



# TAGLICH BROTHERS

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## Research Report – Update

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

### CTI Industries Corporation

Rating: Speculative Buy

Juan Noble

July 1, 2009

#### CTIB \$1.99 — (NASDAQ CM)

	2007A	2008A	2009E	2010E
Total revenues (in millions)	\$36.5	\$45.0	\$39.6	\$42.0
Earnings (loss) per share	\$0.03	\$0.40	\$0.30	\$0.43
52 - Week range	\$7.30 - \$1.20		Fiscal year ends:	December
Shares outstanding as of May 1, 2009	2.8 million		Revenue/share (ttm)	\$15.09
Approximate float	1.5 million		Price/Sales (ttm)	0.13X
Market Capitalization	\$5.6 million		Price/Sales (2010)E	0.15X
Tangible Book value as of March 31, 2009	\$2.39		Price/Earnings (ttm)	6.0X
Price/Book	0.8X		Price/Earnings (2010)E	4.6X

*CTI Industries Corporation (CTIB: Nasdaq CM), headquartered in Barrington, IL, manufactures metalized (foil) and latex balloons, latex toy products, plastic films for packaging applications, and flexible plastic containers for packaging and storage applications. Balloons are marketed in the US, Mexico, and the UK. Film and flexible containers are sold in the US.*

#### Key Investment Considerations:

*We are reiterating our investment rating of Speculative Buy on CTI Industries Corporation (CTIB: NASDAQ CM) and maintaining a 12-month price target of \$2.60 per share. Our target is based on a valuation of 6X (slightly below the midpoint of CTI's historical P-E range) estimated 2010 earnings.*

*For 1Q09 (results released May 14, 2009), the company earned a profit of \$93,000, or \$0.03 per share, on revenue of \$9.6 million, vs. a 1Q08 profit of \$0.10 per share on revenue of \$10.7 million.*

*Revenue has climbed steadily during the past four years. But due partly to economic conditions, sales have declined across most product lines during the past two quarters, signaling potential weakness in revenue during the next few quarters. 1Q results showed a sharp decline in pouch sales to a major customer*

*For 2009, we project earnings of \$0.30 per share on revenue of \$39.6 million, vs. a 2008 profit of \$0.40 per share on revenue of \$45 million. We have reduced our 2009 forecast slightly to reflect 1Q results, a loss of revenue growth momentum due to continued economic weakness, and a diminished margin outlook. We previously forecasted 2009 earnings of \$0.32 per share on revenue of \$42.2 million.*

*We have introduced projections for 2010, estimating revenue of \$42 million and earnings per share of \$0.43. Due to the weakness we project for 2009, revenue comparisons in 2010 should be easier. Our 2010 earnings growth projection is based on a sales gain driven in part by a strengthening economy, and a slight improvement in margins.*

*CTI's balance sheet is leveraged, with only a quarter of assets financed by shareholders' equity. But strong cash flow and available sources of financing should amply support requirements through the end of 2010. By our cash flow projections, CTI should be able to slightly reduce its line of credit utilization by the end of 2010.*

*\* Please view our disclaimer located on page 16.*

700 New York Avenue, Huntington, New York 11743  
(800) 383-8464 • Fax (631) 757-1333  
[www.taglichbrothers.com](http://www.taglichbrothers.com)

**Investment Recommendation**

**We are reiterating our investment rating of Speculative Buy on CTI Industries Corporation (CTIB: NASDAQ CM) and maintaining a 12-month price target of \$2.60 per share.** Our target is based on our 2010 earnings estimate and a P-E within the historical range of multiples for the rubber and plastics sector.

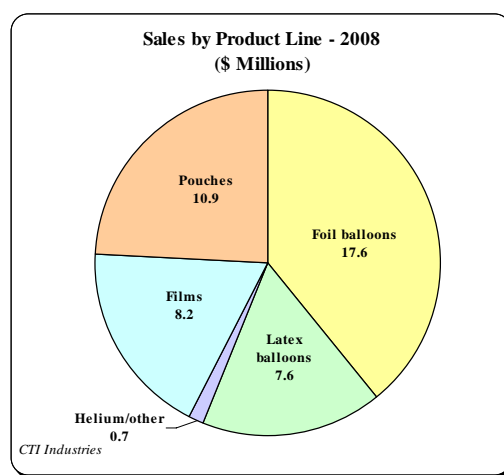
Of the 12 comparable (market capitalizations of less than \$100 million) rubber and plastics sector stocks profiled by Capital IQ, 10 showed no earnings projections for 2009 or 2010. As a valuation metric, we are using P-E ranges – 16.8X to 3.2X – of the rubber and plastics sector for the past five years. CTI’s P-Es for the past three years ranged from 4.1X to 11.2X.

We believe that within the next 12 months, investors will accord CTIB shares a valuation of 6X estimated 2010 earnings of \$0.43 per share, or \$2.60, a target that implies stock price appreciation of 30%.

**Company Overview**

CTI Industries Corporation, headquartered in Barrington, IL, manufactures metalized (foil) and latex balloons, latex toy products, plastic films for packaging applications, and flexible plastic containers for packaging and storage applications. Balloons are marketed in the US, Mexico and the UK. Film and flexible containers are sold in the US. CTI operates production facilities in the US and Mexico.

