

Orchids Paper Products CO /DE
Form 10-Q
August 04, 2011
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

- x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2011

OR

- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

Commission File Number 001-32563

Orchids Paper Products Company

(Exact name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

23-2956944
(I.R.S. Employer
Identification No.)

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4826 Hunt Street

Pryor, Oklahoma 74361

(Address of Principal Executive Offices and Zip Code)

(918) 825-0616

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Number of shares outstanding of the issuer's Common Stock, par value \$.001 per share, as of July 31, 2011: 7,490,475 shares.

Table of Contents

ORCHIDS PAPER PRODUCTS COMPANY

TABLE OF CONTENTS

QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE AND SIX MONTHS ENDED June 30, 2011

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>ITEM 1.</u>	
<u>Financial Statements</u>	3
<u>Balance Sheets as of June 30, 2011 (Unaudited) and December 31, 2010</u>	3
<u>Statements of Income for the three months ended June 30, 2011 and 2010 (Unaudited) and the six months ended June 30, 2011 and 2010 (Unaudited)</u>	4
<u>Statements of Cash Flows for the six months ended June 30, 2011 and 2010 (Unaudited)</u>	5
<u>Notes to Unaudited Interim Financial Statements</u>	6
<u>ITEM 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	12
<u>ITEM 3.</u>	
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	22
<u>ITEM 4.</u>	
<u>Controls and Procedures</u>	22
<u>PART II. OTHER INFORMATION</u>	
<u>ITEM 1.</u>	
<u>Legal Proceedings</u>	22
<u>ITEM 1A.</u>	
<u>Risk Factors</u>	22
<u>ITEM 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	22
<u>ITEM 3.</u>	
<u>Defaults Upon Senior Securities</u>	23
<u>ITEM 4.</u>	
<u>RESERVED</u>	23
<u>ITEM 5.</u>	
<u>Other Information</u>	23
<u>ITEM 6.</u>	
<u>Exhibits</u>	23
<u>Signatures</u>	24

[Table of Contents](#)**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****ORCHIDS PAPER PRODUCTS COMPANY****BALANCE SHEETS****(Dollars in thousands, except share data)**

	June 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash	\$ 1,492	\$ 142
Accounts receivable, net of allowance of \$175 in 2011 and 2010	7,214	6,155
Inventories, net	8,455	7,595
Income taxes receivable		3,952
Short term investments	2,022	9,518
Prepaid expenses	346	538
Deferred income taxes	2,067	790
Total current assets	21,596	28,690
Property, plant and equipment	116,241	114,321
Accumulated depreciation	(24,012)	(20,516)
Net property, plant and equipment	92,229	93,805
Deferred debt issuance costs, net of accumulated amortization of \$1 in 2011 and \$686 in 2010	54	76
Total assets	\$ 113,879	\$ 122,571
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 4,359	\$ 5,250
Accrued liabilities	2,591	2,269
Current portion of long-term debt	1,152	10,742
Total current liabilities	8,102	18,261
Long-term debt, less current portion	16,726	16,615
Deferred income taxes	18,887	18,099
Stockholders' equity:		
Common stock, \$.001 par value, 25,000,000 shares authorized, 7,490,475 and 7,486,725 shares issued and outstanding in 2011 and 2010, respectively	7	7
Additional paid-in capital	39,165	38,916
Retained earnings	30,992	30,673
Total stockholders' equity	70,164	69,596
Total liabilities and stockholders' equity	\$ 113,879	\$ 122,571

See notes to unaudited interim financial statements.

Table of Contents**ORCHIDS PAPER PRODUCTS COMPANY****STATEMENTS OF INCOME****(Dollars in thousands, except share and per share data)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Net sales	\$ 23,383	\$ 24,685	\$ 46,058	\$ 45,725
Cost of sales	19,666	19,610	39,633	36,789
Gross profit	3,717	5,075	6,425	8,936
Selling, general and administrative expenses	1,816	1,841	3,396	3,576
Operating income	1,901	3,234	3,029	5,360
Interest expense	191	211	440	426
Other income	(7)	(13)	(16)	(27)
Income before income taxes	1,717	3,036	2,605	4,961
Provision for (benefit from) income taxes:				
Current	(38)	1,012		1,532
Deferred	558	(148)	788	(103)
	520	864	788	1,429
Net income	\$ 1,197	\$ 2,172	\$ 1,817	\$ 3,532
Net income per share:				
Basic	\$ 0.16	\$ 0.29	\$ 0.24	\$ 0.47
Diluted	\$ 0.16	\$ 0.28	\$ 0.24	\$ 0.46
Shares used in calculating net income per share:				
Basic	7,490,475	7,486,725	7,489,335	7,441,069
Diluted	7,706,148	7,768,013	7,709,449	7,753,905
Dividends per share	\$ 0.10	\$	\$ 0.20	\$

See notes to unaudited interim financial statements.

Table of Contents**ORCHIDS PAPER PRODUCTS COMPANY****STATEMENTS OF CASH FLOWS****(Dollars in thousands)**

	Six Months Ended June 30, 2011 (unaudited)	Six Months Ended June 30, 2010 (unaudited)
Cash Flows From Operating Activities		
Net income	\$ 1,817	\$ 3,532
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,573	2,244
Provision for doubtful accounts		30
Deferred income taxes	788	(103)
Stock option plan expense	230	383
Changes in cash due to changes in operating assets and liabilities:		
Accounts receivable	(1,059)	(446)
Inventories	(860)	(15)
Income taxes receivable	2,675	
Prepaid expenses	192	(279)
Accounts payable	(891)	1,793
Accrued liabilities	322	(27)
Net cash provided by operating activities	6,787	7,112
Cash Flows From Investing Activities		
Purchases of property, plant and equipment	(1,920)	(18,698)
Proceeds from the sale of investment securities	7,496	8,996
Net cash provided by (used in) investing activities	5,576	(9,702)
Cash Flows From Financing Activities		
Borrowings under long-term debt	18,000	3,628
Principal payments on long-term debt	(1,490)	(1,865)
Repayment of long-term debt at maturity	(5,878)	
Repayment of long-term debt prior to maturity	(17,439)	
Net borrowings (repayments) on revolving credit line	(2,672)	
Dividends paid to stockholders	(1,498)	
Proceeds from the exercise of stock options	19	
Deferred issuance cost	(55)	(25)
Net cash provided by (used in) financing activities	(11,013)	1,738
Net increase (decrease) in cash	\$ 1,350	\$ (852)
Cash, beginning	142	1,232
Cash, ending	\$ 1,492	\$ 380
Supplemental Disclosure:		
Interest paid	\$ 400	\$ 426
Income taxes paid (refunded)	\$ (2,675)	\$ 1,225

See notes to unaudited interim financial statements.

