

Orchids Paper Products CO /DE
Form 10-Q
November 09, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

OR

**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 **23-2956944**
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

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 October 31, 2015:
10,268,891 shares.

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION**ITEM 1. Financial Statements****ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands, except share data)

	September 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash	\$ 8,550	\$ 1,021
Accounts receivable, net of allowance of \$155 in 2015 and 2014	12,763	9,109
Receivables from related party	1,032	1,086
Inventories, net	12,047	9,650
Income taxes receivable	-	634
Prepaid expenses	1,626	1,285
VAT receivable	1,735	1,734
Other current assets	157	899
Deferred income taxes	592	614
Total current assets	38,502	26,032
Property, plant and equipment	205,036	169,551
Accumulated depreciation	(56,807)	(49,831)
Net property, plant and equipment	148,229	119,720
Intangible assets, net of accumulated amortization of \$1,883 in 2015 and \$753 in 2014	16,107	17,237
Goodwill	7,560	7,560
Deferred debt issuance costs, net of accumulated amortization of \$72 in 2015 and \$20 in 2014	872	190
Total assets	\$ 211,270	\$ 170,739
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Bank overdrafts	\$ -	\$ 1,706

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Accounts payable	4,705	4,796
Accounts payable to related party	4,846	6,595
Accrued liabilities	5,668	3,747
Current portion of long-term debt	3,025	2,700
Total current liabilities	18,244	19,544
Long-term debt, less current portion	43,600	33,662
Deferred income taxes	16,175	17,020
Stockholders' equity:		
Common stock, \$.001 par value, 25,000,000 shares authorized, 10,268,891 and 8,757,975 shares issued and outstanding in 2015 and 2014, respectively	10	9
Additional paid-in capital	97,410	64,275
Retained earnings	35,831	36,229
Total stockholders' equity	133,251	100,513
Total liabilities and stockholders' equity	\$ 211,270	\$ 170,739

See notes to unaudited consolidated interim financial statements.

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF INCOME****(Dollars in thousands, except share and per share data)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Net sales	\$46,832	\$44,429	\$126,542	\$101,384
Cost of sales	36,987	35,645	104,192	81,092
Gross profit	9,845	8,784	22,350	20,292
Selling, general and administrative expenses	2,437	2,541	7,174	9,127
Intangibles amortization	376	322	1,130	430
Operating income	7,032	5,921	14,046	10,735
Interest expense	11	90	289	215
Other (income) expense, net	(169)	) 147	(507)	) 141
Income before income taxes	7,190	5,684	14,264	10,379
Provision for income taxes:				
Current	2,708	3,041	5,230	4,858
Deferred	(260)	) (1,187)	(822)	) (1,498)
	2,448	1,854	4,408	3,360
Net income	\$4,742	\$3,830	\$9,856	\$7,019
Net income per common share:				
Basic	\$0.46	\$0.44	\$1.02	\$0.84
Diluted	\$0.45	\$0.44	\$1.02	\$0.83
Shares used in calculating net income per common share:				
Basic	10,367,026	8,753,308	9,613,412	8,363,913
Diluted	10,425,485	8,823,937	9,672,961	8,442,057
Dividends per share	\$0.35	\$0.35	\$1.05	\$1.05

See notes to unaudited consolidated interim financial statements.

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF CASH FLOWS****(Dollars in thousands)**

	Nine Months Ended September 30, 2015 (unaudited)	Nine Months Ended September 30, 2014 (unaudited)
Cash Flows From Operating Activities		
Net income	\$ 9,856	\$ 7,019
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,255	7,286
Provision for doubtful accounts	-	1
Deferred income taxes	(823)	(1,498)
Stock compensation expense	777	1,609
Loss on disposal of property, plant and equipment	-	8
Changes in cash due to changes in operating assets and liabilities:		
Accounts receivable	(3,600)	(4,727)
Inventories	(2,397)	777
Income taxes receivable	634	-
Prepaid expenses	(341)	(300)
Other current assets	741	(2,579)
Accounts payable	(1,840)	6,913
Accrued liabilities	1,921	1,362
Net cash provided by operating activities	13,183	15,871

Cash Flows From Investing Activities

Acquisition of Fabrica assets and U.S. business	-	(16,700)	)
Purchases of property, plant and equipment	(35,485)	(13,346)	)
Purchases of short-term investments	-	(2)	)
Proceeds from the sale of investment securities	-	5,037	
Net cash used in investing activities	(35,485)	(25,011)	)

Cash Flows From Financing Activities

Borrowings under long-term debt	20,000	30,000	
Principal payments on long-term debt	(2,025)	(15,754)	)
Decrease in bank overdrafts	(1,706)	-	
Net borrowings (repayments) on revolving credit line	(7,712)	-	
Dividends paid to stockholders	(10,254)	(8,716)	)
Net proceeds from follow on stock offering	32,155	-	
Proceeds from the exercise of stock options	210	79	
Excess tax benefit (deficit) of stock options exercised	(6)	20	
Deferred debt issuance costs	(831)	(203)	)
Net cash provided by financing activities	29,831	5,426	

Net increase (decrease) in cash	\$	7,529	\$	(3,714)	)
Cash, beginning		1,021		7,205	
Cash, ending	\$	8,550	\$	3,491	

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Interest paid	\$	490	\$	350
Income taxes paid	\$	4,470	\$	3,671
Tax benefits realized from stock options exercised	\$	23	\$	16
Stock issued for Fabrica assets and U.S. business	\$	-	\$	16,000

See notes to unaudited consolidated interim financial statements.

