

Taglich Brothers, Inc.

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Research Report-Update

CTI Industries Corp.

Rating: Speculative Buy

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CTIB – \$1.35 (NASDAQ)

December 12, 2001

	<u>FY1998A</u>	<u>FY1999A</u>	<u>FY2000A*</u>	<u>FY2001E</u>	<u>FY2002E</u>
Revenues (Thousands)	\$19,953	\$18,565	\$22,978	\$26,665	\$32,500
Earnings per share	\$0.09	\$(0.86)	\$(0.73)	\$0.00	\$0.42
52-Week Range	\$2.50 – 0.969		Fiscal Year Ends	December	
Shares Outstanding-full dil (000)	1,208		Revenues/Share (TTM)	\$20.91	
Approximate Float (000)	600		Price/Sales (TTM)	0.06X	
Insider Holdings	50%		Price/Sales (2002)	0.05X	
Tangible Book Value/Share	\$2.36		Price/Earnings (TTM)	NM	
Price/Tangible book	0.6X		Price/Earnings (2002)	3.2X	

*CTIB changed its fiscal year from October to December during fiscal 2000

CTI Industries Corp. is an international manufacturer and marketer of mylar and latex balloons and specialty, laminated and printed film.

Key Investment Considerations:

- We are reiterating our Speculative Buy rating for shares of CTI Industries Corp. (CTIB) and establishing a 15-month target price of \$6.69 per share. CTIB is a compelling investment opportunity trading at 3.2X estimated 2002 EPS and 0.6X tangible book value.
- CTIB's third quarter net sales increased by 39% to \$6.8 million. Revenue increases were led by the laminated and specialty films segment, which increased 84% over the same quarter last year. Income from operations increased to \$312 thousand from a net loss of \$91 thousand in the year ago quarter.
- Taglich Brothers estimated that the Company would post net sales of \$6.2 million and income of \$25 thousand or \$0.02 per share. Sales exceeded our expectations, while EPS fell short of expectations.
- We believe that the Company will become profitable in the fourth quarter of fiscal 2001. Taglich Brothers estimates call for EPS of \$0.07 per share in 4Q01.
- We are maintaining our estimates for 2002. We are projecting fiscal 2002 EPS of \$0.42 per share on revenues of \$ 32.5 million.

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

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Company Overview

CTI Industries Corporation (CTIB) is engaged in the development, manufacture, sale and distribution of:

- Novelty products, principally balloons, including mylar balloons, latex balloons, punch balls and other inflatable toy items; and
- Specialty and printed films primarily for food packaging, specialized consumer uses and various commercial applications.

Recent Results- 3rd Quarter 2001

CTI Industries announced third quarter net sales increased by 39% to \$6.8 million versus \$4.9 million in last year's third quarter. The Company reported a net loss for the quarter of \$15 thousand or \$(0.01) per share. This compares to a net loss of \$156 thousand or \$(0.13) per share in the year ago quarter. The loss for 3Q01 was primarily due to costs related to loans and foreign exchange losses. Income from operations increased to \$312 thousand from a loss of \$91 thousand in the year ago quarter. This was primarily due to increased operating efficiencies as compared to the year ago period:

- Gross margins increased to 29% of net sales as compared to 28%;
- Administrative expenses decreased to 12.6% of net sales as compared 16.6%; and
- Advertising and marketing expenses decreased to 4.3% of net sales as compared to 5.7% of net sales.

Revenue increases were led by the laminated and specialty films segment, which increased 84% over the same quarter last year. This follows strong gains in the second quarter of 2001.

Taglich Brothers had estimated that the Company would post net sales of \$6.2 million and income of \$25,000 or \$0.02 per share. Sales exceeded our expectations due to strong gains in the Company's laminated and specialty films segment, while the bottom line was negatively impacted by \$70,000 in currency loss and \$23,000 in loan fees.

Financial Leverage & Strength

At September 30, 2001, the Company had a cash balance of \$237 thousand, a working capital deficit of \$338 thousand, a current ratio of 0.98X, and a debt to equity ratio of 0.9X. The Company's current cash management strategy includes maintaining minimal cash balances and utilizing the revolving line of credit for liquidity. **The Company believes that existing capital resources and cash generated from operations will be sufficient to meet the Company's requirements for at least 12 months.** CTIB has an outstanding balance on its domestic line of credit of approximately \$5.0 million and a balance its equipment term loan of approximately \$1.3 million. The balance outstanding on the Mexico loan is approximately \$750,000.

In January 2001, the Company entered into a Loan and Security Agreement with a new lender under which the lender has provided the Company with a credit facility in the amount of \$9.5 million secured by equipment, inventory, receivables, and other assets of the Company. The credit facility includes a term loan of \$1.4 million, at an interest rate of prime plus 0.75%, and a revolving line of credit at an interest rate of prime plus 0.50%, the amount of which is based on advances of up to 85% of eligible receivables and 50% of the value of the Company's inventory.

