

# Taglich Brothers, Inc.

The Standard of Excellence in the Microcap Market

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## Research Report - Update

**UFP Technologies, Inc.**

**Rating: Speculative Buy**

John Nobile

**UFPT \$1.34 — (NASDAQ SC)**

November 27, 2001

	FY (2000)	FY (2001)E	FY (2002)E	FY (2003)E
Revenues (millions)	\$74.5	\$60.4	\$69.0	\$80.0
Earnings per share (diluted)	\$0.25	\$(0.50)	\$0.08	\$0.45

52week range	\$0.21 – \$2.44	Fiscal year ends:	December
Shares outstanding (millions)	4.2	Revenue per share (TTM)	\$14.99
Trading float (millions)	2.5	Price/Sales (TTM)	0.09X
Insider Ownership	41%	Price/Sales (2003)	0.07X
Tangible book value/share	\$2.19	Price/Earnings (TTM)	NA
Price/ tangible book	0.61X	Price/Earnings (2003)	2.98X

*UFP Technologies is a designer and manufacturer of a broad range of high performance cushion foam and molded fiber products, and specialty foam and plastic products for the industrial and consumer markets. 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, telecommunications, industrial, medical and pharmaceutical markets. ([www.ufpt.com](http://www.ufpt.com))*

### **Key investment considerations:**

- We are maintaining our speculative buy rating for shares of UFP Technologies (UFPT) with a 24-month price target of \$5.50 per share.*
- For the third quarter ended September 30 2001, UFP Technologies net sales decreased 26% to \$13.9 million from \$18.9 million in 2000. The net loss was \$900,000 or \$(0.22) per share versus net income of \$280,000 or \$0.05 per share in 2000. In comparison, Taglich Brothers' estimates called for third quarter net sales of \$14.6 million and a net loss of \$432,000 or \$(0.10) per share.*
- We believe the loss was greater than anticipated due to the costs associated with the start up of the nine new automotive programs that occurred during the third quarter. The new automotive programs are expected to add approximately \$5.3 million annually to revenue for the next four years.*
- In November 2001, UFP Technologies purchased the equipment and intellectual property of the "E-cube" product line from E-Tech Inc. This purchase provides the Company with a molded fiber cube product line that will be used for loose fill packaging where an environmentally friendly loose fill product is required.*
- For 2002, we estimate sales will increase 14% to \$69 million and UFP technologies will post earnings of \$338,000 or \$0.08 per share. For 2003, we estimate sales will increase 16% to \$80 million and net earnings will increase to \$1.9 million or \$0.45 per share.*

*\*Please view our disclaimer located at the end of the text portion of this report.*

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### ***Recent Financial Results***

For the three month period ended September 30, 2001, versus the same period in 2000:

- **Net sales decreased 26% to \$13.9 million from \$18.9 million.** The decrease in net sales was primarily due to a reduction in automotive product sales resulting from a large customer that developed an in-house solution to the Company's products and the continued slowdown in computer/electronics packaging.
- **Gross margins decreased to 13% from 23.4%.** We believe the large decrease in gross margins was primarily attributable to the costs associated with the start up of nine new automotive programs during the quarter along with the reduction in net sales. However, we expect the new automotive programs to help increase future sales and earnings.
- **SG&A expenses decreased by 10.4% to \$3.3 million from \$3.7 million.** The reduction in SG&A expenses was due primarily to cost cutting efforts in light of the lower sales. The cost cutting measures were kept modest to enable the Company to respond to new opportunities that might arise.
- **The net loss was \$900,000 or \$(0.22) per diluted share versus net income of \$220,000 or \$0.05 per diluted share.**

Taglich Brothers' estimates called for third quarter net sales of \$14.6 million and a net loss of \$432,000 or \$(0.10) per share. We believe the loss was greater than we anticipated due to the costs associated with the start up of new automotive programs that occurred during the third quarter.

