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Research Report - Update

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

UFP Technologies, Inc.

Rating: Speculative Buy

John Nobile
July 21, 2006

UFPT $7.00 — (NASDAQ SC)

	FY (2004)A	FY (2005)A	FY (2006)E	FY (2007)E
Revenues (millions)	$68.6	$84.0	$98.8	$105.2
Earnings per share (diluted)	$0.17	$0.13	$0.50	$0.62

52-Week range	$2.17 – $7.69	Fiscal year ends:	December
Shares outstanding (millions)	4.9	Revenue per share (TTM)	$17.57
Trading float (millions)	2.7	Price/Sales (TTM)	0.4X
Insider + 5% ownership	73%	Price/Sales (2007)E	0.4X
Tangible book value/share	$1.85	Price/Earnings (TTM)	31.8X
Price/tangible book	3.8X	Price/Earnings (2007)E	11.3X

UFP Technologies is a designer and manufacturer of a broad range of high performance cushion packaging and molded fiber products and specialty foam and plastic products. These products are custom designed and fabricated or molded to provide protection for fragile and valuable items, and are sold primarily to original equipment manufacturers in the computer, electronics, automotive, medical/pharmaceutical and industrial markets. (www.ufpt.com)

Key investment considerations:

We are downgrading our rating for shares of UFP Technologies (NASDAQ SC: UFPT) to Speculative Buy from Buy as we feel the risk/reward ratio has increased. We are setting a new twelve-month price target of $9.00 per share (previously $5.00 per share) based on a discounted valuation on our fiscal 2007 estimates.

For the first quarter ended March 31, 2006, versus the same period in 2005: net sales increased 33% to $24.1 million from $18.2 million. Net income was $0.6 million or $0.11 per diluted share versus net income of $0.1 million or $0.02 per diluted share.

UFP Technologies' gross margins have been under pressure during the latter half of 2005. However, it appears that the impact of the high scrap rates and excessive direct labor costs associated with the start-up of several new automotive programs is finally under control.

For fiscal 2006, we estimate UFPT's sales will increase by 18% to $98.8 million and the Company will report net income of $2.6 million or $0.50 per diluted share. Previous estimates for fiscal 2006 called for sales of $93.7 million and net income of $2.3 million or $0.43 per diluted share.

We are introducing estimates for fiscal 2007 calling for sales to increase by 6% to $105.2 million and net income of $3.3 million or $0.62 per diluted share.

****Please view our disclaimer located on page 9.***

Business

The Company operates in two segments: Packaging Products and Component Products.

UFP Technologies' packaging products are used to contain, display and/or protect manufactured goods during shipment, handling, storage, marketing and use. The interior cushion packaging market is characterized by three primary sectors: (1) custom fabricated or molded products for low volume, high fragility products; (2) molded or die-cut products for high volume, industrial and consumer goods; and (3) loose fill and commodity packaging materials for products which do not require custom-designed packaging. Examples of the Company's packaging products include end-cap packs for computers, corner blocks for telecommunications consoles, anti-static foam packs for printed circuit boards, die-cut inserts for attaché cases and plastic trays for medical devices and components.

The Company's component products segment features specialty foam and plastic products that are sold primarily to customers in the automotive, sporting goods, medical, beauty, leisure and footwear industries. These products include components for automobiles and medical diagnostic equipment, abrasive nail files and anti-fatigue mats, and shock absorbing inserts used in athletic and leisure footwear.

Industry

According to the packaging industry Website, packaging-gateway.com, the global packaging industry was worth an estimated $424 billion in 2004 and is projected to grow to almost $600 billion by 2014 for a compound annual growth rate of 3.5%. Driving this growth is stringent legislation, increasing competition and dynamic new markets that are forcing packaging executives to develop and manufacture innovative packaging more quickly, effectively and profitability than before.

Freedonia Group (a publisher of industry market research) recently forecasted demand for certain markets that UFP Technologies operates in. In May 2006, Freedonia forecasted the U.S. protective packaging market to grow by 4.7% annually to $4 billion by 2010. Freedonia said that advances will be driven by specialized packaging applications in the electronic, medical and other industries, as well as growing Internet-based sales. Molded foam is estimated to remain dominant as a result of its shock and vibration dampening characteristics and ability to be custom molded to protect sensitive electronic and other equipment.

