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Research Report - Update

Investors should consider this report as only a single factor in making their investment decision.

Orchids Paper Products Company

Rating: Speculative Buy

John Nobile
March 28, 2013

TIS \$23.30 — (NYSE MKT)

	<u>2011A</u>	<u>2012A</u>	<u>2013E</u>	<u>2014E</u>
Revenues (millions)	\$97.8	\$100.8	\$114.0	\$125.4
Earnings per share	\$0.80	\$1.18	\$1.45	\$1.68

52-Week range	\$24.02 – \$15.21	Fiscal year ends:	December
Shares outstanding a/o 3/1/13	7.7 million	Revenue per share (TTM)	\$12.87
Approximate float	5.5 million	Price/Sales (TTM)	1.8X
Market capitalization	\$180 million	Price/Sales (FY2014)E	1.6X
Tangible book value/share	\$10.10	Price/Earnings (TTM)	19.8X
Price/tangible book value	2.3X	Price/Earnings (FY2014)E	13.9X
Annual dividend	\$1.20	Dividend Yield	5.1%

Orchids Paper Products, headquartered in Pryor, Oklahoma, manufactures bulk tissue paper, known as parent rolls, and converts parent rolls into a full line of tissue products, including paper towels, bathroom tissue and paper napkins for the private label segment of the consumer, or “at home,” market. The company has focused its product design and manufacturing on the discount retail market, primarily the dollar store retailers. (www.orchidspaper.com)

Key investment considerations:

Reiterating Speculative Buy rating and raising 12-month price target to \$25.50 from \$24.50 based on a multiple of 16X applied to our discounted 2014 EPS estimate. Our target implies a total (including dividend) year-ahead return of 15%.

Growth of private label tissue products such as Orchids’ has been steady. The October/November 2012 issue of Tissue World Magazine reported that US private label tissue products are increasing their share of the tissue products market. As Orchids sells predominantly to the private label market, a growing market should bode well for sales of the company’s products.

Orchids’ earnings for 2012 increased 49% due to increased shipments of higher margin converted products.

We expect additional converted product orders (9,000 tons annually) to ship in 2013 increasing converted product tonnage by 20% in 2013 while decreasing parent roll sales by almost 70%. We project a further 10% increase in converted product tonnage to be shipped in 2014 (as we do not believe the 20% rate sustainable) and a corresponding 67% decrease in parent roll sales.

For 2013, we project revenue of \$114 million and EPS of \$1.45 with 90% realization of recent orders. For 2014, we project revenue of \$125.4 million and EPS of \$1.68 as the company continues to grow sales of higher margin converted products.

On February 6, 2013, Orchids reported FY12 revenue of \$100.8 million and EPS of \$1.18.

Please view our disclosures on pages 13 - 15.

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Recommendation and Valuation

Reiterating **Speculative Buy** rating and raising **12-month price target to \$25.50** from \$24.50 based on a multiple of 16X applied to our discounted 2014 EPS estimate. Our target implies a total (including dividend) year-ahead return of 15%.

Orchids' shares traded at an average multiple of 16X TTM earnings over the past two years (since significant levels of higher tier converted products started shipping and the dividend policy was instituted). We believe that during the next twelve months, the market will accord the stock a multiple of 16X as sales and earnings continue to grow. Applying a multiple of 16X to our earnings per share estimate of \$1.68 for 2014 discounted to a twelve-month value of \$1.60 gives us a price target of approximately \$25.50 per share. We derived a discount factor of 5% using a risk free rate of 2%, a market premium of 6.2%, and the company's beta of 0.49.

Recent Developments

Increased Dividend – In March 2013, Orchids' board of directors authorized an increase in the company's quarterly cash dividend to \$0.30 per share from \$0.25 effective for the dividend payable on March 29, 2013.

Business

Orchids Paper Products, headquartered in Pryor, Oklahoma, manufactures bulk tissue paper, converting it into a full line of tissue products, including paper towels, bathroom tissue and paper napkins for the private label segment of the consumer or "at home" market. The company targets the discount retail market, primarily dollar store retailers, due to their consistent order patterns, limited number of stock keeping units (SKUs) and the growth in this channel of the retail market. Orchids has customers throughout the United States, but its sales efforts are focused within a 500 mile radius of its northeast Oklahoma facility, which it considers to be a cost-effective shipping area.

The company's products are sold primarily under its customers' private labels and, to a lesser extent, under brand names such as Colortex® and Velvet®. Orchids does not have supply contracts with any of its customers. Orchids' products are daily consumable items so order streams are fairly consistent with no significant seasonal fluctuations. Changes in the national economy do not materially affect the market for Orchids' products. However, local conditions might.

An article in Tissue World Magazine (Sofidel: going for growth in the USA; October/November 2012) reported that while the US is predominately a branded market, private label tissue products are increasingly taking market share each year. Tissue World said this may be due to American retailers increasingly demanding premium quality for their private label tissue products.

In August 2012, IBISWorld estimated that revenue from paper towels has decreased slightly as a share of the sanitary paper products industry revenue over the past five years. However, IBISWorld projects the overall industry to increase modestly at an average annualized rate of 1.3% from 2012 to 2017. This is largely due to strong competition among major players, and the emergence of generic brands (private label) that sell similar products at much lower prices (such as Orchids).

Economic Outlook

In January 2013, the International Monetary Fund (IMF) revised its projections for US economic growth to 2% in 2013 and 3% in 2014. These are slightly changed from earlier projections (October 2012) of 2.1% in 2013 and 2.9% in 2014. The IMF said that the US needs to avoid excessive fiscal consolidation (reduction of deficit and debt accumulation) in the short-term, promptly raise the debt ceiling, and agree on a medium-term fiscal consolidation plan focused on entitlement and tax reform.

