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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

September 7, 2011

TIS \$12.74 — (NYSE AMEX)

	<u>2009A</u>	<u>2010A</u>	<u>2011E</u>	<u>2012E</u>
Revenues (millions)	\$96.0	\$92.5	\$94.8	\$98.2
Earnings per share	\$1.89	\$0.76	\$0.66	\$0.89

52-Week range	\$8.53 – \$15.10	Fiscal year ends:	December
Shares outstanding a/o 7/31/11	7.5 million	Revenue per share (TTM)	\$12.01
Approximate float	5.2 million	Price/Sales (TTM)	1.1X
Market capitalization	\$96 million	Price/Sales (FY2012)E	1.0X
Tangible book value/share	\$9.37	Price/Earnings (TTM)	23.6X
Price/tangible book value	1.4X	Price/Earnings (FY2012)E	14.3X
Annual dividend	0.40	Dividend Yield	3.1%

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:

Reiterate Speculative Buy rating. \$14.00 (12-month) target, reduced from \$14.50.

Private label tissue products such as Orchids’ are forecasted to capture market share. This should bode well for Orchids’ sales as its products are primarily sold under its customers’ private labels.

Shipping on previously announced orders (for 0.7 million cases annually) did not start until late in Q2/11 with future shipments expected to be greater in subsequent quarters.

Sales force doubled (from 4 to 8) in Q2/11 with the hiring of a sales and marketing organization with expertise in the at-home tissue market.

We project 2011 revenue of \$94.8 million and EPS of \$0.66, up from revenue of \$93.6 million and EPS of \$0.65.

We project 2012 revenue of \$98.2 million and EPS of \$0.89 versus earlier estimates of \$96.6 million in revenue and EPS of \$0.95.

On July 27, 2011, Orchids reported Q2/11 sales decreased 5% to \$23.4 million. Q2/11 EPS of \$0.16 (versus \$0.28 in Q2/10) exceeded our estimates.

Please view our disclosures on pages 14 - 16.

Recommendation and Valuation

Reiterating our **Speculative Buy** rating. \$14.00 (12-month) priced target, reduced from \$14.50 based on lowered 2012 EPS forecast.

The company’s trailing P/E multiple has varied widely since 2005. We believe investors will accord TIS a P/E valuation of 16X which applied to our earnings per share estimate of \$0.89 for 2012 and discounting this to a twelve-month value using a discount factor of 6.4% gives us a **price target of approximately \$14.00 per share**. We derived our discount factor using Orchids’ beta of 0.67.

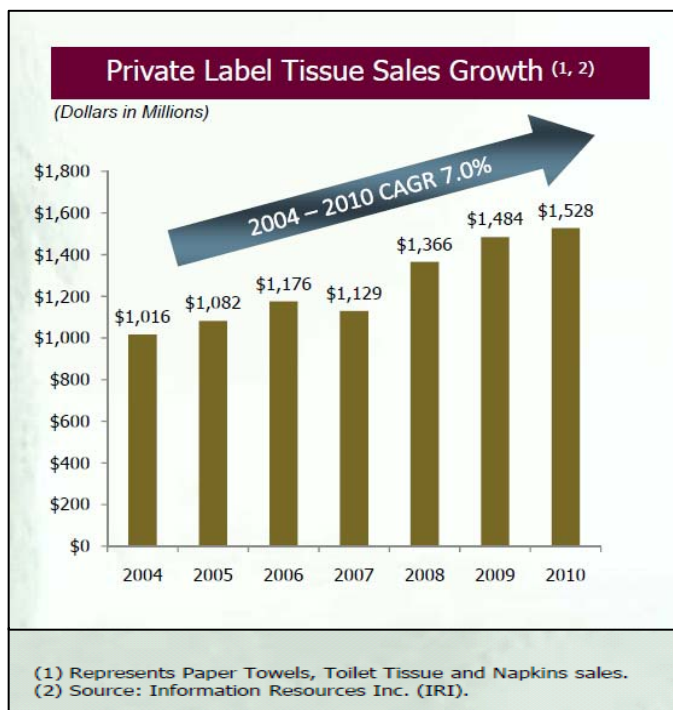
Business

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®. Private label tissue sales in the industry have grown at a compound annual growth rate of 7.0% from 2004 to 2010 (see right). Branded tissue sales grew at a compound annual growth rate of 1.9% over the same period.

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.

In 2010, the global consulting and engineering firm Poyry Management Consulting said the tissue paper industry in North America has historically outperformed other paper grades, achieving an average long-term growth rate of about 2%/year between 1990 and 2009, but with a maturing rate of 1.6% for 2001-2009. Poyry expects North American tissue demand to grow between 0.7% and 1.8% annually over the next five years.