1st Quarter Financial Results

For the first quarter ended March 31, 2006, versus the same period in 2005:

- Net sales increased 33% to $24.1 million from $18.2 million.
- Gross margins increased to 20.2% from 19.9%.
- SG&A expenses increased to $3.7 million from $3.1 million.
- Net income was $0.6 million or $0.11 per diluted share versus net income of $0.1 million or $0.02 per diluted share.

In comparison, Taglich Brothers' estimates called for first quarter net sales of $23.0 million and net income of $0.4 million or $0.08 per diluted share.

The Company attributed the increase in net sales primarily to an increase in Component Product sales stemming from the new automotive contract in the southeast and increased sales to the Aerospace and Defense market. Overall, Component Product sales increased 61% to $14.9 million from $9.2, million while Engineered Packaging Product sales increased 3% to $9.3 million from $9.0 million.

The increase in gross margins was primarily due to the fixed portion of labor and overhead expenses measured against higher sales.

SG&A expenses increased primarily from increased expenses associated with the new automotive program in the southeast, higher sales commissions, and increased public company compliance expenses.

Balance Sheet as of March 31, 2006

Cash and cash equivalents was approximately $0.1 million. UFP Technologies used a good portion ($1.7 million) of its positive cash flow to pay down its notes payable balance. The Company had working capital of $4.1 million, a tangible book value of $1.85 per share and a long-term debt-to-equity ratio of 0.3X. Cash provided by operations during the first three months of fiscal 2006 was approximately $2.7 million. UFPT had an available balance under its line of credit of approximately $7.7 million. We believe that UFPT's current line of credit and future expected cash flows from operations will be sufficient to fund operations for the next twelve months.

Discussion and Analysis

During 2005, the Company absorbed costs associated with the launch of several new programs in its automotive operations in Michigan, as well as in its large, estimated, 8 year, $95 million program in the Southeast that caused significant losses in its automotive business unit. These costs were in the form of higher than anticipated scrap rates and additional direct labor requirements that caused significant losses in this business unit. However, robust demand in the remaining markets that the Company serves generated sufficient profits to more than absorb these losses. Particularly strong demand for UFPT's products was in the military and medical markets. The high scrap rates and excessive direct labor improved dramatically by the end of 2005 and throughout the three-month period ended March 31, 2006. Accordingly, operating results within the automotive business unit were materially better in the first quarter of 2006.

In April 2006, UFP Technologies announced the acquisition of substantially all of the assets of Stephen Packaging Corporation, a fabricator of custom foam packaging solutions in Miami, Florida. UFP Technologies' latest 10-Q report revealed the purchase price of approximately $0.3 million. We view this acquisition as a strategic move for the Company as it brings the Company a book of business of approximately $1 million and Management believes it fits very well with UFPT's existing capabilities in Florida.

Stephen Packaging Corporation will be combining its manufacturing operations into UFPT's Florida plant, but plans to remain responsive to its customers' needs by maintaining a local final assembly and distribution center.

Projections

For fiscal 2006, we estimate UFPT's sales will increase by 18% to $98.8 million and the Company will report net income of $2.6 million or $0.50 per diluted share. Previous estimates for fiscal 2006 called for sales of $93.7 million and net income of $2.3 million or $0.43 per diluted share.

We have increased our fiscal 2006 estimates primarily due to the better than expected first quarter results. It appears that the impact of the high scrap rates and excessive direct labor costs associated with the start-up of several new automotive programs is finally under control. Thus, we have increased our gross margin estimates. However, the new automotive programs have resulted in larger SG&A expenses than we originally estimated causing us to raise our SG&A assumptions for fiscal 2006. We are also assuming that starting in the second quarter, SG&A expenses will begin to be impacted by the Stephen Packaging acquisition (we are estimating that the acquisition will add approximately $0.2 million annually to UFPT's SG&A expenses).

We are introducing estimates for fiscal 2007 calling for sales to increase by 6% to $105.2 million and net income of $3.3 million or $0.62 per diluted share. Assumptions for 2007 include a slowing in the Company's sales growth to a rate that is closer to the industry's growth rate, higher gross margins stemming from higher levels of sales, an increase in SG&A expenses due to the higher level of sales, and a full year of incorporating Stephen Packaging's operational expenses, and a slightly higher share count due the recent stock units awards received by Management.

We are assuming that the $95 million contract discussed earlier will be operating near full rate production in 2006 and beyond.

