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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
August 24, 2012

TIS \$17.26 — (NYSE AMEX)

	<u>2010A</u>	<u>2011A</u>	<u>2012E</u>	<u>2013E</u>
Revenues (millions)	\$92.5	\$97.8	\$103.7	\$108.4
Earnings per share	\$0.76	\$0.80	\$1.14	\$1.27

52-Week range	\$19.25 – \$11.36	Fiscal year ends:	December
Shares outstanding a/o 7/31/12	7.6 million	Revenue per share (TTM)	\$13.17
Approximate float	5.5 million	Price/Sales (TTM)	1.3X
Market capitalization	\$131 million	Price/Sales (FY2013)E	1.2X
Tangible book value/share	\$9.91	Price/Earnings (TTM)	14.8X
Price/tangible book value	1.7X	Price/Earnings (FY2013)E	13.6X
Annual dividend	\$0.80	Dividend Yield	4.6%

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:

Reiterate Speculative Buy rating. Maintaining 12-month price target of \$21.00 despite increased earnings estimates, as the stock’s valuation has weakened.

Management Consulting firm Poyry forecasts private label tissue products such as Orchids’ to capture market share.

Orchids has shown significant sales and earnings growth (11% and 91% respectively) over the past twelve months. New higher margin converted product business (3,100 tons annually) expected to start shipping early in 4Q12 should result in increased earnings through our forecast horizon.

We project 2012 revenue of \$103.7 million and EPS of \$1.14 versus earlier estimates of \$103 million revenue and EPS of \$1.02. The increase reflects 2Q12 results and additional converted product tonnage from a recent order. We project 2013 revenue of \$108.4 million and EPS of \$1.27 per share versus earlier estimates of \$105 million revenue and EPS of \$1.07 per share. The increase reflects additional converted product tonnage from a recent order.

On July 24, 2012, Orchids reported 2Q12 sales increased 8% to \$22.3 million. 2Q12 EPS of \$0.29 (versus \$0.16 in 2Q11) exceeded our estimate of \$0.23.

Please view our disclosures on pages 12 - 14.

Recommendation and Valuation

Reiterate **Speculative Buy** rating. Maintaining **12-month price target of \$21.00** despite increased earnings estimates, as the stock's valuation has weakened.

Over the past three years, TIS traded at an average earnings multiple of 15X TTM and is currently trading at a multiple of 15X. Orchids' earning multiple was 17X and its sales multiple was 1.4X when we published our last update in May 2012. In light of current valuations, we are lowering our earnings multiple from 20X previously to 17X. Applying a multiple of 17X to our earnings per share estimate of \$1.27 for 2013 discounted to a twelve-month value of \$1.25, gives us a price target of approximately \$21.00 per share. Our discount factor of 5% was derived using the company's beta of 0.54.

Business

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.

An article in Tissue World Magazine (Operations Report on Clearwater Paper; April/May 2012) said that private label growth in the American tissue market has been steady. More and more consumers now prefer private labels as an alternative to more expensive branded products.

In February 2012, IBISWorld said that revenue from paper towels is estimated to have decreased slightly as a share of the sanitary paper products industry revenue over the past five years. This is largely due to strong competition among major players, and the emergence of generic brands that sell similar products at much lower prices. Also, demand was hurt by the recession over 2008 and 2009, when customers substituted name brands with that of cheaper products.

According to IBISWorld, revenue from tissues as a share of industry revenue over the past five years is estimated to have remained stable. This is due to tissues being considered necessities, thus experiencing stable demand levels through the recession. While industry revenue has declined over the past few years, IBISWorld projects the overall industry to increase modestly at an average annualized rate of 1.3% from 2012 to 2017.

Economic Outlook

In July 2012, the International Monetary Fund (IMF) revised its projections for US economic growth to 2.0% in 2012 and 2.3% in 2013. These are down from earlier projections (April 2012) of 2.1% in 2012 and 2.4% in 2013. However, the IMF said that growth in the US would stall because of excessive fiscal tightening caused by political gridlock. If US policy makers fail to reach consensus on extending tax cuts and reversing deep automatic spending cuts, the IMF projects the US economy could face a steep decline of more than 4% of GDP in its fiscal deficit in 2013.