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Note 1 — Basis of Presentation

Orchids Paper Products Company and its subsidiaries (collectively, “Orchids” or the “Company”) produces bulk tissue paper, known as parent rolls, and converts parent rolls into finished products, including paper towels, bathroom tissue and paper napkins. The Company predominately sells its products for use in the “at-home” market under private labels to a customer base consisting primarily of dollar stores, discount retailers and grocery stores that offer limited alternatives across a wide range of products, and, to a lesser extent, the “away-from-home” market. The Company has owned and operated its manufacturing facility in Pryor, Oklahoma since 1998. On June 3, 2014, the Company completed the acquisition of certain assets from Fabrica de Papel San Francisco, S.A. de C.V. (“Fabrica”) pursuant to an Asset Purchase Agreement (see Note 2). In connection with the acquisition of these assets, the Company formed three wholly-owned subsidiaries: Orchids Mexico DE Holdings, LLC, Orchids Mexico DE Member, LLC, and OPP Acquisition Mexico, S. de R.L. de C.V. (“Orchids Mexico”). The accompanying consolidated financial statements include the accounts of Orchids and these wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

The Company’s common stock trades on the NYSE MKT 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, 2014, filed with the SEC on March 9, 2015. 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.

Certain prior period amounts in the accompanying financial statements have been reclassified to conform to the current period presentation. These reclassifications did not affect previously reported amounts of net income.

Note 2 — Acquisition of Fabrica Assets and U.S. Business

On May 5, 2014, Orchids Paper Products Company and its wholly owned subsidiary, Orchids Mexico, entered into an asset purchase agreement (“APA”) with Fabrica to acquire certain assets and 100% of the U.S. business of Fabrica. On June 3, 2014, the Company closed on the transaction set forth in the APA, and in connection therewith, entered into a supply agreement (“Supply Agreement”) and a lease agreement (“Equipment Lease Agreement”) (collectively, the “Fabrica Transaction”).

Related Party Transactions

The Company incurred the following transactions with Fabrica during the three and nine-month periods ended September 30:

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
	(in thousands)		(in thousands)	
Products purchased under the Supply Agreement	\$9,472	\$8,393	\$29,025	\$12,271
Amounts billed to Fabrica under the Equipment Lease Agreement	\$666	\$779	\$1,590	\$977
Parent rolls purchased by Fabrica	\$3,094	\$-	\$4,464	\$-

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (continued)***Intangibles and Goodwill*

Intangible assets at September 30, 2015 were:

	Life (in years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
(in thousands)				
Intangible Asset - Supply and Equipment Lease Agreement	20	\$ 12,800	\$ 800	\$ 12,000
Intangible Asset - Licenses/Trademarks	20	1,350	84	1,266
Intangible Asset - Non-Compete Agreement	2	1,150	719	431
Intangible Asset - Customer Relationships	12	2,690	280	2,410
		\$ 17,990	\$ 1,883	\$ 16,107

Intangible assets at December 31, 2014 were:

	Life (in years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
(in thousands)				
Intangible Asset - Supply and Equipment Lease Agreement	20	\$ 12,800	\$ 320	\$ 12,480
Intangible Asset - Licenses/Trademarks	20	1,350	34	1,316
Intangible Asset - Non-Compete Agreement	2	1,150	287	863
Intangible Asset - Customer Relationships	12	2,690	112	2,578
		\$ 17,990	\$ 753	\$ 17,237

There were no changes to the \$7.6 million goodwill recognized from the Fabrica Transaction during the three and nine-month periods ending September 30, 2015 and 2014. No goodwill impairment has been recorded as of September 30, 2015.

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (continued)****Note 3 — Fair Value Measurements**

The Company does not report any assets or liabilities at fair value in the financial statements. However, the fair value of the Company's long-term debt is estimated by management to approximate the carrying value of \$46,625,000 and \$36,362,000 at September 30, 2015 and December 31, 2014, respectively. Management's estimates are based on periodic comparisons of the characteristics of the Company's obligations, including floating interest rates, credit rating, maturity and collateral, to current market conditions as stated by an independent third-party financial institution. Such valuation inputs are considered a Level 2 measurement in the fair value valuation hierarchy.

Note 4 — 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 October 2008, the Company entered into a contract to purchase 334,000 MMBTU per year of natural gas. This contract has been extended through December 2016. In September 2014, the Company entered into a similar contract with a different vendor for natural gas requirements in 2017. Commitments remaining under these contracts are as follows:

Period	MMBTUs	Price per MMBTU	Management fee per MMBTU
October 2015 - December 2015	91,900	\$ 4.50	\$ 0.07
January 2016 - March 2016	95,900	\$ 4.53	\$ 0.07
April 2016 - June 2016	93,600	\$ 4.17	\$ 0.07
July 2016 - September 2016	92,300	\$ 4.26	\$ 0.07
October 2016 - December 2016	91,900	\$ 4.42	\$ 0.07
January 2017 - December 2017	467,505	\$ 4.06	\$ -

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (continued)**

Purchases under the gas contract were \$0.5 million for each of the three-months periods ended September 30, 2015 and 2014, respectively, and \$1.3 million and \$1.4 million for the nine-month periods ended September 30, 2015 and 2014, 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 difference between the contracted amount and the amount actually purchased, multiplied by the difference between the contract price and a price designated in the contract (approximates spot price).

In the second quarter of 2015, the Company began construction on a new manufacturing facility in Barnwell, South Carolina, which has a total estimated cost of \$110.0 million to \$127.0 million. As of September 30, 2015, we had \$61.7 million of obligations under significant purchase orders related to this facility.