Risks

Large Contract

The Company has a large automotive contract that could be worth as much as $95 million. The $95 million revenue value is an estimate, based on the automotive supplier's projected needs. UFP Technologies cannot guarantee that it will fully benefit from this contract, which is terminable by the automotive supplier for any reason. The Company's revenues from this contract are directly dependent on the ability of the automotive supplier to develop, market, and sell its products in a timely, cost-effective manner. If the automotive supplier's needs decrease over the course of the contract, UFP Technologies' estimated revenues from this contract may also decrease. Even if the Company generates revenue from the project, it cannot guarantee that the project will be profitable, particularly if revenues from the contract are less than expected.

Competition

The packaging and specialty foam products industry is highly competitive. The Company's foam and fiber packaging products compete against other alternative products made from materials such as expanded polystyrene foams, die-cut corrugated, plastic peanuts, plastic bubbles and foam-in-place urethane. UFP Technologies also faces competition in the specialty foam products area from smaller companies that typically concentrate on production for specific industries.

Patents and other proprietary rights

The Company relies upon trade secret, patent protection and trademarks to protect its technology and proprietary rights. UFP Technologies has three U.S. patents relating to its molded fiber technology (including certain proprietary machine designs), and has patent applications pending with respect to such technology in certain foreign countries and international patent offices. The Company also has a total of twelve U.S. patents relating to technologies including foam and packaging, rubber mat, patterned nail file, and superforming process technologies. In addition, UFP Technologies has patent applications pending in the United States with respect to superforming products and processes. There can be no assurance that any of the Company's patent applications will be granted, or that any patent or patent application will provide significant protection for the Company's products and technology, or will not be challenged or circumvented by others.

Environmental Considerations

In addition to offering molded fiber packaging products made from recycled paper derived primarily from post-consumer newspaper waste, UFP Technologies actively promotes its philosophy of reducing product volume and resulting post-user product waste. The Company designs products to provide optimum performance with minimum material. In addition, UFP Technologies actively participates in a recovery and reuse program for certain of its plastic packaging products. The Company is aware of public support for environmentally responsible packaging and other products. Future government action may impose restrictions affecting the industry in which the Company operates. There can be no assurance that any such action will not adversely impact UFP Technologies' products and business.

Other risks include:

i. economic conditions that affect sales of the products of the Company's packaging customers,
ii. actions taken by the Company's competitors and the ability of the Company to respond to such actions,
iii. the ability of the Company to obtain new customers, and
iv. the ability of the Company to execute and integrate favorable acquisitions.

Share-based compensation

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123(R) (SFAS 123(R) "Share-Based Payment". SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values at the date of grant. Pro forma disclosure is no longer an alternative. SFAS 123(R) is effective for public companies at the beginning of the first fiscal year beginning after June 15, 2005.

UFP Technologies adopted SFAS 123(R) in the first quarter of fiscal 2006 and believes the effect will be comparable to the pro forma effect it has shown in the past. For fiscal 2005, UFP Technologies' pro forma stock-based compensation expense was $0.553 million or $0.11 per diluted share. In the first quarter of fiscal 2006, UFP Technologies recorded stock-based compensation expense of $0.032 million or $0.01 per diluted share.

Failure to satisfy NASDAQ listing requirement

In June 2006, UFP Technologies announced that it had received a letter from Nasdaq indicating that, as a result of the recently announced resignation of Peter R. Worrell from the Board of Directors of the Company, the Company does not comply with Nasdaq's independent director requirements. The Company had previously informed Nasdaq that, due to Mr. Worrell's resignation, the Company's Board of Directors is not currently comprised of a majority of independent directors, as required by Nasdaq. In its letter, Nasdaq indicated that, pursuant to its rules, the Company will be provided a cure period until the earlier of the Company's next annual shareholders' meeting or June 8, 2007 to regain compliance with Nasdaq's independent director requirements. UFP Technologies said it is currently commencing a search to replace Mr. Worrell with another independent director and intends to regain compliance with Nasdaq's independent director requirements prior to expiration of the cure period.

Federal Reserve

Over the past two years, the Federal Reserve has raised short-term interest rates 17 times. Investors need to be aware that such a monetary policy is theoretically bad news for equity prices and valuations.

Liquidity

With only 4.9 million shares outstanding and 2.7 million in the float, liquidity issues must be considered. Average daily volume is approximately 100,000 shares. Any significant trading in shares of UFPT could result in large swings in the price of the stock.

