December 31, 2011	$ 5,000	$ 34,000	$ —	$ 39,000

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5. Inventory

Our inventory, which consists entirely of finished goods inventory, was approximately $1.7 million and $4.2 million at September 30, 2012 and December 31, 2011, respectively. As of September 30, 2012 and December 31, 2011, there was approximately $0 and $75,000, respectively, capitalized in inventory related to the restricted stock grant for a supply agreement with Light Way Green New Energy Co., Ltd, (Lightway) and approximately $3,000 and $12,000, respectively, related to rent, depreciation and salary costs.

6. Property and Equipment, Net

Property and equipment, net consist of the following:

	September 30, 2012 (Unaudited)	December 31, 2011
Office equipment	$ 573,852	$573,852
Leasehold improvements	148,759	148,759
Vehicles	17,992	17,992
	740,603	740,603
Less: Accumulated depreciation and amortization	(664,230)	(543,885)
	$ 76,373	$196,718

Depreciation expense for the three months ended September 30, 2012 and 2011 was approximately $40,000 and $46,000, respectively. For the nine months ended September 30, 2012 and 2011, depreciation expense was approximately $120,000 and $155,000, respectively.

7. Accrued Liabilities

Accrued liabilities consist of the following:

	September 30, 2012 (Unaudited)	December 31, 2011
Accrued salaries, wages, benefits and bonus	$ 61,719	$92,692
Accrued accounting and legal fees	343,146	138,233
Allowance for returns	—	20,081
Customer deposit payable	40,945	13,819
Accrued tariff	21,625	—
Royalty payable	315,000	125,000
Accrued interest	60,426	—
Other accrued liabilities	24,795	38,988
	$ 867,656	$428,813

8. Credit Facility

On February 15, 2011, we entered into a Business Financing Agreement (the "2011 Credit Facility") with Bridge Bank, National Association (“Bridge Bank”) to finance our accounts receivables. The 2011 Credit Facility provides for a credit limit of $750,000, representing the maximum amount of advances based on up to 50% of $1.5 million of gross eligible accounts receivables. The 2011 Credit Facility may be terminated at any time by either party and may be renewed under similar terms if acceptable and agreed to by both parties. If any advance is not repaid in full within 90 days from the earlier of (a) invoice date, or (b) the date on which such advance is made, we are obligated to immediately pay the outstanding amount to Bridge Bank. Outstanding loans under the 2011 Credit Facility will accrue interest at the Bridge Bank Prime rate plus 3.0% (annualized) of the daily gross financed amount outstanding. The 2011 Credit Facility is secured by substantially all of our assets. As of September 30, 2012 and December 31, 2011, there was approximately $53,000 and $92,000, respectively, borrowed under the 2011 Credit Facility.

9. Stockholders' Equity

On February 17, 2011, we entered into a securities purchase agreement with certain institutional accredited investors relating to the sale of 4,000 units at a price of $900 per unit. See "Convertible Redeemable Preferred Stock and Preferred Deemed Dividend" for a discussion of the sale of units.

On March 25, 2011, we entered into a Supply Agreement (the "Lightway Supply Agreement") with Light Way Green New Energy Co., Ltd (Lightway). Lightway is a vertically integrated manufacturer of polycrystalline silicon wafers, solar cells and solar modules. Lightway is a supplier for our proprietary Westinghouse solar panels. In consideration of the new contract manufacturing arrangement, we agreed to issue to Lightway shares of our common stock with a market value of $520,000, based on the closing share price of our common stock on the date of the first shipment of products by Lightway. On July 31, 2011, in conjunction with their first shipment, we issued Lightway 361,111 unvested shares of our common stock. The shares vested ratably on a monthly basis over a one year period beginning August 31, 2011 and, as of September 30, 2012, all shares have vested.