Table of Contents

ORCHIDS PAPER PRODUCTS COMPANY

NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

Note 1 Basis of Presentation

Orchids Paper Products Company (Orchids or the Company) was formed in 1998 to acquire and operate the paper manufacturing facility, built in 1976, in Pryor, Oklahoma. Orchids Acquisition Group, Inc. (Orchids Acquisition) was established in November 2003, for the purpose of acquiring the common stock of Orchids. The sale of equity and debt securities closed in March 2004 and Orchids Acquisition Group, Inc. acquired Orchids for a price of \$21.6 million. Orchids Acquisition was subsequently merged into Orchids. In July 2005, the Company completed its initial public offering of its common stock. The Company's stock trades on the NYSE Amex under the ticker symbol TIS.

The accompanying financial statements have been prepared without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted (GAAP) in the United States have been condensed or omitted pursuant to the rules and regulations. However, the Company believes that the disclosures made are adequate to make the information presented not misleading when read in conjunction with the audited financial statements and the notes in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on March 11, 2011. Management believes that the financial statements contain all adjustments necessary for a fair presentation of the results for the interim periods presented. All adjustments were of a normal, recurring nature. The results of operations for the interim period are not necessarily indicative of the results for the entire fiscal year.

Note 2 Fair Value Measurements

The Company has previously adopted fair value measurement accounting guidance. The valuation hierarchy considers the transparency of inputs used to value assets and liabilities as of the measurement date. The less transparent or observable the inputs used to value assets and liabilities, the lower the classification of the assets and liabilities in the valuation hierarchy. A financial instrument's classification within the valuation hierarchy is based on the lowest level of input that is significant to its fair value measurement. The three levels of the valuation hierarchy and the classification of the Company's financial assets and liabilities within the hierarchy are as follows:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 - Observable inputs other than quoted prices included within Level 1 for the asset or liability, either directly or indirectly. If an asset or liability has a specified term, a Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Unobservable inputs for the asset or liability.

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Table of Contents

Set forth below are the assets that are measured at fair value on a recurring basis as of June 30, 2011 and December 31, 2010:

Fair Value Measurements at June 30, 2011 Using Inputs Considered as			
Level 1	Level 2 (in thousands)	Level 3	
Assets			
Commercial Deposit	\$ 2,022	\$	\$
Total Short-Term Investments	\$ 2,022	\$	\$

Fair Value Measurements at December 31, 2010 Using Inputs Considered as			
Level 1	Level 2 (in thousands)	Level 3	
Assets			
US government guaranteed certificate of deposit	\$ 5,000	\$	\$
Commercial Deposit	3,018		
Certificate of Deposit	1,500		
Total Short-Term Investments	\$ 9,518	\$	\$

The Company has no liabilities measured at fair value at June 30, 2011 or December 31, 2010. The carrying value of the Company's long-term debt is estimated by management to approximate fair value based on the obligations' characteristics, including floating interest rate, credit rating, maturity and collateral.

There were no transfers between Level 1 and Level 2 assets during the first six months in 2011 or 2010.

Note 3 Commitments and Contingencies

The Company may be involved from time to time in litigation arising from the normal course of business. In management's opinion, as of the date of this report, the Company is not engaged in legal proceedings which individually or in the aggregate are expected to have a materially adverse effect on the Company's results of operations or financial condition.

In the fourth quarter of 2008, the Company entered into a contract to purchase 334,000 MMBTU per year of natural gas at \$7.50 per MMBTU plus a \$0.07 per MMBTU management delivery fee for the period from April 2009 through March 2011. The amounts represent approximately 60% of the Company's natural gas requirements. In November 2009, the agreement was extended for one year to March 2012 for 334,000 MMBTU per year at a price of \$6.50 per MMBTU plus a \$0.07 per MMBTU management delivery fee. In August of 2010, the agreement was extended another year to March 2013 with a contract price of \$5.50 per MMBTU plus a \$0.07 per MMBU management fee. Purchases under the gas contract were \$0.5 million and \$0.6 million for the three months ended June 30, 2011 and 2010, respectively, and \$1.2 million and \$1.3 million for the six months ended June 30, 2011 and 2010, respectively. If the Company is unable to purchase the contracted amounts and the market price at that time is less than the contracted price, the Company would be obligated under the terms of the agreement to reimburse an amount equal to the volume purchased that was less than the contracted amount multiplied by the difference between the contract price and

current spot price.

Table of Contents**Note 4 Inventories**

Inventories at June 30, 2011 and December 31, 2010 are as follows:

	June 30, 2011		December 31, 2010
	(in thousands)		
Raw materials	\$ 2,642	\$	2,115
Bulk paper rolls	732		1,274
Converted finished goods	5,231		4,426
Inventory valuation reserve	(150)		(220)
	\$ 8,455	\$	7,595

Note 5 Long-Term Debt and Revolving Line of Credit

In April 2011, the Company paid off the remaining unmatured loans under our existing credit facility which totaled \$17.5 million and entered into a new \$36 million credit agreement (the "Credit Agreement") with JPMorgan Chase consisting of the following:

- an \$18.0 million revolving credit line due April 2014;
- a \$10.8 million Real Estate Term Loan 1 with a 10-year term due April 2021 and amortized as if it had a 25-year life; and
- a \$7.2 million Machinery and Equipment Term Loan 2 with a 7-year term due April 2018 and amortized as if it had a 10-year life.

The Credit Agreement has the effect of (i) extending and increasing the Company's revolving line of credit from \$8.0 million to \$18.0 million, (ii) refinancing and extending the Company's current \$10.0 million term loan to a \$10.8 million term loan and (iii) refinancing and extending the Company's two construction loans of \$10.7 million into a single \$7.2 million term loan.

Under the terms of the Credit Agreement, amounts outstanding under the revolving credit line and the Real Estate Term Loan 1 will bear interest, at the Company's election, at the prime rate (with a floor equal to the Adjusted One Month LIBOR rate, as defined in the credit facility agreement) or LIBOR, plus a margin, which is based on the Company's quarterly Funded Debt-to-EBITDA ratio. The margin ranges from negative 50 basis points to 25 basis points for prime rate loans and 185 basis points to 265 basis points for LIBOR rate loans. Amounts outstanding under the Machinery and Equipment Term Loan 2 will bear interest at LIBOR plus 175 basis points.

Table of Contents

Long-term debt at June 30, 2011 and December 31, 2010 consists of:

	June 30, 2011	December 31, 2010
	(in thousands)	
Revolving line of credit, maturing on April 24, 2014	\$	\$ 2,672
Term Loan 1, maturing on April 24, 2021, due in monthly installments of \$36,000, excluding interest paid separately	10,764	
Term Loan 2, maturing on April 24, 2018, due in monthly installments of \$60,000, excluding interest paid separately	7,114	
Term Loan A, maturing on April 9, 2017, due in monthly installments of \$58,000, including interest		9,441
Term Loan B, maturing on April 9, 2011, due in monthly installments of \$265,000, including interest		6,862
Waste water treatment project term loan, maturing on November 4, 2012, due in monthly installments of \$58,000, including interest		3,185
Finished goods warehouse term loan, maturing on October 31, 2016, due in monthly installments of \$37,000, including interest, beginning in January 2011		5,197
	\$ 17,878	\$ 27,357
Less current portion	(1,152)	(10,742)
	\$ 16,726	\$ 16,615

The amount available under the revolving credit line may be reduced in the event that the Company's borrowing base, which is based upon qualified receivables, qualified inventory, and equipment with a value up to a maximum of \$3.0 million, is less than \$18.0 million. As of June 30, 2011, our qualified receivables were \$5.3 million and our qualified inventory was \$3.5 million, which, when added to the \$3.0 million of equipment availability yielded a total borrowing base of \$11.8 million.