The IMF's projections were predicated on assumptions made in October 2012 that the US automatic spending cuts (sequestration) would be reversed. As this has not materialized, the IMF's growth forecast for the US (due mid-April) is subject to revision.

In February 2013, the Federal Reserve Bank of the Tenth Federal Reserve District, which includes most of the Oklahoma area, released its survey of manufacturing activity. The survey reported that the region's manufacturing activity contracted in February 2013 as there were disruptions due to bad weather and many firms noted that possible federal spending cuts were hurting business. However, capital spending plans for later in the year improved considerably.

As tissue products are considered consumer staples, changes in the economy do not materially affect sales.

Market and Competition

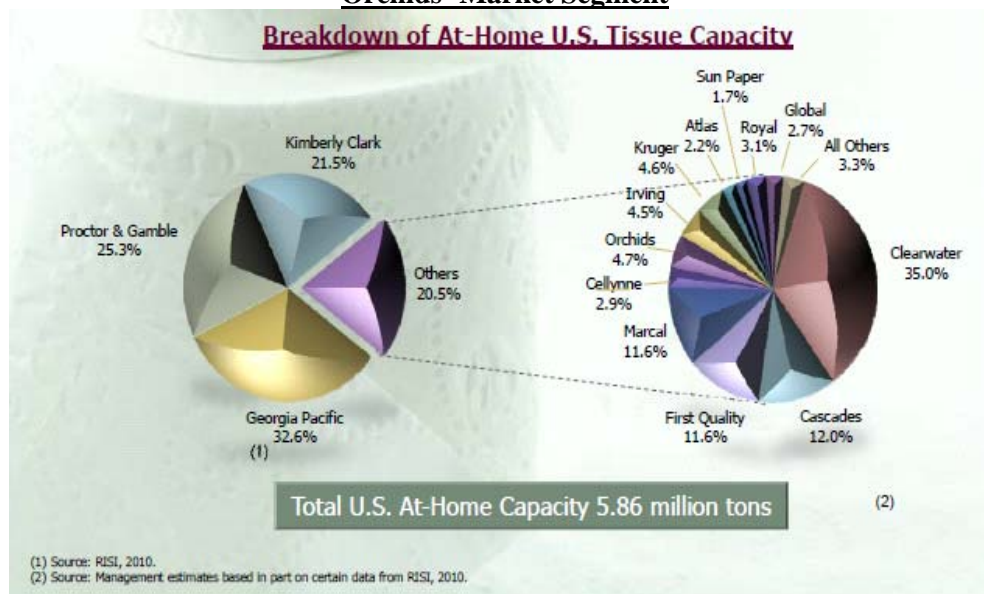
IBISWorld estimated the US tissue market (paper towels, bathroom tissue, and paper napkins) at \$2.6 billion in 2012. While industry revenue has declined over the past few years, IBISWorld projects the overall industry to increase 1.3% annually from 2012 to 2017.

Dollar and variety stores, Orchids' primary target markets, are estimated to realize sales of \$59.8 billion in 2013. IBISWorld projects dollar and variety stores' revenue growth averaging 2.5% annually from 2012 to 2017.

Due to the company's proximity to the dollar and grocery stores in its target market, Orchids' products should save these stores approximately 70% in shipping costs compared with most competitors' products, a significant competitive advantage. However, since 2010, competitors have moved into Orchids' market areas. The increased competition has reduced Orchids' competitive cost advantage and reduced gross margins from 29.2% in 2009 to 17.0% in 2010, and 16.3% in 2011. In 2012 Orchids was able to reverse this downward trend as lower raw material costs and growing sales of higher margin converted products increased Orchids' gross margins to 22.4%.

Competition in the value-end of the market is significantly affected by proximity, as freight costs represent a material portion of delivered product costs. In Oklahoma and the immediately surrounding area, Clearwater Paper's Oklahoma City, Oklahoma plant, Georgia-Pacific's Muskogee, Oklahoma plant, Cascades' Memphis, Tennessee plant, and Pacific Paper's Memphis, Tennessee plant give these competitors a significant presence.

Orchids' Market Segment



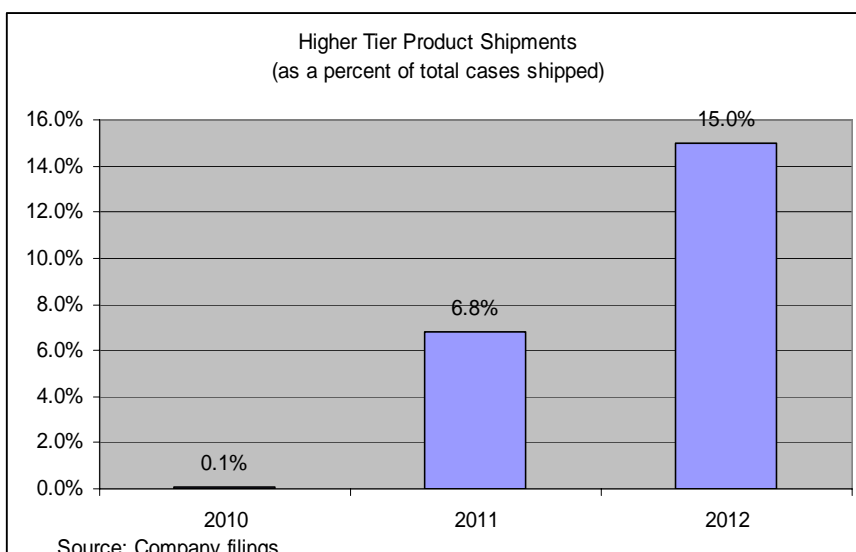
Source: Orchids Paper Products

Clearwater Paper and Cascades are the only publicly held direct competitors. Clearwater Paper's 2011 and 2012 revenue was \$1.9 billion for both periods with gross margins of 11.7% and 13.9% respectively, while Cascades 2011 and 2012 revenue was \$3.5 billion for both periods with gross margins of 10.4% and 13.4% respectively. These competitors' lower gross margins versus Orchids' 16.3% in 2011 and 22.4% in 2012 could drive them to expand in Orchids' market, increasing pressure on Orchids' prices and margins.