The outlook for Orchids' focus region is promising. In July 2012, The Federal Reserve Bank of the Tenth Federal Reserve District released its survey of that district's manufacturing activity (includes the majority of the states that Orchids' sales efforts are focused on – the Oklahoma region). The survey reported that growth in the region's manufacturing activity remained modest in July, and producers were slightly more optimistic than a month earlier. Firms in the region continued to add to their workforces and anticipate increased capital spending. The future composite index climbed from 8 to 13. The composite index is an average of the production, new orders, employment, supplier delivery time, and raw materials inventory indexes.

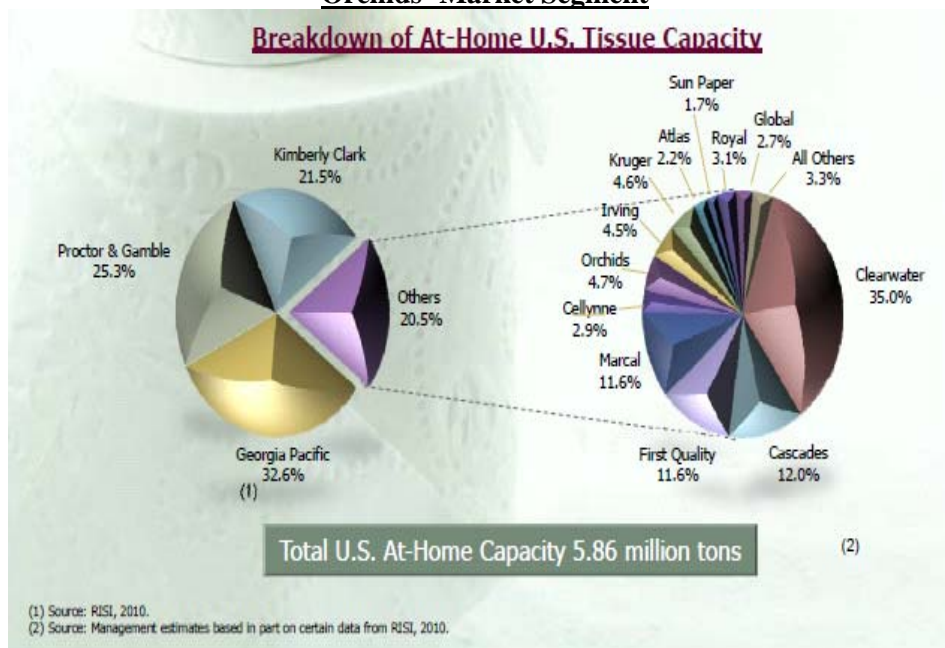
Market and Competition

Industry research firm RISI breaks down the North American tissue market as follows: toilet tissue (45% share of North American consumption), toweling (36%), napkins (12%), facial tissue (6%), and other (1%).

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

Dollar and variety stores, Orchids' primary target markets, realized sales of \$55.6 billion in 2011. IBISWorld projects dollar and variety stores' revenue growth averaging 2.5% annually from 2012 to 2017.

Orchids' Market Segment



Source: Orchids Paper Products

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, over the past two years, competitors have moved into Orchids' operating region (within Orchids' focused 500-mile sales area). This increased competition in the company's focused region has reduced its competitive cost advantage and lowered margins. This can be evidenced in part by looking at the decline in Orchids' gross margins over the past two years. Orchids' gross margins declined from 29.2% in 2009 to 17.0% in 2010, and 16.3% in 2011.

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, Clearwater Paper's Oklahoma City, Oklahoma plant, Georgia-Pacific's Muskogee, Oklahoma plant, Cascades' Memphis, Tennessee plant, and Pacific Paper's Memphis, Tennessee plant are competitors who have plants in this region. We were only able to obtain financial information for Clearwater Paper and Cascades as they were the only direct competitors who were public. Clearwater Paper's 1H12 revenue was \$0.9 billion with gross margins of 13.9% while Cascades 1H12 revenue was \$1.8 billion with gross margins of 13.9%. These competitors' lower gross margins when compared to Orchids' (23.0% in 1H12) could lead them to expand in Orchids' geographic focus region. This could in turn lead to downward pressure on Orchids' pricing and margins.

2nd Quarter and Six Months Financial Results

2Q12 sales of \$25.3 million were up 8% from \$23.4 million in 2Q11. Net income was \$2.2 million or \$0.29 per share versus net income of \$1.2 million or \$0.16 per share. Excluding a pre-tax loss of \$336,000 related to the disposal of some older converting equipment, 2Q12 EPS was \$0.32. We estimated 2Q12 sales of \$25.7 million and net income of \$1.8 million or \$0.23 per share.