Poyry said that dominant branded tissue products were facing increased competition from private label products. Although we do not have the actual numbers, Poyry said that in 2009, private label saw one of its biggest share gains in toilet tissue. Large retailers including Wal-Mart have made coupons and free samples available to increase the sales of branded tissue paper products, but Poyry expects that private labels will continue to capture market share, as not all consumers will switch back to branded products as the economy recovers. This is especially true because private labels are improving product quality. If Poyry’s expectations for private labels to gain market share come to fruition, this should bode well for Orchids’ sales as its products are primarily sold under its customers’ private labels.

In July 2011, IBISWorld said that revenue from tissues 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. 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 2011 to 2016.

Outlook

Orchids' new warehouse and expanded converting line were completed and started operating in June 2010. The new converting line is capable of producing both bathroom tissue and towel products. It is also capable of various packaging options and enhanced graphics and embossing, product features that could 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 10,000 parent rolls in the outside market to augment its current 56,000 ton parent roll capacity. The additional converting capacity will support over a 50% increase in annual production.

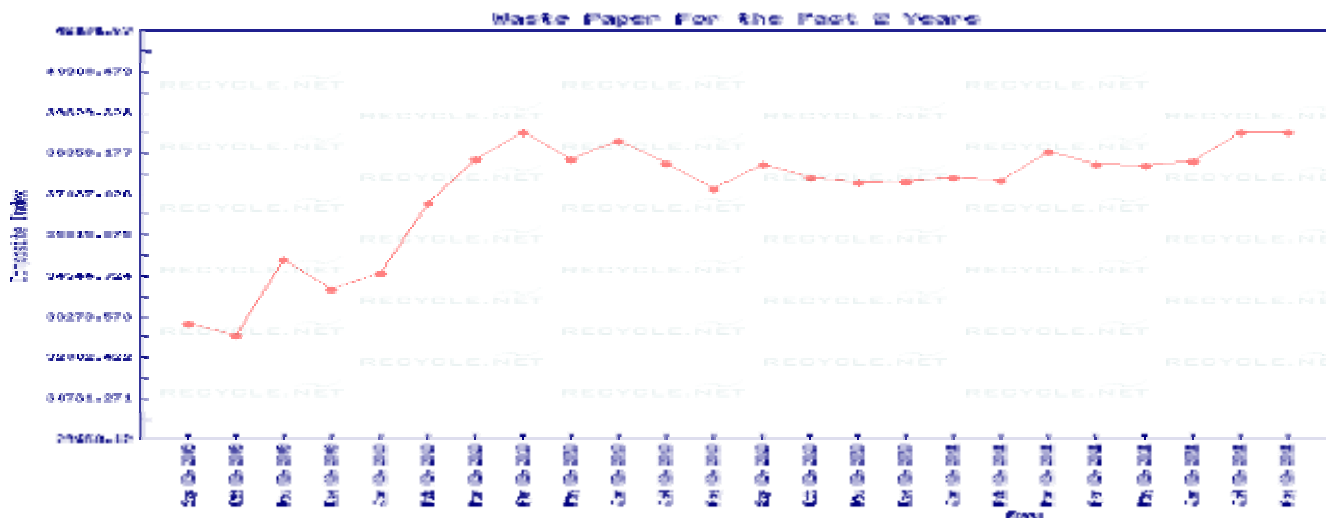
Higher quality product should improve penetration of the dollar store sector. However, higher tier products are not expected to displace lower tier products. A purchasing agent for a top-tier dollar store indicated that Orchids offers a better quality lower tier product than a direct competitor. This supports our view that Orchids will maintain its market share of lower tier business. We do not have any comparisons yet of Orchids' higher tier products with that of competitors.

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.

Competitors have moved into in Orchids' operating region. In 2009 Pacific Paper added a converting plant in Memphis, Tennessee and Clearwater Paper (NYSE: CLW) opened a converting plant in Oklahoma City, Oklahoma in 2010. Both plants are in Orchids' focused 500-mile sales area. This increased competition in the company's focused region has reduced its competitive cost advantage and lowered margins significantly.

Judging by a rough estimate of the size of Orchids' primary market (over 200,000 tons of converted products consumed annually based on population), the market could, theoretically, absorb all of Orchids' 66,000 ton capacity. However, based on the current competitive environment, we project only modest increases in converted sales over our forecast horizon.

Significant increases in waste paper prices and aggressive pricing of competitors' branded products have compressed Orchids' margins. The following chart shows how waste paper prices have remained relatively high for the past year and a half.