Obligations under the Credit Agreement are secured by substantially all of the Company's assets. The Credit Agreement contains representations and warranties, and affirmative and negative covenants customary for financings of this type, including, but not limited to, limitations on additional borrowings, additional investments and asset sales, and maintaining certain financial ratios.

Note 6 Earnings per Share

The computation of basic and diluted net income per share for the three-month and six-month periods ended June 30, 2011 and 2010 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net income - (\$ thousands)	\$ 1,197	\$ 2,172	\$ 1,817	\$ 3,532
Weighted average shares outstanding	7,490,475	7,486,725	7,489,335	7,441,069
Effect of stock options	215,673	281,288	220,114	312,836

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Weighted average shares outstanding - assuming dilution	7,706,148	7,768,013	7,709,449	7,753,905
Net income per share:				
Basic	\$ 0.16	\$ 0.29	\$ 0.24	\$ 0.47
Diluted	\$ 0.16	\$ 0.28	\$ 0.24	\$ 0.46
Stock options not considered above because they were anti-dilutive	114,750	57,250	114,750	57,250

Note 7 Stock Incentive Plan

In April 2005, the board of directors and the stockholders approved the 2005 Stock Incentive Plan (the "Plan"). The Plan provides for the granting of incentive stock options to employees selected by the board's compensation committee. Prior to May 2011, the Plan was authorized to distribute up to 897,500 shares. In May 2011, our stockholders approved an amendment to the Plan to increase the number of authorized shares under the Plan to 1,097,500. Options typically have a 10-year life.

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Table of Contents

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, options valuation models require the input of highly subjective assumptions including the expected stock price volatility.

The following table details the options granted to certain members of the board of directors and management during the six months ended June 30, 2011 and 2010.

Grant Date	Number of Shares	Exercise Price	Grant Date Fair Value	Risk-Free Interest Rate	Estimated Volatility	Dividend Yield	Expected Life
May-11	28,750	\$ 11.95	\$ 3.95	3.17%	46%	3.35%	5 years
May-10	28,750	\$ 13.84	\$ 6.44	3.36%	49%	0.00%	5 years
January-10	10,000	\$ 20.825	\$ 10.67	3.82%	49%	0.00%	5-7 years

Estimated volatility is calculated based on actual historical volatility of the Company's common stock from the Company's initial public offering date to the grant date. The Company's dividend yield assumption is based on the expected dividend yield as of the grant date. Expected life is calculated based on the simplified method for plain vanilla options, due to limited available exercise information.

The Company expenses the cost of options granted over the vesting period of the option based on the grant-date fair value of the award. The Company recognized expense of \$168,000 and \$274,000 for the three months ended June 30, 2011 and 2010, respectively, and \$230,000 and \$383,000 for the six months ended June 30, 2011 and 2010, respectively, related to options granted under the Plan.

Note 8 Major Customers and Concentration of Credit Risk

The Company sells its paper production in the form of converted products and bulk tissue paper, called parent rolls. Revenues from converted product sales and parent roll sales in the three months and six months ended June 30, 2011 and 2010 were:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands)		(in thousands)	
Converted product net sales	\$ 18,751	\$ 20,187	\$ 36,735	\$ 37,824
Parent roll net sales	4,632	4,498	9,323	7,901
Net sales	\$ 23,383	\$ 24,685	\$ 46,058	\$ 45,725

Credit risk for the Company in the three months and six months ended June 30, 2011 and 2010 was concentrated in the following customers who comprised more than 10% of the Company's total net sales:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Converted product customer 1	32%	32%	32%	33%
Converted product customer 2	12%	10%	11%	10%
Converted product customer 3	14%	*	14%	*
Parent roll customer 1	15%	12%	15%	14%
Total percent of net sales	73%	54%	72%	57%

* Customer did not account for more than 10% of sales during the period indicated

At June 30, 2011 and 2010, respectively, approximately \$5.5 million (75%) and \$4.4 million (61%) of accounts receivable was due from the customers described above. No other customer of the Company accounted for more than 10% of sales during these periods. The Company generally does not require collateral from its customers and has not incurred any significant losses on uncollectible accounts receivable.

Table of Contents

Note 9 New Accounting Pronouncements

The Financial Accounting Standards Board (FASB) periodically issues new accounting standards in a continuing effort to improve standards of financial accounting and reporting. We have reviewed the recently issued pronouncements and concluded that the following new standard issued this quarter is applicable to the Company:

In May 2011, the FASB issued Accounting Standards Update 2011-04, Fair Value Measurement Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). ASU 2011-04 generally provides a uniform framework for fair value measurements and related disclosures between GAAP and International Financial Reporting Standards (IFRS). Additional disclosure requirements in the update include: (1) for Level 3 fair value measurements, quantitative information about unobservable inputs used, a description of the valuation process used by the entity, and a qualitative discussion about the sensitivity of the measurements to changes in the unobservable inputs; (2) for an entity's use of a nonfinancial asset that is different from the asset's highest and best use, the reason for the difference; and (3) for financial instruments not measured at fair value but for which disclosure of fair value is required, the fair value hierarchy level in which the fair value measurements were determined. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011, or January 1, 2012 for the Company. Other than requiring possible additional disclosures, adoption of this new guidance is not expected to have a material impact on the Company's financial statements.

Table of Contents

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Information

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. These statements relate to, among other things:

- our business strategy;
- the market opportunity for our products, including expected demand for our products;
- our estimates regarding our capital requirements; and
- any of our other plans, objectives, and intentions contained in this report that are not historical facts.

These statements relate to future events or future financial performance, and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, should, could, expects, plans, intends, anticipates, believes, estimates, potential or continue or the negative of such terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. These statements are only predictions.