Note 5 — Inventories

Inventories at September 30, 2015 and December 31, 2014 were as follows:

	September 30, 2015	December 31, 2014
	(in thousands)	
Raw materials	\$3,698	\$ 4,392
Bulk paper rolls	1,453	861
Converted finished goods	7,136	4,595
Inventory valuation reserve	(240)	(198)
	\$12,047	\$ 9,650

Note 6 — Property, Plant and Equipment

Property, plant and equipment at September 30, 2015 and December 31, 2014 was:

SeptemberDecember
30, 31,
2015 2014
(in thousands)

Land	\$1,127	\$ 1,119
Buildings and improvements	23,770	23,190
Machinery and equipment	141,225	107,251
Vehicles	1,489	1,489
Nondepreciable machinery and equipment (parts and spares)	9,931	9,121
Construction-in-process	27,494	27,381
	\$205,036	\$ 169,551

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (continued)

Note 7 — Long-Term Debt and Revolving Line of Credit

In June 2015, the Company entered into the Second Amended and Restated Credit Agreement (the “Credit Agreement”), with U.S. Bank National Association (“U.S. Bank”) consisting of the following:

a \$25.0
million
revolving
credit line
due June
2020;
a \$47.3
million Term
Loan with a
5-year term
due
June 2020
and payable
in quarterly
installments
of \$675,000
through June
2016 and
\$1.0 million
per quarter
thereafter;
a \$115.0
million
delayed draw
term loan
with a 2-year
draw period
due June
2020 and
payable in
quarterly
installments
beginning in

September
2017 of
1.5% of the
June 30,
2017
outstanding
balance; and
an accordion
feature
allowing the
revolving
credit line
and/or
delayed draw
commitment
under the
Credit
Agreement
to be
increased by
up to \$50.0
million at
any time on
or before the
expiration
date of the
Credit
Agreement.

The Credit Agreement has the effect of (i) combining the Company's existing \$20 million revolving line of credit designated for the purchase and construction of a paper machine and converting line in Pryor, Oklahoma and \$27.3 million currently outstanding under the Company's existing term loan into a \$47.3 million term loan, (ii) increasing the delayed draw facility from \$40 million to \$115 million, (iii) extending the maturity of the delayed draw facility from August 2015 to June 2020, and (iv) adding a \$50 million accordion feature. Proceeds from the delayed draw term loan must be utilized solely to finance the purchase and installation of new equipment and construction at the Company's Barnwell, South Carolina facility.

Under the terms of the Credit Agreement, amounts outstanding will bear interest at a variable rate of LIBOR plus a specified margin, or the base rate plus a specified margin, at the Company's option. The specified margin is based on the Company's quarterly Leverage Ratio, as defined in the Credit Agreement. The following table outlines the specified margins and the commitment fees payable under the Credit Agreement:

Leverage Ratio	LIBOR Margin	Base Margin	Commitment Fee			
Less than 1.00	1.25	%	0.00	%	0.15	%
Greater than or equal to 1.00 but less than 2.00	1.50	%	0.00	%	0.20	%

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Greater than or equal to 2.00 but less than 3.00	1.75	%	0.00	%	0.25	%
Greater than or equal to 3.00 but less than 3.50	2.25	%	0.00	%	0.30	%
Greater than or equal to 3.50	2.50	%	0.25	%	0.35	%

The Company's leverage ratio at September 30, 2015 was approximately 1.55.

Long-term debt at September 30, 2015 and December 31, 2014 consists of:

	September 30, 2015	December 31, 2014
	(in thousands)	
Revolving line of credit, maturing on June 3, 2019	\$-	\$ 7,712
Term Loan, maturing on June 3, 2020, due in quarterly installments of \$675,000 for the first two years and \$1,000,000 thereafter, excluding interest paid separately	-	28,650
Term Loan, maturing on June 25, 2020, due in quarterly installments of \$675,000 for the first year and \$1,000,000 thereafter, excluding interest paid separately	46,625	-
	\$46,625	\$ 36,362
Less current portion	3,025	2,700
	\$43,600	\$ 33,662

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 and qualified inventory, is less than \$25 million.

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (continued)**

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. The financial covenants, which are tested as of the end of each fiscal quarter, require the Company to maintain the following specific ratios: fixed charge coverage (minimum of 1.20 to 1.0) and leverage (maximum of 4.00 to 1.0 through June 2017; maximum of 3.75 to 1.0 on September 30, 2017; maximum of 3.50 to 1.0 on December 31, 2017, and thereafter). The Company was in compliance with these financial covenants at September 30, 2015.

Note 8 — Income Taxes

As of September 30, 2015, our annual estimated effective income tax rate is 33.9%. The annual estimated effective tax rate for 2015 differs from the statutory rate due primarily to U.S. manufacturing tax credits and foreign and state income taxes. Our actual effective income tax rate was 34.0% and 30.9% for the three and nine-month periods ended September 30, 2015, respectively. These rates differ from the estimated effective income tax rate primarily due to a change in our estimated state tax liabilities in the second quarter of 2015. As of September 30, 2014, our annual estimated effective income tax rate is 32.4%. The actual effective tax rate for the three and nine-month periods ended September 30, 2014 was 32.6% and 32.4%, respectively. The annual estimated effective tax rate for 2014 differs from the statutory rate due primarily to U.S. manufacturing tax credits.

Note 9 — Earnings per Share

During the first quarter of 2013, the Company granted restricted stock to certain employees. These awards include a nonforfeitable right to receive dividends and therefore are considered to participate in undistributed earnings with common shareholders. Therefore, the Company calculates basic and diluted earnings per common share using the two-class method, under which net earnings are allocated to each class of common stock and participating security. The computation of basic and diluted net income per common share for the three-month and nine-month periods ended September 30, 2015 and 2014 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income - (\$ thousands)	\$4,742	\$3,830	\$9,856	\$7,019

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Less: distributed earnings allocable to participating securities	(1	)	(2	)	(2	)	(6	)
Less: undistributed earnings allocable to participating securities	-		-		-		1	
Distributed and undistributed earnings allocable to common shareholders	\$4,741		\$3,828		\$9,854		\$7,014	
Weighted average shares outstanding	10,367,026		8,753,308		9,613,412		8,363,913	
Effect of stock options	58,459		70,629		59,549		78,144	
Weighted average shares outstanding - assuming dilution	10,425,485		8,823,937		9,672,961		8,442,057	
Net income per common share:								
Basic	\$0.46		\$0.44		\$1.02		\$0.84	
Diluted	\$0.45		\$0.44		\$1.02		\$0.83	
Stock options not considered above because they were anti-dilutive	563,600		560,000		535,000		520,000	

Note 10 — Stock Incentives

In April 2014, the Orchids Paper Products Company 2014 Stock Incentive Plan (the “2014 Plan”) was approved. The 2014 Plan replaced the Orchids Paper Products Company 2005 Stock Incentive Plan (the “2005 Plan”) and provides for the granting of stock options and other stock based awards to employees and Board members selected by the Board’s Compensation Committee. A total of 400,000 shares may be issued pursuant to the 2014 Plan. As of September 30, 2015, there were 286,400 shares available for issuance under the 2014 Plan.