Source: Paper Fiber Network

Market and Competition

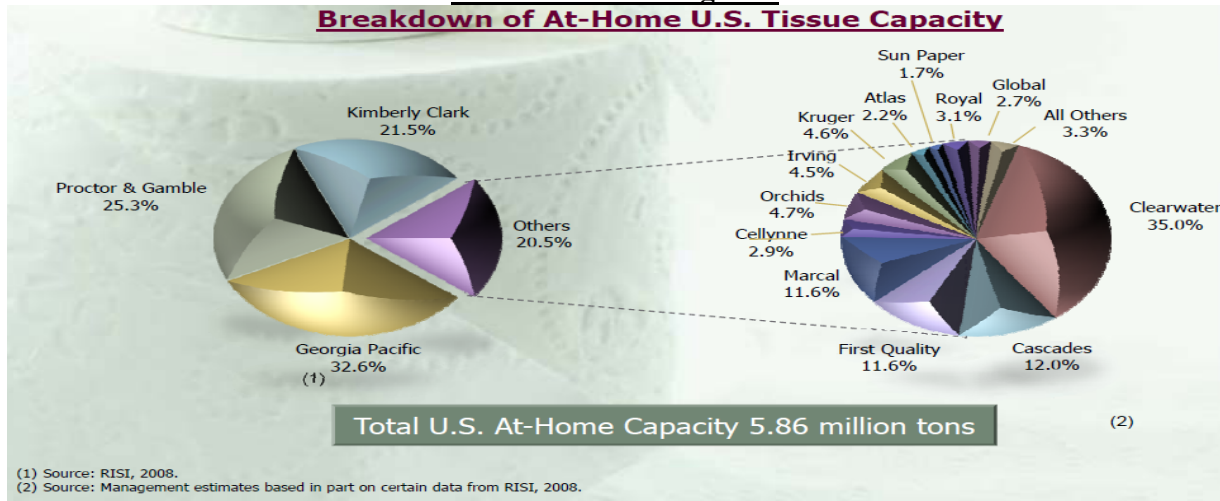
Industry research firm RISI breaks down the North American tissue market as follows: toilet tissue (45% share of North American consumption), toweling (36%), napkins (12%), facial tissue (6%), and other (1%).

Based on the IBISWorld’s projected growth of 2.8% in 2011 for the industry, we project the US tissue market will grow to \$4.5 billion in 2011 from \$4.4 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 1.3% from 2011 to 2016.

Dollar and variety stores, Orchids’ primary target markets, realized sales of \$53.3 billion in 2010. IBISWorld projects dollar and variety stores’ revenue growth averaging 2.9% annually from 2011 to 2016.

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’ Memphis, Tennessee plant, and Pacific Paper’s Memphis, Tennessee plant are competitors who have plants in this region. Clearwater Paper also opened a converting facility in Oklahoma City, Oklahoma and started shipping product in 2010.

Orchids’ Market Segment



Source: Orchids Paper Products

2nd Quarter and Six Months 2011 Financial Results

Q2/11 sales of \$23.4 million were down 5% from \$24.7 million in Q2/10. Net income was \$1.2 million or \$0.16 per share versus net income of \$2.2 million or \$0.28 per share.

We estimated Q2/11 sales of \$23.2 million and net income of \$1.0 million or \$0.13 per share.

Converted product (paper towels, bathroom tissue, and paper napkins) sales in Q2/11 decreased 7% to \$18.8 million from \$20.2 million while parent roll (bulk tissue paper) sales increased 3% to \$4.6 million from \$4.5 million. Total tons shipped decreased to 13,580 from 14,614, while paper costs increased 6% to approximately \$11.4 million from approximately \$10.8 million. The overall net selling price per ton increased 2% to \$1,722 from \$1,689.

The decrease in converted product sales in Q1/11 was due to a 10% decrease in converted tonnage shipped which was partially offset by a 3% increase in net selling price per ton. Net sales of parent rolls increased due to a 4% increase in selling prices partially offset by a 1% decrease in tonnage shipped. The decrease in converted product tonnage shipments was primarily due to softer demand from certain customers.

Although the overall selling price per ton increased 2% in Q2/11, gross margins decreased to 15.9% from 20.6% due to higher raw material costs, higher depreciation expense, and a tilt in product mix toward lower margin parent rolls.

Selling, general and administrative (SG&A) and interest expenses in Q2/11 remained relatively flat at \$1.8 million and \$191,000 respectively.

H1/11 sales of \$46.1 million increased 1% from \$45.7 million in H1/10. Net income was \$1.8 million or \$0.24 per share, down sharply from net income of \$3.5 million or \$0.46 per share.

Converted product sales in H1/11 decreased 3% to \$36.7 million from \$37.8 million while parent roll (bulk tissue paper) sales increased 18% to \$9.3 million from \$7.9 million. Total tons shipped decreased to 27,208 from 27,793, while paper costs increased 6% to approximately \$22.6 million from approximately \$21.3 million. The overall net selling price per ton increased 3% to \$1,693 from \$1,645.