The business started in the mid 1970s as a manufacturer of flexible containers for the storage of liquids, food products, household goods and other items. In 1978 CTI started to manufacture foil balloons. In 1985 the company extended its balloon line, first marketing latex balloons then manufacturing them starting in 1988. The coated and laminated films business was started in 1999.

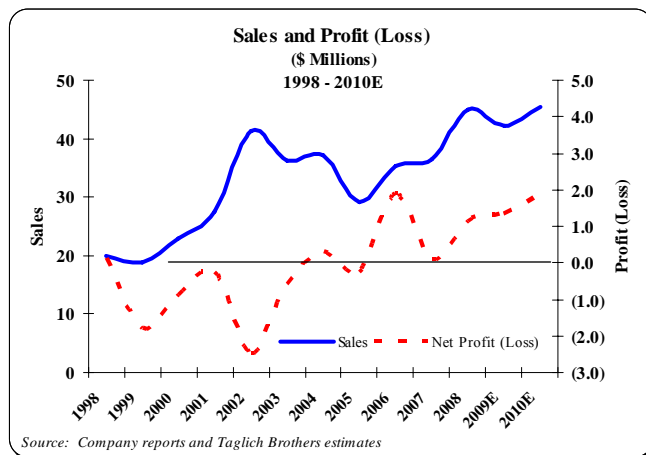


CTI markets foil balloons, latex balloons and related novelty items to retail stores and chains, as well as to distributors who sell to retail stores and chains. Balloon and novelty products are sold to consumers by general merchandise stores, discount and drugstore chains, grocery chains, card and gift shops, and party goods stores, florists and balloon decorators. The laminated and printed films manufactured by CTI are sold to processors that produce bags or pouches for the packaging of food, liquids and other items.

The company also manufactures pouches and bags which are used for a variety of applications. These include storage devices for clothing and other household items, and pouches for household use in storage of food and other items. CIT has developed vacuum storage bags with zipper closures and valves through which air can be removed from the bag after it is sealed, ensuring airtight storage. CTI also produces containers that are “dunnage” items which, when inflated, cushion products in a package or container.

In 2008, sales to customers in the US and Mexico accounted, respectively, for 77% and 17% of sales. The rest consisted of UK sales.

During the past ten years, CTI’s sales have fluctuated from year to year but have maintained a largely upward trend. Profitability has been variable. For most of the



period between 1998 and 2005, CTI's annual results showed a loss. For the past three years, however, operations have been profitable due to rising revenue.

Product quality and innovation have enabled the company to maintain a degree of pricing flexibility but material costs have compressed CTI's gross margin in each of the past three years. Raw material (43% of 2008 manufacturing costs) costs are largely petroleum-based, so as the price (average/barrel) of oil doubled from \$50 in 2005 to \$100 in 2008, CTI saw significant upward pressure on raw material prices and the cost of energy used to operate production facilities. The price of natural gas influences the cost of the resins and polyethylene sheeting that CTI purchases to manufacture films and bags. Between 2005 and 2008, the wellhead price of US natural gas (\$ per thousand cubic feet) ranged roughly between \$6.00 and \$10.00. In the first four months of 2009, prices fell from around \$5.00 to \$3.00.

The price of latex, also one of CTI's important raw materials, has increased sharply during the past few years. Since mid-2005, the price of bulk latex has increased more than 80%, a consequence mainly of shortages caused by the impact of typhoons in Malaysia and Thailand, the largest rubber-producing nations. Latex prices have also been driven by demand from tire and latex glove manufacturers. As an alternative, synthetic latex has provided little cost relief due to the rising price of oil.

As gross margins have narrowed, operating expenses have, in dollar terms, increased steadily, limiting the company's ability to leverage operating expenses and improve operating margins. But 2008 results suggest that larger volume can drive bottom line gains despite reduced gross margins.

### ***1Q09 Results***

*Operations* For 1Q09, CTI earned a profit of \$93,000, or \$0.03 per share, on revenue of \$9.6 million. We had previously projected a 1Q profit of \$283,000, or \$0.09 per share, on revenue of 10.4 million. Sales for the period were down 11%. Sales of foil balloons were up 10% due to larger purchases by a major customer; sales of latex balloons were up 3%. But balloon sales gains were offset by a decline in other products, mainly pouches, sales of which dropped 60% to \$986,000 due to reduced sales to SC Johnson.

CTI supplies SC Johnson with a vacuum-sealed pouch that was launched in September 2008. During SC Johnson's pre-launch inventory buildup, CTI sales to this account increased sharply through 3Q08, by which point SC Johnson had ample stocks of the vacuum-sealed pouch. Since then, pouch sales to SC Johnson have been significantly reduced. Management has indicated that it believes that sales comparisons (with 2008) for vacuum-sealed pouches will be difficult through 3Q09.

The gross margin for 1Q dropped slightly. Between the slight (20 basis points) decline in the gross margin and an increase in the operating expense margin to 16.7% from 15.8%, the operating margin for the quarter narrowed to 4.8% from 6%.

Operating expenses for 1Q dropped 5% to \$1.6 million mainly on a 30% decline in G&A expenses to \$1 million. The reduction in G&A expenses was due mainly to the recovery of \$195,000 in funds misappropriated by a former employee and some reduction in overhead costs. Selling expenses were down 2% to \$177,000 due to lower sales. Advertising and marketing expenses were up 12% to \$388,000 due to higher salaries and advertising relating to the ZipVac™, a proprietary vacuum-sealed storage pouch.

