



# TAGLICH BROTHERS

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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: Buy

John Nobile

August 10, 2010

TIS \$15.24 — (NYSE AMEX)

	<u>2008A</u>	<u>2009A</u>	<u>2010E</u>	<u>2011E</u>
Revenues (millions)	\$90.2	\$96.0	\$97.7	\$116.0
Earnings per share	\$0.79	\$1.89	\$1.16	\$1.76

52-Week range	\$11.85 – \$22.10	Fiscal year ends:	December
Shares outstanding as of 8/2/10	7.5 million	Revenue per share (TTM)	\$12.26
Approximate float	5.9 million	Price/Sales (TTM)	1.2X
Market capitalization	\$114 million	Price/Sales (FY2011)E	1.0X
Tangible book value/share	\$8.95	Price/Earnings (TTM)	11.1X
Price/tangible book value	1.7X	Price/Earnings (FY2011)E	8.7X

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, due to their consistent order patterns, limited number of stock keeping units offered and the growth potential in this channel of the retail market. ([www.orchidspaper.com](http://www.orchidspaper.com))

#### Key investment considerations:

We are reiterating our Buy rating on Orchids Paper Products Company (NYSE AMEX: TIS) and raising our twelve-month price target to \$25.00 per share from \$20.00 primarily due to expectations for higher earnings than originally forecasted and an expansion of the stock’s earnings multiple.

Although we are only projecting 50% utilization from the new converting line in 2011 due to the effects that increased competition should have on sales, Orchids should be able to convert 100% of its current parent roll capacity (54,000 tons) into finished product. This richer product mix combined with a \$2 million reduction in annual warehousing costs should result in gross margin improvement.

Orchids’ new warehouse and expanded converting line were completed and started operating in June 2010. The new converting line will be capable of producing both bathroom tissue and towel products with various packaging options, enhanced graphics and embossing thereby facilitating penetration of the grocery store market.

We project 2010 revenue of \$97.7 million and EPS of \$1.16 per diluted share. We increased our estimates from 2010 revenue of \$92.5 million and EPS \$0.91 primarily due to a greater ramp up in sales and better margins than originally anticipated.

We project a 30% rise in sales of higher margin converted products in 2011, resulting in revenue of \$116.0 million and EPS of \$1.76. We previously projected revenue of \$114.0 million and EPS of \$1.69. The slight increase in our estimates is based on a continuing ramp in converted product sales.

Orchids reported Q2/10 sales increased 2% to \$24.7 million. Q2/10 EPS decreased to \$0.28 from \$0.55 in Q2/09. We projected Q2/10 sales of \$21.5 million and EPS of \$0.19.

Please view our disclosures starting on page 14.

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### ***Recommendation and Valuation***

We are reiterating our **Buy** rating on Orchids Paper Products and raising our twelve-month price target to \$25.00 per share from \$20.00 primarily due to expectations for higher earnings than we previously forecasted and an expansion of the stock's earnings multiple.

The company's multiple has averaged only 9X TTM earnings over the last two years but has expanded to 11X earnings currently. We believe the stock's multiple will continue to expand closer to its historic average (15X earnings) as the company's high margin converted product sales start to show significant increases and the balance sheet strengthens. Applying a multiple of 14X to our earnings per share estimate of \$1.76 for 2011 gives us a **price target of approximately \$25.00 per share.**

### ***Business***

In March 2004, Orchids Acquisition Group, Inc. acquired the company for a price of \$21.6 million. Orchids Acquisition Group, Inc., formed by Taglich Brothers, Inc. and Weatherly Group, LLC to acquire all of the outstanding shares of Orchids Paper Products Company, was subsequently merged into the company. In July 2005, Orchids completed its initial public offering at \$8.00 per share (\$5.33 adjusted for a 3-for-2 stock split in July 2006) and began trading under the symbol TIS.

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 targets the discount retail market, primarily dollar store retailers, due to their consistent order patterns, limited number of stock keeping units (SKUs) offered and the growth in this channel of the retail market. While Orchids has customers located throughout the United States, 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. Because Orchids products are daily consumable items, order streams are fairly consistent with no significant seasonal fluctuations. Changes in the national economy do not materially affect the market for Orchids' products.

### ***Market and Competition***

According to RISI, a leading information provider for the global forest products industry, the North American tissue market includes toilet tissue (45% share of North American consumption), toweling (36%), napkins (12%), facial tissue (6%), and other (1%).

IBISWorld projects a US tissue market of \$10 billion in 2010. While industry revenue has declined over the past few years, IBISWorld projects the overall industry to increase modestly at an average annualized rate of 0.6% during the five years through 2015.