The decrease in converted product sales in H1/11 was due to an 8% decrease in converted tonnage shipped which was partially offset by a 5% increase in net selling prices. Net sales of parent rolls increased due to a 9% increase in tonnage shipped and an 8% increase in selling prices. The increase in parent roll tonnage was due to improved efficiencies in paper manufacturing.

	<u>6mos10</u>	<u>6mos11</u>
Net sales	45,725	46,058
Cost of sales	<u>36,789</u>	<u>39,633</u>
Gross profit	8,936	6,425
SG&A expenses	<u>3,576</u>	<u>3,396</u>
Operating income (loss)	5,360	3,029
Interest expense	426	440
Other (income) expense	<u>(27)</u>	<u>(16)</u>
Income (loss) before taxes	4,961	2,605
Income tax expense (benefit)	<u>1,429</u>	<u>788</u>
Net income (loss)	<u><u>3,532</u></u>	<u><u>1,817</u></u>
Diluted EPS	0.46	0.24
Diluted Shares Outstanding	7,754	7,709
Margin Analysis		
Gross margin	19.5%	13.9%
SG&A expenses	7.8%	7.4%
Operating margin	11.7%	6.6%
Net margin	7.7%	3.9%
Source: Company filings		

Although the overall selling price per ton increased 3% in H1/11, gross margins decreased to 13.9% from 19.5% due to higher raw material costs, higher depreciation expense, and a tilt in product mix toward lower margin parent rolls.

Orchids Paper Products Company

Selling, general and administrative (SG&A) expenses in H1/11 decreased to \$3.4 million from \$3.6 million primarily due to lower accruals under the company's incentive bonus plan and decreased stock compensation expense. Interest expenses remained relatively flat at \$440,000.

Liquidity

Based on our forecasts, Orchids should have sufficient resources to meet its financial obligations through 2012. As of June 30, 2011, Orchids' cash balance was \$1.5 million and short term investments totaled \$2.0 million. Orchids has a debt/equity ratio of 0.3 versus 1.0 for the paper products industry.

Cash earnings of \$6.4 million and a \$379,000 decrease in working capital resulted in \$6.8 million cash from operations in the first six months of 2011. The changes in working capital were driven by a \$2.7 million decrease in taxes receivable, a \$322,000 increase in accrued liabilities, and a \$192,000 decrease in prepaid expenses, offset in part by a \$1.1 million increase in accounts receivable, a \$0.9 million decrease in accounts payable, and a \$0.9 million increase in inventories.

The company received proceeds from the sale of investment securities of \$7.5 million which was partially offset by capital expenditures of \$1.9 million resulting in \$5.6 million cash from investing. A net reduction in debt of \$9.5 million, and \$1.5 million dividend payments partially offset cash from operations of \$6.8 million and cash from investing of \$5.6 million resulting in a \$1.4 million increase in cash to \$1.5 million at the end of Q2/11.

Credit Facility

In April 2011, Orchids paid off the remaining unmatured loans under its existing credit facility which totaled \$17.5 million and entered into a new \$36 million credit agreement with JP Morgan Chase consisting of: an \$18.0 million revolving credit line (due April 2014); (\$0.0 million outstanding at June 30, 2011); a \$10.8 million real estate term loan with a ten-year term (due April 2021) and amortized as if it had a 25-year life (\$10.8 million outstanding at June 30, 2011); and a \$7.2 million machinery and equipment term loan with a seven-year term (due April 2018) (\$7.1 million outstanding at June 30, 2011).

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 quarterly tangible net worth. As of June 30, 2011, the company was in compliance with these covenants.

Projections

We project a 7% increase in converted product sales in 2012 as there should be a full year's contribution from the orders for 700,000 cases annually (we estimated approximately ½ that amount for 2011). We believe the current weak economic outlook will keep Orchids from raising selling prices in our forecast horizon. On August 9, 2011, the Federal Reserve's Open Market Committee indicated that economic growth so far this year has been considerably slower than had been expected. The Committee now expects a somewhat slower pace of recovery over the coming quarters than it did previously.

Although waste paper prices are high, we do not see them increasing from current levels given the struggling economy. However, we believe China's strong demand for waste paper should also keep prices from falling. Expectations are for China's growth to remain robust in 2011 and 2012, however, The Conference Board is projecting that tightening monetary policy will cause China to grow at a slower pace than last year.

Orchids Paper Products Company

With close to 60% of this year's cost of sales being variable (cost of paper), margins can change significantly with minor changes in paper costs. We ran a sensitivity analysis to see how gross margins would be affected by a 5% change in variable costs while keeping fixed costs constant (at approximately \$33 million). The table below shows the magnitude of these changes.