Converted product (paper towels, bathroom tissue, and paper napkins) sales in 2Q12 increased 19% to \$22.3 million while parent roll (bulk tissue paper) sales decreased 36% to \$2.9 million. Total tons shipped increased to 13,915 from 13,580, while paper costs decreased 6% to approximately \$10.7 million. The overall net selling price per ton increased 6% to \$1,817.

The increase in converted product sales in 1Q12 was due to a 24% increase in tonnage shipped, partially offset by a 4% decrease in net selling price per ton. The increase in converted product shipments was primarily due to new product sales in the mid-tier market and increased demand from existing customers. Net sales of parent rolls decreased due to the increased requirements of the converting operations.

Gross margins increased to 22.2% in 2Q12 from 15.9% in 2Q11 primarily due to increased levels of higher margin converted product shipments and lower raw material costs. Selling, general and administrative (SG&A) expenses in 2Q12 increased to \$2.1 million from \$1.8 million primarily due to increased professional fees, sales commissions due to the higher levels of converted product sales, and bonuses. The increase in revenue and gross profit offset the increase in SG&A expenses, increasing operating margin to 13.8% from 8.1%. Interest expense decreased to \$102,000 from \$191,000 due to lower debt levels and interest rates.

1H12 sales of \$51.0 million were up 11% from \$46.1 million in 1H11. Net income was \$4.8 million or \$0.61 per share versus net income of \$1.8 million or \$0.24 per share. Excluding a pre-tax loss of \$336,000 related to the disposal of some older converting equipment, 1H12 EPS was \$0.64.

Converted product (paper towels, bathroom tissue, and paper napkins) sales in 1H12 increased 25% to \$45.9 million while parent roll (bulk tissue paper) sales decreased 46% to \$5.1 million. Total tons shipped increased to 27,384 from 27,208, while paper costs decreased 7% to approximately \$20.9 million. The overall net selling price per ton increased 10% to \$1,863.

The increase in converted product sales in 1H12 was due to a 28% increase in tonnage shipped, partially offset by a 2% decrease in net selling price per ton. The

	6mos11	6mos12
Net sales	46,058	51,006
Cost of sales	39,633	39,269
Gross profit	6,425	11,737
SG&A expenses	3,396	4,399
Operating income (loss)	3,029	7,338
Interest expense	440	209
Other (income) expense	(16)	316
Income (loss) before taxes	2,605	6,813
Income tax expense (benefit)	788	2,054
Net income (loss)	1,817	4,759
Diluted EPS	0.24	0.61
Diluted Shares Outstanding	7,709	7,843
<u>Margin Analysis</u>		
Gross margin	13.9%	23.0%
SG&A expenses	7.4%	8.6%
Operating margin	6.6%	14.4%
Net margin	3.9%	9.3%
Source: Company filings		

increase in converted product shipments was primarily due to new product sales in the mid-tier market and increased demand from existing customers. Net sales of parent rolls decreased due to the increased requirements of the converting operations.

Gross margins increased to 23.0% in 1H12 from 13.9% in 1H11 primarily due to increased levels of higher margin converted product shipments and lower raw material costs. Selling, general and administrative (SG&A) expenses in 1H12 increased to \$4.4 million from \$3.4 million primarily due to increased professional fees, sales commissions due to the higher levels of converted product sales, bonuses and packaging related expenditures. The increase in revenue and gross profit offset the increase in SG&A expenses, increasing operating margin to 14.4% from 6.6%. Interest expense decreased to \$209,000 from \$440,000 due to lower debt levels and interest rates.

Liquidity - Based on our forecasts, Orchids should have sufficient resources to meet its financial obligations through 2013. As of June 30, 2012, Orchids' cash balance was \$2.8 million and short term investments totaled \$5.0 million. Orchids has a debt/equity ratio of 0.2 versus 1.0 for the paper products industry.

Cash earnings of \$9.0 million and a \$1.1 million increase in working capital resulted in \$7.9 million cash from operations in 1H12. The changes in working capital were primarily driven by a \$1.5 million increase in inventories and a \$0.7 million increase in accounts receivable, offset in part by a \$0.5 million increase in accrued liabilities, a \$338,000 increase in other current assets, and a \$285,000 decrease in income taxes receivable.

The company purchased \$3.0 million of investment securities and had \$3.1 million of capital expenditures during 1H12. A net reduction in debt of \$0.6 million, \$3.0 million dividend payments, and \$289,000 proceeds from the exercise of stock options resulted in a \$1.5 million decrease in cash to \$2.8 million at the end of 1H12.

