

# Taglich Brothers, Inc.

The Standard of Excellence in the Microcap Market

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## Research Report

Speculative Buy

**CTI Industries Corp**  
**CTIB \$ 2.00 (NASDAQ-SC)**

Laura A. Conroy  
May 1, 2000

	FYE (10/98)	FYE (10/99) E	FYE (10/00) E	FYE (10/01) E
Revenues	\$20.0	\$17.6	\$27.0	\$30.8
Earnings per share (diluted)	\$0.09	\$(0.86)	\$0.37	\$0.59

52week range	7 1/8 -- 1 1/8	Fiscal year ends:	October
Shares outstanding	1.2 million	Revenue/shares (TTM)	\$16.19
Trading float	0.5 million	Price/Sales (TTM)	0.12X
Institutional ownership	1.73%	Price/Sales (00)	0.09X
Book value/share	\$4.52	Price/Earnings (TTM)	NM
Price/Book	0.44X	Price/Earnings (00)	3.4X

CTI Industries manufactures and sells mylar balloons. Mylar balloons are the popular helium balloons with a metallized coating which usually have printed messages and designs often with characters such as Garfield, Peanuts and Precious Moments, which CTIB maintains licenses to. CTIB also sells latex balloons, toy products and produces laminated and specialty films for food packaging and other commercial uses.

### **Key investment considerations:**

- **We are reiterating our Speculative Buy recommendation for shares of CTI Industries common stock with a 12-18 month target price range of \$3.00 to \$4.00.**
- **Trading at 3X estimated fiscal 2000 earnings, 0.12X sales and 0.44X book value;**
- **Company returned to profitability in the first quarter of fiscal 2000, earning \$0.21 per diluted share;**
- **Sales in the laminated and printed films segment increased by \$1.1 million in the first quarter to \$1.5 million from \$400,000 last year;**
- **CTI expects latex sales to double through increased equity investment in Mexican operations;**
- **Highly seasonal business dependent upon the Social Expression industry. A higher concentration of sales occur in the first half of the fiscal year;**
- **Increases in general and administrative costs and interest expense will result from the additional stake in CTI Mexico but CTI is working to cut costs and has implemented a price increase across the board.**

*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. We, our affiliates, and any officer, director or stockholder, or any member of their families, may have a position in and may from time to time purchase or sell any of the above-mentioned or related securities. 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.*

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### ***Recent Financials***

For the first quarter of fiscal 2000 ended January 31, 2000 versus the same quarter last year:

- Revenues increased by 41% to \$7.0 million versus \$5.0 million;
- Gross margins decreased to 32% from 38%;
- Operating margins increased to 6% from 5%;
- Net income increased to \$263,000 or \$0.21 per diluted share from \$60,000 or \$.05 per diluted share.

The increase in revenues can be attributed to growth in all product lines. Most notably, sales in the laminated and printed films segment increased by \$1.1 million in the quarter to \$1.5 million from \$400,000 last year. Latex balloon sales also grew due to the acquisition of an additional equity stake in CTI Mexico. Gross margins decreased when compared to the same quarter last year but they increased significantly over the prior three quarters. The reason for the decline quarter over quarter is because of the consolidation of the Company and CTI Mexico which had higher costs of goods sold than CTI. Although operating expenses were significantly higher in the areas of general and administrative costs, expenses decreased in selling, advertising and marketing and helped the Company achieve better operating margins. General and administrative expenses increased mainly because of the inclusion of CTI Mexico. Since January, management implemented costs cuts in these areas for CTI Mexico and will continue to shave off unnecessary costs for the remainder of the year. The reduction in selling costs resulted from the re-negotiation of some licensing agreements, which have reduced the level of royalty payments. Advertising and marketing expenses were reduced through lower servicing costs on several national account programs and a reduction in the amount of trade shows the Company attended in the quarter.

As of January 31, 2000 CTI had approximately \$154,000 in cash, EBITDA of approximately \$1.2 million and negative working capital of \$(539,000). CTI has a revolver with a limit of \$5 million and its line balance was approximately \$4 million. The Company generally maintains a minimal cash balance and uses the line of credit for liquidity. \$6.1 million in receivables and \$6.1 in inventory. Its receivables turnover was 4.6 and its inventory turnover was 2.3. The Company generated EBITDA of approximately \$1.2 million

### ***Outlook***

So far, CTI has captured about 10% of the mylar market and less than 1% of the latex market leaving tremendous room for growth. The mylar business is highly cyclical and most of the company's mylar sales take place in the first half of the fiscal year when holidays like Valentines Day, Mothers Day and events like graduations occur. Latex balloons are far more common and CTI believes that eventually, latex will be a bigger business for the Company than mylar.