The recovery of misappropriated funds reflected in G&A represents restitution by a former manager who embezzled a total of \$1.4 million between 1997 and 2008, presenting dummy invoices for repair and maintenance services payable to a company that he owned. The embezzlement was discovered in March 2009 during a review of accounting and production records. The employee in question resigned and agreed to make full restitution, but the extent and timing of recovery are uncertain.

Although total borrowings were down in 1Q09, interest expense increased 9% to \$296,000 due to a loan fee paid during the quarter. The increase in interest expense and a \$22,000 loss on asset disposal (vs. a \$30,000 gain in the year-earlier quarter) contributed to a 65% drop in pretax income to \$145,000.

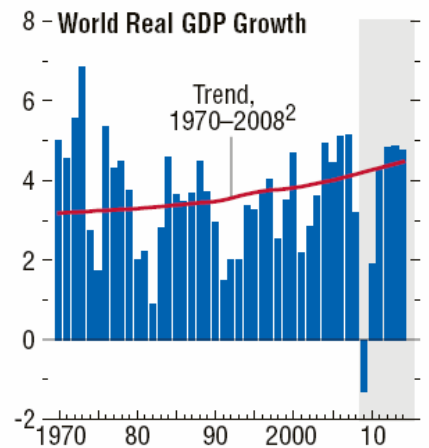
**Finances** 1Q09 cash throw off from operations of \$680,000 covered a nominal addition to working capital, capital expenditures of \$235,000 and debt reduction of almost \$300,000, increasing cash by \$64,000 to \$245,000 at the end of the quarter. CTI remains leveraged, with only 25% of total assets financed by shareholders' equity.

**Credit Agreement** Under a February 2006 loan agreement, RBS Citizens NA extends the company a \$15.3 million line of credit consisting of a \$2.8 million five-year mortgage on the facilities in Barrington, IL, a \$3.5 million term loan secured by physical assets in Barrington, IL, and a \$9 million three-year revolving line secured by receivables and inventory. RBS has also extended a \$1.5 million capital lease line of credit. In January 2009 the expiration of the revolving line of credit was extended to January 2010. Interest rates vary according to the level of senior debt relative to EBITDA. As of March 31, 2009, the rate was prime + 0.75%. Amounts due to RBS as of March 31, 2009 consisted of \$7.9 under the line of credit and \$5 million in term and mortgage loans. The lending agreement contains certain restrictive and financial covenants.

Under the RBS loan agreement, CTI was required to purchase a swap agreement covering at least 60% of the mortgage and term loans extended by the bank. The swap agreement has, in effect, fixed the interest rate for the mortgage and term loans at 8.49%. Another swap agreement covers \$3 million of the revolving line, fixing the interest rate for the amount covered at 6.17%.

## Projections

**Operations** Our revenue forecasts are based in part on the economic outlook through 2010. The International Monetary Fund forecasts a recovery in GDP growth by next year. That recovery, however, is predicated on decisive and cohesive government intervention, mainly by easing monetary policy and maintaining a high rate of spending. The IMF's view is that despite vigorous government intervention, the projected recovery, illustrated graphically in an April 2009 IMF chart (right), is likely to be slow and weak.



Operating results will be influenced heavily not only by revenue gains but also by the prices of energy and latex. Management believes that at the current level of oil (approximately \$70 a barrel) and latex (approximately \$1.75 per kilogram), CTI should be able to operate profitably. But if oil prices range much higher, e.g., to \$100 a barrel, sustaining profits would be difficult. Profitability would also be constrained if the price of latex rose as high as \$3.00 per kilogram.

For 2009, we project a decline in sales due to economic weakness and a sharp drop in full-year pouch sales to SC Johnson. As SC Johnson's 2008 inventory filling purchases were abnormally large, pouch sales comparisons will be difficult. By our projections, the effect of weaker sales will be exacerbated by margin contraction stemming from the 1H09 increase in oil prices. For 2010, however, we anticipate a recovery in sales growth momentum as the economic climate improves. Our projections reflect relatively stable gross margins, implying that oil and latex prices will not range significantly higher or lower than current levels.

We project a 2009 profit of \$865,000, or \$0.30 per share, on revenue of \$39.6 million. We had previously projected 2009 earnings of \$0.32 per share on revenue of \$42.2 million but reduced our estimates slightly to reflect 1Q results and our outlook for a narrowing of margins due to limited pricing flexibility amid weak economic conditions and a 1H09 oil price-driven increase in raw material costs.

We project a 12% decline in revenue, mainly in the commercial product (films and pouches) lines that are more sensitive to changes in the business cycle. The decline will be led by an estimated 51% drop in pouch sales to \$5.6 million (vs. \$11 million in 2008), much of that relating to SC Johnson. By our estimates, the decline in 1Q pouch sales to SC Johnson will extend, albeit at lesser rates, into 2Q and 3Q. We also anticipate a 9% decline in film sales to \$8 million. Balloon sales are expected to rise slightly.

Gross margins are projected to narrow further to 21.8% from 22.9%. We believe that margin compression will stem from the effect of rising oil prices on raw material costs and a limited ability to raise selling prices during a difficult economic environment. G&A expenses should be more moderate as CTI continues to collect restitution of embezzled funds, which we project at the same rate seen in 1Q09 (\$195,000) through the end of 2010. The rate and extent of recovery of misappropriated funds is not certain. Due mainly to that relief, the operating expense margin for 2009 should narrow to 17.4% (vs. 17.7% for 2008).