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 \$18.0 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 \$16.8 million as of June 30, 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), depending on 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 June 30, 2012, the company was in compliance with these covenants.

Projections

We project a 10% increase in converted product tonnage in 2012, as there should be a full year's contribution from a 2011 order for 700,000 cases annually and a new 3,100 tons/year order is expected to start shipping early in 4Q12. Our research has shown that in the industry, sales contracts are not the norm. However, because the products are daily consumable items, customer order streams are fairly consistent and typically last several years. With the new order, if it fully materializes, we anticipate an 8% increase in converted product tonnage shipped for 2013. Selling prices (converted and parent roll) are projected to increase by 1% annually

<u>Revenue Model</u>				
<u>2011</u>				
	Tons Shipped	Selling Price/Ton		Revenue
Converted	39,300	\$ 2,084	\$	\$ 81,901,200
Parent Roll	16,200	\$ 982	\$	\$ 15,908,400
Total	55,500	\$ 1,762	\$	\$ 97,809,600
<u>2012</u>				
	Tons Shipped	Selling Price/Ton		Revenue
Converted	43,200	\$ 2,105	\$	\$ 90,936,000
Parent Roll	12,800	\$ 996	\$	\$ 12,748,800
Total	56,000	\$ 1,852	\$	\$ 103,684,800
<u>2013</u>				
	Tons Shipped	Selling Price/Ton		Revenue
Converted	46,500	\$ 2,126	\$	\$ 98,859,000
Parent Roll	9,500	\$ 1,006	\$	\$ 9,557,000
Total	56,000	\$ 1,936	\$	\$ 108,416,000

Source: Taglich Brothers estimates

Orchids Paper Products Company

through our forecast horizon, consistent with IBISWorld projections for paper manufacturer selling price increases through 2017. These factors should result in revenue of approximately \$103.7 million in 2012 and \$108.4 million in 2013.

Orchids' results over the past few years show over 80% of cost of sales as being variable with the cost of paper averaging 56% of total cost of sales and other variable costs (packaging supplies, direct labor, freight, etc.) averaging 28%. Fixed costs (overhead, depreciation) have averaged approximately 16% of total cost of sales in this time frame. The following table shows our estimated costs per ton (variable and fixed) over the past three years and our estimates for 2012 and 2013.

<u>COGS (in thousands \$) Model</u>					
	<u>2009A</u>	<u>2010A</u>	<u>2011A</u>	<u>2012E</u>	<u>2013E</u>
Variable cost (paper)	\$ 36,497	\$ 43,947	\$ 46,337	\$ 44,408	\$ 46,760
Est. variable cost (other)	\$ 20,817	\$ 20,334	\$ 21,373	\$ 22,603	\$ 23,635
Total est. variable costs	\$ 57,314	\$ 64,281	\$ 67,710	\$ 67,011	\$ 70,395
Est. fixed cost (overhead)	\$ 6,939	\$ 6,778	\$ 7,124	\$ 7,124	\$ 7,124
Fixed cost (depreciation)	\$ 3,683	\$ 5,693	\$ 7,052	\$ 7,300	\$ 7,100
Total est. fixed costs	\$ 10,622	\$ 12,471	\$ 14,176	\$ 14,424	\$ 14,224
COGS	\$ 67,936	\$ 76,752	\$ 81,886	\$ 81,435	\$ 84,619
Tons shipped	52,355	56,663	55,514	56,000	56,000
Variable (paper) costs/ton	\$ 697	\$ 776	\$ 835	\$ 793	\$ 835
Est. variable (other) cost/ton	\$ 398	\$ 359	\$ 385	\$ 404	\$ 422
Total variable costs/ton	\$ 1,095	\$ 1,134	\$ 1,220	\$ 1,197	\$ 1,257
Fixed costs/ton	\$ 203	\$ 220	\$ 255	\$ 258	\$ 254
Total COGS/ton	\$ 1,298	\$ 1,355	\$ 1,475	\$ 1,454	\$ 1,511
Gross profit	\$ 28,027	\$ 15,752	\$ 15,957	\$ 22,221	\$ 23,781
Gross margin	29.2%	17.0%	16.3%	21.4%	21.9%

Source: Company filings and Taglich Brothers estimates

Although paper costs have decreased since the peak in 3Q11 (down 12% to \$769/ton in 2Q12), we are estimating the cost per ton to average \$793/ton in 2012 and \$835/ton in 2013 given a moderately improving economy. We project other variable costs to increase in 2012 and 2013 but remain at 21.8% of sales, consistent with the past few years. Fixed costs are projected to remain near current levels through our forecast horizon.