Sensitivity Analysis from 5% Change in Variable Costs						
	UNCH	5% INC	5% DEC	UNCH	5% INC	5% DEC
	<u>2011E</u>	<u>2011E</u>	<u>2011E</u>	<u>2012E</u>	<u>2012E</u>	<u>2012E</u>
Net sales	94,808	94,808	94,808	98,200	98,200	98,200
Cost of sales	80,241	82,648	77,834	81,506	83,951	79,061
Gross profit	14,567	12,160	16,974	16,694	14,249	19,139
Gross margin	15.4%	12.8%	17.9%	17.0%	14.5%	19.5%

Source: Taglich Brothers estimates

We believe that with no further increases in variable costs, the current level of fixed costs should leave room for margin improvement as increased volumes of higher margin converted products should improve manufacturing overhead coverage. Q2/11 gross margins of 15.9% should improve in the later half of 2011 (to average 16.7%) due to increased volumes of higher margin converted products. Although we project increasing gross margins, with the effect of Q1/11's low gross margins of 11.9%, we project FY2011 total gross margins of 15.4%.

With a 7% projected increase in converted product sales in 2012, we have decreased our COGS/Ton calculation in this area (by less than 2%) to reflect improved manufacturing overhead coverage. We feel a 17% total gross margin in 2012 is reasonable given the 2,800 ton increase in higher margin converted product sales.

Our revenue and gross margin projections through 2012 are shown below.

Approximate tons shipped, selling prices/ton, revenue, COGS and margins (est)

	<u>2011</u>							
	Tons Shipped	Selling Price/Ton	Revenue	COGS	COGS/Ton	Gross Profit	GM	
Converted	38,100	\$ 2,075	\$ 79,057,500	\$ 65,798,700	\$ 1,727	\$ 13,258,800	16.8%	
Parent Roll	17,900	\$ 880	\$ 15,752,000	\$ 14,427,400	\$ 806	\$ 1,324,600	8.4%	
Total	56,000	\$ 1,693	\$ 94,809,500	\$ 80,226,100	\$ 1,433	\$ 14,583,400	15.4%	
	<u>2012</u>							
	Tons Shipped	Selling Price/Ton	Revenue	COGS	COGS/Ton	Gross Profit	GM	
Converted	40,900	\$ 2,075	\$ 84,867,500	\$ 69,407,300	\$ 1,697	\$ 15,460,200	18.2%	
Parent Roll	15,100	\$ 880	\$ 13,288,000	\$ 12,080,000	\$ 800	\$ 1,208,000	9.1%	
Total	56,000	\$ 1,753	\$ 98,155,500	\$ 81,487,300	\$ 1,455	\$ 16,668,200	17.0%	

We project 2011 revenue of \$94.8 million and net income of \$5.1 million or \$0.66 per diluted share. We previously projected 2011 revenue of \$93.6 million and net income of \$5.0 million or \$0.65 per diluted share. The increase in our estimates is due to better than expected sales in H1/11. Higher sales of converted product have resulted in a slight increase in our 2011 gross margins to 15.4% from 15.3%.

Our 2011 estimates are based on converted product sales ramping in the second half. Orchids recently announced that it received orders for approximately 0.7 million cases on an annual basis which represents an increase in converted product shipments of approximately 12% annually based on the 5.8 million cases that were manufactured in 2010. Shipping on these orders did not start until June 2011 with future shipments expected to be greater in subsequent quarters. Also, in Q2/11, the company effectively doubled (from 4 to 8) its sales force by hiring a sales and marketing organization with expertise in mid-tier to upper-tier marketing and sales in the at-home tissue market.

We project the company will continue to keep its SG&A expenses under control (7.0% of sales) in 2011. The tax rate is estimated at 30% based on the current effective tax rate. Days sales outstanding and inventory turnover are projected to remain at 24 and 10 respectively.

For 2011 we project cash earnings of \$11.8 million. A reduction in working capital of \$3.8 million primarily due to reduced income taxes receivable will result in cash from operations of approximately \$15.5 million. Cash from operations and \$7.5 million proceeds from the sale of investment securities will cover capital expenditures of \$3.5 million, a \$12.1 million net pay down of debt, and \$3.0 million in dividends. These items should result in a \$4.4 million net increase in cash to \$4.6 million.

We project 2012 revenue of \$98.2 million and net income of \$6.9 million or \$0.89 per diluted share. We previously projected 2012 revenue of \$96.6 million and net income of \$7.3 million or \$0.95 per diluted share. Our 2012 estimates are based on higher margin converted product sales growth. The company recently secured new converted product business despite ongoing competitive pressures. Also, the doubling of its sales force should help to expand converted product sales. Due to the high cost of waste paper, we have lowered gross margins to 17.0% (previously 17.9%). SG&A expenses are projected to increase to \$6.7 million in 2012 and the tax rate is estimated at 30% based on the current effective tax rate. Days sales outstanding and inventory turnover are projected to remain at 24 and 10 respectively.