We believe a change in balloon product mix in favor of latex, will aid the Company in overcoming the cyclicity that it currently experiences. The laminates business should help smooth earnings as well. CTI demonstrated the possibilities for growth in laminates in its most recent quarter and believes we will continue to see explosive growth in that segment over the next few years. CTI plans to expand the specialty films portion of the business by branching out to new products. Management believes the printed and specialty films segment, especially the industrial and commercial films, will grow to \$20 million or more in sales per year in three (3) years.

We are very optimistic about the remainder of fiscal 2000. However, we are lowering our estimates to factor in increased general and administrative and interest expenses related to the additional equity stake in CTI Mexico. We expect the addition of CTI Mexico to boost latex balloon sales this year but that facility carries higher operating costs that will offset those increases in the short run. CTI is working to decrease its overhead and has implemented an across the board price increase that was effective March 2000. We believe these cost cuts and price increases will enable CTI to increase its profitability. We also expect to see increased mylar sales as a result increased marketing and advertising efforts. We expect increases in the printed and specialty films business in

## CTI Industries Corp

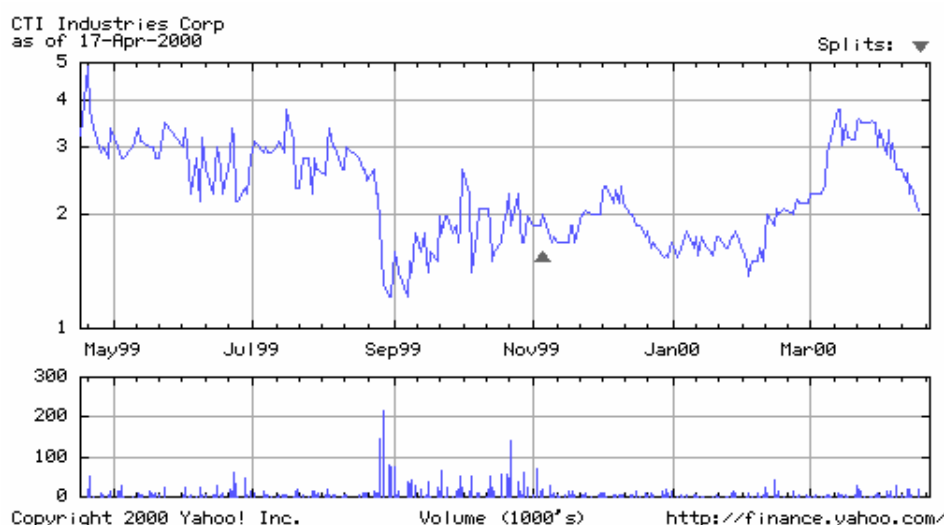
the area of 25% in 2000 through increased food packaging and the addition of more industrial and commercial products that are in the pipeline. According to our projections, CTI should be profitable throughout 2000 and generate EBITDA of over \$3.5 million.

### *Other Considerations*

The Company's current business is seasonal and a considerable portion of sales occur in the first half of the fiscal year resulting in profitability while the second half of the year the Company usually experiences a short fall that can negatively effect operations. CTI has been trying to combat this problem but there is no guarantee that its printed and specialty films business will pick up at the rate expected or when its new advertising and marketing programs will make a big difference. In addition, the industry as a whole has suffered a decline in sales, a result of lower priced competition, and changes to raw material prices could negatively affect the Company's profitability. In the event that operations do not improve as expected, the Company's ability to procure additional financing will also greatly effect its future business prospects.