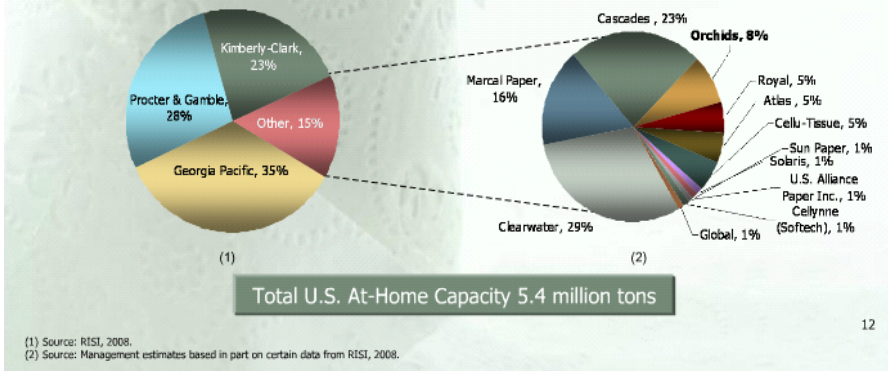
Dollar and variety stores, Orchids' primary target markets, realized sales of \$50 billion in 2009. IBISWorld projects dollar and variety stores' growth averaging 2.7% over the next five years.

Competition in the value-end of the market is significantly affected by proximity, as freight costs represent a material portion of end product costs. Although it is economically feasible to ship within a 900-mile radius of Orchids' production site, the company is focused on a 500-mile radius. In Oklahoma and the immediately surrounding area, Georgia-Pacific's Muskogee, Oklahoma plant, Cascades' (OTC PK: CADNF) Memphis, Tennessee plant, and Pacific Paper's Memphis, Tennessee plant are the only competitors' plants in this region. Cellu Tissue recently announced plans to construct a converting facility in Oklahoma City, Oklahoma.

**Orchids' Market Segment**

- Don't directly compete with large branded products companies
- Highly fragmented sector

**Breakdown of At-Home U.S. Tissue Capacity**



Source: Orchids Paper Products

**2<sup>nd</sup> Quarter and Six Months Financial Results**

For the second quarter ended June 30, 2010 versus the same period in 2009:

- Net sales increased 2% to \$24.7 million from \$24.1 million.
- Gross margins decreased to 20.6% from 32.4%.
- Selling, general and administrative (SG&A) expenses decreased to \$1.8 million from \$2.1 million.
- Interest expense increased to \$0.2 million from \$0.1 million.
- Net income was \$2.2 million or \$0.28 per diluted share versus net income of \$3.8 million or \$0.55 per diluted share.

We estimated second quarter net sales of \$21.5 million and net income of \$1.5 million or \$0.19 per diluted share.

Converted product (paper towels, bathroom tissue, and paper napkins) sales decreased to \$20.2 million from \$22.5 million while parent roll (bulk tissue paper) sales increased to \$4.5 million from \$1.6 million. Total tons shipped increased to 14,614 from 12,297, while paper costs increased to approximately \$10.8 million from approximately \$7.9 million. The overall net selling price per ton decreased to \$1,689 from \$1,962.

The decrease in converted product sales resulted from a 5% decline in both tonnage shipped and net selling prices. Converting product shipments were negatively affected by continued aggressive pricing by branded producers. The reduction in the net selling price per ton was primarily due to a change in product mix. Net sales of parent rolls were positively affected by a 145% increase in parent roll tonnage shipped and a 15% increase in the net selling price.

The decrease in gross margins was due to higher raw material costs, product mix (increased parent roll sales generally provide a lower gross profit than converted product sales), and higher depreciation costs.

The decrease in SG&A expenses was due to lower incentive bonuses and lower stock option expense.

## Orchids Paper Products Company

For the six months ended June 30, 2010 versus the same period in 2009:

- Net sales decreased 42% to \$45.7 million from \$47.8 million.
- Gross margins decreased to 19.5% from 29.9%.
- Selling, general and administrative (SG&A) expenses decreased to \$3.6 million from \$3.9 million.
- Interest expense increased to \$0.4 million from \$0.3 million.
- Net income was \$3.5 million or \$0.46 per diluted share versus net income of \$6.6 million or \$0.97 per diluted share.

	<u>6mos2009</u>	<u>6mos2010</u>
Net sales	47,771	45,725
Cost of sales	33,511	36,789
Gross profit	14,260	8,936
SG&A expenses	3,917	3,576
Operating income (loss)	10,343	5,360
Interest expense	294	426
Other (income) expense	(4)	(27)
Income (loss) before taxes	10,053	4,961
Income tax expense (benefit)	3,481	1,429
Net income (loss)	6,572	3,532
Basic EPS	1.02	0.47
Diluted EPS	0.97	0.46
Basic Shares Outstanding	6,421	7,441
Diluted Shares Outstanding	6,779	7,754
<u>Margin Analysis</u>		
Gross margin	29.9%	19.5%
SG&A expenses	8.2%	7.8%
Operating margin	21.7%	11.7%
Net margin	13.8%	7.7%

Source: Company filings and Taglich Brothers' estimates

Converted product sales decreased to \$37.8 million from \$43.6 million while parent roll sales increased to \$7.9 million from \$4.2 million. Total tons shipped increased to 27,793 from 24,726, while paper costs increased to approximately \$21.3 million from approximately \$16.4 million. The overall net selling price per ton decreased to \$1,645 from \$1,932.