We project 2012 revenue of \$103.7 million and net income of \$8.9 million or \$1.14 per share. We previously projected 2012 revenue of \$103 million and net income of \$8 million or \$1.02 per share. The increase reflects 2Q12 results and potential additional converted product tonnage from the recent 3,100 tons/year order. Also, Orchids' largest customer, Dollar General, responsible for 42% of Orchids' converted product sales in 2011, plans to open approximately 625 new stores in 2012. The additional stores represent a 6% increase which should be accretive to Orchids' sales. We have raised our gross margin estimate to 21.4% (previously 20.3%) due to increased higher margin converted product sales.

SG&A expenses are projected to increase 28% to \$8.7 million in 2012 (of which approximately 18% or \$1.6 million of SG&A expenses are commission related). Operating margins should increase to 13% in 2012 from 9.3% in 2011 due to increased higher margin converted product sales offsetting the increase in operating expenses. The tax rate is estimated at 30.3% based on company guidance. Days sales outstanding and inventory turnover are projected to remain at 26 and 10 respectively.

For 2012 we are projecting cash earnings of \$17.5 million and a \$185,000 increase in working capital will result in cash from operations of approximately \$17.3 million. The increase in working capital is primarily due to a \$412,000 increase in accounts receivable offset in part by a \$155,000 increase in accrued liabilities. Cash from operations will fall short of a \$3 million purchase of investment securities, \$5 million of capital expenditures, a \$5 million net pay down of debt, and \$6 million in dividends, decreasing cash by \$1.5 million to \$2.8 million at December 31, 2012.

We project 2013 revenue of \$108.4 million and net income of \$10.0 million or \$1.27 per share. We previously projected 2012 revenue of \$105 million and net income of \$8.4 million or \$1.07 per share. The increase reflects additional converted product tonnage from the recent 3,100 tons/year order. Our gross margin projection of 21.9% reflects a paper cost estimate of \$835/ton.

We project SG&A expenses of \$9.1 million in 2013 (of which approximately 18% or \$1.6 million of SG&A expenses are commission-related). Operating margins should increase to 13.5% in 2013 from 13.0% in 2012. The tax rate is estimated at 30.3%. Days sales outstanding and inventory turnover are projected to remain at 26 and 10 respectively.

For 2013 we project cash earnings of \$18.0 million and a \$0.5 million increase in working capital will result in cash from operations of \$17.5 million. The increase in working capital is primarily due to a \$336,000 increase in accounts receivable and a \$304,000 increase in inventories, offset in part by a \$137,000 increase in accounts payable and a \$127,000 increase in accrued liabilities. Cash from operations will more than cover \$5.0 million of capital expenditures, a \$5.0 million net pay down of debt, and \$6.0 million in dividends, increasing cash by \$1.8 million to \$4.6 million at December 31, 2013.

Risks

Customer concentration

Three customers (Dollar General, Family Dollar, and Wal-Mart) accounted for approximately 72% of converted product sales in 2011. 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 focused region has reduced some of its competitive cost advantages and lowered margins due to pressure on selling prices.

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.

Unexpected shutdowns

Unexpected production disruptions could cause the company to shut down its paper mill. Those disruptions could occur due to shortages of raw materials, disruptions in the availability of transportation, labor union disputes and mechanical or process failures.

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 32,000 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	6/12A	2012E	2013E
Cash	142	4,297	2,765	2,840	4,639
Accounts receivable	6,155	6,939	7,677	7,351	7,688
Inventories	7,595	7,811	9,301	7,768	8,072
Short term investments	9,518	2,019	5,022	5,022	5,022
Income taxes receivable	3,952	285	-	-	-
Prepaid expenses	538	530	499	561	587
Other	-	338	-	-	-
Deferred income taxes	790	410	410	616	679
Total current assets	28,690	22,629	25,674	24,158	26,687
Property, plant and equipment	93,805	92,285	91,448	89,985	87,885
Deferred debt issuance costs	76	54	51	51	51
Total Assets	122,571	114,968	117,173	114,194	114,623
Accounts payable	5,250	3,520	3,505	3,501	3,637
Accrued liabilities	2,269	2,615	3,070	2,770	2,897
Current portion of long-term debt	10,742	1,152	1,152	1,152	1,152
Total current liabilities	18,261	7,287	7,727	7,423	7,687
Long-term debt	16,615	16,231	15,655	11,231	6,231
Deferred income taxes	18,099	18,801	18,816	19,400	20,000
Total liabilities	52,975	42,319	42,198	38,054	33,918
Total stockholders' equity	69,596	72,649	74,975	76,140	80,705
Total liabilities & stockholders' equity	122,571	114,968	117,173	114,194	114,623