As of September 30, 2001, cash was \$95,000. Cash used in operations for the third quarter was \$180,000. UFP Technologies' working capital as of September 30, 2001 was \$2.6 million with long-term debt of \$7.0 million. The Company has a \$10 million revolving line of credit, of which \$3 million was available on September 30, 2001. Also, the Company has a \$4 million acquisition line of credit available. Of significance is a goodwill balance of \$6.4 million as of September 30, 2001. Under the new accounting standard, SFAS 142, this goodwill balance, if considered impaired, could result in UFP Technologies taking a large write off against operating income. This should result in the Company taking a large loss in the period they take the charge, but in the long term, should result in an increase in net income and taxes and could result in a decrease in cash flow.

The Company has no significant capital commitments, but plans to invest in capital equipment to support its operations. We believe the Company's working capital, projected cash from operations and available borrowings through its line of credit will be sufficient to support operations for the next twelve months.

### ***Recent Acquisition***

In November 2001, the Company announced it had purchased the equipment and intellectual property of the "E-cube" product line from E-Tech Inc. The E-cube product line consists of molded fiber cubes used for loose fill packaging and will enable UFPT to meet the need for an environmentally friendly loose fill product. This product line will allow the Company to expand its current offerings in its packaging segment with minimal additional cost as the product line will be integrated into UFPT's existing equipment. Terms of the acquisition were not disclosed.

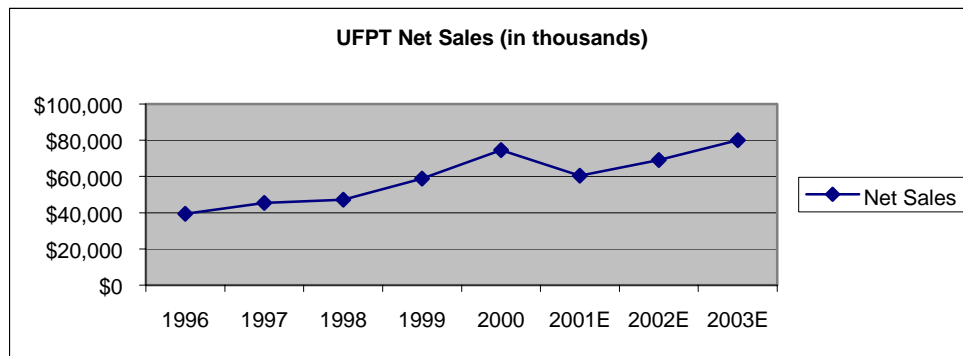
### ***Outlook***

UFP Technologies' automotive sales were hampered by the loss of a \$5.7 million annual automotive program that was taken in-house by a large customer earlier in the year. However, the recent launch of nine new automotive programs should help to offset this loss as Company estimates call for revenues of approximately \$5.3 million annually.

The current weakness in the U.S. economy has resulted in computer/electronics manufacturers producing and selling less. This has directly affected the companies that produce the material needed to package and protect their products. We believe the economy will play a major role in the turn-around of these industries and that sales of packaging products will remain at reduced levels until the economy recovers.

The Federal Reserve, in an effort to revive the economy, has cut short-term interest rates ten times this year, for a total reduction of 4.5 percentage points. We expect this will help boost the economy in 2002, which should have a positive effect on sales of computer/electronics equipment. According to a survey of 33 economists that was released in November 2001 by the National Association for Business Economics, the economy should return to sustained positive growth in the first half of 2002. This should have a positive effect on sales of computer/electronics equipment, thus creating an increase in demand for packaging equipment.

Taking into account the economic projections, the expected revenue from the nine new automotive programs, the recent acquisition, and that UFP Technologies' sales growth rate for the past five years has been approximately double the overall industry's (16.9% versus 8.3%), we estimate the Company will report a 14% increase in sales for 2002 of \$69 million and post earnings of \$338,000 or \$0.08 per share. For 2003, we estimate sales will increase 16% to \$80 million and net earnings will increase to \$1.9 million or \$0.45 per share. We believe that the recent cost cutting measures will result in a more efficient Company and reduced SG&A expenses in 2002. However, in 2003 we believe that UFP Technologies will need to increase their SG&A spending as the current level of capacity will not be able to handle the increase in net sales that we anticipate. Applying the historic price/earnings multiple of 13X to our projected earnings per share of \$0.45 for 2003, we arrive at a 24-month price target of \$5.85 per share.