We project a 23% decline in interest expense due to reduced borrowing and lower interest rates.

The income taxes we project for 2009 (and 2010) reflect rates that are lower than US statutory rates, as CTI had, as of December 31, 2008, net operating loss carry forwards of \$6 million expiring in various years through 2025.

For 2010, we project a profit of \$3.3 million, or \$0.43 per share, on revenue of \$42 million. The projected 6% sales gain should be fairly broad but is likely to be led by pouch sales as they recover from the prior year's weakness, rising an estimated 15% to \$6.1 million. We project modest revenue gains in all other product lines.

Manufacturing costs and operating expense are projected to increase at roughly the same rate as revenue, implying no cost leveraging, and largely stable cost of sales and operating expense margins. Interest expense is projected to fall 21% to \$594,000 due to a projected reduction in borrowings.

*Finances* For 2009, we project \$3.3 million in cash throw off from operations and a \$1.1 million reduction in working capital stemming mainly for a reduction in inventory. The \$4.4 million in cash from operations should cover projected capital expenditures of \$1.7 million and debt reduction of \$1.1 million, enabling CTI to increase cash by \$500,000 to around \$700,000 by the end of the year. Cash throw off for 2010 is projected at \$3.8 million, partly offset by a \$600,000 increase in working capital as receivables and inventory rise with a recovery of sales growth. Projected cash from operations should be sufficient to cover capital expenditures of \$2 million and \$1.1 million in debt repayment, increasing cash by over \$100,000 to around \$800,000 by the end of 2010.

## ***Products and Markets***

*Foil Balloons* CTI produces over 500 foil balloon designs in different shapes and colors, and in sizes ranging from 4-½ inches to 31 inches in diameter. Foil balloons remain buoyant for extended periods when filled with helium and lend themselves to the printing and display of graphics and messages like those on greeting cards. Many foil balloons feature printed messages or designs – figures, licensed characters and cartoon images. The balloons are sold as toys or decorative items in party settings or with floral arrangements and candy containers.

Foil balloons are sold directly by manufacturers or through distributors to a variety of retail outlets, including grocery, general merchandise, discount and drug store chains, card and gift shops, party goods stores, florists and balloon decorators.

*Latex Balloons* CTI manufactures latex balloons in six shapes and 42 colors; the latex balloon line is produced at a subsidiary's facility in Mexico. Latex balloons, also widely used as toys and decorative items, are sold to the same customers, the same regional markets, and through the same channels as foil balloons. CTI's latex balloon line includes punch balls, water bombs and balloons that can be twisted into various shapes.

While the US is believed to be the largest market for foil balloons, they are sold practically all over the world. At drugstore chain units on Long Island, NY, foil balloons sell for roughly \$2.50 each; latex balloons sell for around

\$0.90 each. Sales of balloons can be sensitive to changes in the business cycle but they tend to be less so than sales of film and packaging products. CTI's 2008 sales to Dollar Tree, the company's largest balloon customer, totaled \$9 million, 20% of total revenue and more than one-third of CTI's balloon sales. Dollar Tree's FY2009 (ended January 2009) sales were up 10% to \$4.6 billion; for the first FY2010 quarter (ended May 2009), Dollar Tree's sales increased 14% to \$1.2 billion.

Packaging Films/Custom Film Products CTI laminates, extrudes, coats and prints films and sells them to customers who use the films for packaging. Most of the customers for film products convert them to bags or for the packaging their own products, mainly solid and liquid food items such as cola syrup, coffee, juices and other items. Flexible containers are also used for medical purposes such as colostomy bags and saline solution containers, air-filled bags used to cushion products being packaged, storage of personal and household items, and other purposes.

CTI sells its printed and laminated films directly and through independent sales representatives throughout the United States. The company's largest customer for film products is Rapak, L.L.C., which is committed, under an agreement in effect until October 2011, to purchase at least 75% of its requirements for embossed film from CTI. In 2008, sales to Rapak totaled \$7.6 million, or 17% of sales.

Pouches, Bags and Other Custom Film Products CTI manufactures completed film products, generally in the form of a bag or pouch. These products include valved, resealable pouches for storage of household items, vacuum sealable bags for food storage, resealable, valved bags for storage and vacuum sealing of food items in the household, and dunnage bags (inflatable pouches used to cushion products in packages). CTI also produces open-top bags for use with home heat sealing machines. Resealable, valved bags, launched in 2008, are sold mainly to SC Johnson.

Proprietary pouches include ZipVac™ bags, which function with a small hand or powered pump to evacuate air when the bag is sealed. ZipVacs, which are similar to the valved, resealable pouches sold by SC Johnson under the ZipLoc brand, are sold by CTI to markets other than those addressed by SC Johnson. Flexible containers and pouches are sold in numerous forms in the consumer market, including simple open-top plastic bags, resealable bags and zippered bags. The market also includes containers and pouches of special design or purpose, including vacuumable bags for storage of food or household items, medical bags, or commercial uses.