Strategy

Orchids aims to sell all of its manufactured paper goods as converted products, which yield higher margins. In 2010, Orchids' increased its annual converting capacity by approximately 4 million cases with the installation of a new converting line, bringing its annual converting capacity to 12.5 million cases per year. In 2011, Orchids made changes to its operating procedures and invested in equipment in order to develop higher quality products for the mid-tier market.

Orchids plans to expand into other retail channels such as grocery stores, mass merchandise and other discount retail sectors. Initial efforts to expand into these other channels previously had limited success due to capacity constraints and the inability to produce higher grade products. However, these shortcomings have been partly overcome by the additional converting line and new product initiatives (higher grade products). The graph at right shows how shipments of Orchids' higher grade converted products have grown over the past three years. Growth was driven by sales of new higher quality products (with better paper, enhanced graphics, and improved embossing).



4th Quarter and Fiscal 2012 Financial Results

4Q12 sales of \$24 million were down 6% from \$25.7 million in 4Q11. Net income was \$2.2 million or \$0.28 per share versus net income of \$2.7 million or \$0.35 per share. We projected 4Q12 sales of \$26.9 million and net income of \$3 million or \$0.38 per share.

Converted product (paper towels, bathroom tissue, and paper napkins) sales in 4Q12 decreased 8% to \$21.8 million while parent roll (bulk tissue paper) sales increased 20% to \$2.2 million.

The decrease in converted product sales was due to a 10% decrease in tonnage shipped, partially offset by a 2% increase in net selling price per ton. However, due to increased sales of parent rolls with their lower selling prices compared to converted products, the overall selling price per ton remained relatively flat at \$1,908. The decrease in converted product shipments was primarily due to promotional sales activities in 4Q11 which did not repeat in the current year quarter. Net sales of bulk tissue paper increased due to reduced sales of finished products.

Cash earnings of \$4.7 million and a \$1 million decrease in working capital resulted in \$5.7 million cash from operations in 4Q12. The changes in working capital were due mainly to a \$1 million increase in inventories. Capital expenditures of \$2.5 million, a \$288,000 reduction in debt, and \$1.9 million in dividend payments increased cash by \$2 million to \$5.7 million during 4Q12.

Orchids Paper Products Company

Gross margins increased to 22.6% from 21.8% primarily due to lower raw material costs and lower maintenance and repair costs. Selling, general and administrative (SG&A) expenses increased to \$2 million from \$1.9 million. The decrease in revenue and increase in SG&A expenses reduced operating income to \$3.4 million or 14% of sales from \$3.7 million or 14% of sales. Interest expense remained relatively flat at \$99,000.

Sales in FY12 were up 3% to \$100.8 million from \$97.8 million. Net income was \$9.3 million or \$1.18 per share versus net income of \$6.2 million or \$0.80 per share.

Converted product (paper towels, bathroom tissue, and paper napkins) sales increased 10% to \$90.5 million while parent roll (bulk tissue paper) sales decreased 35% to \$10.3 million.

The increase in converted product sales was due to a 12% increase in tonnage shipped, partially offset by a 1% decrease in net selling price per ton. However, due to increased sales of converted products with their higher selling prices compared to parent rolls, the overall selling price per ton increased 6% to \$1,867. The increase in converted product shipments was primarily due to new product sales in the mid-tier (paper products with better paper, enhanced graphics, and improved embossing compared to lower-tier products) market. Net sales of bulk tissue paper decreased due to the increased requirements of the converting operations.

Gross margins increased to 22.4% from 16.3% primarily due to increased levels of higher margin converted product shipments and lower raw material costs. SG&A expenses increased to \$8.5 million from \$6.8 million primarily due to increased professional fees, bonuses, packaging related expenditures, and sales commissions on converted product sales. The increase in revenue and gross profit offset the increase in SG&A expenses, increasing operating income to \$14.1 million or 14% of sales from \$9.1 million or 9.3% of sales. Interest expense decreased to \$407,000 from \$0.6 million due to lower debt levels and interest rates.

Liquidity - Based on our forecasts, Orchids should have sufficient resources to meet its financial obligations through 2014. As of December 31, 2012, Orchids' had a strong balance sheet with cash of \$5.7 million and a debt/equity ratio of 0.2 versus 1.1 for the paper products industry.

Cash earnings of \$18.1 million and a \$0.7 million increase in working capital resulted in \$17.5 million cash from operations in 2012. The changes in working capital were due mainly to a \$2.5 million increase in inventories offset by a \$1.6 million decrease in accounts receivable. The purchase of \$3 million of investment securities, \$6.8 million of capital expenditures, reduction in debt of \$1.2 million, and \$6.4 million in dividend payments increased cash by \$1.4 million to \$5.7 million as of December 31, 2012.

In 2011, Orchids paid off \$17.5 million in loans under its existing credit facility and entered into a new \$36 million credit agreement with JP Morgan Chase that provided for an \$18 million revolving credit line (due April 2014), a \$10.8 million real estate term loan with a ten-year term (due April 2021) but amortized as if it had a 25-year life, and a \$7.2 million machinery and equipment term loan with a seven-year term (due April 2018). The amount outstanding under this credit facility was \$16.2 million as of December 31, 2012.