Source: Company filings and Taglich Brothers' estimates

Orchids Paper Products Company

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

	<u>2009A</u>	<u>2010A</u>	<u>2011A</u>	<u>2012E</u>	<u>2013E</u>
Net sales	95,963	92,504	97,843	103,656	108,400
Cost of sales	<u>67,936</u>	<u>76,752</u>	<u>81,886</u>	<u>81,435</u>	<u>84,619</u>
Gross profit	28,027	15,752	15,957	22,221	23,781
SG&A expenses	<u>7,343</u>	<u>6,618</u>	<u>6,810</u>	<u>8,699</u>	<u>9,100</u>
Operating income (loss)	20,684	9,134	9,147	13,522	14,681
Interest expense	692	934	647	409	400
Other (income) expense	<u>(24)</u>	<u>(65)</u>	<u>(42)</u>	<u>286</u>	<u>(60)</u>
Income (loss) before taxes	20,016	8,265	8,542	12,827	14,341
Income tax expense (benefit)	<u>6,464</u>	<u>2,351</u>	<u>2,344</u>	<u>3,887</u>	<u>4,346</u>
Net income (loss)	<u>13,552</u>	<u>5,914</u>	<u>6,198</u>	<u>8,940</u>	<u>9,995</u>
EPS	1.89	0.76	0.80	1.14	1.27
Shares Outstanding	7,177	7,755	7,722	7,847	7,844
<u>Margin Analysis</u>					
Gross margin	29.2%	17.0%	16.3%	21.4%	21.9%
SG&A expenses	7.7%	7.2%	7.0%	8.4%	8.4%
Operating margin	21.6%	9.9%	9.3%	13.0%	13.5%
Net margin	14.1%	6.4%	6.3%	8.6%	9.2%
Tax rate	32.3%	28.4%	27.4%	30.3%	30.3%
<u>Year / Year Growth</u>					
Total Revenues	6.4%	(3.6%)	5.8%	5.9%	4.6%
Net Income	161.1%	(56.4%)	4.8%	44.2%	11.8%
EPS	138.0%	(59.6%)	5.3%	41.9%	11.8%

Source: Company filings and Taglich Brothers' estimates

Orchids Paper Products Company

Quarterly Income Statement for the Fiscal Years Ending December 31, 2011, 2012, and 2013
(in thousands \$)