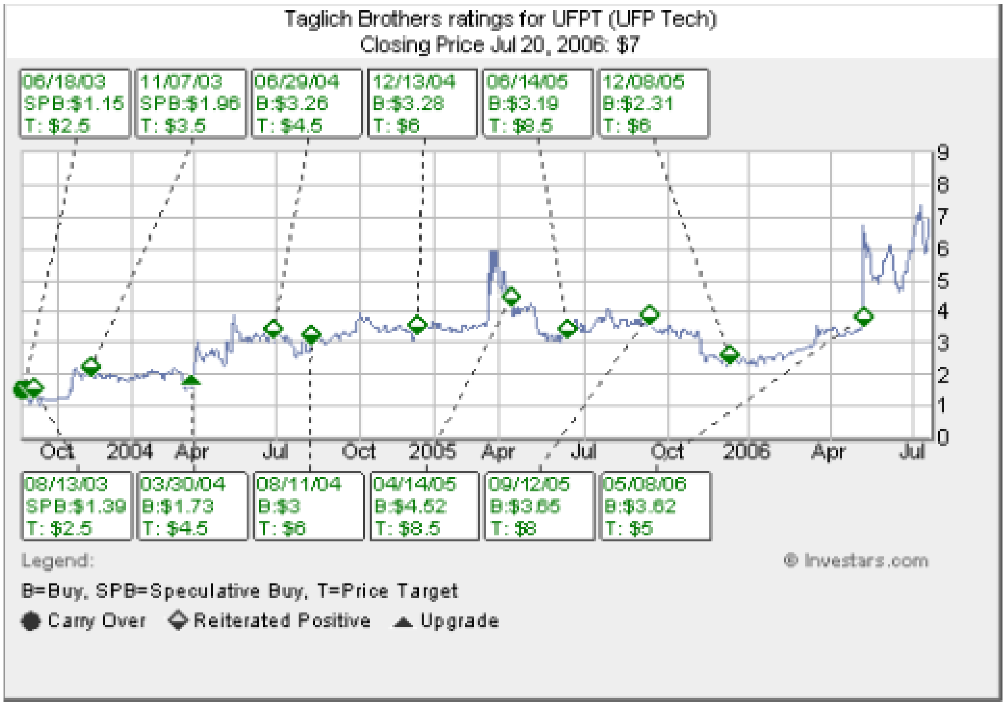
Miscellaneous risks

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.

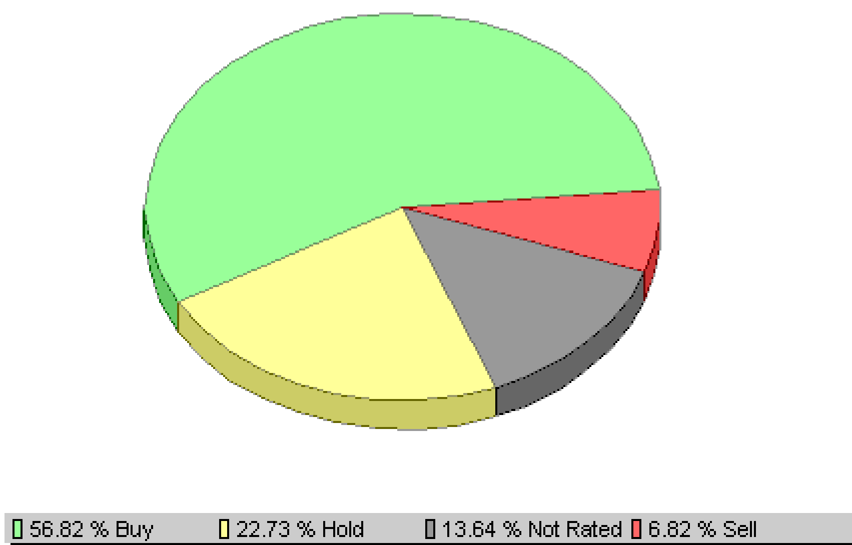
Conclusion and Valuation

We are downgrading our rating for shares of UFP Technologies (NASDAQ SC: UFPT) to **Speculative Buy** from Buy as we feel the risk/reward ratio has increased.

We chose to value shares of UFPT using a multiple of 15X applied to our discounted earnings per diluted share estimate of $0.59 ($0.62 discounted to a twelve-month value using the Capital Asset Pricing Model with a discount factor of 7%) in fiscal 2007. We derived this multiple by applying a roughly 40% discount to our projected growth rate in earnings for fiscal 2007 (24.4%) to take into consideration the risks associated with investing in microcap stocks and the Company's historic earnings multiple of 12X. We believe the stock will trade at a higher earnings multiple than its historic rate given the strong rate of growth we project. With this model we arrive at a **twelve-month price target of approximately $9.00 per share.**



Taglich Brothers' Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	1	3.33%
Hold	0	0
Sell	0	0
Not Rated	1	7.14%

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.