You should not place undue reliance on forward-looking statements because they involve known and unknown risks, uncertainties, and other factors that are, in some cases, beyond our control and that could materially affect actual results, levels of activity, performance or achievements. Factors that could materially affect our actual results, levels of activity, performance or achievements include, without limitation, those detailed under the caption "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, as filed with the SEC on March 11, 2011, and include the following items:

- intense competition in our market and aggressive pricing by our competitors could force us to decrease our prices and reduce our profitability;
- a substantial percentage of our converted product revenues are attributable to a small number of customers which may decrease or cease purchases at any time;
- disruption in our supply or increase in the cost of waste paper;
- increased competition in our region;

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- changes in our retail trade customers' policies and increased dependence on key retailers in developed markets;
- indebtedness limits our free cash flow and subjects us to restrictive covenants relating to the operation of our business;
- the availability of and prices for energy;
- failure to purchase the contracted quantity of natural gas may result in financial exposure;
- our exposure to variable interest rates;
- the loss of key personnel;
- labor interruption;
- natural disaster or other disruption to our facility;
- ability to finance the capital requirements of our business;
- cost to comply with existing and new laws and regulations;
- failure to maintain an effective system of internal controls necessary to accurately report our financial results and prevent fraud;
- the parent roll market is a commodity market and subject to fluctuations in demand and pricing;
- excess supply in the market may reduce our prices;
- an inability to continue to implement our business strategies; and
- inability to sell the capacity generated from our new converting line.

If any of these risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary significantly from what we projected. Any forward-looking statement you read in the following Management's Discussion and Analysis of Financial Condition and Results of Operations reflects our current views with respect to future events and is subject to these and other risks, uncertainties, and assumptions relating to our operations, results of operations, growth strategy, and liquidity. We assume no obligation to publicly update or revise these forward-looking statements for any reason, whether as a result of new information, future events, or otherwise.

Overview

We are an integrated manufacturer of private label tissue products, including paper towels, bathroom tissue and paper napkins for the consumer, or at-home, market. We produce bulk tissue paper, known as parent rolls and convert parent rolls into finished products. We have tailored our operations to serve our core customer base of dollar stores and other discount retailers. By dollar stores, we mean retailers that offer a limited

Table of Contents

selection across a broad range of products at everyday low prices in a smaller store format. We focus on the dollar stores (which are also referred to as value retailers) and discount retail market because of their consistent order patterns and low number of stock keeping units (SKUs). While we focus on the value retailers, we also service the grocery store channels as well.

While we have customers located throughout the United States, most of our products are distributed within an approximate 900-mile radius of our Oklahoma facility. However, our sales efforts are focused on an area within approximately 500 miles of our facility in northeast Oklahoma, which includes Texas, Oklahoma, Kansas, Missouri, Arkansas, Nebraska and Iowa. Because we are one of the few tissue paper manufacturers in this area, we typically have lower freight costs to our customers' distribution centers located in our target region. At-home tissue market growth has historically been closely correlated to population growth and as such, performs well in a variety of economic conditions. Our target region has experienced strong population growth in the past five years relative to the national average and these trends are expected to continue.

Our converted products are sold primarily under our customers' private labels and, to a lesser extent, under our brand names such as Colortex®, My Size®, Velvet®, Big Mopper®, Tackle®, Noble®, Soft and Fluffy® and care®. All of our converted product revenue is derived pursuant to truck load purchase orders from our customers. Parent roll revenue is derived from purchase orders that generally cover a one month time period. We do not have supply contracts with any of our customers. Because our product is a daily consumable item, the order stream from our customer base is fairly consistent with no significant seasonal fluctuations. Changes in the national economy, in general, do not materially affect the market for our converted products.

Our profitability depends on several key factors, including:

- the market price of our product;
- the cost of waste paper used in producing paper;
- the efficiency of operations in both our paper mill and converting operations; and
- the cost of energy.

The private label segment of the tissue industry is highly competitive, and discount retail customers are extremely price sensitive. As a result, it is difficult to affect price increases. We expect these competitive conditions to continue.

Background

Since June 2006, when we began operations of a new paper machine, our paper-making capacity of approximately 56,000 tons per year has exceeded the demand requirements of our converting operations. We sell the excess supply into the market in the form of parent rolls. We adjust our paper making production based on our internal converting needs for parent rolls and the open market demand for parent rolls. Parent rolls are a commodity product and thus are subject to market pricing. We plan to continue to sell any excess parent roll capacity on the open market as long as market pricing is profitable.

Our parent rolls are processed into paper towels, bathroom tissue and napkins in our adjacent converting facility. Our eleven converting lines have a total annual capacity of approximately 12.0 million cases of finished tissue products. Our strategy is to sell all of our parent roll capacity as converted products which generally carry higher margins than parent rolls. To help achieve that goal, we continue to focus considerable efforts to improve our converting efficiencies. In addition, we are placing significant focus on improving our sales efforts to sell this additional capacity.

Our strategy is to expand our position as a low cost provider of private label tissue products to the growing discount retail channel within our geographic area while leveraging our competitive advantages to increase our presence in other retail channels. This will be accomplished through our continued high service levels, increased total manufacturing capacity and expansion of our product offering.

We intend to implement this strategy through our key initiatives set forth below:

- maintain and strengthen our core customer relationships;
- improve the product quality of our higher tier offerings to meet and or exceed the required attributes;
- increase our flexibility to meet a wider array of customer needs;
- utilize a third-party sales agency that specializes in premium grade tissue product sales and marketing along with our existing sales structure to develop business opportunities in the higher tier tissue market;
- further expand our customer base in other retail channels; and
- continue to improve operating efficiencies and reduce manufacturing costs.

Since our inception in 1998, we have strategically expanded capacity to meet demand. In mid-2010, we completed an expansion project which added an eleventh converting line to our converting capacity and a 245,000 square foot warehouse. The new line has a rated annual capacity of approximately four million cases of either kitchen towel or bathroom tissue products, bringing our total annual converting capacity to approximately twelve million cases from eleven lines. The new line provides higher quality products and broadens our product offerings to

Table of Contents

supply the higher-quality, mid-tier market segment through increased packaging configurations, enhanced graphics and improved embossing. In addition, we have made changes to our paper production process and pulp sourcing to improve the quality of our parent rolls designed for the higher tier product segments. We expect to sell the majority of the output from this new line to new customers, particularly in the grocery segment. Start-up of the new line began in July 2010. The completion of the new warehouse has allowed us to consolidate all warehousing and shipping in our Pryor location, thereby eliminating third-party warehouse charges beginning in September of 2010.

Although we have an annual converting capacity of approximately 12 million cases, our in-house supply of parent rolls provides enough to convert approximately 10 million cases. In order to convert at an annual capacity above approximately 10 million cases, we would have to supplement our supplies by purchasing parent rolls in the open market.

Comparative Three-Month Periods Ended June 30, 2011 and 2010

Net Sales

Three Months Ended June 30,				
	2011		2010	
	(in thousands, except average price per ton and tons)			
Converted product net sales	\$	18,751	\$	20,187
Parent roll net sales		4,632		4,498
Net sales	\$	23,383	\$	24,685
Total tons shipped		13,580		14,614
Net selling price per ton	\$	1,722	\$	1,689

Net sales in the quarter ended June 30, 2011, decreased 5% to \$23.4 million, compared to \$24.7 million in the same period of 2010. Net sales figures represent the gross selling price, including freight, less discounts and pricing allowances. The decrease in net sales is due to a \$1.4 million decrease in net sales of converted product which was partially offset by a \$134,000 increase in parent roll net sales. Net sales of converted product decreased in the quarter ended June 30, 2011, by \$1.4 million, or 7%, to \$18.8 million compared to \$20.2 million in the same period last year. The decrease in net sales of converted product is primarily the result of a 10% decrease in the tonnage shipped being partially offset by a 3% increase in the net selling price per ton. The decrease in converted product tonnage shipped is a result of the softer demand for our products from certain existing customers and to a lesser extent a shift in product mix. The increase in net selling price per ton is primarily due to a shift in mix and did not materially affect gross margin.