On August 16, 2011, we entered into a securities purchase agreement with an institutional accredited investor relating to the sale of 990,099 shares of common stock at a price of $1.01 per share, along with the sale of Series L Warrants to purchase up to 643,564 shares of common stock (65% of the number of shares of common stock initially issued) at an exercise price of $1.17 per share. The warrants were not exercisable until six months after issuance and have a term of five years from the date they are first exercisable. The aggregate purchase price for the shares and the warrants was $1,000,000. Under the securities purchase agreement, we agreed to amend the outstanding Series J Warrants, such that the exercise price of the Series J Warrants was reduced from $2.44 per share to $1.17 per share. In addition, each of the Series J Warrants, (i) is not exercisable until the six month anniversary of the closing under the August 16, 2011 securities purchase agreement, and (ii) the expiration date is extended such that the warrant is exercisable for five years from the delayed initial exercise date.

On September 28, 2011, we entered into a securities purchase agreement with an institutional accredited investor relating to the sale of 500,000 shares of common stock at a price of $0.80 per share, along with the sale of Series M Warrants to purchase up to 325,000 shares of common stock (65% of the number of shares of common stock initially issued) at an exercise price of $0.81 per share. The warrants were not exercisable for six months after issuance and have a term of 5½ years from the date they are first exercisable. The aggregate purchase price for the shares and the warrants was $500,000. Under the securities purchase agreement, we agreed to amend the outstanding Series L Warrants, such that the exercise price of the Series L Warrants is reduced from $1.17 per share to $0.81 per share. In addition, each of the Series L Warrants, (i) was not exercisable for the six month anniversary of the closing under the September 28, 2011 securities purchase agreement, and (ii) the expiration date is extended such that the warrant is exercisable for five years from the delayed initial exercise date.

On December 30, 2011, we entered into a securities purchase agreement with CBD Energy Limited ("CBD"), an Australian corporation, relating to the sale of 1,666,667 shares of common stock at a price of $0.60 per share. The aggregate purchase price was $1,000,000. As a result of the December 30, 2011 sale, (i) the conversion price of the Series B Preferred was reduced to $0.60 per share of common stock, and (ii) the exercise price per share of the Series K Warrants was reduced to $0.60 per share of common stock.

On March 30, 2012, we entered into an amendment to the outstanding Series K warrants which removed the provision for any future price adjustment to the exercise price. See "Stock Warrants and Warrant Liability" for a discussion on the accounting treatment of these warrants.

Pursuant to the Lightway Supply Agreement, on March 30, 2012, we issued 1,900,000 shares of our common stock to Lightway. The shares were issued at $0.55 per share based on the latest closing sale price on the date of issuance. The issuance of the common stock, valued at $1,045,000, increased equity and reduced accounts payable by an equal amount. We filed a registration statement, on May 15, 2012, to register for resale the shares of common stock issued to Lightway. The registration statement was declared effective on May 25, 2012.

On August 14, 2012, we entered into a securities purchase agreement with an institutional accredited investor relating to the sale of 2,000,000 shares of our common stock at a price of $0.25 per share. The aggregate purchase price was $500,000. As a result of the August 14, 2012 sale, the conversion price of the Series B Preferred was further reduced to $0.25 per share of common stock. There are currently 2,263 shares of Series B Preferred that remain outstanding. After adjustment to the conversion price, the outstanding Series B Preferred would be convertible into 8,145,670 shares of common stock. Because we have previously recognized the full amount of proceeds allocated to the preferred stock as a preferred deemed dividend, there was no further accounting implication to this adjustment.

See Note 18 “Subsequent Events” for a discussion of an additional equity financing and further reduction of the conversion price of the Series B Preferred.

10. Convertible Redeemable Preferred Stock and Preferred Deemed Dividend

On February 17, 2011, we entered into a securities purchase agreement with certain institutional accredited investors relating to the sale of 4,000 units at a price of $900 per unit (the “Securities Purchase Agreement”). Each unit consists of (i) one share of Series B Preferred Stock (the “Series B Preferred”), with each such share of Series B Preferred initially convertible into 500 shares of common stock at an initial conversion price of $1.80 per share, subject to future adjustment for various events, and (ii) warrants to purchase 425 shares of common stock at an initial exercise price of $2.40 per share, subject to future adjustment for various events, which warrants were not exercisable for six months after issuance and have a term of five years from the date of first exercisability (the “Series K Warrants” and together with the Series B Preferred, the “Securities”). The aggregate purchase price for the Securities was $3,600,000, less $532,000 in issuance costs. As of September 30, 2012, 1,737 shares of preferred stock had been converted into 927,601 shares of common stock.