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.

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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.

Consolidated Balance Sheets
(in thousands)

	March 31, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 88	$ 265
Receivables	13,934	15,300
Inventories	6,038	6,441
Prepaid expenses and other	1,986	1,574
Total current assets	22,046	23,580
Net property, plant and equipment	10,625	10,973
Goodwill	6,481	6,481
Other assets	2,957	2,966
Total Assets	**$ 42,109**	**$ 44,000**
Liabilities & stockholders' equity		
Current liabilities:		
Notes payable	$ 6,265	$ 7,991
Current portion of long-term debt	1,084	1,087
Current portion of capital lease obligations	649	639
Accounts payable	5,096	6,063
Accrued taxes and other expenses	4,820	4,480
Total current liabilities	17,914	20,260
Long-term debt	5,116	5,286
Capital lease obligations	2,269	2,363
Minority interest	561	634
Other liabilities	696	696
Total liabilities	**26,556**	**29,239**
Total stockholders' equity	**15,553**	**14,761**
Total liabilities & stockholders' equity	**$ 42,109**	**$ 44,000**

Annual Income Statements for the Years Ended
(in thousands)

	FY(12/03)A	FY(12/04)A	FY(12/05)A	FY(12/06)E	FY(12/07)E
Net sales	**$ 60,902**	**$ 68,624**	**$ 83,962**	**$ 98,841**	**$ 105,200**
Cost of sales	50,178	54,653	69,361	78,648	83,424
Gross profit	10,724	13,971	14,601	20,194	21,776
Gross Margin	*17.61%*	*20.36%*	*17.39%*	*20.43%*	*20.70%*
Restructuring charge	1,405	(280)	-	-	-
SG&A	10,827	12,106	12,431	14,757	15,300
Operating income	(1,508)	2,145	2,170	5,437	6,476
Operating Margin	*-2.48%*	*3.13%*	*2.58%*	*5.50%*	*6.16%*
Interest expense, other income and expenses	(847)	(786)	(1,303)	(1,195)	(1,200)
Income before taxes	(2,355)	1,359	867	4,242	5,276
Income tax	(839)	488	208	1,613	2,005
Tax rate	*35.63%*	*35.91%*	*23.99%*	*38.02%*	*38.00%*
Net Income / (Loss)	**$ (1,516)**	**$ 871**	**$ 659**	**$ 2,629**	**$ 3,271**
Basic EPS	**$ (0.34)**	**$ 0.19**	**$ 0.14**	**$ 0.54**	**$ 0.67**
Diluted EPS	**$ (0.34)**	**$ 0.17**	**$ 0.13**	**$ 0.50**	**$ 0.62**
Basic Shares Outstanding	4,490	4,617	4,798	4,901	4,910
Diluted Shares Outstanding	4,490	4,995	5,261	5,261	5,280
Percent of Revenue					
Cost of goods sold	82.39%	79.64%	82.61%	79.57%	79.30%
SG&A	17.78%	17.64%	14.81%	14.93%	14.54%
Year / Year Growth					
Total Revenues	-0.47%	12.68%	22.35%	17.72%	6.43%
Net Income	NA	157.45%	-24.34%	298.94%	24.42%
EPS	NA	151.65%	-28.17%	298.94%	23.97%

Quarterly Income Statement for the Year Ended 2005
(in thousands)

	Q1(3/05)A	Q2(6/05)A	Q3(9/05)A	Q4(12/05)A	FY(12/05)A
Net sales	**$ 18,192**	**$ 20,918**	**$ 21,649**	**$ 23,203**	**$ 83,962**
Cost of sales	14,569	16,792	18,562	19,439	69,361
Gross profit	3,623	4,126	3,087	3,764	14,601
Gross Margin	*19.92%*	*19.72%*	*14.26%*	*17.00%*	*17.39%*
SG&A	3,050	3,373	3,069	2,939	12,431
Operating income	573	753	18	825	2,170
Operating Margin	*3.15%*	*3.60%*	*0.08%*	*3.56%*	*2.58%*
Interest expense, other income & expenses	(436)	(246)	(258)	(363)	(1,303)
Income before taxes	137	507	(240)	462	867
Income tax (benefit)	52	193	(91)	54	208
Tax rate	*37.96%*	*38.07%*	*37.92%*	*11.69%*	*23.99%*
Net Income / (Loss)	**$ 85**	**$ 314**	**$ (149)**	**$ 408**	**$ 659**
Basic EPS	**$ 0.02**	**$ 0.07**	**$ (0.03)**	**$ 0.08**	**$ 0.14**
Diluted EPS	**$ 0.02**	**$ 0.06**	**$ (0.03)**	**$ 0.08**	**$ 0.13**
Basic Shares Outstanding	4,731	4,814	4,820	4,824	4,798
Diluted Shares Outstanding	5,257	5,235	4,820	5,185	5,261
Percent of Revenue					
Cost of goods sold	80.08%	80.28%	85.74%	83.78%	82.61%
SG&A	16.77%	16.12%	14.18%	12.67%	14.81%
Year / Year Growth					
Total Revenues	14.17%	24.31%	22.60%	27.45%	22.35%
Net Income	57.41%	45.37%	-178.42%	-0.73%	-24.34%
EPS	52.18%	51.17%	-175.28%	-4.25%	-27.19%