All loans have a floating interest rate of either the prime rate plus 25 to minus 50 basis points, or LIBOR plus 175 to 265 basis points (based on the ratio of funded debt to EBITDA), at the company's discretion. The credit agreement contains covenants that require Orchids to maintain a specific funded debt-to-EBITDA ratio, fixed charge coverage ratio, and a tangible net worth. As of December 31, 2012, the company was in compliance with these covenants.

Projections

If new orders fully materialize, it could increase converted tonnage shipped by 10,000 tons in 2013. However, with recent (4Q12) sales levels falling short of company expectations, we are forecasting approximately 9,000 additional converted tons being shipped in 2013. There are no sales contracts guaranteeing these sales. However, customer order streams are fairly consistent and typically last several years. Selling prices (converted and parent roll) are projected to increase 2% annually through our forecast horizon, consistent with IBISWorld projections for paper manufacturer selling price increases through 2017. These factors should result in revenue of approximately \$114 million in 2013.

Revenue Model			
2012			
	Tons Shipped	Selling Price/Ton	Revenue (\$,000)
Converted	44,167	\$ 2,049	\$ 90,498
Parent Roll	9,828	\$ 1,049	\$ 10,310
Total	53,995	\$ 1,867	\$ 100,808
2013			
	Tons Shipped	Selling Price/Ton	Revenue (\$,000)
Converted	53,000	\$ 2,090	\$ 110,770
Parent Roll	3,000	\$ 1,070	\$ 3,210
Total	56,000	\$ 2,035	\$ 113,980
2014			
	Tons Shipped	Selling Price/Ton	Revenue (\$,000)
Converted	58,300	\$ 2,132	\$ 124,296
Parent Roll	1,000	\$ 1,091	\$ 1,091
Total	59,300	\$ 2,114	\$ 125,387

Source: Taglich Brothers estimates

Orchids' results over the past three years show that approximately 80% of manufacturing costs are variable with the cost of paper averaging 56% of total cost of sales and other variable costs (packaging supplies, direct labor, freight, etc.) averaging 26%. The table at right shows our estimated costs per ton (variable and fixed) over the past four years and our estimates for 2013 and 2014.

We project paper costs to average \$875/ton in 2013 and \$910/ton in 2014, in line with the projected 11% increase in pulp prices in 2013 and 4% increase in 2014 (IBISWorld). We project other variable costs in 2013 and 2014 to increase

COGS (in thousands \$) Model						
	<u>2009A</u>	<u>2010A</u>	<u>2011A</u>	<u>2012A</u>	<u>2013E</u>	<u>2014E</u>
Variable cost (paper)	\$ 36,497	\$ 43,947	\$ 46,337	\$ 42,566	\$ 49,000	\$ 53,963
Est. variable cost (other)	\$ 20,817	\$ 20,334	\$ 21,373	\$ 21,110	\$ 22,595	\$ 24,610
Total est. variable costs	\$ 57,314	\$ 64,281	\$ 67,710	\$ 63,676	\$ 71,595	\$ 78,573
Est. fixed cost (overhead)	\$ 6,939	\$ 6,778	\$ 7,124	\$ 7,036	\$ 7,550	\$ 8,300
Fixed cost (depreciation)	\$ 3,683	\$ 5,693	\$ 7,052	\$ 7,541	\$ 7,556	\$ 7,708
Total est. fixed costs	\$ 10,622	\$ 12,471	\$ 14,176	\$ 14,577	\$ 15,106	\$ 16,008
COGS	\$ 67,936	\$ 76,752	\$ 81,886	\$ 78,253	\$ 86,701	\$ 94,581
Tons shipped	52,355	56,663	55,514	53,995	56,000	59,300
Variable (paper) costs/ton	\$ 697	\$ 776	\$ 835	\$ 788	\$ 875	\$ 910
Est. variable (other) cost/ton	\$ 398	\$ 359	\$ 385	\$ 391	\$ 403	\$ 415
Total variable costs/ton	\$ 1,095	\$ 1,134	\$ 1,220	\$ 1,179	\$ 1,278	\$ 1,325
Fixed costs/ton	\$ 203	\$ 220	\$ 255	\$ 270	\$ 270	\$ 270
Total COGS/ton	\$ 1,298	\$ 1,355	\$ 1,475	\$ 1,449	\$ 1,548	\$ 1,595
Gross profit	\$ 28,027	\$ 15,752	\$ 15,957	\$ 22,566	\$ 27,300	\$ 30,819
Gross margin	29.2%	17.0%	16.3%	22.4%	23.9%	24.6%

Source: Company filings and Taglich Brothers estimates

in line with the historic rate of inflation. Fixed costs are projected to remain near current aggregate levels on a per ton basis through 2014.

We project 2013 revenue of \$114 million and net income of \$11.6 million or \$1.45 per share. Our projections reflect additional converted product tonnage from recent orders. Our gross margin projection of 23.9% reflects a paper cost estimate of \$875/ton.

We project SG&A expenses of \$9.6 million in 2013 (of which approximately 17% or \$1.6 million of SG&A expenses are commission-related). Operating margins should increase to 15.6% in 2013 from 14% in 2012 due to increased tonnage of higher margin converted products. The tax rate is estimated at 34%. Days sales outstanding and inventory turnover are projected to remain at 20 and 8 respectively.