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (continued)***Stock Options with Time-Based Vesting Conditions*

The grant date fair value of the following option grants was estimated using the Black-Scholes option valuation model. Option 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 that were valued using the Black-Scholes valuation model and the assumptions used in the valuation model for those grants during the nine months ended September 30, 2015 and 2014:

Grant Date	Number of Shares	Exercise Price	Grant Date Fair Value	Risk-Free Interest Rate	Estimated Volatility	Dividend Yield	Expected Life (years)
May-14	35,000	\$ 29.65	\$ 7.50	2.62 %	41	% 4.72	% 5
June-14	5,000	\$ 30.09	\$ 7.67	2.63 %	41	% 4.65	% 5
May-15	40,000	\$ 22.485	\$ 4.64	2.13 %	40	% 6.23	% 5

The Company expenses the cost of these options granted over the vesting period of the option based on the grant-date fair value of the award.

Stock Options with Market-Based Vesting Conditions

During the first nine months of 2015 and 2014, the Board of Directors granted options to purchase 28,600 and 145,000 shares, respectively, of the Company's common stock to certain members of management. These options will become exercisable in four equal tranches, if at all, if and when the share price of the common stock closes at a certain percentage of the purchase price of the option for three consecutive business days, in accordance with the following vesting schedule:

Share price required to achieve vesting	2014 options	2015 options
Tranche 1	\$34.788	\$29.560
Tranche 2	\$42.350	\$36.000

Tranche 3	\$51.425	\$43.710
Tranche 4	\$60.500	\$51.430

Any unvested portion of the 2014 options shall expire five years from the date of grant. Any unvested portion of the 2015 options shall expire on November 8, 2018. Both the 2014 options and the 2015 options shall terminate ten years after the date of grant. As these options include a market condition, the grant date fair value and implicit service period of these option grants were estimated using a Monte Carlo option valuation model. The following table details the options granted to certain members of management that were valued using the Monte Carlo valuation model and the assumptions used in the valuation model for those grants during the nine months ended September 30, 2015 and 2014:

Grant Date	Number of Shares	Exercise Price	Grant Date Fair Value	Risk-Free					Expected Life (years)	Derived Service Period (years)
				Interest Rate	Estimated Volatility	Dividend Yield	Expected	Life (years)		
January 14 - Tranche 1	10,000	\$31.125	\$5.64	1.98	% 31	% 4.50	% 5.15	0.31		
January 14 - Tranche 2	10,000	\$31.125	\$5.46	1.98	% 31	% 4.50	% 5.58	1.15		
January 14 - Tranche 3	10,000	\$31.125	\$5.03	1.98	% 31	% 4.50	% 5.97	1.94		
January 14 - Tranche 4	10,000	\$31.125	\$4.27	1.98	% 31	% 4.50	% 6.25	2.50		
February 14 - Tranche 1	25,000	\$30.88	\$5.51	1.98	% 31	% 4.60	% 5.17	0.35		
February 14 - Tranche 2	25,000	\$30.88	\$5.35	1.98	% 31	% 4.60	% 5.60	1.19		
February 14 - Tranche 3	25,000	\$30.88	\$4.88	1.98	% 31	% 4.60	% 5.99	1.98		
February 14 - Tranche 4	25,000	\$30.88	\$4.15	1.98	% 31	% 4.60	% 6.27	2.54		
May 14 - Tranche 1	1,250	\$28.185	\$5.06	2.03	% 31	% 4.70	% 5.36	0.71		
May 14 - Tranche 2	1,250	\$28.185	\$4.74	2.03	% 31	% 4.70	% 5.78	1.56		
May 14 - Tranche 3	1,250	\$28.185	\$4.02	2.03	% 31	% 4.70	% 6.14	2.29		
May 14 - Tranche 4	1,250	\$28.185	\$3.29	2.03	% 31	% 4.70	% 6.39	2.79		
September 15 - Tranche 1	7,150	\$25.24	\$4.44	1.82	% 34	% 5.20	% 5.20	0.40		
September 15 - Tranche 2	7,150	\$25.24	\$3.92	1.82	% 34	% 5.20	% 5.51	1.02		
September 15 - Tranche 3	7,150	\$25.24	\$3.11	1.82	% 34	% 5.20	% 5.77	1.54		
September 15 - Tranche 4	7,150	\$25.24	\$2.36	1.82	% 34	% 5.20	% 5.93	1.87		

The Company expenses the cost of these options granted over the implicit, or derived, service period of the option based on the grant-date fair value of the award.