In addition, we used a discounted cash flow model using EBITDA as a proxy for cash flow and derived a discount rate of 7.7% using the Capital Asset Pricing Model. This model values shares of UFPT at a price of \$5.22. Averaging these two valuation models puts our anticipated 27-month price target for shares of UFPT at \$5.50.

### ***Other Considerations***

#### *Liquidity*

With only 4.2 million shares outstanding and 2.5 million in the float, liquidity issues must be considered. Average daily volume is less than 1,000 shares and there are many days when the stock does not trade at all. Any significant trading in shares of UFPT could result in large swings in the price of the stock.

#### *Competition*

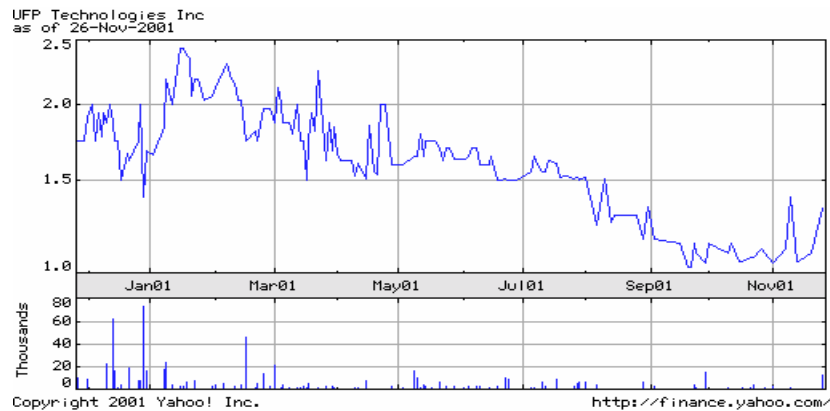
The packaging and specialty foam products industry is highly competitive. The Company's foam and fiber packaging products compete against other alternative products made from materials such as expanded polystyrene foams, die-cut corrugated, plastic peanuts, plastic bubbles and foam-in-place urethane. UFP Technologies also

faces competition in the specialty foam products area from smaller companies that typically concentrate on production for specific industries.

### **Conclusion**

We reiterate our speculative buy rating for shares of UFP Technologies (UFPT) with a 24-month price target of \$5.50 per share. The nine new automotive programs, which were launched during the third quarter of 2001, should add approximately \$5.3 million to revenue on an annual basis. We believe that the recent cost cutting efforts combined with improving industry and economic conditions should enable UFP Technologies to become profitable in the third quarter of 2002.

### **Price Performance of UFP Technologies**



*\* 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 change in figures or our views. This is not a solicitation of any order to buy or sell. Taglich Brothers, Inc. is not a market maker and does not sell to or buy from customers on a principal basis. 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. 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. As of the date of this report, we, our affiliates, any officer, director or stockholder, or any member of their families have a position in the stock of the company mentioned in this report. Taglich Brothers, Inc., does not currently have an Investment Banking relationship with the company and was not a manager or co-manager of any offering for the company within the last three years. Since February 2000, the company pays a monthly monetary fee of \$1,000 (USD) to Taglich Brothers, Inc. for the creation and dissemination of research reports.*

Consolidated Balance Sheets  
(in thousands)