The Certificate of Designation to create the Series B Preferred includes certain negative covenants regarding indebtedness and other matters, and includes provisions under which the holders of the Series B Preferred are entitled to demand redemption for cash upon specified triggering events. The Series B Preferred bears dividends at the rate 4% per year for the first year, and 8% per year thereafter, payable in stock or in cash at our election, subject to certain restrictions.

In connection with the sale of the Securities under the Securities Purchase Agreement, we entered into a registration rights agreement with the purchasers (the “Registration Rights Agreement”). In accordance with the Registration Rights Agreement, we filed a registration statement, on March 18, 2011, to register for resale the shares of common stock issued and issuable to the purchasers upon conversion of the Series B Preferred and the shares issuable upon exercise of the Series K Warrants. The registration statement was declared effective on June 17, 2011. Under the terms of the Registration Rights Agreement, we are obligated to maintain the effectiveness of the resale registration statement until all securities registered thereunder are sold or otherwise can be sold pursuant to Rule 144, without restriction.

On the date of issuance, we recorded the value of the Series B Preferred of $1.0 million and of the warrants of $2.6 million on our balance sheet. The closing price of our common stock on the date of issuance was used to value the Series B Preferred and we used the Black-Scholes model to value the Series K Warrants. For purposes of calculating the fair value of the warrants, we used a risk free rate of return of 1.4%, an expected life of 4.1 years and a volatility percentage of 103.2%. The intrinsic value of the beneficial conversion feature is considered a preferred deemed dividend totaling $975,000 to the preferred shareholders, and was charged to additional paid-in capital on our condensed consolidated balance sheets and net loss attributable to common stockholders on our condensed consolidated statements of operations.

Effective August 23, 2011, we amended our Certificate of Designation of Preferences, Rights and Limitations of the Series B 4% Convertible Preferred Stock to amend the terms of the outstanding Series B 4% Convertible Preferred Stock. The principal changes included in the Certificate of Amendment are to: (i) add a hard floor price of $0.10 per share of common stock as a limitation to any future conversion price adjustment to the Series B Preferred Stock resulting from future sales of common stock (or common stock equivalents) or at the one year anniversary of the original issuance date (February 18, 2012) if the recent trading price (20 day VWAP) is below the then current conversion price; (ii) reclassify the consequence of certain breaches and triggering events such that the holders of the Series B Preferred Stock would not be entitled to potentially receive cash redemption in such events, but instead would have rights to receive additional shares of common stock (either in the form of increased dividend payments or upon redemption of their Series B Preferred); and (iii) take into account certain adjustment events that have occurred since the Original Filing, including the 1-for-4 reverse stock split of our common stock implemented after the close of business on April 13, 2011. The purpose for adopting the Certificate of Amendment was to implement revisions that caused the balance sheet value associated with the Series B Preferred Stock to be treated as stockholders’ equity, rather than as “mezzanine” equity, for accounting purposes.

As a result of our December 30, 2011 stock sale to CBD, the conversion price of the Series B Preferred was reduced to $0.60 per share of common stock. As a result of our August 14, 2012 stock sale, the conversion price of the Series B Preferred was further reduced to $0.25 per share of common stock. The maximum intrinsic value of the beneficial conversion feature was previously recorded on the date of issuance for the Series B Preferred and, consequently, no additional preferred deemed dividend was recorded as a result of the reduction in the conversion price of the Series B Preferred.

See Note 12 “Stock Warrants and Warrant Liability” for a discussion of the accounting treatment of the stock warrant transactions described above. See Note 18 “Subsequent Events” for a discussion of an additional amendment to our Series B Certificate of Designation and the creation of a new series of Preferred Stock, and an additional equity financing and further reduction of the conversion price of the Series B Preferred.

11. Stock Option Plan and Stock Incentive Plan

On August 8, 2006, we adopted the Westinghouse Solar, Inc. 2006 Stock Incentive Plan (the “Stock Plan”) pursuant to which shares of common stock are available for issuance to employees, directors and consultants under the Stock Plan as restricted stock and/or options to purchase common stock. The Stock Plan allows for issuance of up to 3,000,000 shares and there were 1,679,897 shares available for issuance under the Stock Plan as of September 30, 2012.