### *Conclusion*

We expect that CTI can earn \$0.37 per diluted share in fiscal 2000, a decrease from our original estimate of 0.48 per diluted share. On the surface this change may seem significant but one should keep in mind that as a result of the few shares outstanding, slight fluctuations in earnings can dramatically affect earnings per share. CTI's stock is currently trading at 0.12X TTM sales and 5.5X our estimated fiscal 2000 earnings. CTI's direct peers are privately held companies or have been acquired by larger companies with capital structures extremely different from CTI and therefore are not necessarily comparable in a valuation analysis. A similar argument can be made when comparing CTI to the Fabricated Plastic and Rubber Industry. The balloon industry has been consolidating over the past few years and companies have been willing to pay more than 10X EBITDA as evidenced by the acquisition of Anagram by Amscan in 1998. At the time of the acquisition, Anagram had revenues in the area of \$65 million and an earnings margin of 13%. CTI is about a third of the size and has an earnings margin of about 3%. An argument can be made that because CTI is not as sizable or as profitable as Anagram, it should be trading at less than 10X EBITDA and is correctly valued at its current price. Nonetheless, we expect CTI to continue to be profitable and believe there is limited downside to CTI at its current price. Applying a conservative multiple of 7X earnings, we have set our 12-18 month target price range at \$3.00 to \$4.00.



(chart courtesy of Yahoo! Inc.)

Taglich Brothers, Inc.

CTI Industries Corp  
Consolidated Balance Sheets  
(in thousands)

	<b>January 31, 2000</b>	<b>October 31, 1999</b>
<b>Assets</b>		
<b>Current Assets</b>		
Cash	\$ 154	\$ 337
Accounts Receivable	6,155	3,226
Inventories	6,109	5,426
Deferred tax assets	209	209
Other	<u>563</u>	<u>754</u>
<b>Total Current Assets</b>	<b>13,190</b>	<b>9,952</b>
PP&E	19,832	18,105
less accum depreciation	<u>(9,505)</u>	<u>(9,048)</u>
<b>Total property and equipment, net</b>	<b>10,328</b>	<b>9,056</b>
<b>Other assets</b>		
Deferred financing costs, net	25	29
Goodwill	635	-
Investment in subsidiary	-	810
Note receivable	-	715
Deferred tax assets	766	766
Other assets	<u>298</u>	<u>111</u>
<b>Total other assets</b>	<b>1,725</b>	<b>2,431</b>
<b>Total Assets</b>	<b><u>\$ 25,243</u></b>	<b><u>\$ 21,439</u></b>
<b>Liabilities and Stockholders Equity</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 5,398	\$ 2,981
Line of credit	4,016	3,574
Notes payable- current portion	957	1,367
Accrued liabilities	<u>3,358</u>	<u>1,400</u>
<b>Total current liabilities</b>	<b>13,730</b>	<b>9,321</b>
<b>Long-term liabilities</b>		
Non-current liabilities	92	16
Notes payable	4,091	5,535
Subordinated debt	<u>835</u>	<u>865</u>
<b>Total long-term liabilities</b>	<b>5,018</b>	<b>6,416</b>
Redeemable common stock	413	413
Minority interest	571	
<b>Stockholders' equity</b>		
Common stock	188	188
Class B common stock	1,000	1,000
Paid-in capital	5,554	5,554
Retained earnings	(218)	(481)
Foreign currency translation	37	15
less:		
Treasury stock	( 575)	( 513)
Redeemable common stock	( 413)	( 413)
Stock subscription receivable	( 5)	( 5)
Notes receivable from stockholders	<u>(56)</u>	<u>(56)</u>
<b>Total stockholders' equity</b>	<b>5,511</b>	<b>5,288</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b><u>\$ 25,243</u></b>	<b><u>\$ 21,439</u></b>

Taglich Brothers, Inc.

CTI Industries Corp  
Annual Income Statement Model  
For the Years Ended October 31,