Net sales of parent rolls increased \$134,000, or 3%, to \$4.6 million in the quarter ended June 30, 2011, compared to \$4.5 million in the same period last year. Net sales of parent rolls increased primarily as a result of a 4% increase in the net selling price per ton of parent rolls, offset by a 1% decrease in tonnage shipped. The decrease in parent roll tonnage shipments is due to higher requirements by our converting operation resulting in less excess paper available to sell in parent roll form. The higher converting requirements in the quarter over quarter comparison is primarily due to reduction in converting production in the prior year quarter to facilitate the implementation of our converting expansion project compared to a build in inventory in the current year quarter. The improvement in parent roll net selling prices is due to the stronger parent roll market and market reaction to higher waste paper prices.

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Total shipments in the second quarter of 2011 decreased by 1,034 tons, or 7%, to 13,580 tons compared to 14,614 tons in the same period of 2010. This decrease is primarily the result of lower converted product shipments. The increase in selling price per ton of \$33, or 2%, to \$1,722 in the second quarter of 2011 compared to \$1,689 in the second quarter of 2010 is due to a 3% increase in the net selling price per ton of converted products and a 4% increase in the net selling price per ton of parent rolls, as discussed above.

Table of Contents**Cost of Sales**

	Three Months Ended June 30,	
	2011	2010
(in thousands, except gross profit margin % and paper cost per ton consumed)		
Cost of paper	\$ 11,391	\$ 10,763
Non-paper materials, labor, supplies, etc.	6,515	7,700
Sub-total	17,906	18,463
Depreciation	1,760	1,147
Cost of sales	\$ 19,666	\$ 19,610
Gross profit	\$ 3,717	\$ 5,075
Gross profit margin %	15.9%	20.6%
Total paper cost per ton consumed	\$ 818	\$ 782

The major components of cost of sales are the cost of internally produced paper, raw materials, direct labor and benefits, freight costs of products shipped to customers, insurance, repairs and maintenance, energy, utilities and depreciation.

Cost of sales remained flat in the quarter ended June 30, 2011, as compared to the same period of 2010. Increased paper production costs and depreciation expense were offset by reduced non-paper costs. As a percentage of net sales, cost of sales increased to 84.1% in the 2011 quarter from 79.4% in the 2010 quarter. Cost of sales as a percentage of net sales for the second quarter of 2011 was unfavorable to the prior year quarter due to higher waste paper costs, a higher percentage of parent roll sales and higher depreciation expense.

Our overall cost of paper in the second quarter of 2011 was \$818 per ton, an increase of \$36 per ton compared to the same period in 2010. Paper production costs increased primarily due to higher waste paper prices. Waste paper prices increased approximately 8% in the second quarter of 2011 compared to the same quarter in 2010, thereby increasing our cost of sales by approximately \$380,000 in the quarter-over-quarter comparison.

Excluding the effects of the higher depreciation, converting production costs on a per unit basis were lower in the 2011 quarter compared to the 2010 quarter by 13% as a result of a 7% increase in cases produced and the elimination of \$362,000 in third-party warehouse costs that were incurred in the prior year quarter. As previously discussed, the percentage of our parent roll production sold as parent rolls increased in the second quarter of 2011 compared to the same quarter last year, which had a negative effect on our gross margin percentage as parent roll sales generally generate a lower margin than the sale of converted product. Depreciation expense increased \$613,000 in the second quarter of 2011 compared to the same quarter last year primarily due to the completion of our converting and waste water treatment expansion projects in 2010.

Gross Profit

Gross profit in the quarter ended June 30, 2011, decreased \$1.4 million, or 27%, to \$3.7 million compared to \$5.1 million in the same period last year. Gross profit as a percentage of net sales in the 2011 quarter was 15.9% compared to 20.6% in the 2010 quarter. The gross profit decrease as a percent of net sales was primarily the result of higher waste paper prices, lower converted product shipments, a higher percentage of parent

roll sales and higher depreciation expense.

Selling, General and Administrative Expenses

	Three Months Ended June 30,			
	2011		2010	
	(in thousands, except SG&A as a % of net sales)			
Commission expense	\$	281	\$	331
Other S,G&A expenses		1,535		1,510
Selling, General & Adm exp	\$	1,816	\$	1,841
SG&A as a % of net sales		7.8%		7.5%

Selling, general and administrative expenses include salaries, commissions to brokers and other miscellaneous expenses. Selling, general and administrative expenses remained flat at \$1.8 million in the quarters ended June 30, 2011 and 2010. As a percentage of net sales, selling, general and administrative expenses increased to 7.8% in the second quarter of 2011 compared to 7.5% in the same period of 2010.

Table of Contents**Operating Income**

As a result of the foregoing factors, operating income for the quarter ended June 30, 2011, was \$1.9 million compared to operating income of \$3.2 million for the same period of 2010.

Interest Expense and Other Income

	Three Months Ended June 30,			
	2011	(in thousands)	2010	
Interest expense	\$	191	\$	211
Other income, net	\$	(7)	\$	(13)
Income before income taxes	\$	1,717	\$	3,036

Interest expense includes interest on all debt and amortization of deferred debt issuance costs. Interest expense decreased \$20,000 to \$191,000 in the quarter ended June 30, 2011, compared to \$211,000 in the quarter ended June 30, 2010. The decrease in interest expense resulted from our debt refinancing in April 2011 at lower interest rates and lower average borrowing levels due to repayment of our Term Loan B upon maturity in April 2011.

Income Before Income Taxes

As a result of the foregoing factors, income before income taxes decreased \$1.3 million to \$1.7 million in the quarter ended June 30, 2011, compared to \$3.0 million in the same period in 2010.

Income Tax Provision

For the quarter ended June 30, 2011, our effective income tax rate was 30.3%. This rate is lower than the statutory rate because of manufacturing credits and Oklahoma Investment Tax Credits associated with our investments in a new paper machine in 2006, and new converting warehouse and new converting line that were completed in 2010. For the quarter ended June 30, 2010, our annual effective income tax rate was 28.8%. The effective tax rate is lower than the statutory rate because of the Oklahoma Investment Tax Credits cited above.