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (continued)***Options Issued Outside of the 2014 Plan*

In April 2014, the Company's stockholders voted to approve the options granted to Mr. Jeffrey S. Schoen, the Company's President and Chief Executive Officer, on November 8, 2013. Upon his appointment as an officer of the Company, Mr. Schoen was granted an option to purchase up to 400,000 shares of the common stock of the Company at a purchase price of \$30.25 per share. The option will become exercisable, if at all, if and when the share price of the Company's common stock closes at a certain percentage of the purchase price of the option for three consecutive business days, in accordance with the following vesting schedule:

Share price closes at or above the following percentage of the purchase price for the Option	Number of shares that become vested
115% (share price \$34.788)	100,000
140% (share price \$42.35)	100,000
170% (share price \$51.425)	100,000
200% (share price \$60.50)	100,000

These options were granted outside of the 2005 Plan or the 2014 Plan. Any unvested portion of the option shall expire five years from the date of grant and the option shall terminate ten years after the date of grant. The Company used a Monte Carlo option valuation model to estimate the grant date fair value of each tranche of 100,000 options, as they include a market condition. The Company will expense the cost of the options granted over the implicit service period of the options based on the completed Monte Carlo models. The following table details the assumptions used in the valuation model for the options granted to Mr. Schoen:

Number of Shares	Exercise Price	Grant Date Fair Value	Risk-Free Interest Rate	Estimated Volatility	Dividend Yield	Expected Life (years)	Derived Service Period (years)
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Tranche 1	100,000	\$ 30.25	\$ 5.18	2.10	%	30	%	4.60	%	4.99	0.40
Tranche 2	100,000	\$ 30.25	\$ 5.04	2.10	%	30	%	4.60	%	5.42	1.25
Tranche 3	100,000	\$ 30.25	\$ 4.31	2.10	%	30	%	4.60	%	5.79	2.00
Tranche 4	100,000	\$ 30.25	\$ 3.50	2.10	%	30	%	4.60	%	6.04	2.50

Total Option Expense

The Company recognized the following expenses related to all options granted under the 2005 Plan, the 2014 Plan and the Schoen options:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Time-Based Vesting Options	\$ 1,000	\$ 1,000	\$ 188,000	\$ 307,000
Market-Based Vesting Options	77,000	427,000	555,000	1,264,000
Total compensation expense related to stock options	\$ 78,000	\$ 428,000	\$ 743,000	\$ 1,571,000

Future Expected Market-Based Stock Option Expense

The grant of options that vest based on a market condition will have a material impact on the Company's results of operations. Based on the derived service periods of the options, the Company expects to expense the compensation cost related to these options as shown in the following table. However, if the market condition is achieved for any tranche of these options prior to the end of the derived service period, all remaining expense related to that tranche would be recognized in the period in which the market condition is achieved.

	2015				2015	2016	2017
	Q1	Q2	Q3	Q4	Total	Total	Total
	(in thousands)						
Tranche 1	\$-	\$-	\$-	\$26	\$26	\$5	\$ -
Tranche 2	134	104	1	10	249	19	\$ -
Tranche 3	73	72	47	73	265	73	\$ 3
Tranche 4	47	48	30	48	173	138	\$ 5
Total expense	\$254	\$224	\$78	\$157	\$713	\$235	\$ 8

Restricted Stock

In February 2013, the Company granted 16,000 shares of restricted stock to certain employees under the 2005 Plan. These awards were valued at the arithmetic mean of the high and low market price of the Company's stock on the grant date, which was \$21.695 per share, and vest ratably over a three year period beginning on the first anniversary of the grant date. During the nine months ended September 30, 2015 and 2014, 334 and 667 of these shares were forfeited, respectively. In 2013, 8,000 of these shares were forfeited. The first third of unforfeited shares, or 2,666 shares, vested in February 2014. The second third of unforfeited shares, or 2,333 shares, vested in February 2015. The Company expenses the cost of restricted stock granted over the vesting period of the shares based on the grant-date fair value of the award. The Company recognized expense of \$8,000 and \$9,000 for the three-month periods ended September 30, 2015 and 2014, respectively, and \$34,000 and \$38,000 for the nine-month periods ended September 30, 2015 and 2014, respectively, related to shares of restricted stock granted.

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (continued)****Note 11 — Major Customers and Concentration of Credit Risk**

The Company sells its paper production in the form of parent rolls and converted products. Revenues from converted product sales and parent roll sales in the three and nine months ended September 30, 2015 and 2014 were:

	Three Months Ended September 30, 2015 2014 (in thousands)		Nine Months Ended September 30, 2015 2014 (in thousands)	
Converted product net sales	\$43,675	\$43,157	\$120,877	\$97,042
Parent roll net sales	3,157	1,272	5,665	4,342
Net sales	\$46,832	\$44,429	\$126,542	\$101,384

Credit risk for the Company in the three and nine months ended September 30, 2015 and 2014 was concentrated in the following customers who each comprised more than 10% of the Company's total net sales:

	Three Months Ended September 30, 2015 2014		Nine Months Ended September 30, 2015 2014	
Converted product customer 1	29 %	35 %	33 %	42 %
Converted product customer 2	15 %	13 %	12 %	10 %
Converted product customer 3	15 %	13 %	15 %	11 %
Total percent of net sales	59 %	61 %	60 %	63 %

No additional customers accounted for more than 10% of sales during the three or nine-month periods ended September 30, 2015 or 2014.

At September 30, 2015 and December 31, 2014, the significant customers accounted for the following amounts of the Company's accounts receivable (in thousands):

	September 30, 2015		December 31, 2014	
Converted product customer 1	\$ 2,162	17 %	\$ 2,634	28 %
Converted product customer 2	2,203	17 %	1,410	15 %
Converted product customer 3	1,859	15 %	813	9 %
Total of accounts receivable	\$ 6,224	49 %	\$ 4,857	52 %

At September 30, 2015, one additional parent roll customer, a related party, accounted for approximately 15% of the Company's accounts receivable. This customer did not account for more than 10% of accounts receivable as of December 31, 2014.

Note 12 — Follow-On Stock Offering

In April 2015, the Company completed an underwritten public follow-on offering of 1,500,000 shares of its common stock at \$23.00 per share. The underwriters were granted an option to purchase up to an additional 225,000 shares for a period of 30 days, which was not exercised. Net proceeds to the Company were \$32.2 million, after giving effect to expenses incurred related to the offering.