For 2013 we project cash earnings of \$20.1 million and a \$1.4 million decrease in working capital will result in cash from operations of \$21.5 million. The decrease in working capital is primarily due to increases in accounts payable, accrued liabilities and decreased taxes receivable, offset in part by increases in accounts payable and inventories. Cash from operations will more than cover \$10 million of capital expenditures, a \$3 million pay down of debt, and \$9.2 million in dividends, increasing cash by \$0.7 million to \$5 million at December 31, 2013.

We project 2014 revenue of \$125.4 million and net income of \$13.3 million or \$1.68 per share. Our projections are based on a further 10% increase in converted product tonnage to be shipped in 2014 (as we do not believe the 20% rate in 2013 sustainable) and minimal parent roll sales. We project a paper cost of \$910/ton based on a 4% increase in pulp prices. Our cost of sales projections should result in gross margins of 24.6%.

We project SG&A expenses of \$10.5 million in 2014 (of which approximately 17% or \$1.8 million of SG&A expenses are commission-related). Operating margins are projected to increase to 16.2% due to increased tonnage of higher margin converted products. The tax rate is estimated at 34%. Days sales outstanding and inventory turnover are projected to remain at 20 and 8 respectively.

For 2014 we project cash earnings of \$21.5 million and a \$1.3 million increase in working capital will result in cash from operations of \$20.1 million. The increase in working capital is primarily due to increases in accounts receivables and inventories, offset in part by increases in accounts payable and accrued liabilities. Cash from operations will cover \$10 million of capital expenditures, a \$2 million pay down of debt, and \$9.2 million in dividends, increasing cash by \$304,000 to \$5.3 million at December 31, 2014.

Risks

Customer concentration

Three customers (Dollar General, Family Dollar, and Wal-Mart) accounted for approximately 74% of converted product sales in 2012. Any substantial decrease or delay in sales to one or more of Orchids' key customers would harm sales and financial results.

Competition

Competitors have penetrated Orchids' operating region. More intense competition in the company's market has reduced some of its competitive cost advantages and put pressure on selling prices.

Orchids may not be able to sell the capacity from its expanded converting line

Underutilization of capacity could lead to unabsorbed overhead and gross margin compression.

No reliance on contracts

Sales contracts are not the norm in the industry. Although orders typically result in multi-year revenue streams, there can be no guarantee as to their length.

Liquidity risk

Microcap stocks typically have small trading floats and very low trading volume and can lead to large spreads and high volatility in stock price. Orchids has 5.5 million shares in the float with an average daily volume of approximately 23,000 shares.

Miscellaneous risks

The company's financial results and equity values are subject to other risks, including competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Orchids Paper Products Company

Consolidated Balance Sheets
(in thousands \$)

	2010A	2011A	2012A	2013E	2014E
Cash	142	4,297	5,734	5,014	5,318
Accounts receivable	6,155	6,939	5,406	6,113	6,724
Inventories	7,595	7,811	10,275	11,384	12,419
Short term investments	9,518	2,019	5,027	5,027	5,027
Income taxes receivable	3,952	285	607	853	1,046
Prepaid expenses	538	530	637	727	835
Other	-	338	44	-	-
Deferred income taxes	790	410	393	552	677
Total current assets	28,690	22,629	28,123	29,670	32,046
Property, plant and equipment	93,805	92,285	91,188	91,581	93,873
Deferred debt issuance costs	76	54	47	35	25
Total Assets	<u>122,571</u>	<u>114,968</u>	<u>119,358</u>	<u>121,286</u>	<u>125,944</u>
Accounts payable	5,250	3,520	3,685	4,083	4,454
Accrued liabilities	2,269	2,615	2,832	3,202	3,522
Current portion of long-term debt	10,742	1,152	1,152	1,152	1,152
Total current liabilities	18,261	7,287	7,669	8,437	9,128
Long-term debt	16,615	16,231	15,079	12,079	10,079
Deferred income taxes	18,099	18,801	19,432	19,432	19,432
Total liabilities	52,975	42,319	42,180	39,948	38,639
Total stockholders' equity	<u>69,596</u>	<u>72,649</u>	<u>77,178</u>	<u>81,338</u>	<u>87,304</u>
Total liabilities & stockholders' equity	<u>122,571</u>	<u>114,968</u>	<u>119,358</u>	<u>121,286</u>	<u>125,944</u>

Source: Company filings and Taglich Brothers' estimates

Orchids Paper Products Company

Income Statements for the Fiscal Years Ended
(in thousands \$)

	<u>2010A</u>	<u>2011A</u>	<u>2012A</u>	<u>2013E</u>	<u>2014E</u>
Net sales	92,504	97,843	100,819	114,000	125,400
Cost of sales	<u>76,752</u>	<u>81,886</u>	<u>78,253</u>	<u>86,700</u>	<u>94,581</u>
Gross profit	15,752	15,957	22,566	27,300	30,819
SG&A expenses	<u>6,618</u>	<u>6,810</u>	<u>8,456</u>	<u>9,560</u>	<u>10,520</u>
Operating income (loss)	9,134	9,147	14,110	17,740	20,299
Interest expense	934	647	407	280	140
Other (income) expense	<u>(65)</u>	<u>(42)</u>	<u>302</u>	<u>(40)</u>	<u>(40)</u>
Income (loss) before taxes	8,265	8,542	13,401	17,500	20,199
Income tax expense (benefit)	<u>2,351</u>	<u>2,344</u>	<u>4,144</u>	<u>5,950</u>	<u>6,868</u>
Net income (loss)	<u><u>5,914</u></u>	<u><u>6,198</u></u>	<u><u>9,257</u></u>	<u><u>11,550</u></u>	<u><u>13,331</u></u>
EPS	0.76	0.80	1.18	1.45	1.68
Shares Outstanding	7,755	7,722	7,832	7,950	7,950
 <u>Margin Analysis</u>					
Gross margin	17.0%	16.3%	22.4%	23.9%	24.6%
SG&A expenses	7.2%	7.0%	8.4%	8.4%	8.4%
Operating margin	9.9%	9.3%	14.0%	15.6%	16.2%
Net margin	6.4%	6.3%	9.2%	10.1%	10.6%
Tax rate	28.4%	27.4%	30.9%	34.0%	34.0%
 <u>Year / Year Growth</u>					
Total Revenues	(3.6%)	5.8%	3.0%	13.1%	10.0%
Net Income	(56.4%)	4.8%	49.4%	24.8%	15.4%
EPS	(59.6%)	5.3%	47.3%	22.9%	15.4%