The decrease in converted product sales resulted from a 7% decline in both tonnage shipped and net selling prices. Converting product shipments were negatively affected by continued aggressive pricing by branded producers and unusually inclement weather in the first quarter of 2010. The reduction in the net selling price per ton was primarily due to a change in product mix. Net sales of parent rolls were positively affected by a 94% increase in parent roll tonnage shipped partially offset by a 3% decrease in net selling prices.

The decrease in gross margins was due to higher raw material costs, lower converted product shipments, a higher percentage of parent roll sales, and higher depreciation expense.

The decrease in SG&A expenses was due to lower incentive bonuses, lower professional and legal fees, and lower stock option expense.

### *Liquidity*

Orchids exhibits a healthy balance sheet. Orchids has a current ratio of 1.4 and a debt/equity ratio of 0.4. This compares to the paper products industry's current ratio of 1.6 and debt/equity ratio of 1.0. As the company pays down debt, we believe these ratios will only improve. Orchids has total debt of \$25.0 million of which \$9.3 million is due in less than one year (April 2011). All loans have an interest rate of LIBOR plus 200 to 450 basis points (based on the ratio of funded debt to EBITDA less income tax paid) with a floor of 3.5%.

Cash flows from operating activities were \$7.1 million in the first six months of 2010. Cash earnings of \$6.1 million, a \$1.8 million increase in accounts payable, a \$0.4 million increase in accounts receivable, and a \$0.3 million increase in prepaid expenses were the main drivers.

Cash flows used in investing activities were \$9.7 million in the first six months of 2010 due to \$18.7 million invested in capital equipment projects and \$9.0 million in proceeds from the sale of investment securities.

Cash flows from financing activities were \$1.7 million in the first six months of 2010 related to \$3.6 million borrowings under a construction loan and principal payments on long-term debt of \$1.9 million.

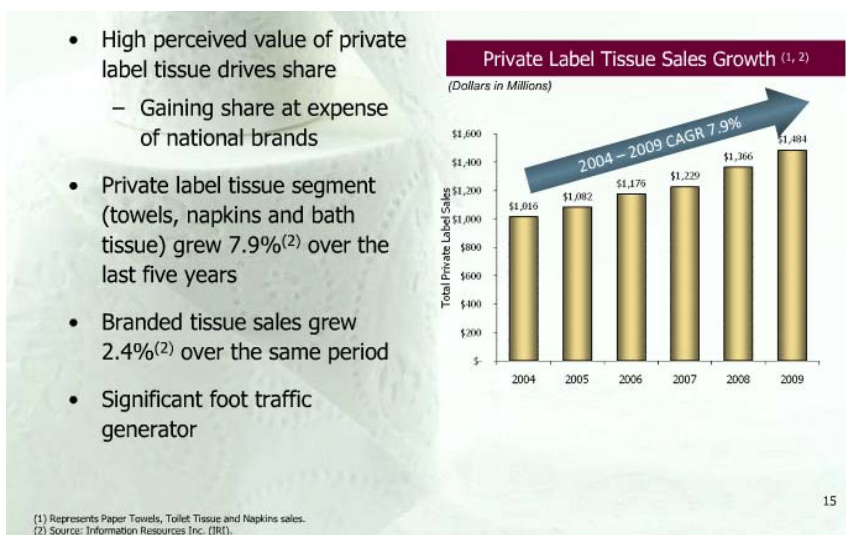
In the first six months of 2010, cash decreased by \$0.9 million to \$0.4 million.

On June 1, 2010, Orchids amended its credit facility. Details are as follows:

- increase the annual unfunded capital expenditures limit for the fiscal year ended December 31, 2010 from \$11.0 million to \$13.0 million to cover the cost of expanding the capacity of the wastewater treatment facility
- remove the restriction on the payment of dividends under certain circumstances, including dividends payable solely in additional shares of the company's common stock and cash dividends not exceeding \$8.0 million in the aggregate in any fiscal year
- eliminate the requirement to maintain a debt service coverage ratio
- add the requirement that to maintain a fixed charge coverage ratio of not less than 1.25 to 1.00, commencing with the fiscal quarter ending June 30, 2010
- add a quarterly tangible net worth covenant pursuant to which required the maintenance of a tangible net worth of not less than the sum of (i) \$50.0 million, plus (ii) 50% of the Company's net income, plus (iii) 100% of the net proceeds from any offering of equity securities after December 31, 2009

### ***Outlook***

Since 2004, private label tissue sales have grown at a compound annual growth rate of almost 8% while branded tissue products have only grown at a 2.4% rate. This positive trend in private label sales bodes well for Orchids' products.