Note 13 – ODFA Pooled Financing

In September 2014, the Company entered into an agreement with the Oklahoma Development Finance Authority ("ODFA") whereby the ODFA agreed to provide the Company up to \$3.5 million to fund a portion of the cost of a new paper production line before September 1, 2020. The agreement provides for the Oklahoma state withholding payroll taxes withheld by the Company from its employees to be placed into the Community Economic Development Pooled Finance Revolving Fund – Orchids Paper Products ("Revolving Fund"). Each year on September 1, beginning in 2015 and ending in 2020, the ODFA will return these state withholding taxes in the Revolving Fund to the Company, up to an amount totaling \$3.5 million. These amounts are recognized as a note receivable in other current assets in the consolidated balance sheet and in other income in the consolidated statements of income as they are withheld from employees.

As of September 30, 2015, the Company had a note receivable of \$157,000 related to amounts due under the ODFA pooled financing agreement. The Company recognized \$169,000 and \$56,000 of other income in the consolidated statement of income for the three-month periods ended September 30, 2015 and 2014, respectively, related to this agreement. The Company recognized \$514,000 and \$56,000 of other income in the consolidated statement of income for the nine-month periods ended September 30, 2015 and 2014, respectively, related to this agreement. The increase in other income for the 2015 periods is due to the fact that the agreement with the ODFA was effective on September 1, 2014 and was in effect for the entire three-month and nine-month periods in 2015 rather than the one-month of September in 2014.

ORCHIDS PAPER PRODUCTS COMPANY AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (continued)

Note 14 — Registration of Securities

On September 16, 2015, the Company's shelf Registration Statement on Form S-3 (the "Registration Statement") was declared effective by the Securities and Exchange Commission. Pursuant to the Registration Statement, the Company, from time to time, may sell common stock, warrants or units comprised of the other securities described in the Registration Statement, in a single or multiple offerings up to a total dollar amount of \$50,000,000, at prices and terms that will be determined at the time of the offering.

The Company's willingness and ability to raise capital pursuant to the Registration Statement will depend upon a number of circumstances, including, without limitation, the Company's need for additional capital to fund operations, organic growth or acquisitions, the Company's financial and operating performance and the receptiveness of the capital markets to potential offerings by the Company. As of the date of this report, the Company does not have any agreements with respect to the issuance of securities pursuant to the Registration Statement.

Note 15 — New Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). ASU 2014-09 clarifies the principles for recognizing revenue and develops a common revenue standard under U.S. GAAP under which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Due to the issuance of Accounting Standards Update 2015-14, "Revenue from Contracts with Customers – Deferral of the Effective Date" ("ASU 2015-14"), in July 2015, the effective date of ASU 2014-09 was deferred for one year and becomes effective for the Company for interim and annual periods beginning on or after December 15, 2017. Management is currently assessing the impact ASU 2014-09 will have on the Company, but it is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

In April 2015, the FASB issued Accounting Standards Update 2015-03, "Interest – Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs" ("ASU 2015-03"). ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt

liability, consistent with debt discounts. ASU 2015-03 is effective for annual and interim periods beginning after December 15, 2015. This standard is not expected to have a material effect on the Company's financial position, results of operations or cash flows, as it simply requires a change in presentation and does not affect the recognition and measurement guidance for debt issuance costs.

In April 2015, the FASB issued Accounting Standards Update 2015-05, "Intangibles – Goodwill and Other – Internal-Use Software – Customer's Accounting for Fees Paid in a Cloud Computing Arrangement" ("ASU 2015-05"). ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance does not change the accounting for a customer's service contracts. ASU 2015-05 is effective for annual and interim periods beginning after December 15, 2015. Management is currently assessing the impact ASU 2015-05 will have, if any, on the Company's financial position, results of operations and cash flows.

In July 2015, the FASB issued Accounting Standards Update 2015-11, "Inventory – Simplifying the Measurement of Inventory" ("ASU 2015-11"). ASU 2015-11 requires inventory measured using all methods other than the last-in, first-out (LIFO) or retail methods to be measured at the lower of cost or net realizable value. Net realizable value is defined as the estimated selling price in the ordinary course of business less reasonably predictable costs of completion, disposal and transportation. ASU 2015-11 is effective for public companies for annual and interim periods beginning after December 15, 2016. Management is currently assessing the impact ASU 2015-11 will have, if any, on the Company's financial position, results of operations and cash flows.

In August 2015, the FASB issued Accounting Standards Update 2015-15, "Interest – Imputation of Interest: Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements" ("ASU 2015-15"). ASU 2015-15 states that since ASU 2015-03, as discussed above, does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements, the SEC staff will not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. Management is currently assessing the impact ASU 2015-15 will have, if any, on the Company's financial position, results of operations and cash flows.

Note 16 — Subsequent Events

On October 21, 2015, the Board of Directors authorized a quarterly cash dividend of \$0.35 per outstanding share of the Company's common stock. The Company expects to pay this dividend on November 16, 2015 to stockholders of record at the close of business on November 2, 2015.

On November 6, 2015, the Company entered into Amendment No. 1 to Second Amended and Restated Credit Agreement (“Amendment 1”) with U.S. Bank to amend the definition of “Change in Control” in the Credit Agreement. Amendment 1 did not have a material impact on the terms of the Credit Agreement.

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," "will," "should," "could," "would," "target," "expects," "plans," "intends," "anticipates," "believes," "estimates," "predicts," "continue" or the negative of such terms or other comparable terminology, or by discussion of strategy that may involve risks and uncertainties. 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. The forward-looking statements contained in this Form 10-Q reflect our views and assumptions only as of the date hereof. You should not place undue reliance on forward-looking statements. We caution you that these forward-looking statements are only predictions, which are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.