Quarterly Income Statement for the Year Ending 2006
(in thousands)

	Q1(3/06)A	Q2(6/06)E	Q3(9/06)E	Q4(12/06)E	FY(12/06)E
Net sales	**$ 24,141**	**$ 24,400**	**$ 24,900**	**$ 25,400**	**$ 98,841**
Cost of sales	19,262	19,422	19,796	20,168	78,648
Gross profit	4,879	4,978	5,105	5,232	20,194
Gross Margin	*20.21%*	*20.40%*	*20.50%*	*20.60%*	*20.43%*
SG&A	3,657	3,700	3,700	3,700	14,757
Operating income	1,222	1,278	1,405	1,532	5,437
Operating Margin	*5.06%*	*5.24%*	*5.64%*	*6.03%*	*5.50%*
Interest expense, other income & expenses	(295)	(300)	(300)	(300)	(1,195)
Income before taxes	927	978	1,105	1,232	4,242
Income tax (benefit)	353	371	420	468	1,613
Tax rate	*38.08%*	*38.00%*	*38.00%*	*38.00%*	*38.02%*
Net Income / (Loss)	**$ 574**	**$ 606**	**$ 685**	**$ 764**	**$ 2,629**
Basic EPS	**$ 0.12**	**$ 0.12**	**$ 0.14**	**$ 0.16**	**$ 0.54**
Diluted EPS	**$ 0.11**	**$ 0.12**	**$ 0.13**	**$ 0.14**	**$ 0.50**
Basic Shares Outstanding	4,874	4,910	4,910	4,910	4,901
Diluted Shares Outstanding	5,233	5,270	5,270	5,270	5,261
Percent of Revenue					
Cost of goods sold	79.79%	79.60%	79.50%	79.40%	79.57%
SG&A	15.15%	15.16%	14.86%	14.57%	14.93%
Year / Year Growth					
Total Revenues	32.70%	16.65%	15.02%	9.47%	17.72%
Net Income	575.29%	93.03%	559.59%	87.28%	298.94%
EPS	555.48%	89.26%	551.17%	84.00%	290.55%

Statement of Cash Flows for the Three Months Ended
(in thousands)

	March 31, 2006	March 31, 2005
Cash Flows from Operating Activities		
Net income	$ 574	$ 85
Depreciation & amortization	772	623
Minority interest	32	219
Stock issued in lieu of compensation	144	241
Share-based compensation	32	-
Deferred income taxes	250	52
Changes in assets and liabilities		
Receivables	1,365	147
Inventories	404	(196)
Prepaid expenses	(662)	(582)
Accounts payable	(562)	446
Accrued restructuring charge	-	(35)
Accrued expenses	340	(727)
Retirement and other liabilites	-	(20)
Other assets	-	6
Net Cash Provided by Operations	**2,689**	**259**
Cash Flows from Investing Activities		
Additions to property, plant and equipment	(340)	(694)
Net Cash Used in Investing	**(340)**	**(694)**
Cash Flows from Financing Activities		
Borrowings (payments) of notes payable	(1,725)	184
Change in book overdrafts	(405)	494
Principal repayments of long-term debt	(174)	(257)
Principle repayments of capital lease obligations	(159)	(99)
Distribution to United Development Company partners	(105)	(105)
Proceeds from sale of common stock	42	46
Net cash Provided Financing	**(2,526)**	**263**
Net change in Cash	**(177)**	**(172)**
Cash - Beginning of Period	**265**	**318**
Cash - End of Period	**$ 88**	**$ 146**