CTI sells flexible containers and pouches to a number of companies for commercial packaging purposes. The company's consumer storage packages are sold to a major customer, and to retail chains and outlets. Major supply agreements include the following:

- S.C. Johnson & Son, Inc. Under a license and supply agreement, CTI manufactures home food management products that are sold by SC Johnson (or its designee, Goodwill Commercial Services, Inc.) under the SC Johnson ZipLoc® brand. The agreement expires in June 2011 and provides for two renewal terms of two years each at the option of SC Johnson. During 2008, sales to SC Johnson totaled \$7 million, or 16% of sales.
- ITW Space Bag, a division of Illinois Tool Works, Inc. Under a March 2006 four-year agreement with ITW, CIT supplies all of ITW's requirements for certain of their pouches marketed under the name Space Bag® in North America. Under the agreement, CIT also supplies ITW's film needs for certain of pouches produced by ITW.
- CTI's ZipVac pouches are sold to chains such as the sporting good retailer Cabela's. Open-top bags are also marketed to retail chains, including closely-held Menard's, a regional (Midwest) home improvement products retail chain.

## ***Competition***

The company's markets are highly fragmented and characterized by a large number of producers, most of whom manufacture low priced products in large volumes. Generally, CTI competes on the basis of price, product quality, customer service, timely delivery and product differentiation. The company believes that proprietary technology underlies design advantages that enable CTI to maintain moderately good pricing flexibility in all of its markets.

CTI believes that it is the second larger producer of foil balloons in the US. The company has identified five other US companies as major foil balloon manufacturers: Anagram International, Inc. (subsidiary of Amscan, Inc.), Pioneer Balloon Company, Convertidora International S.A. de C.V., Barton Enterprises Inc., and Betallic, LLC. CTI counts approximately five manufacturers of latex balloons whose products are sold in the US and many others whose products are sold elsewhere. CTI also competes with foil and latex balloon manufacturers in Europe, Latin America and Asia. CTI is able to differentiate its foil balloon products with style, design and licensing. But in the market for latex balloons, which are poorly differentiated, price competition is very intense.

There are numerous competitors in the market for films, packaging, flexible containers and custom products, many of which are larger, better entrenched, and have extensive distribution systems. Competition is based on price, new designs, product development and copyright licensing. In these markets, CTI's efforts at product differentiation are supported by proprietary technology.

CTI reports hundreds of manufacturers of printed and specialty film products in the US and in other markets. Companies who package food and other products in film packages often produce or process their own film needs. Many of these companies purchase film – often printed film – and convert the film to pouches or packages at their own facilities while others purchase completed containers from suppliers.

## ***Strategy***

The key elements of CTI's business strategy are as follows:

*Core Assets and Expertise* CTI has developed assets, technology and expertise which should enable the company to develop, manufacture, and market innovative products of high quality within the market for film products – laminated films, printed films, pouches and film novelty products.

*Margin Gains and Cost Controls* Ongoing review and control of production costs, and selling, general and administrative expenses. Management believes that a gross margin in the range of 24% to 25% is attainable if manufacturing overhead and the cost of raw materials are well controlled, and the company maintains some pricing flexibility.

*New Products, Product Improvements and Technologies* In the novelty line, development work includes new designs, new character licenses and new product developments. In the commercial line, CTI has introduced new pouch closure systems and valves and new film methods for liquid packaging applications. Nine patents have been issued and three patent applications are pending. CTI tries to identify and maintain relationships in which the company can provide value-added services in the form of technology or systems. The company also collaborates with customers to develop custom film products to suit unique needs or requirements of the customer.

*New Channels of Distribution and Sales Relationships* CTI aims to develop new channels of distribution and new sales relationships for both new and existing products. One example is the supply and license agreement to supply to SC Johnson certain home food management products to sold under the SC Johnson ZipLoc® brand.

## ***Risks***

In our view, these are the principal risks underlying the stock:

***Competition*** CTI produces commodity products, the markets for which are highly fragmented and competitive. Competition is based, among other factors, on price and product quality. Constrained pricing flexibility could limit potential for gross margin improvement.

***Raw Material Costs*** CTI's profitability can be significantly influenced by the cost of oil, natural gas and latex, prices for which have fluctuated widely during the past three years.

***Customer Concentration*** A very large proportion of sales are concentrated in a handful of customers. In 2008, 52% of revenue derived from sales to three customers, each of which accounted for substantial proportions of specific product line revenue. Dollar Tree Stores accounted for 36% of total balloon sales in 2008. Film sales to Rapak LLC represented 93% of total film sales. SC Johnson accounted for two-thirds of 2008 pouch sales. The loss of all or a portion of sales to customers such as these (e.g., the drop in pouch sales to SC Johnson in 1Q09) could have a significant effect on operating results.

***Concentration of Control*** John Schwan, chairman, and Stephen Merrick, CFO, each own or control 24% of CTI's common shares. In addition, Howard Schwan, president and brother of John Schwan, owns or controls 7% of the company's common stock. Collectively, these three officers control the company. Their ownership arguably underlies a strong commitment to CTI's success. However, decisions made by these officers may not necessarily be in the best interest of the rest of the shareholders.

John Schwan and Stephen Merrick are also among CTI's creditors, accounting for an aggregate of almost \$1 million in officer loans as of March 31, 2009. Both also maintain an interest in vendors that provide paid services to CTI.