	FYE (10/98)A	FYE (10/99)E	FYE (10/00)E	FYE (10/01)E
Net sales	\$ 19,953	\$ 18,565	\$ 27,005	\$ 30,607
Cost of sales	<u>12,707</u>	<u>13,447</u>	<u>18,484</u>	<u>20,860</u>
Gross profit	7,246	5,117	8,521	9,747
<i>Gross margin</i>	36.32%	27.56%	31.55%	31.84%
Operating expenses				
General and administrative	2,353	2,224	3,463	3,050
Selling	2,587	2,527	2,158	3,250
Advertising and marketing	<u>1,805</u>	<u>1,584</u>	<u>1,455</u>	<u>1,900</u>
Total operating expenses	<u>6,745</u>	<u>6,335</u>	<u>7,076</u>	<u>8,200</u>
Operating income	501	(1,218)	1,445	1,547
<i>Operating margins</i>	2.51%	-6.56%	5.35%	5.05%
Other income (expense)				
Interest expense	(765)	(933)	(1,361)	(700)
Interest income	161	88	81	100
Other	<u>285</u>	<u>250</u>	<u>268</u>	<u>200</u>
Total other expense	<u>(319)</u>	<u>(595)</u>	<u>(712)</u>	<u>(400)</u>
Pretax income (loss)	182	(1,813)	733	1,147
<i>Pretax margins</i>	0.91%	-9.76%	2.71%	3.75%
Income tax expense (benefit)	<u>60</u>	<u>(707)</u>	<u>294</u>	<u>447</u>
<i>Tax rate</i>	32.99%	39.02%	40.07%	39.00%
Net income (loss)	122	(1,105)	439	700
Preferred stock dividends	-	-	-	-
Net income (loss) for common	<u>\$ 122</u>	<u>\$ (1,105)</u>	<u>\$ 471</u>	<u>\$ 780</u>
EPS basic	\$ 0.10	(\$ 0.87)	\$ 0.38	\$ 0.59
EPS diluted	<u>\$ 0.09</u>	<u>\$ (0.86)</u>	<u>\$ 0.37</u>	<u>\$ 0.59</u>
Weighted average shares (basic)	1,266	1,269	1,256	1,315
Weighted average shares (diluted)	<u>1,374</u>	<u>1,283</u>	<u>1,264</u>	<u>1,315</u>
<i>% of revenue</i>				
Cost of sales	63.68%	72.44%	68.45%	68.16%
General and administrative	11.79%	11.98%	12.82%	9.97%
Selling	12.97%	13.61%	7.99%	10.62%
Advertising and marketing	9.05%	8.53%	5.39%	6.21%
<i>year / year growth</i>				
revenues	21.44%	-6.96%	45.47%	13.34%
net margin	-88.30%	-1007.04%	142.65%	-65.34%
EPS (diluted)	-82.68%	-1071.41%	143.28%	58.91%

Taglich Brothers, Inc.

CTI Industries Corp  
Quarterly Income Statement Model  
For the Year Ended October 31, 2000

	<u>Q1 (1/00)E</u>	<u>Q2 (4/00)E</u>	<u>Q3 (7/00)E</u>	<u>Q4 (10/00)E</u>	<u>FYE (10/00)E</u>
Net sales	\$ 7,013	\$ 7,202	\$ 6,435	\$ 6,355	\$ 27,005
Cost of sales	<u>4,756</u>	<u>4,947</u>	<u>4,419</u>	<u>4,362</u>	<u>18,484</u>
Gross profit	2,257	2,255	2,016	1,993	8,521
<i>Gross margin</i>	32.18%	31.31%	31.33%	31.36%	31.55%
Operating expenses					
General and administrative	928	875	845	815	3,463
Selling	550	566	523	520	2,158
Advertising and marketing	<u>332</u>	<u>375</u>	<u>373</u>	<u>375</u>	<u>1,455</u>
Total operating expenses	<u>1,810</u>	<u>1,816</u>	<u>1,741</u>	<u>1,710</u>	<u>7,076</u>
Operating income	447	439	275	283	1,445
<i>Operating margins</i>	6.37%	6.10%	4.28%	4.46%	5.35%
Other income (expense)					
Interest expense	(341)	(340)	(340)	(340)	(1,361)
Interest income	6	25	25	25	81
Other	<u>28</u>	<u>80</u>	<u>80</u>	<u>80</u>	<u>268</u>
Total other expense	<u>(7)</u>	<u>(235)</u>	<u>(235)</u>	<u>(235)</u>	<u>(712)</u>
Pretax income (loss)	440	204	40	48	733
<i>Pretax margins</i>	6.28%	2.84%	0.63%	0.76%	2.71%
Income tax expense (benefit)	<u>179</u>	<u>80</u>	<u>16</u>	<u>19</u>	<u>294</u>
<i>Tax rate</i>	40.76%	39.00%	39.00%	39.00%	40.07%
Net income (loss) for common	<u>\$ 263</u>	<u>\$ 130</u>	<u>\$ 35</u>	<u>\$ 45</u>	<u>\$ 471</u>
EPS basic	\$ 0.22	\$ 0.10	\$ 0.03	\$ 0.03	\$ 0.38
EPS diluted	<u>\$ 0.21</u>	<u>\$ 0.10</u>	<u>\$ 0.03</u>	<u>\$ 0.03</u>	<u>\$ 0.37</u>
Weighted average shares (basic)	1,218	1,245	1,245	1,315	1,256
Weighted average shares (diluted)	<u>1,251</u>	<u>1,245</u>	<u>1,245</u>	<u>1,315</u>	<u>1,264</u>
<i>% of revenue</i>					
Cost of sales	67.82%	68.69%	68.67%	68.64%	68.45%
General and administrative	13.24%	12.15%	13.13%	12.82%	12.82%
Selling	7.84%	7.85%	8.12%	8.18%	7.99%
Advertising and marketing	4.74%	5.21%	5.80%	5.90%	5.39%
<i>year/year growth</i>					
revenues	40.59%	48.13%	65.03%	31.99%	45.47%
net margin	335.12%	132.81%	107.56%	114.19%	142.65%
EPS (diluted)	363.96%	133.69%	107.74%	113.43%	143.28%