Comparative Six-Month Periods Ended June 30, 2011 and 2010

Net Sales

		Six Months Ended June 30,	
		2011	2010
(in thousands, except average price per ton and tons)			
Converted product net sales	\$	36,735	\$ 37,824
Parent roll net sales		9,323	7,901
Net sales	\$	46,058	\$ 45,725
Total tons shipped		27,208	27,793
Net selling price per ton	\$	1,693	\$ 1,645

Net sales increased 1% to \$46.1 million in the six months ended June 30, 2011, compared to \$45.7 million in the same period of 2010. Net sales figures represent gross selling price, including freight, less discounts and pricing allowances. The increase in net sales is due to a \$1.4 million increase in the sales of parent rolls being partially offset by a \$1.1 million decrease in the net sales of converted product. Net sales of converted product decreased for the six months ended June 30, 2011, by \$1.1 million, or 3% to \$36.7 million compared to \$37.8 million in the same period last year. The decrease in net sales of converted products is the result of an 8% decrease in the tons of product shipped offset by a 5% increase in net selling price. The decrease in shipments of converted product was primarily due to shift in mix and to a lesser extent, softer demand from certain of our customers. The increase in net selling prices is primarily the result of a shift in mix and, to a lesser extent, decreased promotional

Table of Contents

pricing. Net sales of parent rolls increased \$1.4 million, or 18%, to \$9.3 million in the six months ended June 30, 2011, compared to \$7.9 million in the same period last year. Net sales of parent rolls increased due to a 9% increase in parent roll tonnage shipped and an 8% increase in net selling prices. A higher level of parent roll production was the primary reason for the increased parent roll sales, while a strengthening parent roll market and market reaction to higher waste paper costs resulted in the higher net selling prices.

Total shipments in the six-month period of 2011 decreased by 585 tons, or 2%, to 27,208 tons compared to 27,793 tons in the same period of 2010, primarily due to an 8% decrease in shipments of converted products, partially offset by a 9% increase in parent roll shipments. Our overall net selling price per ton increased by 3% in the first six months of 2011 compared to the comparable prior year period. This increase was primarily attributable to higher prices for converted products and parent rolls being partially offset by an increased percentage of parent roll production shipped in parent roll form.

Cost of Sales

	Six Months Ended June 30,	
	2011	2010
(in thousands, except gross profit margin % and paper cost per ton consumed)		
Cost of paper	\$ 22,552	\$ 21,253
Non-paper materials, labor, supplies, etc.	13,585	13,258
Sub-total	36,137	34,511
Depreciation	3,496	2,278
Cost of sales	\$ 39,633	\$ 36,789
Gross profit	\$ 6,425	\$ 8,936
Gross profit margin %	13.9%	19.5%
Total paper cost per ton consumed	\$ 819	\$ 789

The major components of cost of sales are the cost of internally produced paper, raw materials, direct labor and benefits, freight costs of products shipped to customers, insurance, repairs and maintenance, energy, utilities and depreciation.

Cost of sales increased approximately \$2.8 million, or 8%, to \$39.6 million for the six months ended June 30, 2011, compared to \$36.8 million in the same period of 2010. As a percentage of net sales, cost of sales increased to 86.1% of net sales in the six-month period ended June 30, 2011, compared to 80.5% of net sales in the six-month period ended June 30, 2010. The increase in cost of sales as a percentage of net sales in the six months ended June 30, 2011, was primarily attributed to higher waste paper costs, lower converted product sales, a higher percentage of parent roll sales and higher depreciation expense.

In the six months ended June 30, 2011, our overall cost of paper was \$819 per ton, an increase of \$30 per ton when compared to the same period in 2010. Our cost per ton increased primarily due to increased waste paper prices. Average waste paper prices increased 7% from the 2010 period to the 2011 period, which raised the cost of our waste paper by approximately \$707,000 in the first six months of 2011 compared to the same period of 2010.

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Converting production costs, excluding depreciation, decreased in the first six months of 2011 compared to the same period in 2010 by approximately 7% on a per unit basis primarily due to reduced overhead costs per case. Reduced overhead resulted from a \$900,000 reduction in outside warehousing costs and higher production levels. The previously discussed increase in the percentage of our parent roll production sold as parent rolls negatively affected our gross margin percentage. Depreciation expense increased \$1.2 million in the first six months of 2011 compared to the same period last year primarily due to the completion of our converting and waste water treatment expansion projects in 2010.

Gross Profit

Gross profit in the six months ended June 30, 2011, decreased \$2.5 million, or 28%, to \$6.4 million compared to \$8.9 million in the same period last year. Gross profit as a percentage of net sales in the six-month period ended June 30, 2011, was 13.9% compared to 19.5% in the same period in 2010. The decrease in gross profit as a percent of net sales was primarily due to higher waste paper costs, lower converted product shipments, a higher percentage of parent roll sales and higher depreciation expense.

Table of Contents**Selling, General and Administrative Expenses**

	Six Months Ended June 30,	
	2011	2010
	(in thousands, except SG&A as a % of net sales)	
Commission expense	\$ 551	\$ 631
Other S,G&A expenses	2,845	2,945
Selling, General & Adm exp	\$ 3,396	\$ 3,576
SG&A as a % of net sales	7.4%	7.8%

Selling, general and administrative expenses include salaries, commissions to brokers and other miscellaneous expenses. Selling, general and administrative expenses decreased \$180,000, or 5%, to \$3.4 million in the six months ended June 30, 2011 compared to \$3.6 million in the comparable 2010 period, mainly as a result of decreased accruals under our incentive bonus plan and decreased stock option expense, primarily due to a decrease in the price of our stock. As a percentage of net sales, selling, general and administrative expenses decreased to 7.4% in the six months ended June 30, 2011 compared to 7.8% in the same period of 2010.

Operating Income

As a result of the foregoing factors, operating income for the six months ended June 30, 2011 was \$3.0 million compared to operating income of \$5.4 million for the same period of 2010.

Interest Expense and Other Income

	Six Months Ended June 30,	
	2011	2010
	(in thousands)	
Interest expense	\$ 440	\$ 426
Other income, net	\$ (16)	\$ (27)
Income before income taxes	\$ 2,605	\$ 4,961

Interest expense increased by \$14,000 to \$440,000 in the six months ended June 30, 2011, compared to \$426,000 in the same period in the prior year. The increase was primarily attributable to higher balances of outstanding debt during 2011 related to the 2010 expansion of our waste water treatment facility and the construction of the new warehouse, prior to our debt refinancing in April 2011.

Income Before Income Taxes

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As a result of the foregoing factors, income before income taxes decreased \$2.4 million to \$2.6 million in the six months ended June 30, 2011, compared to \$5.0 million in the same period in 2010.

Income Tax Provision

As of June 30, 2011, our effective income tax rate was 30.3%. This rate is lower than the statutory rate because of manufacturing credits and Oklahoma Investment Tax Credits associated with our investments in a new paper machine in 2006, and a new converting warehouse and new converting line completed in 2010. For the six months ended June 30, 2010, our annual effective income tax rate was 28.8%. The effective tax rate is lower than the statutory rate because of the Oklahoma Investment Tax Credits cited above.