***Internal Controls*** As a result of the March 2009 discovery of a former employee's embezzlement of \$1.4 million between 1997 and 2008, the company has taken a number of steps to remedy control deficiencies. These steps include the examination of every invoice received since 2007 to determine proper documentation and authorization, independent verification of receipt of goods or performance of services on each invoice authorized by the employee in questions, direct verification of each current vendor having no physical address in company records, the assignment of new personnel to invoice review and verification, and limitations on internal authority to set up new vendors. CTI has taken steps to develop or enhance, and test an internal audit function and control processes relating to treasury, payables, property, plant and equipment, accounts receivable, accounts payable and information technology. CTI stated that except as for these, there were no other significant changes in controls or in other factors that could significantly affect disclosure controls and procedures during the quarter ended March 31, 2009. There were no significant deficiencies or material weaknesses in internal controls reported as the end of 1Q09.

***Uncertainty of Restitution*** Our forecasts reflect the recovery of \$1.4 million in misappropriated funds (as an offset to G&A expense) by the end of 2010. The extent and timing of recovery is uncertain. To the extent that recovery is less than total, G&A expenses could be higher than forecasted.

***Seasonality*** There are seasonal patterns that may underlie quarter-to-quarter variability that make year on year comparisons less meaningful. In an effort to more adequately reflect this seasonality in our quarterly forecasts, we have calculated seasonal composite indexes for each product line based on results for the prior two years and applied these to our 2009 and 2010 revenue projections.

***Microcap Concerns*** Shares of CTIB have risks common to the stocks of other microcap (which we define as market capitalizations of \$250 mil or less) companies. These risks often underlie stock price discounts from the valuations of larger-capitalization stocks. Liquidity risk, typically caused by small trading floats and very low

## CTI Industries Corporation

trading volume, can lead to large spreads and high volatility in stock price. The company has approximately 1.5 million shares in the float. On average, approximately 14,500 shares are traded daily.

*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.

CTI Industries Corporation

Annual Income Statements  
2006–2010E  
(\$ Thousands)

	2006A	2007A	2008A	2009E	2010E
Sales	35,428	36,510	44,981	39,633	42,007
Cost of sales	26,531	27,825	34,658	30,977	32,702
Gross profit	8,897	8,684	10,322	8,656	9,305
Operating expenses					
G&A	4,554	5,211	5,376	4,488	4,779
Selling	847	754	886	807	872
Advertising/marketing	1,201	1,474	1,678	1,619	1,713
Loss on sale of asset	145				
Other income	(472)				
Total	6,275	7,439	7,940	6,914	7,364
Operating income	2,622	1,245	2,383	1,742	1,941
Interest expense	(1,714)	(1,295)	(1,037)	(793)	(594)
Interest income	23	9	6	13	16
Gain on sale of assets	191	174	50	(22)	
Pre-tax profit	1,122	132	1,401	940	1,363
Income taxes (benefit)	(774)	51	247	74	41
Net income before minority interest	1,896	82	1,154	866	1,322
Minority interest	2	(0)		1	
Net income	1,895	82	1,154	865	1,322
Average shares outstanding	2,235	2,590	2,899	2,888	3,075
Earnings (loss) per share	0.85	0.03	0.40	0.30	0.43
Margin Analysis					
Gross margin	25.1%	23.8%	22.9%	21.8%	22.2%
G&A	12.9%	14.3%	12.0%	11.3%	11.4%
Selling	2.4%	2.1%	2.0%	2.0%	2.1%
Advertising/marketing	3.4%	4.0%	3.7%	4.1%	4.1%
Operating income	7.4%	3.4%	5.3%	4.4%	4.6%
Pretax profit	3.2%	0.4%	3.1%	2.4%	3.2%
Net income	5.3%	0.2%	2.6%	2.2%	3.1%
Income tax (benefit) rate	(69.0%)	38.3%	17.6%	7.9%	3.0%

Source: Company reports and Taglich Brothers estimates

CTI Industries Corporation

Quarterly Income Statements  
2009–2010E  
(\$ Thousands)