Also in January 2001, another lender loaned to the Company \$2.87 million in a refinance of the Company's principal office building and property. The loan is secured by the aforementioned building and property, and has been made in the form of two notes. The first note is in the principal amount of \$2.7 million bears interest at the rate of 9.75%, and has a term of five years with an amortization period of 25 years. The

second note is in the principal amount of \$173 thousand with an interest rate of 10% and has a term of three years.

During 2001, CTI Mexico obtained a bank loan for \$1.1 million and used the proceeds for working capital, maintenance and equipment upgrades. The Company has been working to improve the physical condition of CTI Mexico. The completed improvements have already resulted in improved efficiencies and operating profitability over the past two quarters.

Outlook & Projections

We are fine-tuning our estimates for fiscal 2001 due to third quarter results. We are now projecting fiscal 2001 EPS of \$0.00 per share on revenues of \$26.7 million. We previously projected fiscal 2001 EPS of \$0.01 per share on revenues of \$25.8 million. We continue to believe that the Company will be profitable in the fourth quarter of fiscal 2001 as operating trends continue to be healthy.

We are maintaining our estimates for fiscal 2002. We are projecting EPS of \$0.42 per share on revenues of \$32.5 million. We are projecting that the 2002 revenue mix will be 46% mylar, 23% latex, and 31% films.

Our projections are based on:

- Continued strength in the Company's film and laminate business, which increased 78% in the last six months as compared to the year ago period. We believe that the Company should continue to capture revenues in this \$1 billion plus market.
- Regained momentum in its balloon business and further expansion into the latex market in Mexico, the US and the UK;
- Operating and net margins are expected to significantly increase over the next eighteen months as CTIB achieves greater operating leverage as its fixed costs are spread over a larger revenue base. Additionally, the recent change in the Company's State of Incorporation is expected to save CTIB approximately \$25,000 per annum (In October of 2001, the Company change its state of incorporation from Delaware to Illinois).

Our conservative assumptions include a decrease in gross margins for fiscal 2002. This is based on:

- 1) Increased competitive pressures in the balloon business; and
- 2) Lower margin products making up a greater percentage of the overall revenue mix;

However, we may reevaluate our assumptions after the end of the 2001 fiscal year, as there will be further visibility into the Company's product and margin mix.

Other Considerations

CTI Mexico

CTI Mexico, located in Guadalajara, manufactures latex balloons and latex novelty items. CTI Mexico has been the midst of an overhaul. CTI has been working to improve the financial and physical condition of CTI Mexico and to increase latex revenues. For the third quarter, Mexico reported a minimal loss primarily due to currency translation.

Macroeconomics

The domestic economy is in the midst of a recession. The recent terrorist attacks in America further increase economic uncertainty. A continuing decline in the economy could have a negative effect on the financial and operating performance of the Company. However, novelty items tend to do well in economic downturns.

Liquidity

The shares of CTIB have risks common to those of the microcap segment of the market. Often these risks 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 and can lead to large spreads and high volatility in stock price. These concerns are exacerbated in times of earnings shortfalls or uncertainty. CTIB has approximately 600 thousand shares in the float. On average, approximately 681 shares are traded daily.