Some factors that could materially affect our actual results are detailed under the caption "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014, as filed with the SEC on March 9, 2015, subsequent filings made with the SEC, and those identified in Part II, Item 1A of this Form 10-Q, which include but are not limited to:

- failure to complete in a timely and cost efficient manner the construction planned in Barnwell, South Carolina;
- intense competition in our markets 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 who may decrease or cease purchases at any time;
- disruption in our supply or increase in the cost of fiber;
- Fabrica's failure to execute under the Supply Agreement;

changes in our retail trade customers' policies and increased dependence on key retailers in developed markets;
excess supply in the market may reduce our prices;
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 facilities; and
other factors discussed from time to time in our filings with the SEC.

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 the risks listed above 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 of the Business

We are a customer focused, national supplier of high quality consumer tissue products. We produce bulk tissue paper, known as parent rolls, and convert parent rolls into finished products, including paper towels, bathroom tissue and paper napkins. We sell any parent rolls not required by our converting operation to other converters. Our integrated manufacturing facilities have flexible production capabilities, which allow us to produce high quality tissue products with short production times across all quality tiers for customers in our target regions. We predominately sell our products under private labels to our core customer base in the “at home” market, which consists primarily of dollar stores, discount retailers and grocery stores that offer limited alternatives across a wide range of products. Our focus to date has been the dollar stores (which are also referred to as discount retailers) and the broader discount retail market because of their overall market growth, consistent order patterns and low number of stock keeping units (“SKUs”). The “at-home” tissue market consists of several quality levels, including a value tier, premium tier and ultra-premium tier. To a lesser extent, we service customers in the “away from home” market. Our core customer base in the “away from home” market consists of companies in the janitorial market and food service market. Most of the products we sell in the “away from home” market are included in the value tier. While we expect to continue to service this market in the near term, we do not consider the “away from home” market a growth vehicle for us.

Our strategy is to capitalize on positive market trends by leveraging our industry experience, customer relationships and low cost, strategic operating footprint to drive growth and profitability for the business. Our facilities have been designed to have the flexibility to produce and convert parent rolls across different product tiers and to use both virgin and recycled fibers to maximize quality and to control costs. We own an integrated facility in Pryor, Oklahoma which has the capacity to supply 74,000 tons of parent rolls per year primarily to service the central United States. Since 2006, we have consistently invested to modernize the paper making and converting equipment at this location and provide the flexibility discussed above. Furthermore, over the past several years, we have invested approximately \$39 million at this facility for a new paper machine and a new converting line. The new paper machine commenced operations in March 2015. We believe the new paper machine will improve our margins by reducing our manufacturing cost and by providing us additional parent roll capacity. Our new converting line commenced operations in June 2015 and is expected to add 12,500 tons of capacity, for a total of 83,000 tons of converting capacity in our Pryor facility. In June 2014, we expanded our geographic presence to service the United States West coast through a strategic transaction with Fabrica de Papel San Francisco, S.A. de C.V. (“Fabrica”), one of the largest tissue manufacturers by capacity in Mexico. The Fabrica Transaction provided us access to its U.S. customers, which we believe will allow us to further penetrate the region, and the supply agreement (“Supply Agreement”) we entered into with Fabrica has provided access to up to 19,800 tons of product each year (up to 27,500 tons in the first two years of the agreement).

As part of our strategy to be a national supplier of high quality consumer tissue products, we began construction on our plans to build a world-class integrated tissue operation in Barnwell, South Carolina in the second quarter of 2015. We believe that this new facility will allow us to better serve our existing customers in the Southeast United States, while also enabling us to penetrate new customers in this region. The facility is designed to provide highly flexible, cost competitive production across all quality tiers with paper making capacity of between 35,000 and 40,000 tons per year and converting capacity of between 30,000 and 32,000 tons per year. The first converting line is expected to be operational by the end of the first quarter of 2016 and the second converting line is expected to be operational by the

end of the second quarter of 2016. The paper machine will utilize a highly versatile process capable of producing ultra-premium tier products, and is expected to be operational by the beginning of 2017. We estimate the total costs of the project to be approximately \$110 to \$127 million, which will be financed through a combination of bank debt and the proceeds from our recent follow-on stock offering.

Since our inception, we have strategically expanded capacity in both paper manufacturing and finished product converting to meet market demand and customers' quality requirements. The installation of a new paper machine in our Oklahoma facility, which started up in early March 2015, and installation of a new converting line in our Oklahoma facility, which started up in June 2015, is expected to bring our manufacturing capacity in line with our paper production capacity, at approximately 74,000 tons. However, any parent rolls in excess of converting production requirements are sold into the market. We adjust our paper making production based on our internal converting needs for parent rolls and the open market demand for parent rolls. Our strategy is to sell all of the parent rolls we manufacture as converted products (such as paper towels, bathroom tissue and napkins), which generally carry higher margins than non-converted parent rolls. The capacity obtained under the previously described Fabrica Transaction will be sold in converted product form and we do not plan to sell any excess capacity arising from this transaction in parent roll form. Parent rolls are a commodity product and thus are subject to market pricing. We plan to continue to sell any excess parent roll capacity from Oklahoma on the open market as long as market pricing is profitable. When converting production requirements exceed paper mill capacity, we will purchase parent rolls in the open market to meet those converting requirements.