	1Q09A	2Q09E	3Q09E	4Q09E	2009E	1Q10E	2Q10E	3Q10E	4Q10E	2010E
Sales	9,603	10,126	9,457	10,447	<b>39,633</b>	9,776	11,042	10,331	10,858	<b>42,007</b>
Cost of sales	7,537	7,873	7,471	8,096	<b>30,977</b>	7,674	8,558	8,110	8,361	<b>32,702</b>
Gross profit	2,067	2,253	1,986	2,351	<b>8,656</b>	2,102	2,484	2,221	2,497	<b>9,305</b>
Operating expenses										
G&A	1,040	1,165	1,135	1,149	<b>4,488</b>	1,075	1,270	1,240	1,194	<b>4,779</b>
Selling	177	213	208	209	<b>807</b>	196	232	227	217	<b>872</b>
Advertising/marketing	388	425	388	418	<b>1,619</b>	391	464	424	434	<b>1,713</b>
Total	1,605	1,802	1,731	1,776	<b>6,914</b>	1,662	1,965	1,891	1,846	<b>7,364</b>
Operating income	462	451	255	575	<b>1,742</b>	440	519	331	652	<b>1,941</b>
Interest expense	(296)	(173)	(165)	(159)	<b>(793)</b>	(154)	(150)	(147)	(143)	<b>(594)</b>
Interest income	0	3	5	5	<b>13</b>	4	4	4	4	<b>16</b>
Gain (loss) on sale of assets	(22)				<b>(22)</b>					<b>0</b>
Other					<b>0</b>					<b>0</b>
Pre-tax profit	145	281	95	420	<b>940</b>	290	373	187	512	<b>1,363</b>
Income taxes (benefit)	50	8	3	13	<b>74</b>	9	11	6	15	<b>41</b>
Net income before minority interest	94	272	92	407	<b>866</b>	281	361	182	497	<b>1,322</b>
Minority interest	1				<b>1</b>					<b>0</b>
Net income	93	272	92	407	<b>865</b>	281	361	182	497	<b>1,322</b>
Average shares outstanding	2,825	2,850	2,900	2,950	<b>2,888</b>	3,000	3,050	3,100	3,150	<b>3,075</b>
Earnings (loss) per share	0.03	0.10	0.03	0.14	<b>0.30</b>	0.09	0.12	0.06	0.16	<b>0.43</b>
Margin Analysis										
Gross margin	21.5%	22.3%	21.0%	22.5%	<b>21.8%</b>	21.5%	22.5%	21.5%	23.0%	<b>22.2%</b>
G&A	10.8%	11.5%	12.0%	11.0%	<b>11.3%</b>	11.0%	11.5%	12.0%	11.0%	<b>11.4%</b>
Selling	1.8%	2.1%	2.2%	2.0%	<b>2.0%</b>	2.0%	2.1%	2.2%	2.0%	<b>2.1%</b>
Advertising/marketing	4.0%	4.2%	4.1%	4.0%	<b>4.1%</b>	4.0%	4.2%	4.1%	4.0%	<b>4.1%</b>
Operating income	4.8%	4.5%	2.7%	5.5%	<b>4.4%</b>	4.5%	4.7%	3.2%	6.0%	<b>4.6%</b>
Pretax profit	1.5%	2.8%	1.0%	4.0%	<b>2.4%</b>	3.0%	3.4%	1.8%	4.7%	<b>3.2%</b>
Net income	1.0%	2.7%	1.0%	3.9%	<b>2.2%</b>	2.9%	3.3%	1.8%	4.6%	<b>3.1%</b>
Income tax rate	34.7%	3.0%	3.0%	3.0%	<b>7.9%</b>	3.0%	3.0%	3.0%	3.0%	<b>3.0%</b>

Source: Company reports and Taglich Brothers estimates

CTI Industries Corporation

Balance Sheets  
2006–2010E  
(\$ Thousands)

	2006A	2007A	2008A	1Q09A	2009E	2010E
<b>ASSETS</b>						
Current assets						
Cash + equivalents	385	483	181	244	703	827
Accts receivable	6,443	5,951	5,822	6,491	6,055	6,418
Inventory	7,974	9,701	10,505	10,268	9,387	9,910
Deferred taxes	1,026	1,014	675	703	594	630
Prepayments & other	664	652	506	624	515	546
<b>Total</b>	<b>16,491</b>	<b>17,801</b>	<b>17,688</b>	<b>18,330</b>	<b>17,254</b>	<b>18,331</b>
Fixed assets (net)						
Deferred financing costs	207	113	123	118	119	126
Goodwill	989	989	989	989	989	989
Deferred income taxes	101	134	342	263	198	210
Other assets	264	191	270	293	238	252
<b>TOTAL ASSETS</b>	<b>26,645</b>	<b>29,324</b>	<b>29,988</b>	<b>30,278</b>	<b>29,330</b>	<b>30,679</b>
<b>LIABILITIES AND EQUITY</b>						
Current liabilities						
Bank overdraft	109	617	680	622	650	650
Accts pay	3,411	4,228	3,153	3,710	3,442	3,634
Line of credit	6,318	6,746	7,961	7,932	6,750	6,500
Notes pay - current portion	949	864	1,091	1,096	812	812
Notes pay - officers	2,155	2,157	1,363	1,368	1,452	1,452
Accruals & other	1,702	1,872	1,973	2,006	1,982	2,100
<b>Total</b>	<b>14,643</b>	<b>16,483</b>	<b>16,222</b>	<b>16,736</b>	<b>15,088</b>	<b>15,148</b>
Notes payable - affiliates	1,294	1,070	895	946	1,000	1,000
Notes payable (net of curr portion)	4,866	4,352	4,220	3,944	3,474	2,662
Notes payable - officers (subordinated)	727	815	904	926	950	950
Shareholders' equity	5,102	6,591	7,735	7,712	8,806	10,907
Noncontrolling interest	13	13	13	14	14	14
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>26,645</b>	<b>29,324</b>	<b>29,988</b>	<b>30,278</b>	<b>29,331</b>	<b>30,680</b>