Liquidity and Capital Resources

Liquidity refers to the liquid financial assets available to fund our business operations and pay for near-term obligations. These liquid financial assets consist of cash as well as unused borrowing capacity under our revolving credit facility. Our cash requirements have historically been satisfied through a combination of cash flows from operations and debt financings.

During the six months ended June 30, 2011, cash increased \$1.4 million to \$1.5 million at June 30, 2011. During the 2011 period, we utilized \$7.5 million of short term investments. The primary driver of this use of short term investments was the payoff of our Term Loan B, which matured in April 2011 and had an outstanding balance of \$5.9 million at maturity.

Table of Contents

As of June 30, 2011, total debt outstanding was \$17.9 million. Cash and short-term investments as of June 30, 2011, totaled \$3.5 million, resulting in a net debt level of \$14.4 million. This compares to \$27.4 million in total debt and \$9.7 million in total cash and short-term investments as of December 31, 2010, resulting in a net debt level of \$17.7 million. In the six months ended June 30, 2011, we repaid the outstanding debt under our existing credit facility, which totaled \$23.3 million, and entered into a new Credit Agreement (Credit Agreement) to extend and increase our revolving line of credit and to refinance and extend our term loans. The Credit Agreement consists of an \$18.0 million revolving credit line and \$18.0 million of term loans. We also paid \$1.5 million in dividends to stockholders during the six-month period of 2011.

The following table summarizes key cash flow information for the six-month periods ended June 30, 2011 and 2010:

	Six Months Ended March 31,	
	2011	2010
	(in thousands)	
Cash flows provided by (used in):		
Operating activities	\$ 6,787	\$ 7,112
Investing activities	\$ 5,576	\$ (9,702)
Financing activities	\$ (11,013)	\$ 1,738

Cash flows provided by operating activities was \$6.8 million in the six-month period ended June 30, 2011, which primarily resulted from earnings before non-cash charges and \$2.7 million of tax refunds received partially offset by increases in accounts receivable and inventories and a reduction in accounts payable. The increase in accounts receivable is primarily related to the timing of sales, while the increase in inventories is the result of increased production efficiencies. The decrease in trade payables is primarily due to timing.

Cash flows provided by investing activities was \$5.6 million in the first six months of 2011 as the result of \$7.5 million of proceeds from the sale of short-term investments, which was primarily used to pay off outstanding debt that matured in April 2011, being partially offset by \$1.9 million in expenditures on capital projects.

Cash flows used in financing activities was \$11.0 million in the six-month period ended June 30, 2011, primarily as the result of \$27.5 million of payments on long-term debt, offset by \$18.0 million received from our debt refinancing in April 2011. Additionally, we paid \$1.5 million in cash dividends to stockholders. While we expect to continue to declare quarterly dividends, the payment of future dividends is at the discretion of the Board of Directors and the timing and amount of any future dividends will depend upon earnings, cash requirements and financial condition of the Company.

Cash flow provided by operating activities was \$7.1 million in the six-month period ended June 30, 2010, which primarily resulted from earnings before non-cash charges and an increase in accounts payable partly offset by an increase in trade receivables. The increase in accounts payable is primarily related to the timing of invoices related to the converting expansion project. The increase in trade receivables is primarily due to timing.

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Cash flow used in investing activities was \$9.7 million in the first six months of 2010 as the result of \$18.7 million in expenditures on capital projects, primarily for the converting expansion project, partially offset by the sale of \$9.0 million of short term investments.

Cash flows provided by financing activities was \$1.7 million in the six-month period ended June 30, 2010, as the result of \$3.6 million in borrowings under a construction loan to partially fund our finished goods warehouse being partially offset by \$1.9 million in loan repayments.

Critical Accounting Policies and Estimates

The preparation of our financial statements and related disclosures in conformity with GAAP in the United States requires management to make estimates and judgments that affect our reported amounts of assets and liabilities, revenue and expense, and related disclosures of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates and assumptions based upon historical experience and various other factors and circumstances. Management believes that our estimates and assumptions are reasonable under the circumstances; however, actual results may vary from these estimates and assumptions under different future circumstances. We have identified the following critical accounting policies that affect the more significant judgments and estimates used in the preparation of our financial statements:

Accounts Receivable. Accounts receivable consist of amounts due to us from normal business activities. Our management must make estimates of accounts receivable that will not be collected. We perform ongoing credit evaluations of our customers and adjust credit limits

Table of Contents

based upon payment history and the customer's creditworthiness as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain an allowance for estimated losses based on historical experience and specific customer collection issues that we have identified. Trade receivables are written-off when all reasonable collection efforts have been exhausted, including, but not limited to, external third-party collection efforts and litigation. While such credit losses have historically been within management's expectations and the allowance provided, there can be no assurance that we will continue to experience the same credit loss rates as in the past. No provision for doubtful accounts was recognized during the six-month period ended June 30, 2011. During the six-month period ended June 30, 2010, a provision for doubtful accounts was recognized in the amount of \$30,000. There were no recoveries credited during the first six months of 2011 or 2010. No accounts receivable balances were written off in the six-month periods ended June 30, 2011 or 2010.

Inventory. Our inventory consists of finished goods and raw materials and is stated at the lower of cost or market. Our management regularly reviews inventory quantities on hand and records a provision for excess and obsolete inventory based on the age of the inventory and forecasts of product demand. A significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand. During the first six months of 2011, the inventory allowance was decreased \$70,000, primarily due to a reduction in slow moving or obsolete items. During the first six months of 2010, the inventory allowance was increased \$60,000, which was more than offset by charges totaling \$191,000 against the valuation reserve. The charges against the reserve were primarily the result of product content changes made to our converted products and the resultant effect on certain raw materials, primarily poly wrapping material, used in the converting process.

New Accounting Pronouncements

Refer to the discussion of recently adopted/issued accounting pronouncements under Part I, Notes to Unaudited Interim Financial Statements Note 9 New Accounting Pronouncements.

Non-GAAP Discussion

In addition to our GAAP results, we also consider non-GAAP measures of our performance for a number of purposes.

We use EBITDA as a supplemental measure of our performance that is not required by, or presented in accordance with GAAP. EBITDA should not be considered as an alternative to net income, operating income or any other performance measure derived in accordance with GAAP, or as an alternative to cash flows from operating activities or a measure of our liquidity.

EBITDA represents net income before net interest expense, income tax expense, depreciation and amortization. Amortization of deferred debt issuance costs is included in net interest expense. We believe EBITDA facilitates operating performance comparisons from period to period and company to company by eliminating potential differences caused by variations in capital structures (affecting relative interest expense), tax positions (such as the impact on periods or companies of changes in effective tax rates or net operating losses) and the age and book depreciation of facilities and equipment (affecting relative depreciation expense).