For 2012 we are projecting cash earnings of \$21.6 million. A \$0.5 million increase in working capital primarily due to increased accounts receivable, inventories and deferred taxes, should result in cash from operations of approximately \$21.1 million. Cash from operations should cover \$3.5 million of capital expenditures, a \$10.0 million net pay down of debt, and \$3.0 million in dividends, increasing cash by \$4.6 million to \$9.1 million.

Risks

Customer concentration

Three customers (Dollar General, Family Dollar, and Wal-Mart) accounted for approximately 66% of converted product sales in 2010. 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 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 with current bargaining agreements set to expire in June 2012 (converting facility workers) and February 2015 (paper mill workers). 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

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 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 5.2 million shares in the float with an average daily volume of approximately 9,000 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 \$)

	2008A	2009A	2010A	6/11A	2011E	2012E
Cash	11	1,232	142	1,492	4,579	9,148
Accounts receivable	6,514	6,750	6,155	7,214	6,308	6,534
Inventories	6,253	7,569	7,595	8,455	7,940	8,065
Short term investments	-	18,509	9,518	2,022	2,022	2,022
Income taxes receivable	-	-	3,952	-	-	-
Prepaid expenses	399	497	538	346	563	586
Deferred income taxes	557	547	790	2,067	748	1,058
Total current assets	13,734	35,104	28,690	21,596	22,160	27,414
Property, plant and equipment	60,659	72,691	93,805	92,229	90,205	86,705
Deferred debt issuance costs	89	104	76	54	54	54
Total Assets	74,482	107,899	122,571	113,879	112,419	114,173
Accounts payable	4,699	4,049	5,250	4,359	5,489	5,575
Accrued liabilities	2,584	3,118	2,269	2,591	2,326	2,409
Current portion of long-term debt	2,998	3,742	10,742	1,152	1,152	1,152
Total current liabilities	10,281	10,909	18,261	8,102	8,966	9,136
Long-term debt	21,067	19,533	16,615	16,726	14,100	4,100
Deferred income taxes	9,572	14,337	18,099	18,887	17,100	24,200
Total liabilities	40,920	44,779	52,975	43,715	40,166	37,436
Total stockholders' equity	33,562	63,120	69,596	70,164	72,253	76,737
Total liabilities & stockholders' equity	74,482	107,899	122,571	113,879	112,419	114,173

Source: Company filings and Taglich Brothers' estimates

Orchids Paper Products Company

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

	<u>2008A</u>	<u>2009A</u>	<u>2010A</u>	<u>2011E</u>	<u>2012E</u>
Net sales	90,202	95,963	92,504	94,808	98,200
Cost of sales	<u>75,196</u>	<u>67,936</u>	<u>76,752</u>	<u>80,241</u>	<u>81,506</u>
Gross profit	15,006	28,027	15,752	14,567	16,694
SG&A expenses	<u>6,259</u>	<u>7,343</u>	<u>6,618</u>	<u>6,646</u>	<u>6,700</u>
Operating income (loss)	8,747	20,684	9,134	7,921	9,994
Interest expense	1,361	692	934	690	200
Other (income) expense	<u>(10)</u>	<u>(24)</u>	<u>(65)</u>	<u>(46)</u>	<u>(60)</u>
Income (loss) before taxes	7,396	20,016	8,265	7,277	9,854
Income tax expense (benefit)	<u>2,205</u>	<u>6,464</u>	<u>2,351</u>	<u>2,204</u>	<u>2,986</u>
Net income (loss)	<u>5,191</u>	<u>13,552</u>	<u>5,914</u>	<u>5,073</u>	<u>6,868</u>
EPS	0.79	1.89	0.76	0.66	0.89
Shares Outstanding	6,542	7,177	7,755	7,708	7,706
<u>Margin Analysis</u>					
Gross margin	16.6%	29.2%	17.0%	15.4%	17.0%
SG&A expenses	6.9%	7.7%	7.2%	7.0%	6.8%
Operating margin	9.7%	21.6%	9.9%	8.4%	10.2%
Net margin	5.8%	14.1%	6.4%	5.4%	7.0%
<u>Year / Year Growth</u>					
Total Revenues	20.8%	6.4%	-3.6%	2.5%	3.6%
Net Income	99.8%	161.1%	-56.4%	-14.2%	35.4%
EPS	97.5%	138.0%	-59.6%	-13.7%	35.4%

Source: Company filings and Taglich Brothers' estimates

Orchids Paper Products Company

Quarterly Income Statement for the Fiscal Years Ending December 31, 2010, 2011, and 2012
(in thousands \$)