	<u>3/11A</u>	<u>6/11A</u>	<u>9/11A</u>	<u>12/11A</u>	<u>2011A</u>	<u>3/12A</u>	<u>6/12A</u>	<u>9/12E</u>	<u>12/12E</u>	<u>2012E</u>	<u>3/13E</u>	<u>6/13E</u>	<u>9/13E</u>	<u>12/13E</u>	<u>2013E</u>
Net sales	22,675	23,383	26,110	25,675	97,843	25,727	25,279	25,750	26,900	103,656	26,950	27,050	27,150	27,250	108,400
Cost of sales	19,967	19,666	22,174	20,079	81,886	19,594	19,675	20,858	21,308	81,435	21,154	21,154	21,155	21,156	84,619
Gross profit	2,708	3,717	3,936	5,596	15,957	6,133	5,604	4,892	5,592	22,221	5,796	5,896	5,995	6,094	23,781
SG&A expenses	1,580	1,816	1,508	1,906	6,810	2,287	2,112	2,150	2,150	8,699	2,250	2,250	2,300	2,300	9,100
Operating income (loss)	1,128	1,901	2,428	3,690	9,147	3,846	3,492	2,742	3,442	13,522	3,546	3,646	3,695	3,794	14,681
Interest expense	249	191	103	104	647	107	102	100	100	409	100	100	100	100	400
Other (income) expense	(9)	(7)	(17)	(9)	(42)	(7)	323	(15)	(15)	286	(15)	(15)	(15)	(15)	(60)
Income (loss) before taxes	888	1,717	2,342	3,595	8,542	3,746	3,067	2,657	3,357	12,827	3,461	3,561	3,610	3,709	14,341
Income tax expense (benefit)	268	520	695	861	2,344	1,224	830	764	1,069	3,887	1,049	1,079	1,094	1,124	4,346
Net income (loss)	620	1,197	1,647	2,734	6,198	2,522	2,237	1,893	2,288	8,940	2,412	2,482	2,516	2,585	9,995
EPS	0.08	0.16	0.21	0.35	0.80	0.32	0.29	0.24	0.29	1.14	0.31	0.32	0.32	0.33	1.27
Shares Outstanding	7,713	7,706	7,733	7,775	7,722	7,855	7,844	7,844	7,844	7,847	7,844	7,844	7,844	7,844	7,844
<u>Margin Analysis</u>															
Gross margin	11.9%	15.9%	15.1%	21.8%	16.3%	23.8%	22.2%	19.0%	20.8%	21.4%	21.5%	21.8%	22.1%	22.4%	21.9%
SG&A expenses	7.0%	7.8%	5.8%	7.4%	7.0%	8.9%	8.4%	8.3%	8.0%	8.4%	8.3%	8.3%	8.5%	8.4%	8.4%
Operating margin	5.0%	8.1%	9.3%	14.4%	9.3%	14.9%	13.8%	10.6%	12.8%	13.0%	13.2%	13.5%	13.6%	13.9%	13.5%
Net margin	2.7%	5.1%	6.3%	10.6%	6.3%	9.8%	8.8%	7.4%	8.5%	8.6%	8.9%	9.2%	9.3%	9.5%	9.2%
Tax rate	30.2%	30.3%	29.7%	23.9%	27.4%	32.7%	27.1%	28.8%	31.8%	30.3%	30.3%	30.3%	30.3%	30.3%	30.3%
<u>Year / Year Growth</u>															
Total Revenues	7.8%	(5.3%)	6.5%	15.4%	5.8%	13.5%	8.1%	(1.4%)	4.8%	5.9%	4.8%	7.0%	5.4%	1.3%	4.6%
Net Income	(54.4%)	(44.9%)	14.2%	190.9%	4.8%	306.8%	86.9%	14.9%	(16.3%)	44.2%	(4.4%)	11.0%	32.9%	13.0%	11.8%
EPS	(54.3%)	(44.4%)	18.3%	189.6%	5.3%	299.4%	83.6%	13.3%	(17.0%)	41.9%	(4.2%)	11.0%	32.9%	13.0%	11.8%