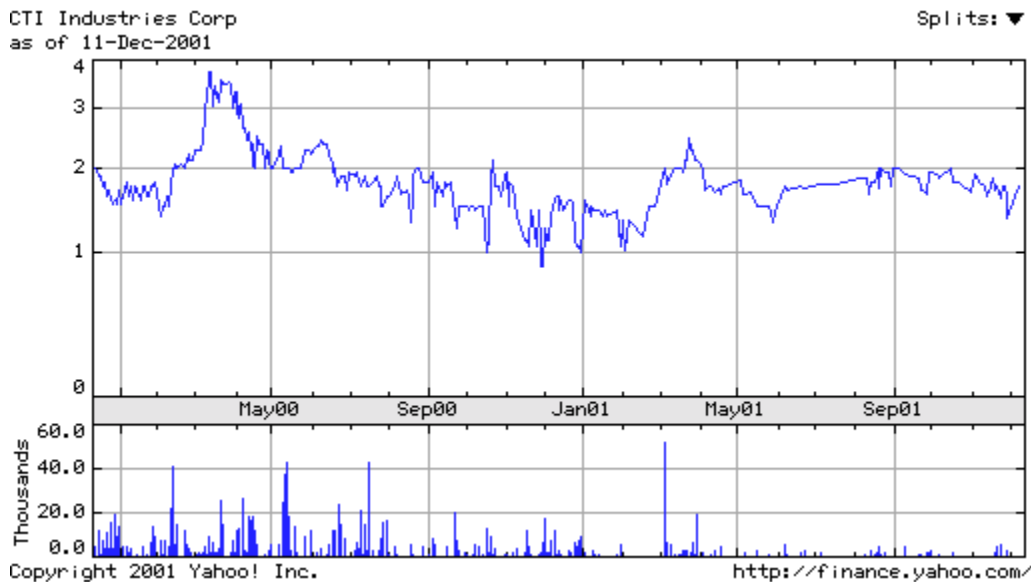
Conclusion

We believe that CTIB is a compelling investment opportunity trading at 3.2X estimated 2002 EPS. Our estimates call for the Company to be profitable in the fourth quarter of fiscal 2001 and build momentum in fiscal 2002. We are maintaining coverage of CTIB with a Speculative Buy. We have set a 15-month price target of \$6.69 per share. Our price target was obtained by applying a 15.9X multiple to our 2002 EPS estimate of \$0.42 per share. Our multiple is based on:

- Fabricated Plastic and Rubber Industry’s price to TTM earnings (P/E) multiple of 25.5X.
- Containers and Packaging Industry’s price to TTM earnings (P/E) multiple of 20.0X
- Discounting the average of the above figures by approximately 30% to give consideration to concerns associated with the Company’s micro-capitalization and other risks.

We believe that there may be further upside in the shares as:

- 1) Wall Street realizes that this under-followed Company has the ability to report steady revenue and EPS growth; and
- 2) Our estimates prove to be conservative.



Courtesy of Yahoo, Inc

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CTI Industries
Annual Income Statement Model
For Fiscal Years Ended *
(in thousands)

	FY10/99A	FY(12/00)A	FY(12/01)E	FY(12/02)E
Net sales	\$ 18,565	\$ 22,978	\$ 26,665	\$ 32,500
Cost of sales	<u>13,447</u>	<u>16,375</u>	<u>19,345</u>	<u>24,050</u>
Gross profit	5,117	6,603	7,320	8,450
Gross margin	27.56%	28.74%	27.45%	26.00%
Operating expenses				
General and administrative	2,224	3,585	3,262	3,500
Selling	2,527	1,840	1,853	2,000
Advertising and marketing	<u>1,584</u>	<u>966</u>	<u>1,169</u>	<u>1,200</u>
Total operating expenses	<u>6,335</u>	<u>6,390</u>	<u>6,284</u>	<u>6,700</u>
Operating income	(1,218)	213	1,036	\$ 1,750
Operating margins	-6.56%	0.93%	3.89%	15%
Other income (expense)				
Interest expense	(933)	(1,099)	(973)	(840)
Interest income	88	14	1	-
Gain on sale of assets	-	30	23	-
Other	<u>250</u>	<u>(15)</u>	<u>(87)</u>	<u>-</u>
Total other expense	<u>(595)</u>	<u>(1,070)</u>	<u>(1,036)</u>	<u>(840)</u>
Pretax income (loss)	(1,813)	(857)	(2)	910
Pretax margins	-9.76%	-3.73%	-0.01%	0
Income tax expense (benefit)	<u>(707)</u>	<u>107</u>	<u>15</u>	<u>364</u>
Tax rate	39.02%	-12.48%	-750.00%	40.00%
Net income (loss) before minority interest	(1,105)	(964)	(17)	546
Minority interest	-	(87)	(12)	44
Net income (loss) for common	<u>\$ (1,105)</u>	<u>\$ (877)</u>	<u>\$ (5)</u>	<u>\$ 502</u>
EPS diluted	<u>\$ (0.86)</u>	<u>\$ (0.73)</u>	<u>\$ (0.00)</u>	<u>\$ 0.42</u>
Weighted average shares (diluted)	1,283	1,208	1,208	\$ 1,208
% of revenue				
Cost of sales	72.44%	71.26%	72.55%	74.00%
General and administrative	11.98%	15.60%	12.23%	10.77%
Selling	13.61%	8.01%	6.95%	6.15%
Advertising and marketing	8.53%	4.20%	4.38%	3.69%
year / year growth				
revenues		23.77%	16.05%	21.88%

*CTIB changed its fiscal year from October to December during fiscal 2000

CTI Industries
Quarterly Annual Income Statement Model
For Fiscal Years 2001& 2002
(in thousand)