Source: Company reports & Taglich Brothers estimates

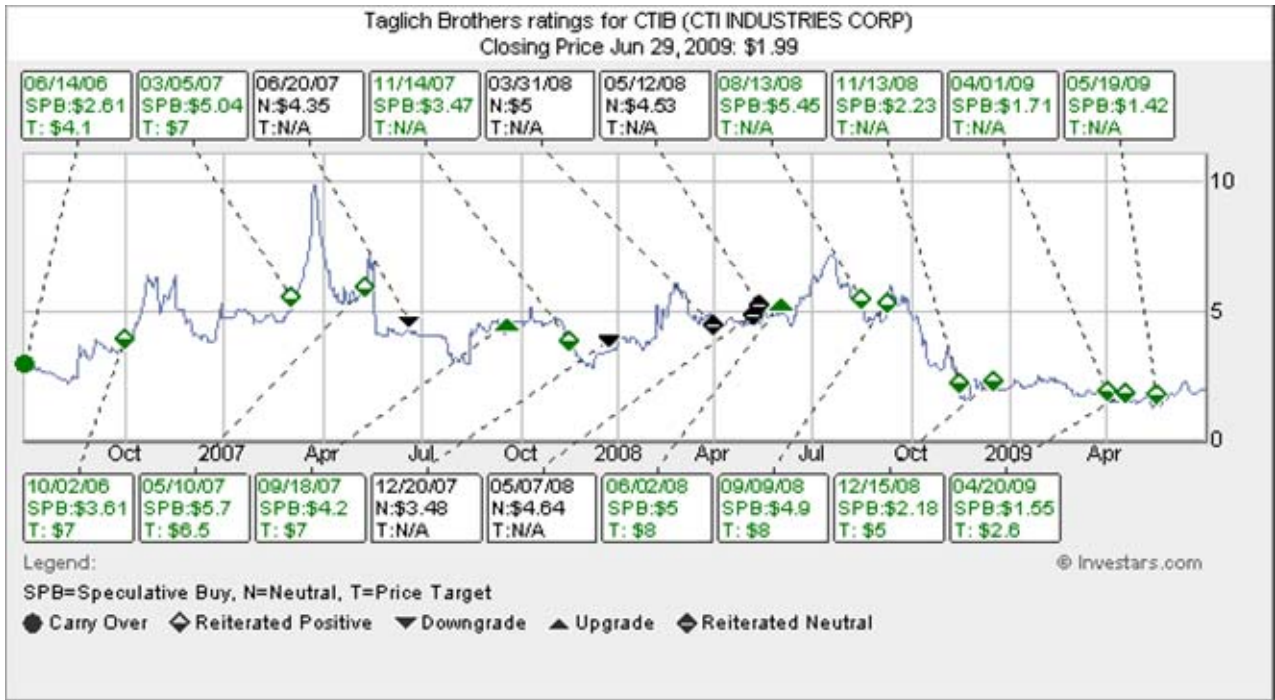
CTI Industries Corporation

Cash Flow Statements  
2006–2010E  
(\$ Thousands)

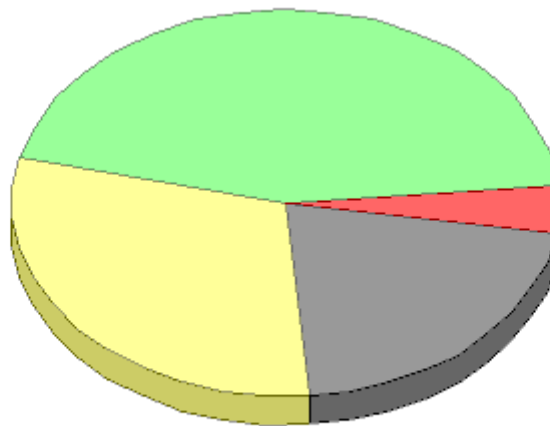
	2006A	2007A	2008A	1Q09A	2009E	2010E
Operating activities				(quarter only)		
Net Income	1,895	82	1,154	93	865	1,322
Depreciation/ amortization	1,424	1,466	1,593	468	1,904	2,005
Amortization of debt discount	103	90	89	22	89	89
Stock based compensation		14	58	21	81	80
Excess tax benefits - stock based comp		(35)	(13)			
Minority interest	2			1	5	5
Loss on sale of asset	145					
Gain on cancellation of vendor claim	(472)					
Provision for losses - accts rec	203	105	139	23	83	82
Provision for losses - inventory	219	141	178	(11)	109	164
Stocks issued to consultants		44	69	13	58	60
Deferred income taxes	(774)	(21)	218	50	105	(14)
Changes in working capital	(4,097)	(530)	(3,085)	(51)	1,081	(606)
Net cash from operations	(1,353)	1,356	400	630	4,380	3,186
Investing activities						
Capital expenditures	(553)	(2,848)	(2,200)	(235)	(1,735)	(2,000)
Financing activities						
Overdraft	(391)	508	80	(58)	(58)	
Net change - line of credit	1,267	428	1,215	(28)	(1,211)	(250)
Proceeds - long term debt/warrants	2,648	326	1,224			
Repayment - long term debt	(960)	(1,242)	(942)	(200)	(809)	(812)
Repayment - short term debt	(363)					
Excess tax benefits - stock based comp		35	13			
Proceeds - exercise of options/warrants	101	195	17			
Proceeds - issuance of stock		1,355	95			
Cash paid for deferred financing fees	(257)	(20)	(19)	(41)	(41)	
Net cash from financing	2,045	1,586	1,681	(326)	(2,118)	(1,062)
Exchange rate effects	(17)	4	(184)	(6)	(6)	
Net change in cash	123	99	(303)	64	522	124
Cash - beginning	262	385	483	180	180	703
Cash - ending	385	483	180	244	703	827

Source: Company reports and Taglich Brothers estimates

# CTI Industries Corporation



## Taglich Brothers Current Ratings Distribution



44.74 % Buy 30.26 % Hold 21.05 % Not Rated 3.95 % Sell

Investment Banking Services for Companies Covered in the Past 12 Months		
Rating	#	%
Buy	1	4.00
Hold	1	14.29
Sell	0	0
Not Rated	0	0

### 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.**

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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.

**Public companies mentioned in this report**

Cabela's	(NYSE: CAB)	Illinois Tool Works	(NYSE: ITW)
Dollar Tree	(Nasdaq: DLTR)		

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