	<u>3/10A</u>	<u>6/10A</u>	<u>9/10A</u>	<u>12/10A</u>	<u>2010A</u>	<u>3/11A</u>	<u>6/11A</u>	<u>9/11E</u>	<u>12/11E</u>	<u>2011E</u>	<u>3/12E</u>	<u>6/12E</u>	<u>9/12E</u>	<u>12/12E</u>	<u>2012E</u>
Net sales	21,040	24,685	24,523	22,256	92,504	22,675	23,383	24,200	24,550	94,808	24,400	24,500	24,600	24,700	98,200
Cost of sales	<u>17,179</u>	<u>19,610</u>	<u>20,494</u>	<u>19,469</u>	<u>76,752</u>	<u>19,967</u>	<u>19,666</u>	<u>20,207</u>	<u>20,401</u>	<u>80,241</u>	<u>20,252</u>	<u>20,335</u>	<u>20,418</u>	<u>20,501</u>	<u>81,506</u>
Gross profit	3,861	5,075	4,029	2,787	15,752	2,708	3,717	3,993	4,149	14,567	4,148	4,165	4,182	4,199	16,694
SG&A expenses	<u>1,735</u>	<u>1,841</u>	<u>1,649</u>	<u>1,393</u>	<u>6,618</u>	<u>1,580</u>	<u>1,816</u>	<u>1,625</u>	<u>1,625</u>	<u>6,646</u>	<u>1,660</u>	<u>1,670</u>	<u>1,680</u>	<u>1,690</u>	<u>6,700</u>
Operating income (loss)	2,126	3,234	2,380	1,394	9,134	1,128	1,901	2,368	2,524	7,921	2,488	2,495	2,502	2,509	9,994
Interest expense	215	211	249	259	934	249	191	150	100	690	50	50	50	50	200
Other (income) expense	<u>(14)</u>	<u>(13)</u>	<u>(24)</u>	<u>(14)</u>	<u>(65)</u>	<u>(9)</u>	<u>(7)</u>	<u>(15)</u>	<u>(15)</u>	<u>(46)</u>	<u>(15)</u>	<u>(15)</u>	<u>(15)</u>	<u>(15)</u>	<u>(60)</u>
Income (loss) before taxes	1,925	3,036	2,155	1,149	8,265	888	1,717	2,233	2,439	7,277	2,453	2,460	2,467	2,474	9,854
Income tax expense (benefit)	<u>565</u>	<u>864</u>	<u>713</u>	<u>209</u>	<u>2,351</u>	<u>268</u>	<u>520</u>	<u>677</u>	<u>739</u>	<u>2,204</u>	<u>743</u>	<u>745</u>	<u>748</u>	<u>750</u>	<u>2,986</u>
Net income (loss)	<u>1,360</u>	<u>2,172</u>	<u>1,442</u>	<u>940</u>	<u>5,914</u>	<u>620</u>	<u>1,197</u>	<u>1,556</u>	<u>1,700</u>	<u>5,073</u>	<u>1,710</u>	<u>1,715</u>	<u>1,719</u>	<u>1,724</u>	<u>6,868</u>
EPS	0.18	0.28	0.18	0.12	0.76	0.08	0.16	0.20	0.22	0.66	0.22	0.22	0.22	0.22	0.89
Shares Outstanding	7,729	7,768	7,762	7,742	7,755	7,713	7,706	7,706	7,706	7,708	7,706	7,706	7,706	7,706	7,706
<u>Margin Analysis</u>															
Gross margin	18.4%	20.6%	16.4%	12.5%	17.0%	11.9%	15.9%	16.5%	16.9%	15.4%	17.0%	17.0%	17.0%	17.0%	17.0%
SG&A expenses	8.2%	7.5%	6.7%	6.3%	7.2%	7.0%	7.8%	6.7%	6.6%	7.0%	6.8%	6.8%	6.8%	6.8%	6.8%
Operating margin	10.1%	13.1%	9.7%	6.3%	9.9%	5.0%	8.1%	9.8%	10.3%	8.4%	10.2%	10.2%	10.2%	10.2%	10.2%
Net margin	6.5%	8.8%	5.9%	4.2%	6.4%	2.7%	5.1%	6.4%	6.9%	5.4%	7.0%	7.0%	7.0%	7.0%	7.0%
<u>Year / Year Growth</u>															
Total Revenues	-11.0%	2.3%	-0.1%	-5.8%	-3.6%	7.8%	-5.3%	-1.3%	10.3%	2.5%	7.6%	4.8%	1.7%	0.6%	3.6%
Net Income	-51.4%	-42.5%	-62.2%	-70.3%	-56.4%	-54.4%	-44.9%	7.9%	80.8%	-14.2%	175.8%	43.3%	10.5%	1.4%	35.4%
EPS	-58.0%	-49.0%	-65.5%	-70.0%	-59.6%	-54.3%	-44.4%	12.2%	81.7%	-13.7%	176.1%	43.3%	10.5%	1.4%	35.4%