Source: Orchids Paper Products

Orchids' new warehouse and expanded converting line were completed and started operating at the end of June 2010. The new converting line, which has a practical capacity of four million cases per year, will be capable of producing both bathroom tissue and towel products. It will also be capable of various packaging options and enhanced graphics and embossing, product features that will facilitate penetration of the grocery store market.

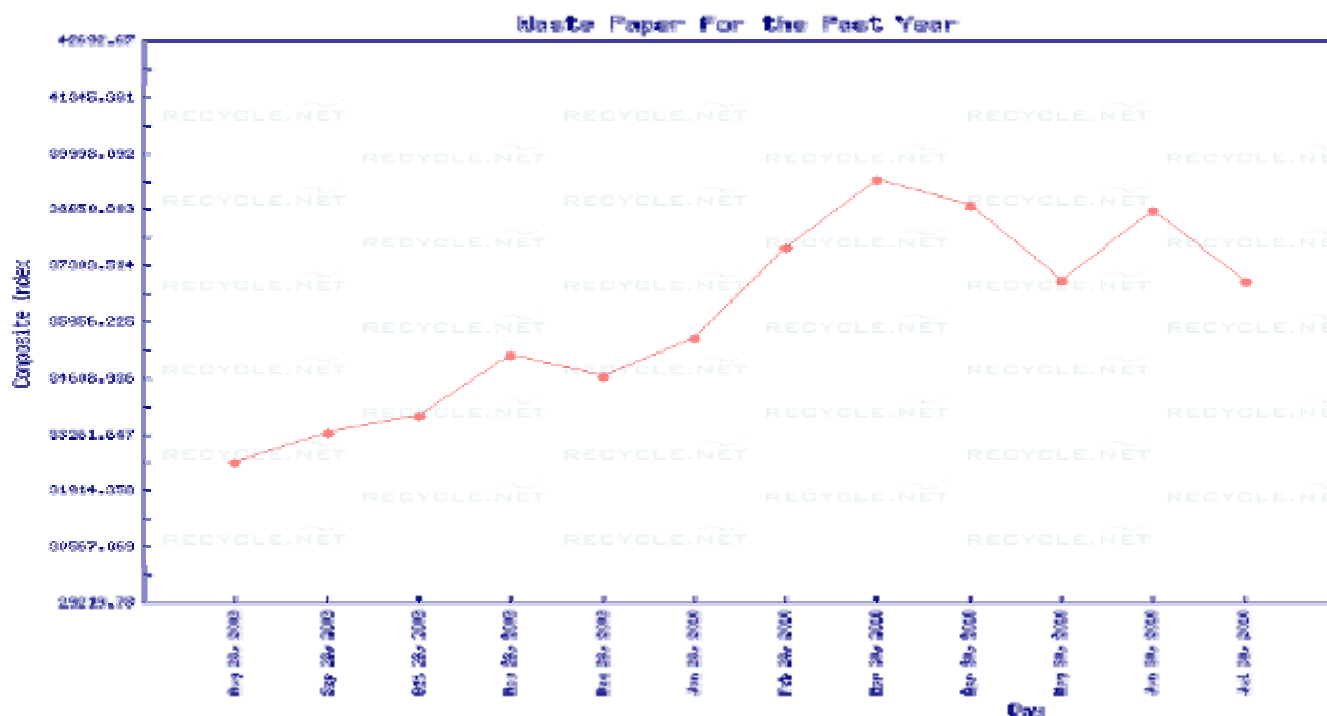
The new converting line's capacity of four million cases per year equates to approximately 26,000 additional tons of converted product. Orchid's total converted capacity with the new line should be approximately 66,000 tons annually. This means that at full capacity, the company would have to purchase approximately 12,000 parent rolls in the outside market to augment its current 54,000 ton parent roll capacity.

The additional converting capacity should support a roughly 60% increase in converted paper production from current levels. We believe that the new converting line's ability to produce a better quality product will enable the company to increase sales to grocery stores. At least two large grocery chains in Orchids' primary selling radius should absorb as much as 2/3 (2.7 million cases) of Orchids' additional capacity and the dollar stores that Orchids currently sells to aim to purchase increased volume from Orchids. Due to the company's proximity to these stores, Orchids' products should save these stores approximately 70% in shipping costs compared with current competitors' products, a significant competitive advantage.

Despite Orchids' current cost competitive advantage, new competitors are moving into Orchids' operating region. In 2009 Pacific Paper added a new converting plant in Memphis, Tennessee and Cellu Tissue (NYSE: CLU) announced the opening of a converting plant in Oklahoma City, Oklahoma for 2010. Both plants are in Orchids' focused 500-mile sales area. The increased presence of competition in the company's focused region may reduce some of its competitive cost advantages which could result in the loss of business or force Orchids to reduce prices.

Judging by a rough estimate of the size of Orchids' primary market (over 200,000 tons of converted products consumed annually based on population), we believe Orchids has the potential to eventually sell its full 60% increase in capacity. However, until we see the effect that new competition is having on Orchids' ability to price and sell products in its cost competitive area, we are projecting operating results based on a 30% increase in converted production (1/2 of new converting line's capacity). This equates to Orchids converting 100% of its current parent roll capacity into finished product.