Source: Company filings and Taglich Brothers' estimates

Orchids Paper Products Company

Quarterly Income Statement for the Fiscal Years Ending December 31, 2012, 2013, and 2014
(in thousands \$)

	<u>3/12A</u>	<u>6/12A</u>	<u>9/12A</u>	<u>12/12A</u>	<u>2012A</u>	<u>3/13E</u>	<u>6/13E</u>	<u>9/13E</u>	<u>12/13E</u>	<u>2013E</u>	<u>3/14E</u>	<u>6/14E</u>	<u>9/14E</u>	<u>12/14E</u>	<u>2014E</u>
Net sales	25,727	25,279	25,778	24,035	100,819	27,000	28,500	29,250	29,250	114,000	30,150	30,950	31,750	32,550	125,400
Cost of sales	19,594	19,675	20,388	18,596	78,253	20,800	21,700	22,100	22,100	86,700	22,740	23,343	23,947	24,551	94,581
Gross profit	6,133	5,604	5,390	5,439	22,566	6,200	6,800	7,150	7,150	27,300	7,410	7,607	7,803	7,999	30,819
SG&A expenses	2,287	2,112	2,029	2,028	8,456	2,270	2,390	2,450	2,450	9,560	2,530	2,600	2,660	2,730	10,520
Operating income (loss)	3,846	3,492	3,361	3,411	14,110	3,930	4,410	4,700	4,700	17,740	4,880	5,007	5,143	5,269	20,299
Interest expense	107	102	99	99	407	70	70	70	70	280	35	35	35	35	140
Other (income) expense	(7)	323	(4)	(10)	302	(10)	(10)	(10)	(10)	(40)	(10)	(10)	(10)	(10)	(40)
Income (loss) before taxes	3,746	3,067	3,266	3,322	13,401	3,870	4,350	4,640	4,640	17,500	4,855	4,982	5,118	5,244	20,199
Income tax expense (benefit)	1,224	830	941	1,149	4,144	1,316	1,479	1,578	1,578	5,950	1,651	1,694	1,740	1,783	6,868
Net income (loss)	<u>2,522</u>	<u>2,237</u>	<u>2,325</u>	<u>2,173</u>	<u>9,257</u>	<u>2,554</u>	<u>2,871</u>	<u>3,062</u>	<u>3,062</u>	<u>11,550</u>	<u>3,204</u>	<u>3,288</u>	<u>3,378</u>	<u>3,461</u>	<u>13,331</u>
EPS	0.32	0.29	0.29	0.28	1.18	0.32	0.36	0.39	0.39	1.45	0.40	0.41	0.42	0.44	1.68
Shares Outstanding	7,855	7,844	7,863	7,899	7,832	7,950	7,950	7,950	7,950	7,950	7,950	7,950	7,950	7,950	7,950
<u>Margin Analysis</u>															
Gross margin	23.8%	22.2%	20.9%	22.6%	22.4%	23.0%	23.9%	24.4%	24.4%	23.9%	24.6%	24.6%	24.6%	24.6%	24.6%
SG&A expenses	8.9%	8.4%	7.9%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%
Operating margin	14.9%	13.8%	13.0%	14.2%	14.0%	14.6%	15.5%	16.1%	16.1%	15.6%	16.2%	16.2%	16.2%	16.2%	16.2%
Net margin	9.8%	8.8%	9.0%	9.0%	9.2%	9.5%	10.1%	10.5%	10.5%	10.1%	10.6%	10.6%	10.6%	10.6%	10.6%
Tax rate	32.7%	27.1%	28.8%	34.6%	30.9%	34.0%	34.0%	34.0%	34.0%	34.0%	34.0%	34.0%	34.0%	34.0%	34.0%
<u>Year / Year Growth</u>															
Total Revenues	13.5%	8.1%	(1.3%)	(6.4%)	3.0%	4.9%	12.7%	13.5%	21.7%	13.1%	11.7%	8.6%	8.5%	11.3%	10.0%
Net Income	306.8%	86.9%	41.2%	(20.5%)	49.4%	1.3%	28.3%	31.7%	40.9%	24.8%	25.5%	14.5%	10.3%	13.0%	15.4%
EPS	299.4%	83.6%	36.2%	(21.8%)	47.3%	0.1%	26.6%	32.8%	40.0%	22.9%	25.5%	14.5%	10.3%	13.0%	15.4%