	30-Sep <u>2001</u>	31-Dec <u>2000</u>
<b>Assets</b>		
<i>Current assets:</i>		
Cash and cash equivalents	\$ 95	\$ 94
Accounts receivable	9,776	10,693
Inventories	5,853	6,780
Prepaid expenses and other current assets	<u>2,421</u>	<u>946</u>
<b>Total Current Assets</b>	<b>18,145</b>	<b>18,513</b>
Property and equipment, net	12,081	12,453
Goodwill, net	6,398	6,725
Other assets	<u>2,601</u>	<u>2,661</u>
<b>Total Assets</b>	<b><u>\$ 39,225</u></b>	<b><u>\$ 40,352</u></b>
 <b>Liabilities &amp; shareholders' investment</b>		
<i>Current Liabilities:</i>		
Notes payable	\$ 7,026	\$ 4,737
Current portion of long-term debt	1,467	1,057
Current portion of capital lease obligations	296	290
Accounts payable	3,440	4,440
Accrued expenses and other	<u>3,362</u>	<u>3,850</u>
<b>Total current liabilities</b>	<b>15,591</b>	<b>14,374</b>
Long-term debt	7,047	7,174
Capital lease obligations	175	415
Other liabilities	<u>777</u>	<u>862</u>
<b>Total liabilities</b>	<b>23,590</b>	<b>22,825</b>
<b>Total stockholder's equity</b>	<b><u>15,635</u></b>	<b><u>17,527</u></b>
<b>Total liabilities &amp; stockholder's equity</b>	<b><u>\$ 39,225</u></b>	<b><u>\$ 40,352</u></b>

UFP Technologies, Inc.

Annual Income Statements for the Years Ended  
(in thousands)

	<u>FY(12/99)</u>	<u>FY(12/00)</u>	<u>FY(12/01)E</u>	<u>FY(12/02)E</u>	<u>FY(12/03)E</u>
<b>Net sales</b>	<b>\$ 58,801</b>	<b>\$ 74,491</b>	<b>\$ 60,382</b>	<b>\$ 69,000</b>	<b>\$ 80,000</b>
Cost of sales	<u>43,939</u>	<u>56,870</u>	<u>49,701</u>	<u>54,626</u>	<u>61,600</u>
Gross profit	14,862	17,621	10,681	14,374	18,400
<i>Gross Margin</i>	25.28%	23.66%	17.69%	20.83%	23.00%
SG&A	<u>11,582</u>	<u>14,236</u>	<u>13,545</u>	<u>12,800</u>	<u>13,700</u>
Operating income	3,280	3,385	(2,864)	1,574	4,700
<i>Operating Margin</i>	5.58%	4.54%	-4.74%	2.28%	5.88%
Interest expense	(641)	(1,221)	(1,022)	(960)	(1,000)
Other income (expense)	<u>191</u>	<u>(162)</u>	<u>16</u>	<u>-</u>	<u>-</u>
Income before taxes	2,830	2,002	(3,870)	614	3,700
Income tax	<u>1,136</u>	<u>921</u>	<u>(1,747)</u>	<u>276</u>	<u>1,782</u>
<i>Tax rate</i>	40.14%	46.00%	45.14%	44.95%	48.16%
<b>Net Income / (Loss)</b>	<b><u>\$ 1,694</u></b>	<b><u>\$ 1,081</u></b>	<b><u>\$ (2,123)</u></b>	<b><u>\$ 338</u></b>	<b><u>\$ 1,918</u></b>
<b>Basic EPS</b>	<b><u>\$ 0.35</u></b>	<b><u>\$ 0.25</u></b>	<b><u>\$ (0.50)</u></b>	<b><u>\$ 0.08</u></b>	<b><u>\$ 0.45</u></b>
<b>Diluted EPS</b>	<b><u>\$ 0.35</u></b>	<b><u>\$ 0.25</u></b>	<b><u>\$ (0.50)</u></b>	<b><u>\$ 0.08</u></b>	<b><u>\$ 0.45</u></b>
Basic Shares Outstanding	4,809	4,374	4,252	4,227	4,227
Diluted Shares Outstanding	4,896	4,386	4,252	4,227	4,227
<u>Percent of Revenue</u>					
Cost of goods sold	74.72%	76.34%	82.31%	79.17%	77.00%
SG&A	19.70%	19.11%	22.43%	18.55%	17.13%
<u>Year / Year Growth</u>					
Total Revenues	24.53%	26.68%	-18.94%	14.27%	15.94%
Net Income	2.85%	-36.19%	-296.39%	115.91%	467.46%
EPS	1.47%	-28.77%	-302.58%	116.00%	462.50%

UFP Technologies, Inc.