Source: Company filings and Taglich Brothers' estimates

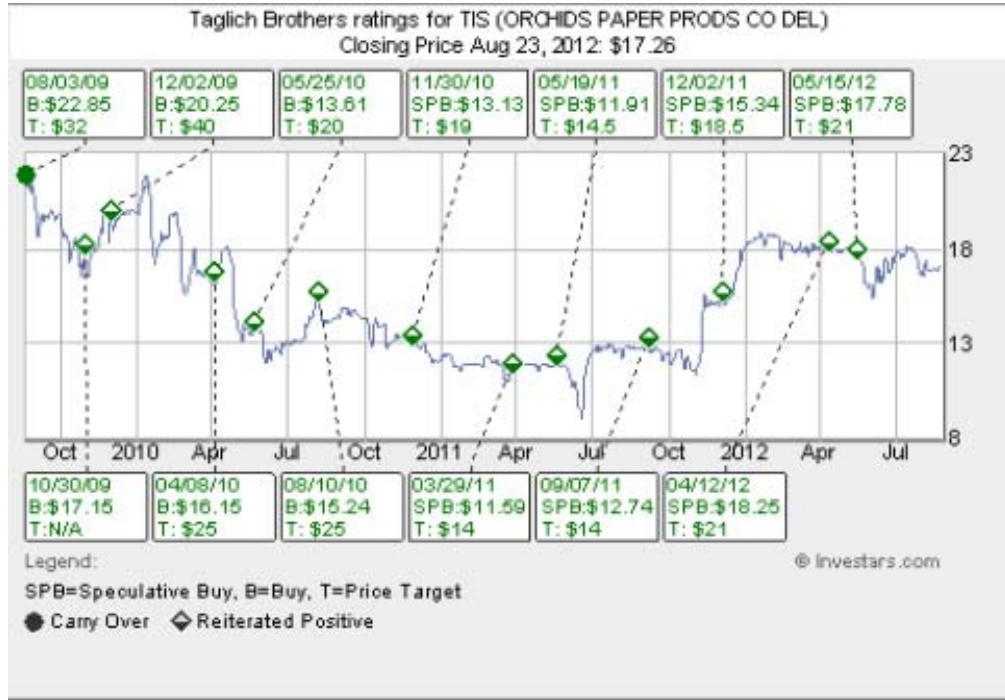
Orchids Paper Products Company

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

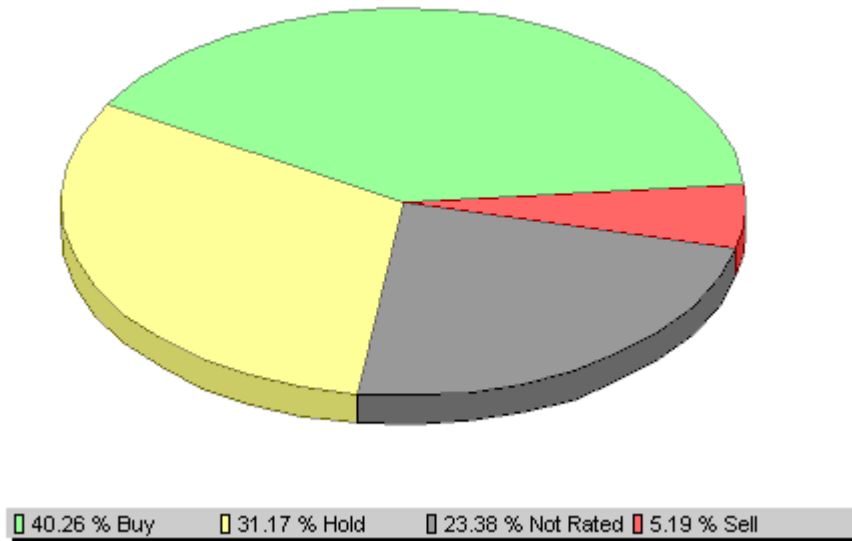
	2010A	2011A	6mos12A	2012E	2013E
Net income(loss)	5,914	6,198	4,759	8,940	9,995
Depreciation and amortization	5,725	7,132	3,651	7,300	7,100
Provision for doubtful accounts	(34)	(30)	(20)	(30)	(30)
Deferred income taxes	3,519	2,359	15	599	600
Stock based compensation	562	290	291	307	321
Loss on disposal of property, plant and equipment	-	-	336	336	-
<i>Changes in assets and liabilities</i>					
Accounts receivable	629	(754)	(718)	(412)	(336)
Inventories	(26)	(216)	(1,490)	43	(304)
Prepaid expenses	(41)	8	31	(31)	(26)
Income taxes receivable	(3,952)	2,390	285	79	(63)
Other current assets	-	(338)	338	-	-
Accounts payable	1,201	(1,730)	(15)	(19)	137
Accrued liabilities	(849)	346	455	155	127
Net Cash Provided by (Used in) Operations	12,648	15,655	7,918	17,267	17,520
Proceeds from the sale of investment securities	8,991	7,500	-	-	-
Purchase of investment securities	-	-	(3,003)	(3,003)	-
Purchase of property and equipment	(26,786)	(5,531)	(3,147)	(5,000)	(5,000)
Net Cash Provided by (Used in) Investing	(17,795)	1,969	(6,150)	(8,003)	(5,000)
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)	(576)	(5,000)	(5,000)
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	289	300	300
Excess tax benefit of stock options exercised	-	15	5	15	15
Deferred debt issuance cost	(25)	(59)	-	-	-
Dividends paid	-	(3,753)	(3,018)	(6,036)	(6,036)
Net Cash Provided by (Used in) Financing	4,057	(13,469)	(3,300)	(10,721)	(10,721)
Net Change in Cash	(1,090)	4,155	(1,532)	(1,457)	1,799
Cash - Beginning of Period	1,232	142	4,297	4,297	2,840
Cash - End of Period	142	4,297	2,765	2,840	4,639
Cash Flow from Operations	12,648	15,655	7,918	17,267	17,520
Capital Expenditures	(26,786)	(5,531)	(3,147)	(5,000)	(5,000)
Free Cash Flow	(14,138)	10,124	4,771	12,267	12,520

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		
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 436,135 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 419,254 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 162,900 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 8,087 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 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.