As noted in the second quarter financial results, significant increases in waste paper prices and promotional pricing of competitors' branded products have compressed Orchids' margins. Although waste paper prices have been trending upward, they appear to have leveled off over the past six months. We believe an improving economy will keep demand for waste paper high resulting in waste paper prices remaining near current high levels.



Source: Paper Fiber Network

Natural gas is an important production resource, accounting for 6% of the cost of sales. The company entered into a contract to purchase 334,000 MMBTU of its natural gas requirements at \$7.50 per MMBTU plus a \$0.07 per MMBTU management delivery fee for the period from April 2009 through March 2011. The contract was extended for one year to March 2012 for 334,000 MMBTU at \$6.50 per MMBTU plus a \$0.07 per MMBTU management delivery fee. The amounts represent approximately 60% of the company's natural gas requirements based upon usage rates for 2009. Due to hedging, changes in the price of natural gas should not have as pronounced an effect on the cost of sales as it previously did.

### Projections

We project 2010 revenue of \$97.7 million and net income of \$9.0 million or \$1.16 per diluted share. We previously projected 2010 revenue of \$92.5 million and net income of \$7.1 million or \$0.91 per diluted share. The increase in our estimates is primarily due to a greater ramp up in sales and better margins than originally anticipated. Our projections are made on the basis that waste paper prices will stay near current elevated levels resulting in gross margins of 21.7%.

Our 2010 estimates are based on:

- Revenue ramp in the second half of the year as the new converting line becomes operational. On the Q2/10 conference call, 70% to 75% of maximum capacity was projected for Q4/10, but we believe the presence of new competition could hamper growth.
- SG&A expenses increasing due to increased converted product sales.
- A company guided tax rate of 28.8%.

For 2010 we are projecting cash earnings of \$19.3 million. Changes in working capital should result in cash from operations of approximately \$18.8 million. \$22.6 million of capital expenditures for facility expansion will be partially offset by \$15.0 million proceeds from the sale of investment securities. The company plans on borrowing \$5.4 million under a construction loan. A \$9.9 million pay down in debt should result in cash used in financing of \$4.5 million. We project a \$6.7 million net increase in cash in 2010 for an ending balance of \$8.0 million.

We project 2011 revenue of \$116.0 million and net income of \$13.7 million or \$1.76 per diluted share. We previously projected 2011 revenue of \$114.0 million and net income of \$13.2 million or \$1.69 per diluted share. The slight increase in our estimates is based on a continuing ramp up in converted product sales. Our estimates imply only 50% utilization of the new converting line due to the increased level of competition. This reflects Orchids conversion of 100% of its current parent roll capacity (54,000 tons) into finished product.

Our 2011 estimates are based on:

- A 30% increase in converted product sales due to the new converting line. Converted products should now constitute 100% of total sales.
- Gross margins of 25%, based on a richer product mix and a \$2 million reduction in annual warehousing costs. Our projection accounts for the effect that competitive pressure and plant underutilization could have on margins.
- SG&A expenses increasing due to increased converted product sales.
- A tax rate of 28.8%.

For 2011 we are projecting cash earnings of \$19.7 million. An increase in sales will increase accounts receivables, inventories, accounts payable, and accrued liabilities, resulting in cash from operations of approximately \$18.5 million. We project \$3.5 million of capital expenditures and a \$10.0 million pay down of debt will result in a \$5.0 million net increase in cash in 2011 for an ending balance of \$13.0 million.

## ***Risks***

### Customer concentration

A substantial percentage of Orchids' product revenues are attributable to three significant customers (Dollar General, Family Dollar (NYSE: FDO), and Wal-Mart (NYSE: WMT)) that accounted for approximately 64% of converted product sales in 2009. Any substantial decrease or delay in sales to one or more of Orchids' key customers would harm sales and financial results.

### Competition

As mentioned earlier, competitors are moving into Orchids' operating region. In 2009 Pacific Paper added a new converting plant in Memphis, Tennessee and Cellu Tissue (NYSE: CLU) announced the opening of a converting plant in Oklahoma City, Oklahoma for 2010. Both plants are in Orchids' focused 500-mile sales area. The increased presence of competition in the company's focused region may reduce some of its competitive cost advantages which could result in the loss of business or force Orchids to reduce prices.

### Orchids may experience problems with its new converting line which could delay or cancel customer orders

The new converting line may not provide the capacity, capability or efficiency originally projected. This could lead to customer orders being delayed or canceled which could cause significant harm to the company's relationships with new or existing customers.

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

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



Labor interruptions

All of Orchids' hourly paid employees are represented by a labor union. The collective bargaining agreement with Local 5-930, which represents the paper mill workers, will expire in February 2011, and the collective bargaining agreement with Local 5-1480, which represents the converting facility workers, will expire in June 2012. Negotiations of new collective bargaining agreements may result in significant increases in the cost of labor or could breakdown and result in a strike or other disruption of operations.