	Q1(3/01)A	Q2(6/01)A	Q3(9/01)A	Q4(12/01)E	FY(12/01)E	FY(12/02)E
Net sales	\$ 6,081	\$ 6,876	\$ 6,808	\$ 6,900	\$ 26,665	\$ 32,500
Cost of sales	<u>4,458</u>	<u>5,068</u>	<u>4,851</u>	<u>4,968</u>	<u>19,345</u>	<u>24,050</u>
Gross profit	1,623	1,808	1,957	1,932	7,320	8,450
Gross margin	26.69%	26.29%	28.75%	28.00%	27.45%	26.00%
Operating expenses						
General and administrative	747	818	857	840	3,262	3,500
Selling	426	445	492	490	1,853	2,000
Advertising and marketing	<u>271</u>	<u>307</u>	<u>296</u>	<u>295</u>	<u>1,169</u>	<u>1,200</u>
Total operating expenses	<u>1,444</u>	<u>1,570</u>	<u>1,645</u>	<u>1,625</u>	<u>6,284</u>	<u>6,700</u>
Operating income	179	237	312	307	1,036	1,750
Operating margins	2.94%	3.45%	4.58%	4.45%	3.89%	15%
Other income (expense)						
Interest expense	(300)	(242)	(216)	(215)	(973)	(840)
Interest income	1	-	-	-	1	-
Gain on sale of assets	8	7	8	-	23	-
Other	<u>(35)</u>	<u>84</u>	<u>(136)</u>	<u>-</u>	<u>(87)</u>	<u>-</u>
Total other expense	<u>(327)</u>	<u>(151)</u>	<u>(344)</u>	<u>(215)</u>	<u>(1,036)</u>	<u>(840)</u>
Pretax income (loss)	(148)	86	(32)	92	(2)	910
Pretax margins	-2.43%	1.25%	-0.47%	1.33%	-0.01%	0
Income tax expense (benefit)	<u>9</u>	<u>4</u>	<u>2</u>	<u>-</u>	<u>15</u>	<u>364</u>
Tax rate	-6.08%	4.65%	0.00%	0.00%	-750.00%	40.00%
Net income before minority interest	(157)	82	(34)	92	(17)	546
Minority interest	(23)	22	(20)	9	(12)	44
Net income (loss) for common	<u>\$ (133)</u>	<u>\$ 60</u>	<u>\$ (14)</u>	<u>\$ 83</u>	<u>\$ (5)</u>	<u>\$ 502</u>
EPS diluted	<u>\$ (0.11)</u>	<u>\$ 0.05</u>	<u>\$ (0.01)</u>	<u>\$ 0.07</u>	<u>\$ (0.00)</u>	<u>\$ 0.42</u>
Weighted average shares (diluted)	1,208	1,208	1,208	1,208	1,208	\$ 1,208
% of revenue						
Cost of sales	73.31%	73.71%	71.25%	72.00%	72.55%	74.00%
General and administrative	12.28%	11.90%	12.59%	12.17%	12.23%	10.77%
Selling	7.01%	6.47%	7.23%	7.10%	6.95%	6.15%
Advertising and marketing	4.46%	4.46%	4.35%	4.28%	4.38%	3.69%
year / year growth						
revenues	-13.29%	6.59%	39.19%	8.58%	16.05%	21.88%

CTI Industries
Consolidated Cash Flow Statement
For Period Ended

	30-Sep-01	FY12/00	<u>FY10/99</u>
Assets			
Current Assets			
Cash	\$ 237	\$ 393	\$ 337
Accounts Receivable	4,588	2,574	3,226
Inventories	8,136	7,061	5,426
Deferred tax assets	209	66	209
Other	<u>535</u>	<u>659</u>	<u>754</u>
Total Current Assets	13,705	10,752	9,952
Total property and equipment, net	8,936	9,173	9,056
Other assets			
Deferred financing costs, net	95	11	29
Goodwill	1,135	1,200	-
Deferred tax assets	649	813	766
Other assets	<u>327</u>	<u>270</u>	<u>111</u>
Total other assets	<u>2,206</u>	<u>2,293</u>	<u>2,431</u>
Total Assets	<u>\$ 24,847</u>	<u>\$ 22,219</u>	<u>\$ 21,439</u>
Liabilities and Stockholders Equity			
Current liabilities			
Accounts payable	\$ 5,983	\$ 5,046	\$ 2,981
Line of credit	5,079	3,610	3,574
Notes payable- current portion	954	4,177	1,367
Accrued liabilities	<u>2,027</u>	<u>1,782</u>	<u>1,400</u>
Total current liabilities	14,043	14,614	9,321
Long-term liabilities			
Non-current liabilities	1,434	803	16
Notes payable	3,833	1,301	5,535
Subordinated debt	<u>472</u>	<u>497</u>	<u>865</u>
Total long-term liabilities	5,739	2,600	6,416
Redeemable common stock		-	413
Minority interest	218	239	
Stockholders' equity			
Total stockholders' equity	<u>4,847</u>	<u>4,766</u>	<u>5,288</u>
Total Liabilities and Stockholders' Equity	<u>\$ 24,847</u>	<u>\$ 22,219</u>	<u>\$ 21,439</u>