Source: Company filings and Taglich Brothers' estimates

Orchids Paper Products Company

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

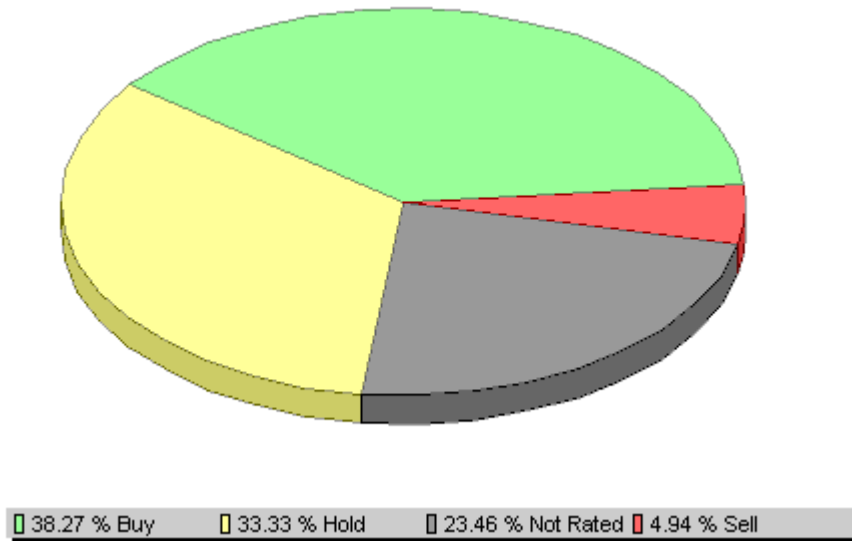
	2008A	2009A	2010A	6mos11A	2011E	2012E
Net income(loss)	5,191	13,552	5,914	1,817	5,073	6,868
Depreciation and amortization	3,156	3,708	5,725	3,573	7,100	7,000
Provision for doubtful accounts	87	60	(34)	-	-	-
Deferred income taxes	2,145	4,774	3,519	788	(999)	7,100
Stock based compensation	313	603	562	230	588	612
<i>Changes in assets and liabilities</i>						
Accounts receivable	(1,074)	(296)	629	(1,059)	(153)	(226)
Inventories	(1,379)	(1,316)	(26)	(860)	(345)	(125)
Prepaid expenses	(18)	(98)	(41)	192	(25)	(23)
Income taxes receivable	24	-	(3,952)	2,675	3,994	(310)
Accounts payable	(61)	(650)	1,201	(891)	239	87
Accrued liabilities	124	535	(849)	322	57	83
Net Cash Provided by (Used in) Operations	8,508	20,872	12,648	6,787	15,528	21,066
Proceeds from the sale of investment securities	-	3,993	8,991	7,496	7,496	-
Purchase of investment securities	-	(22,502)	-	-	-	-
Purchase of property and equipment	(6,926)	(15,711)	(26,786)	(1,920)	(3,500)	(3,500)
Net Cash Provided by (Used in) Investing	(6,926)	(34,220)	(17,795)	5,576	3,996	(3,500)
Proceeds from issuance of stock	-	14,847	-	-	-	-
Borrowings under construction loan	-	3,756	5,197	-	-	-
Repayments on construction loan	-	-	-	-	-	-
Borrowings on long-term debt	-	-	-	18,000	18,000	-
Principal payments on long-term debt	(2,286)	(3,059)	(3,787)	(1,490)	(4,066)	(10,000)
Repayment of long-term debt at maturity	-	-	-	(5,878)	(5,878)	-
Repayment of long-term debt prior to maturity	-	-	-	(17,439)	(17,439)	-
Net borrowings (repayments) on revolving credit line	696	(1,487)	2,672	(2,672)	(2,672)	-
Proceeds from the exercise of warrants attached to debentures	16	286	-	-	-	-
Proceeds from the exercise of stock options	-	269	-	19	19	-
Deferred debt issuance cost	-	(43)	(25)	(55)	(55)	-
Dividends paid	-	-	-	(1,498)	(2,996)	(2,996)
Net Cash Provided by (Used in) Financing	(1,574)	14,569	4,057	(11,013)	(15,087)	(12,996)
Net Change in Cash	8	1,221	(1,090)	1,350	4,437	4,570
Cash - Beginning of Period	3	11	1,232	142	142	4,579
Cash - End of Period	11	1,232	142	1,492	4,579	9,148
Cash Flow from Operations	8,508	20,872	12,648	6,787	15,528	21,066
Capital Expenditures	(6,926)	(15,711)	(26,786)	(1,920)	(3,500)	(3,500)
Free Cash Flow	1,582	5,161	(14,138)	4,867	12,028	17,566

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		
Hold		
Sell	None	
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 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 10,262 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 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)
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 of the company due to 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.