Unexpected shutdowns

Three of Orchids' four paper machines are approximately 50 years old. Unexpected production disruptions could cause the company to shut down its paper mill. Those disruptions could occur due to any number of circumstances, including shortages of raw materials, disruptions in the availability of transportation, labor disputes and mechanical or process failures.

Liquidity risk

Shares of TIS have risks common to those of the microcap segment of the market. Often these risks 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 and can lead to large spreads and high volatility in stock price. Orchids has 5.9 million shares in the float with an average daily volume of approximately 43,000 shares.

Miscellaneous risks

The company's financial results and equity values are subject to other risks and uncertainties known and unknown, including but not limited to 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 \$)

	<u>2008A</u>	<u>2009A</u>	<u>6/30/2010A</u>	<u>2010E</u>	<u>2011E</u>
<b>Assets</b>					
Current assets:					
Cash	11	1,232	380	7,981	12,953
Accounts receivable	6,514	6,750	7,166	6,874	8,159
Inventories	6,253	7,569	7,584	8,530	9,693
Short term investments	-	18,509	9,513	3,500	3,500
Income taxes receivable	-	-	-	-	-
Prepaid expenses	399	497	776	400	525
Deferred income taxes	557	547	680	550	550
Total current assets	13,734	35,104	26,099	27,835	35,380
Property, plant and equipment	60,659	72,691	89,166	90,400	89,040
Deferred debt issuance costs	89	104	108	100	100
<b>Total Assets</b>	<b><u>74,482</u></b>	<b><u>107,899</u></b>	<b><u>115,373</u></b>	<b><u>118,335</u></b>	<b><u>124,520</u></b>
<b>Liabilities &amp; stockholders' equity</b>					
Current liabilities:					
Accounts payable	4,699	4,049	5,842	4,563	5,185
Accrued liabilities	2,584	3,118	3,091	3,175	3,769
Current portion of long-term debt	2,998	3,742	9,262	3,700	3,700
Total current liabilities	10,281	10,909	18,195	11,438	12,654
Long-term debt	21,067	19,533	15,776	15,000	5,000
Deferred income taxes	9,572	14,337	14,367	19,700	20,500
<b>Total liabilities</b>	<b><u>40,920</u></b>	<b><u>44,779</u></b>	<b><u>48,338</u></b>	<b><u>46,138</u></b>	<b><u>38,154</u></b>
<b>Total stockholders' equity</b>	<b><u>33,562</u></b>	<b><u>63,120</u></b>	<b><u>67,035</u></b>	<b><u>72,197</u></b>	<b><u>86,366</u></b>
<b>Total liabilities &amp; stockholders' equity</b>	<b><u>74,482</u></b>	<b><u>107,899</u></b>	<b><u>115,373</u></b>	<b><u>118,335</u></b>	<b><u>124,520</u></b>

Source: Company filings and Taglich Brothers' estimates

Orchids Paper Products Company

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

	<u>2007A</u>	<u>2008A</u>	<u>2009A</u>	<u>2010E</u>	<u>2011E</u>
Net sales	74,648	90,202	95,963	97,725	116,000
Cost of sales	<u>63,717</u>	<u>75,196</u>	<u>67,936</u>	<u>76,564</u>	<u>87,000</u>
Gross profit	10,931	15,006	28,027	21,161	29,000
SG&A expenses	<u>5,234</u>	<u>6,259</u>	<u>7,343</u>	<u>7,776</u>	<u>9,000</u>
Operating income (loss)	5,697	8,747	20,684	13,385	20,000
Interest expense	2,828	1,361	692	826	800
Other (income) expense	<u>(36)</u>	<u>(10)</u>	<u>(24)</u>	<u>(57)</u>	<u>(60)</u>
Income (loss) before taxes	2,905	7,396	20,016	12,616	19,260
Income tax expense (benefit)	<u>307</u>	<u>2,205</u>	<u>6,464</u>	<u>3,633</u>	<u>5,548</u>
Net income (loss)	<u><u>2,598</u></u>	<u><u>5,191</u></u>	<u><u>13,552</u></u>	<u><u>8,983</u></u>	<u><u>13,712</u></u>
Basic EPS	0.42	0.82	2.00	1.20	1.83
Diluted EPS	0.40	0.79	1.89	1.16	1.76
Basic Shares Outstanding	6,256	6,329	6,771	7,471	7,500
Diluted Shares Outstanding	6,465	6,542	7,177	7,774	7,800
 <u>Margin Analysis</u>					
Gross margin	14.64%	16.6%	29.2%	21.7%	25.0%
SG&A expenses	7.01%	6.9%	7.7%	8.0%	7.8%
Operating margin	7.63%	9.7%	21.6%	13.7%	17.2%
Net margin	3.48%	5.8%	14.1%	9.2%	11.8%
 <u>Year / Year Growth</u>					
Total Revenues	24.02%	20.8%	6.4%	1.8%	18.7%
Net Income	254.92%	99.8%	161.1%	-33.7%	52.6%
EPS	260.02%	97.5%	138.0%	-38.8%	52.1%