Quarterly Income Statement for the Year Ending 2001  
(in thousands)

	<u>Q1(3/01)</u>	<u>Q2(6/01)</u>	<u>Q3(9/01)</u>	<u>Q4(12/01)E</u>	<u>FY(12/01)E</u>
<b>Net sales</b>	<b>\$ 16,966</b>	<b>\$ 15,481</b>	<b>\$ 13,935</b>	<b>\$ 14,000</b>	<b>\$ 60,382</b>
Cost of sales	<u>13,568</u>	<u>12,460</u>	<u>12,123</u>	<u>11,550</u>	<u>49,701</u>
Gross profit	3,398	3,021	1,812	2,450	10,681
<i>Gross Margin</i>	20.03%	19.51%	13.00%	17.50%	17.69%
SG&A	<u>3,805</u>	<u>3,237</u>	<u>3,303</u>	<u>3,200</u>	<u>13,545</u>
Operating income	(407)	(216)	(1,491)	(750)	(2,864)
<i>Operating Margin</i>	-2.40%	-1.40%	-10.70%	-5.36%	-4.74%
Interest expense	(275)	(284)	(223)	(240)	(1,022)
Other income (expense)	<u>-</u>	<u>16</u>	<u>-</u>	<u>-</u>	<u>16</u>
Income before taxes	(682)	(484)	(1,714)	(990)	(3,870)
Income tax	<u>(314)</u>	<u>(216)</u>	<u>(771)</u>	<u>(446)</u>	<u>(1,747)</u>
<i>Tax rate</i>	46.04%	44.63%	44.98%	45.00%	45.13%
<b>Net Income / (Loss)</b>	<b><u>\$ (368)</u></b>	<b><u>\$ (268)</u></b>	<b><u>\$ (943)</u></b>	<b><u>\$ (545)</u></b>	<b><u>\$ (2,124)</u></b>
<b>Basic EPS</b>	<b><u>\$ (0.08)</u></b>	<b><u>\$ (0.06)</u></b>	<b><u>\$ (0.22)</u></b>	<b><u>\$ (0.13)</u></b>	<b><u>\$ (0.50)</u></b>
<b>Diluted EPS</b>	<b><u>\$ (0.08)</u></b>	<b><u>\$ (0.06)</u></b>	<b><u>\$ (0.22)</u></b>	<b><u>\$ (0.13)</u></b>	<b><u>\$ (0.50)</u></b>
Basic Shares Outstanding	4,375	4,193	4,214	4,227	4,252
Diluted Shares Outstanding	4,375	4,193	4,214	4,227	4,252
<u>Percent of Revenue</u>					
Cost of sales	79.97%	80.49%	87.00%	82.50%	82.31%
SG&A	22.43%	20.91%	23.70%	22.86%	22.43%
<u>Year / Year Growth</u>					
Total Revenues	-7.20%	-20.27%	-26.26%	-24.55%	-20.28%
Net Income	NMF	NMF	NMF	NMF	NMF
EPS	NMF	NMF	NMF	NMF	NMF

UFP Technologies, Inc.

Quarterly Income Statement for the Year Ending 2002  
(in thousands)