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EBITDA has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for any of our results as reported under GAAP. Some of these limitations are:

- it does not reflect our cash expenditures for capital assets;
- it does not reflect changes in, or cash requirements for, our working capital requirements;
- it does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments on our indebtedness;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA does not reflect cash requirements for such replacements; and
- other companies, including other companies in our industry, may calculate these measures differently than we do, limiting their usefulness as a comparative measure.

Because of these limitations, EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business or to reduce our indebtedness. We compensate for these limitations by relying primarily on our GAAP results and using EBITDA on a supplemental basis.

Table of Contents

The following table reconciles EBITDA to net income for the three months ended June 30, 2011 and 2010:

	Three Months Ended June 30,	
	2011	2010
	(in thousands, except % of net sales)	
Net income	\$ 1,197	\$ 2,172
Plus: Interest expense, net	191	211
Plus: Income tax expense	520	864
Plus: Depreciation	1,760	1,147
EBITDA	\$ 3,668	\$ 4,394
% of net sales	15.7%	17.8%

EBITDA decreased \$726,000 to \$3.7 million in the quarter ended June 30, 2011, compared to \$4.4 million in the same period in 2010. EBITDA as a percent of net sales decreased to 15.7% in the second quarter of 2011 from 17.8% in the second quarter of 2010. The foregoing factors discussed in the net sales, cost of sales and selling, general and administrative expenses sections are the reasons for the decrease.

The following table reconciles EBITDA to net income for the six months ended June 30, 2011 and 2010:

	Six Months Ended June 30,	
	2011	2010
	(in thousands, except % of net sales)	
Net income	\$ 1,817	\$ 3,532
Plus: Interest expense, net	440	426
Plus: Income tax expense	788	1,429
Plus: Depreciation	3,496	2,278
EBITDA	\$ 6,541	\$ 7,665
% of net sales	14.2%	16.8%

EBITDA decreased \$1.1 million to \$6.5 million in the six months ended June 30, 2011, compared to \$7.7 million in the same period of 2010. EBITDA as a percent of net sales decreased to 14.2% in the current six-month period from 16.8% in the prior year six-month period. The foregoing factors discussed in the net sales, cost of sales and selling, general and administrative sections are the reasons for these changes.

We use Net Debt as a supplemental measure of our leverage that is not required by, or presented in accordance with GAAP. Net Debt should not be considered as an alternative to total debt, total liabilities or any other performance measure derived in accordance with GAAP. Net Debt represents total debt reduced by cash and short-term investments. We use this figure as a means to evaluate our ability to repay our indebtedness and to measure the risk of our financial structure.

Net Debt represents the amount that Cash and Cash Equivalents is less than total Debt of the Company. The amounts included in the Net Debt calculation are derived from amounts included in the historical Balance Sheets. We have reported Net Debt because we regularly review Net Debt as a measure of the Company's leverage. However, the Net Debt measure presented in this document may not be comparable to similarly

titled measures reported by other companies due to differences in the components of the calculation.

Net Debt decreased from \$17.7 million on December 31, 2010, to \$14.4 million on June 30, 2011, as a result of a decrease in total debt, which was partially offset by a decrease in our cash and short-term investments. The decrease in total debt is due to repayment of our Term Note B, which matured in April 2011, and our debt refinancing in April 2011. The reduction of the cash and short term investment balances is due to repayment of our Term Note B which matured in April 2011.

Table of Contents

The following table presents Net Debt as of June 30, 2011, and December 31, 2010:

	June 30, 2011	As of (in thousands)	December 31, 2010
Current portion long-term debt	\$ 1,152	\$	10,742
Long-term debt	16,726		16,615
Total debt	17,878		27,357
Less cash	(1,492)		(142)
Less short-term investments	(2,022)		(9,518)
Net debt	\$ 14,364	\$	17,697

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

There has been no material change in the information provided in response to Item 7A of the Company's Form 10-K for the year ended December 31, 2010.

ITEM 4. Controls and Procedures

Our management, under the supervision and with the participation of our chief executive officer and our chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended), as of the end of the period covered by this Quarterly Report on Form 10-Q. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Based on such evaluation, our chief executive officer and our chief financial officer have concluded that our disclosure controls and procedures were effective as of June 30, 2011.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended June 30, 2011, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

None.

ITEM 1A. Risk Factors

As of the date of this filing, there have been no material changes from the risk factors disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010 as filed with the SEC on March 11, 2011. We operate in a changing environment that involves numerous known and unknown risks and uncertainties that could materially affect our operations. The risks, uncertainties and other factors set forth in our Annual Report on Form 10-K may cause our actual results, performances and achievements to be materially different from those expressed or implied by our forward-looking statements. If any of these risks or events occur, our business, financial condition or results of operations may be adversely affected.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Unregistered Sales of Equity Securities

None.

(b) Initial Public Offering and Use of Proceeds from the Sale of Registered Securities

None.

Table of Contents

(c) Repurchases of Equity Securities

We do not have any programs to repurchase shares of our common stock and no such repurchases were made during the three or six months ended June 30, 2011.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. RESERVED

ITEM 5. Other Information

None.

ITEM 6. Exhibits

See the Exhibit Index following the signature page to this Form 10-Q, which Exhibit Index is hereby incorporated by reference herein.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ORCHIDS PAPER PRODUCTS COMPANY

Date: August 4, 2011

By: /s/ Keith R. Schroeder
Keith R. Schroeder
Chief Financial Officer
(On behalf of the registrant and as Chief Accounting Officer)

Table of Contents

Exhibit Index

Exhibit	Description
3.1	Amended and Restated Certificate of Incorporation of the Registrant incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement on Form S-1 (File No. 333-124173) filed with the Securities and Exchange Commission on April 19, 2005.
3.1.1	Amendment to the Amended and Restated Certificate of Incorporation of the Registrant incorporated by reference to the Form 10-Q filed with the Securities and Exchange Commission on August 14, 2007.
3.2	Amended and Restated Bylaws of the Registrant incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-1 (File No. 333-124173) filed with the Securities and Exchange Commission on April 19, 2005.
10.3	Credit Agreement, dated as of April 25, 2011, among the Registrant and JPMorgan Chase Bank, N.A. incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-32563) filed with the Securities and Exchange Commission on April 26, 2011.
31.1	Certification of Chief Executive Officer Pursuant to Section 302.
31.2	Certification of Chief Financial Officer Pursuant to Section 302.
32.1	Certification of Chief Executive Officer Pursuant to Section 906.
32.2	Certification of Chief Financial Officer Pursuant to Section 906.
101	The following financial information from Orchids Paper Products Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2011, formatted in XBRL (eXtensible Business Reporting Language): (i) Statements of Income for the three months ended June 30, 2011 and 2010 and the six months ended June 30, 2011 and 2010, (ii) Balance Sheets as of June 30, 2011 and December 31, 2010, (iii) Statements of Cash Flows for the six months ended June 30, 2011 and 2010, and (iv) Notes to Unaudited Interim Financial Statements.*

* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under those sections.