Taglich Brothers, Inc.

CTI Industries Corp  
 Comparable Company Analysis  
 As of April 18, 2000

	<u>Q1 (1/01)E</u>	<u>Q2 (4/01)E</u>	<u>Q3 (7/01)E</u>	<u>Q4 (10/01)E</u>	<u>FYE (10/01)E</u>
Net sales	\$ 8,361	\$ 8,246	\$ 7,089	\$ 6,911	\$ 30,607
Cost of sales	<u>5,697</u>	<u>5,619</u>	<u>4,833</u>	<u>4,711</u>	<u>20,860</u>
Gross profit	2,664	2,627	2,257	2,200	9,747
<i>Gross margin</i>	31.86%	31.85%	31.83%	31.83%	31.84%
Operating expenses					
General and administrative	788	763	763	738	3,050
Selling	713	704	616	605	3,250
Advertising and marketing	<u>532</u>	<u>513</u>	<u>437</u>	<u>418</u>	<u>1,900</u>
Total operating expenses	<u>2,032</u>	<u>1,979</u>	<u>1,816</u>	<u>1,760</u>	<u>8,200</u>
Operating income	<u>631</u>	<u>648</u>	<u>441</u>	<u>439</u>	<u>1,547</u>
<i>Operating margins</i>	7.55%	7.85%	6.22%	6.36%	5.05%
Other income (expense)					
Interest expense	(175)	(175)	(175)	(175)	(700)
Interest income	25	25	25	25	100
Other	<u>50</u>	<u>50</u>	<u>50</u>	<u>50</u>	<u>200</u>
Total other expense	<u>(100)</u>	<u>(100)</u>	<u>(100)</u>	<u>(100)</u>	<u>(400)</u>
Pretax income (loss)	531	548	341	339	1,147
<i>Pretax margins</i>	6.35%	6.64%	4.80%	4.91%	3.75%
Income tax expense (benefit)	<u>207</u>	<u>214</u>	<u>133</u>	<u>132</u>	<u>447</u>
<i>Tax rate</i>	39.00%	39.00%	39.00%	39.00%	39.00%
Net income (loss) for common	<u>\$ 344</u>	<u>\$ 354</u>	<u>\$ 228</u>	<u>\$ 227</u>	<u>\$ 780</u>
EPS basic	\$ 0.26	\$ 0.27	\$ 0.17	\$ 0.17	\$ 0.59
EPS diluted	<u>\$ 0.26</u>	<u>\$ 0.27</u>	<u>\$ 0.17</u>	<u>\$ 0.17</u>	<u>\$ 0.59</u>
Weighted average shares (basic)	1,315	1,315	1,315	1,315	1,315
Weighted average shares (diluted)	<u>1,315</u>	<u>1,315</u>	<u>1,315</u>	<u>1,315</u>	<u>1,315</u>
<i>% of revenue</i>					
Cost of sales	68.14%	68.15%	68.17%	68.17%	68.16%
General and administrative	9.42%	9.25%	10.76%	10.67%	9.97%
Selling	8.53%	8.53%	8.70%	8.75%	10.62%
Advertising and marketing	6.36%	6.22%	6.16%	6.05%	6.21%
<i>year/year growth</i>					
revenues	19.22%	14.50%	10.17%	8.74%	13.34%
net margin	-30.88%	-172.91%	-559.45%	-410.18%	-65.34%
EPS (diluted)	-24.52%	-158.31%	-524.17%	-410.18%	58.91%

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