Restricted stock and options to purchase common stock may be issued under the Stock Plan. The restriction period on restricted stock granted to employees generally expires at a rate of one-fourth per year over four years, unless decided otherwise by our Compensation Committee. Options to purchase common stock granted to employees generally vest and become exercisable as to one-third of the total amount of shares subject to the option on each of the first, second and third anniversaries from the date of grant. The restriction period on restricted stock granted to non-employee directors generally expires at a rate of one-fourth per quarter over one year. Options to purchase common stock granted to non-employee directors generally vest and become exercisable as to one-fourth of the total amount of shares subject to the option each quarter from the date of grant. Options to purchase common stock for employees and non-employee directors generally have a 5-year term.

We use the Black-Scholes-Merton Options Pricing Model (Black-Scholes) to estimate fair value of our employee and our non-employee director stock-based awards. Black-Scholes requires various judgmental assumptions, including estimating stock price volatility, expected option life and forfeiture rates. If we had made different assumptions, the amount of our deferred stock-based compensation, stock-based compensation expense, gross margin, net loss and net loss per share amounts could have been significantly different. We believe that we have used reasonable methodologies, approaches and assumptions to determine the fair value of our common stock, and that our deferred stock-based compensation and related amortization were recorded properly for accounting purposes. If any of the assumptions we used change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period.

We measure compensation expense for non-employee stock-based compensation under Accounting Standards Codification (ASC) 505-50, "Equity-Based Payments to Non-Employees." The fair value of the option issued is used to measure the transaction, as this is more reliable than the fair value of the services received. The estimated fair value is measured utilizing Black-Scholes using the value of our common stock on the date that the commitment for performance by the counterparty has been reached or the counterparty's performance is complete (generally the vesting date). The fair value of the equity instrument is charged directly to expense and additional paid-in capital.

We recognized stock-based compensation expense of approximately $130,000 and $236,000 during the three months ended September 30, 2012 and 2011, respectively, and approximately $570,000 and $842,000 during the nine months ended September 30, 2012 and 2011, respectively, relating to compensation expense calculated based on the fair value at the time of grant for restricted stock and based on Black-Scholes for stock options granted under the Stock Plan.

The following table sets forth a summary of restricted stock activity for the nine months ended September 30, 2012:

	Number of Restricted Shares	Weighted-Average Grant Date Fair Value
Outstanding and not vested beginning balance at January 1, 2012	289,795	$ 1.92
Granted	551,839	$ 0.48
Forfeited/cancelled	(131,216)	$ 1.68
Released/vested	(572,032)	$ 0.70
Outstanding and not vested at September 30, 2012	138,386	$ 1.47

Restricted stock is valued at the grant date fair value of the common stock and expensed over the requisite service period or vesting period. We estimate forfeitures when recognizing stock-based compensation expense for restricted stock, and the estimate of forfeitures is adjusted over the requisite service period should actual forfeitures differ from such estimates. At September 30, 2012 and December 31, 2011, there was approximately $149,000 and $465,000, respectively, of unrecognized stock-based compensation expense associated with the granted but unvested restricted stock. Stock-based compensation expense relating to these restricted shares is being recognized over a weighted-average period of 1.5 years. The total fair value of shares vested during the nine months ended September 30, 2012 and 2011, was approximately $229,000 and $149,000, respectively. Tax benefits resulting from tax deductions in excess of the compensation cost recognized (excess tax benefits) are classified as financing cash flows on our consolidated statements of cash flows. During the three and nine months ended September 30, 2012 and 2011, there were no excess tax benefits relating to restricted stock and therefore there is no impact on the accompanying consolidated statements of cash flows.

The following table sets forth a summary of stock option activity for the nine months ended September 30, 2012:

	Number of Shares Subject to Option	Weighted-Average Exercise Price
Outstanding at January 1, 2012	1,077,744	$ 5.47
Granted	25,000	$ 0.40
Forfeited/cancelled/expired	(444,875)	