Source: Company filings and Taglich Brothers' estimates

Quarterly Income Statement for the Fiscal Years Ending December 31, 2009, 2010, and 2011  
(in thousands \$)

	3/09A	6/09A	9/09A	12/09A	3/10A	6/10A	9/10E	12/10E	2010E	3/11E	6/11E	9/11E	12/11E	2011E
Net sales	23,840	24,131	24,557	23,835	21,040	24,885	25,500	26,500	97,725	27,500	28,500	29,500	30,500	116,000
Cost of sales	17,208	16,303	17,128	17,297	17,179	19,810	19,835	20,140	76,584	20,825	21,375	22,125	22,875	87,000
Gross profit	6,432	7,828	7,429	6,338	3,861	5,075	5,665	6,360	21,161	6,875	7,125	7,375	7,625	29,000
SG&A expenses	1,830	2,087	1,772	1,854	1,735	1,841	2,050	2,150	7,778	2,250	2,250	2,250	2,250	9,000
Operating income (loss)	4,602	5,741	5,657	4,984	2,126	3,234	3,815	4,210	13,385	4,625	4,875	5,125	5,375	20,000
Interest expense	159	135	174	224	215	211	200	200	826	200	200	200	200	800
Other (income) expense	(3)	(1)	(5)	(15)	(14)	(13)	(15)	(15)	(57)	(15)	(15)	(15)	(15)	(60)
Income (loss) before taxes	4,446	5,607	5,488	4,475	1,925	3,036	3,630	4,025	12,618	4,440	4,660	4,940	5,190	19,260
Income tax expense (benefit)	1,849	1,832	1,673	1,310	565	864	1,045	1,159	3,833	1,279	1,351	1,423	1,495	5,548
Net income (loss)	2,797	3,775	3,815	3,165	1,360	2,172	2,585	2,866	8,983	3,161	3,339	3,517	3,695	13,712
Basic EPS	0.44	0.58	0.56	0.42	0.18	0.29	0.34	0.38	1.20	0.42	0.45	0.47	0.49	1.83
Diluted EPS	0.42	0.55	0.52	0.40	0.18	0.28	0.33	0.37	1.16	0.41	0.43	0.45	0.47	1.76
Basic Shares Outstanding	6,409	6,469	6,839	7,392	7,395	7,487	7,500	7,500	7,471	7,500	7,500	7,500	7,500	7,500
Diluted Shares Outstanding	6,694	6,891	7,304	7,931	7,729	7,768	7,800	7,800	7,774	7,800	7,800	7,800	7,800	7,800
<b>Margin Analysis</b>														
Gross margin	27.2%	32.4%	30.3%	26.8%	18.4%	20.6%	23.0%	24.0%	21.7%	25.0%	25.0%	25.0%	25.0%	25.0%
SG&A expenses	7.7%	8.6%	7.2%	7.0%	8.2%	7.5%	8.0%	8.1%	8.0%	8.2%	7.9%	7.6%	7.4%	7.8%
Operating margin	19.5%	23.8%	23.0%	19.8%	10.1%	13.1%	15.0%	15.9%	13.7%	16.8%	17.1%	17.4%	17.6%	17.2%
Net margin	11.8%	15.6%	15.5%	13.4%	6.5%	8.6%	10.1%	10.8%	9.2%	11.5%	11.7%	11.9%	12.1%	11.8%
<b>Year / Year Growth</b>														
Total Revenues	16.6%	8.1%	5.3%	-2.7%	-11.0%	2.3%	3.8%	12.1%	1.8%	30.7%	15.5%	15.7%	15.1%	18.7%
Net Income	357.8%	325.6%	168.1%	39.4%	-51.4%	-42.5%	-32.2%	-8.4%	-33.7%	132.4%	53.7%	36.1%	28.9%	52.6%
EPS	351.9%	303.1%	138.6%	15.7%	-57.9%	-49.0%	-36.5%	-9.1%	-38.8%	129.2%	53.1%	36.1%	28.9%	52.1%