Source: Company filings and Taglich Brothers' estimates

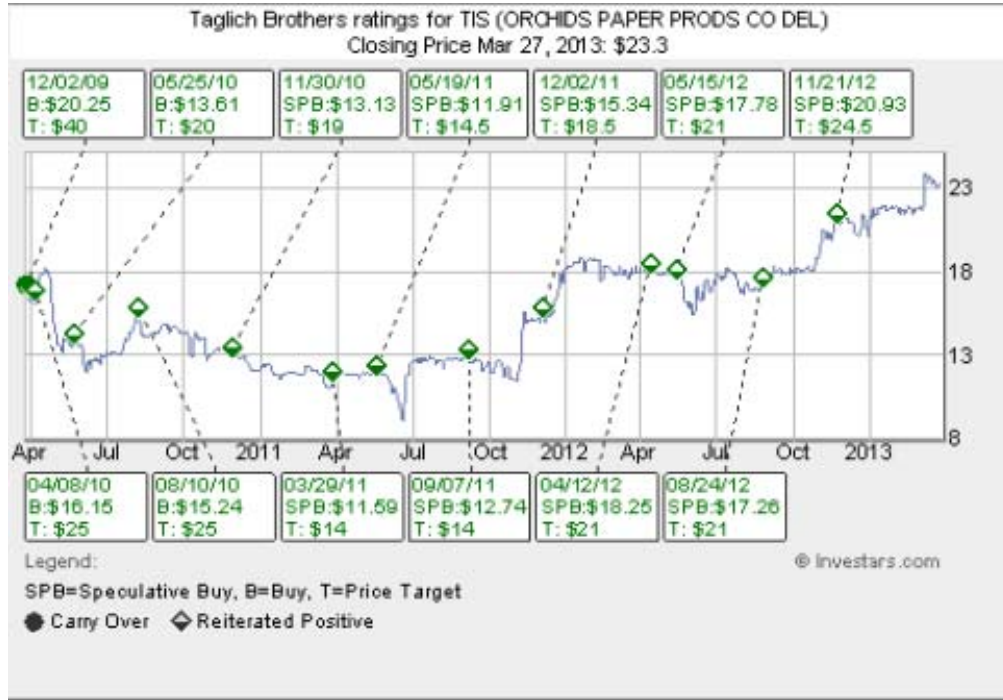
Orchids Paper Products Company

Statement of Cash Flows for the Periods Ended
(in thousands \$)

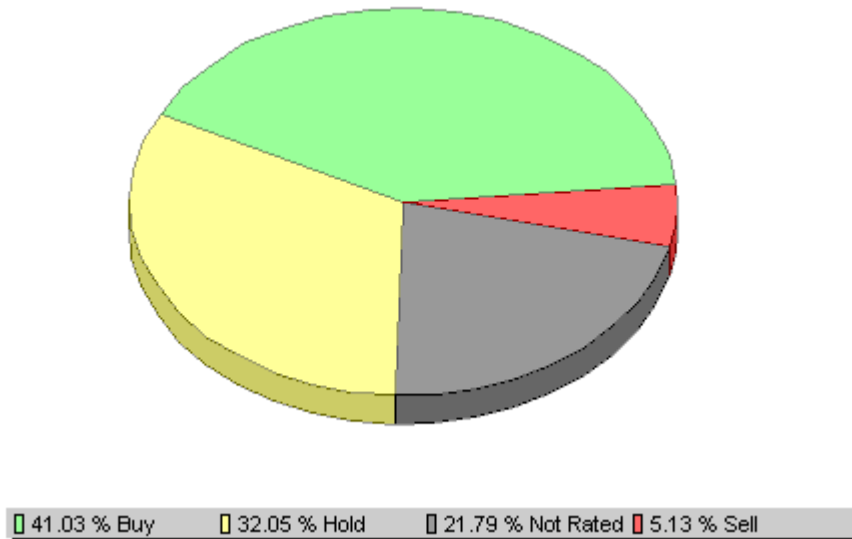
	2010A	2011A	2012A	2013E	2014E
Net income(loss)	5,914	6,198	9,257	11,550	13,331
Depreciation and amortization	5,725	7,132	7,548	7,556	7,708
Provision for doubtful accounts	(34)	(30)	(20)	(30)	(30)
Deferred income taxes	3,519	2,359	648	631	-
Stock based compensation	562	290	346	425	450
Loss on disposal of property, plant and equipment	-	-	336	-	-
<i>Changes in assets and liabilities</i>					
Accounts receivable	629	(754)	1,553	(707)	(611)
Inventories	(26)	(216)	(2,464)	(1,109)	(1,035)
Prepaid expenses	(41)	8	(107)	(90)	(108)
Income taxes receivable	(3,952)	2,390	(322)	2,494	(278)
Other current assets	-	(338)	294	44	-
Accounts payable	1,201	(1,730)	165	398	371
Accrued liabilities	(849)	346	217	370	320
Net Cash Provided by (Used in) Operations	<u>12,648</u>	<u>15,655</u>	<u>17,451</u>	<u>21,532</u>	<u>20,119</u>
Proceeds from the sale of investment securities	8,991	7,500	-	-	-
Purchase of investment securities	-	-	(3,008)	-	-
Purchase of property and equipment	<u>(26,786)</u>	<u>(5,531)</u>	<u>(6,780)</u>	<u>(10,000)</u>	<u>(10,000)</u>
Net Cash Provided by (Used in) Investing	<u>(17,795)</u>	<u>1,969</u>	<u>(9,788)</u>	<u>(10,000)</u>	<u>(10,000)</u>
Proceeds from issuance of stock	-	-	-	-	-
Borrowings under construction loan	5,197	-	-	-	-
Repayments on construction loan	-	-	-	-	-
Borrowings on long-term debt	-	18,021	-	-	-
Principal payments on long-term debt	(3,787)	(2,007)	(1,152)	(3,000)	(2,000)
Repayment of long-term debt at maturity	-	(5,878)	-	-	-
Repayment of long-term debt prior to maturity	-	(17,439)	-	-	-
Net borrowings (repayments) on revolving credit line	2,672	(2,672)	-	-	-
Proceeds from the exercise of warrants attached to debentures	-	-	-	-	-
Proceeds from the exercise of stock options	-	303	974	1,000	1,000
Excess tax benefit of stock options exercised	-	15	395	400	400
Deferred debt issuance cost	(25)	(59)	-	-	-
Dividends paid	<u>-</u>	<u>(3,753)</u>	<u>(6,443)</u>	<u>(9,215)</u>	<u>(9,215)</u>
Net Cash Provided by (Used in) Financing	<u>4,057</u>	<u>(13,469)</u>	<u>(6,226)</u>	<u>(10,815)</u>	<u>(9,815)</u>
Net Change in Cash	<u>(1,090)</u>	<u>4,155</u>	<u>1,437</u>	<u>717</u>	<u>304</u>
Cash - Beginning of Period	<u>1,232</u>	<u>142</u>	<u>4,297</u>	<u>4,297</u>	<u>5,014</u>
Cash - End of Period	<u><u>142</u></u>	<u><u>4,297</u></u>	<u><u>5,734</u></u>	<u><u>5,014</u></u>	<u><u>5,318</u></u>
Cash Flow from Operations	12,648	15,655	17,451	21,532	20,119
Capital Expenditures	<u>(26,786)</u>	<u>(5,531)</u>	<u>(6,780)</u>	<u>(10,000)</u>	<u>(10,000)</u>
Free Cash Flow	<u>(14,138)</u>	<u>10,124</u>	<u>10,671</u>	<u>11,532</u>	<u>10,119</u>