	<u>Q1(3/02)E</u>	<u>Q2(6/02)E</u>	<u>Q3(9/02)E</u>	<u>Q4(12/02)E</u>	<u>FY(12/02)E</u>
<b>Net sales</b>	<b>\$ 15,000</b>	<b>\$ 16,500</b>	<b>\$ 18,000</b>	<b>\$ 19,500</b>	<b>\$ 69,000</b>
Cost of sales	<u>12,150</u>	<u>13,241</u>	<u>14,220</u>	<u>15,015</u>	<u>54,626</u>
Gross profit	2,850	3,259	3,780	4,485	14,374
<i>Gross Margin</i>	19.00%	19.75%	21.00%	23.00%	20.83%
SG&A	<u>3,200</u>	<u>3,200</u>	<u>3,200</u>	<u>3,200</u>	<u>12,800</u>
Operating income	(350)	59	580	1,285	1,574
<i>Operating Margin</i>	-2.33%	0.36%	3.22%	6.59%	2.28%
Interest expense	(240)	(240)	(240)	(240)	(960)
Other income (expense)	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Income before taxes	(590)	(181)	340	1,045	614
Income tax	<u>(266)</u>	<u>(82)</u>	<u>153</u>	<u>470</u>	<u>276</u>
<i>Tax rate</i>	45.00%	45.00%	45.00%	45.00%	45.00%
<b>Net Income / (Loss)</b>	<b><u>\$ (325)</u></b>	<b><u>\$ (100)</u></b>	<b><u>\$ 187</u></b>	<b><u>\$ 575</u></b>	<b><u>\$ 338</u></b>
<b>Basic EPS</b>	<b><u>\$ (0.08)</u></b>	<b><u>\$ (0.02)</u></b>	<b><u>\$ 0.04</u></b>	<b><u>\$ 0.14</u></b>	<b><u>\$ 0.08</u></b>
<b>Diluted EPS</b>	<b><u>\$ (0.08)</u></b>	<b><u>\$ (0.02)</u></b>	<b><u>\$ 0.04</u></b>	<b><u>\$ 0.14</u></b>	<b><u>\$ 0.08</u></b>
Basic Shares Outstanding	4,227	4,227	4,227	4,227	4,227
Diluted Shares Outstanding	4,227	4,227	4,227	4,227	4,227
<u>Percent of Revenue</u>					
Cost of goods sold	81.00%	80.25%	79.00%	77.00%	79.17%
SG&A	21.33%	19.39%	17.78%	16.41%	18.55%
<u>Year / Year Growth</u>					
Total Revenues	-11.59%	6.58%	29.17%	39.29%	14.27%
Net Income	NMF	NMF	119.83%	205.50%	115.91%
EPS	NMF	NMF	118.18%	207.69%	116.00%



UFP Technologies, Inc.

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

	30-Sep <u>2001</u>	30-Sep <u>2000</u>
<i>Cash Flows from Operating Activities</i>		
Net Income	\$ (1,580)	\$ 726
Depreciation & amortization	2,457	2,290
Stock issued in lieu of compensation	141	171
Loss on disposal of PP&E	-	58
<i>Changes in assets and liabilities</i>		
Receivables	917	55
Inventories	927	(267)
Prepaid expenses	(1,475)	(8)
Accounts payable	(999)	(2,405)
Accrued expenses and other	(488)	(333)
Retirement and other liabilities	(84)	(92)
Decrease (increase) in other assets	<u>(1)</u>	<u>(129)</u>
<b>Net Cash Provided by Operations</b>	<b>(185)</b>	<b>66</b>
<i>Cash Flows from Investing Activities</i>		
Additions to property, plant and equipment	(1,740)	(1,233)
Payments from affiliated company	43	32
Acquisition of Simco	-	(5,802)
Proceeds from life insurance	-	155
Proceeds from sale of assets	<u>-</u>	<u>23</u>
<b>Net Cash Used in Investing</b>	<b>(1,697)</b>	<b>(6,825)</b>
<i>Cash Flows from Financing Activities</i>		
Net borrowings under notes payable	2,289	1,514
Principal repayments of long-term debt	(8,718)	(48)
Principle repayments of capital lease obligations	(234)	(1,181)
Proceeds from long-term borrowings	9,000	6,120
Capital stock repurchase	(525)	-
Net proceeds from sale of common stock	<u>71</u>	<u>67</u>
<b>Net cash Provided Financing</b>	<b>1,883</b>	<b>6,472</b>
<b>Net change in Cash</b>	<b>1</b>	<b>(287)</b>
<b>Cash - Beginning of Period</b>	<b><u>94</u></b>	<b><u>349</u></b>
<b>Cash - End of Period</b>	<b><u>\$ 95</u></b>	<b><u>\$ 62</u></b>

Taglich Brothers, Inc.