Source: Company filings and Taglich Brothers' estimates

Orchids Paper Products Company

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

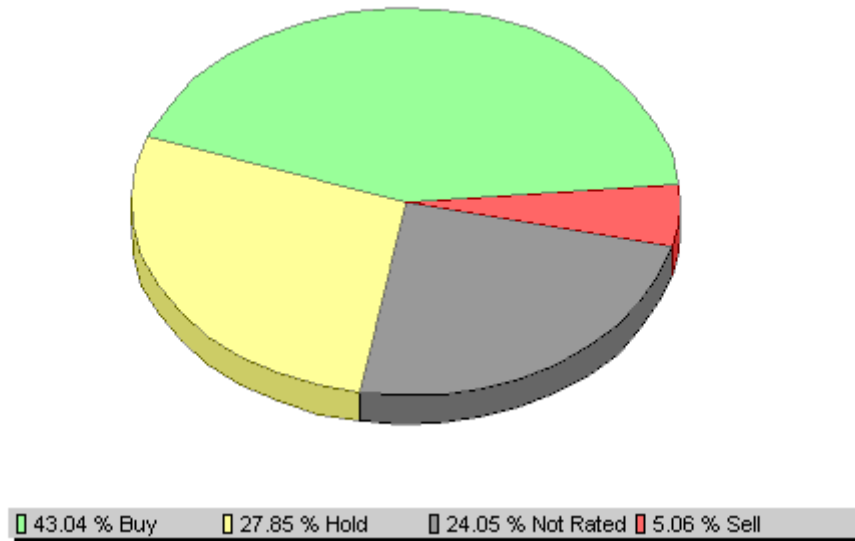
	2008A	2009A	6mos2010A	2010E	2011E
<i>Cash Flows from Operating Activities</i>					
Net income(loss)	5,191	13,552	3,532	8,983	13,712
Depreciation and amortization	3,156	3,708	2,244	4,860	4,860
Provision for doubtful accounts	87	60	30	60	60
Deferred income taxes	2,145	4,774	(103)	4,763	500
Stock based compensation	313	603	383	600	600
<i>Changes in assets and liabilities</i>					
Accounts receivable	(1,074)	(296)	(446)	(124)	(1,285)
Inventories	(1,379)	(1,316)	(15)	(961)	(1,163)
Prepaid expenses	(18)	(98)	(279)	97	(28)
Income taxes receivable	24	-	-	-	-
Accounts payable	(61)	(650)	1,793	514	622
Accrued liabilities	124	535	(27)	57	594
<b>Net Cash Provided by (Used in) Operations</b>	<b>8,508</b>	<b>20,872</b>	<b>7,112</b>	<b>18,849</b>	<b>18,472</b>
<i>Cash Flows from Investing Activities</i>					
Proceeds from the sale of investment securities	-	3,993	8,996	15,000	-
Purchase of investment securities	-	(22,502)	-	-	-
Purchase of property and equipment	(6,926)	(15,711)	(18,698)	(22,600)	(3,500)
<b>Net Cash Provided by (Used in) Investing</b>	<b>(6,926)</b>	<b>(34,220)</b>	<b>(9,702)</b>	<b>(7,600)</b>	<b>(3,500)</b>
<i>Cash Flows from Financing Activities</i>					
Proceeds from issuance of stock	-	14,847	-	-	-
Borrowings under construction loan	-	3,756	3,628	5,400	-
Repayments on construction loan	-	-	-	(6,200)	(500)
Borrowings on long-term debt	-	-	-	-	-
Retirement of borrowings on long-term debt	-	-	-	-	-
Principal payments on long-term debt	(2,286)	(3,059)	(1,865)	(3,700)	(9,500)
Retirement of subordinated debentures	-	-	-	-	-
Net borrowings (repayments) on revolving credit line	696	(1,487)	-	-	-
Purchase of common stock by former CEO	-	-	-	-	-
Purchase by the company of common stock from former CEO	-	-	-	-	-
Proceeds from the exercise of warrants attached to debentures	16	286	-	-	-
Proceeds from the exercise of stock options	-	269	-	-	-
Deferred debt issuance cost	-	(43)	(25)	-	-
<b>Net Cash Provided by (Used in) Financing</b>	<b>(1,574)</b>	<b>14,569</b>	<b>1,738</b>	<b>(4,500)</b>	<b>(10,000)</b>
<b>Net Change in Cash</b>	<b>8</b>	<b>1,221</b>	<b>(852)</b>	<b>6,749</b>	<b>4,972</b>
<b>Cash - Beginning of Period</b>	<b>3</b>	<b>11</b>	<b>1,232</b>	<b>1,232</b>	<b>7,981</b>
<b>Cash - End of Period</b>	<b>11</b>	<b>1,232</b>	<b>380</b>	<b>7,981</b>	<b>12,953</b>
Cash Flow from Operations	8,508	20,872	7,112	18,849	18,472
Capital Expenditures	(6,926)	(15,711)	(18,698)	(22,600)	(3,500)
Free Cash Flow	1,582	5,161	(11,586)	(3,751)	14,972

Source: Company filings and Taglich Brothers' estimates

**Price Chart**



**Taglich Brothers' Current Ratings Distribution**



<b>Investment Banking Services for Companies Covered in the Past 12 Months</b>			
Rating	#	%	
Buy	1	4.00%	
Hold	0	0.00%	
Sell	1	100.00%	
Not Rated	0	0.00%	

### **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 456,216 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 438,317 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 144,150 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 5,262 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. Since April 2008, the company pays 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 the Director of Research.

### **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)  
Cellu Tissue (NYSE: CLU)  
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.

**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.**

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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.