Source: Company filings and Taglich Brothers' estimates

Price Chart



Taglich Brothers' Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months		
Rating	#	%
Buy	1	4
Hold	1	17
Sell		
Not Rated		

Important Disclosures

As of the date of this report, Taglich Brothers, Inc. and/or its affiliates, own more than 1% of TIS common stock. Michael Taglich, President of Taglich Brothers, Inc., owns or has a controlling interest in 407,019 shares of TIS common stock (includes 338,744 shares of restricted stock). Robert Taglich, Managing Director of Taglich Brothers, Inc., owns or has a controlling interest in 391,438 shares of TIS common stock (includes 135,413 shares of restricted stock). Richard Oh, Managing Director of Taglich Brothers, Inc., owns 15,864 shares of TIS common stock. Doug Hailey, Director of Investment Banking at Taglich Brothers, Inc. and a Director of Orchids Paper Products Company, owns 167,900 shares of TIS common stock (includes 33,477 shares of restricted stock). Other employees at Taglich Brothers, Inc., also own or have a controlling interest in 5,000 shares of TIS common stock. Taglich Brothers, Inc. had an Investment Banking relationship with the company mentioned in this report. In March 2004, Orchids Acquisition Group, Inc. was formed by Taglich Brothers, Inc. and Weatherly Group, LLC exclusively for the purpose of acquiring all of the outstanding shares of Orchids Paper Products Company, and was subsequently merged into the company. In July 2005, Orchids completed its initial public offering (of which Taglich Brothers, Inc. was the managing underwriter) and began trading on the American Stock Exchange under the symbol TIS.

All research issued by Taglich Brothers, Inc. is based on public information. From April 2008 to December 2012, the company paid a monthly monetary fee of \$2,000 (USD) to Taglich Brothers, Inc. for the creation and dissemination of research reports.

General Disclosures

The information and statistical data contained herein have been obtained from sources, which we believe to be reliable but in no way are warranted by us as to accuracy or completeness. We do not undertake to advise you as to changes in figures or our views. This is not a solicitation of any order to buy or sell. Taglich Brothers, Inc. is fully disclosed with its clearing firm, Pershing, LLC, is not a market maker and does not sell to or buy from customers on a principal basis. The above statement is the opinion of Taglich Brothers, Inc. and is not a guarantee that the target price for the stock will be met or that predicted business results for the company will occur. There may be instances when fundamental, technical and quantitative opinions contained in this report are not in concert. We, our affiliates, any officer, director or stockholder or any member of their families may from time to time purchase or sell any of the above-mentioned or related securities. Analysts and members of the Research Department are prohibited from buying or selling securities issued by the companies that Taglich Brothers, Inc. has a research relationship with, except if ownership of such securities was prior to the start of such relationship, then an Analyst or member of the Research Department may sell such securities after obtaining expressed written permission from Compliance.

Analyst Certification

I, John Nobile, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be, directly, or indirectly, related to the specific recommendations or views contained in this report.

Public Companies Mentioned in this Report

Cascades (OTC PK: CADNF)
Clearwater Paper (NYSE: CLW)
Dollar General (NYSE: DG)
Family Dollar (NYSE: FDO)
Wal-Mart (NYSE: WMT)

Meaning of Ratings

Buy

We believe the company is undervalued relative to its market and peers. We believe its risk reward ratio strongly advocates purchase of the stock relative to other stocks in the marketplace. Remember, with all equities there is always downside risk.

Speculative Buy

We believe that the long run prospects of the company are positive. We believe its risk reward ratio advocates purchase of the stock. We feel the investment risk is higher than our typical “buy” recommendation. In the short run, the stock may be subject to high volatility and continue to trade at a discount to its market.

Neutral

We will remain neutral pending certain developments.

Underperform

We believe that the company may be fairly valued based on its current status. Upside potential is limited relative to investment risk.

Sell

We believe that the company is significantly overvalued based on its current status. The future of the company's operations may be questionable and there is an extreme level of investment risk relative to reward.

Dropping Coverage

We have discontinued research coverage due to acquisition of the company, termination of research services, non-payment for such services or departure of the analyst.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.