We supply both national and regional customers, with a focus on regions of the United States with high population growth. We focus our sales efforts on areas within approximately 500 miles of either our manufacturing facility in Oklahoma or Fabrica's manufacturing facility in Mexicali, Mexico, as we believe this radius maximizes our freight cost advantage. Because we are one of the few integrated tissue paper manufacturers in the areas around both our Oklahoma facility and Fabrica's Mexicali facilities, we believe we typically have lower freight costs to our customers' distribution centers located in our target regions. Our target region around our Oklahoma facility includes Texas, Oklahoma, Kansas, Missouri and Arkansas. The Fabrica Transaction has allowed us to more effectively service customers that are located on the West Coast by directly shipping them products that are produced in Mexico under the Supply Agreement. As a result, we have expanded our target region to include California, Nevada, Arizona, New Mexico and Utah. Our planned manufacturing facility in Barnwell, South Carolina is intended to help us meet the growing demand in the South Eastern region of the United States. Demand for tissue in the "at-home" tissue market has historically been closely correlated to population growth and as such, performs well in a variety of economic conditions. Our expanded target region has experienced strong population growth for the past fourteen years relative to the national average, and these trends are expected to continue.

Our 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®, Linen Soft®, Soft & Fluffy®, and Tackle®. The Fabrica Transaction gave us the exclusive right to sell products under Fabrica's brand names into the United States, including under the names Virtue®, Truly Green®, Golden Gate Paper® and Big Quality®. All of our converted product net sales are derived through truck load purchase orders from our customers. Parent roll net sales are derived from purchase orders that generally cover a one-month time period. We do not have supply contracts with any of our customers, which is normal practice within our industry. Because our products are a daily consumable item, the order stream from our customer base is fairly consistent with limited seasonal fluctuations. However, we typically experience some mild seasonal softness in the first and fourth quarters of each year, primarily due to the effects of winter weather on consumers' buying habits and occasional effects of holidays on shipping schedules. Changes in the national economy, in general, do not materially affect the market for our converted products due to their non-discretionary nature and high degree of household penetration.

Our profitability depends on several key factors, including but not limited to:

- the volume of converted product sales;
- the cost of fiber used in producing paper;
- the market price of our products;
- the efficiency of operations in both our paper mill and converting facility; and
- the cost of energy.

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

Our Strategy

Our strategy is to be a customer focused national supplier of high quality consumer tissue products. We believe we will achieve this strategy by:

strengthening and expanding our customer base through cooperative and innovative product development and superior customer service;
focusing on higher growth geographic regions and private label channels;
maintaining flexible, low cost integrated facilities able to produce a broad product spectrum;
expanding our manufacturing footprint via the Fabrica Transaction and our expansion in South Carolina; and
employing a disciplined capital strategy by focusing on growing free cash flow and targeting high return capital projects.

Part of our strategy is to increase our volume of premium and ultra-premium tier products shipped to customers, as these products typically have a higher gross margin than value tier products. The following graph shows shipments of our premium tier and ultra-premium tier products as a percentage of total cases shipped. Shipments of premium tier and ultra-premium tier products as a percentage of total cases shipped decreased following the Fabrica Transaction in June 2014 as a majority of the products shipped under the Supply Agreement are considered value tier products.

Comparative Three-Month Periods Ended September 30, 2015 and 2014**Net Sales**

	Three Months Ended September 30, 2015 2014 (in thousands, except tons)	
Converted product net sales	\$43,675	\$43,157
Parent roll net sales	3,157	1,272
Total net sales	\$46,832	\$44,429
Converted product tons shipped	23,001	21,528
Parent roll tons shipped	3,162	1,494
Total tons shipped	26,163	23,022

Net sales in the quarter ended September 30, 2015 increased \$2.4 million, or 5%, from \$44.4 million in 2014 to \$46.8 million in 2015. Net sales figures represent the gross selling price, including freight, less discounts and pricing allowances. The increase in net sales is due to a \$518,000 increase in the sales of converted products and a \$1.9 million increase in the net sales of parent rolls.

Net sales of converted product increased \$518,000, or 1%, from \$43.2 million in 2014 to \$43.7 million in 2015. The increase in converted product net sales is primarily due to a 7% increase in tonnage shipped, which was partially offset by a 5% decrease in net selling price per ton. Converted product tons shipped increased due to higher shipment volumes from both our Pryor location and under the Supply Agreement. Net selling price per ton decreased due to the mix of products sold.

Net sales of parent rolls increased \$1.9 million, or 148%, from \$1.3 million in 2014 to \$3.2 million in 2015. The increase in parent roll net sales is primarily due to a 112% increase in parent roll tons shipped and a 17% increase in the net selling price per ton. Parent roll tons shipped increased primarily due to higher production volumes resulting from our new paper machine, which started up in March 2015. The increase in selling price per ton is primarily due to a stronger market for parent rolls and the higher quality from our new paper machine.

Cost of Sales

**Three Months
Ended September
30,
2015 2014
(in thousands,
except gross profit
margin %)**

Cost of goods sold	\$34,432		\$33,276	
Depreciation	2,555		2,369	
Cost of sales	\$36,987		\$35,645	
Gross profit	\$9,845		\$8,784	
Gross profit margin %	21.0	%	19.8	%

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, depreciation and the cost of converted products purchased under the Supply Agreement with Fabrica.

Cost of sales increased \$1.3 million, or 4%, to \$37.0 million, compared to \$35.6 million in the same period of 2014, due primarily to increased sales, higher fiber costs, and higher depreciation expense. As a percentage of net sales, cost of sales decreased to 79.0% in the 2015 quarter from 80.2% in the 2014 quarter.

Paper production costs in Oklahoma decreased primarily due to the effect of the start-up of the new paper machine. The new paper machine is an energy efficient machine which provides lower production costs than the two machines it replaced, and increased total production by 37%, which had a positive effect on absorption of fixed costs. Average fiber prices across our fiber basket were higher in the third quarter of 2015 compared to the same period in 2014, resulting in an approximate \$680,000 decrease in gross profit.

Gross Profit

Gross profit in the quarter ended September 30, 2015 increased \$1.1 million, or 12%, to \$9.8 million compared to \$8.8 million in the same period last year. Gross profit as a percentage of net sales in the 2015 quarter was 21.0% compared to 19.8% in the 2014 quarter. The gross profit increase as a percent of net sales was primarily the result of higher gross margins under the Supply Agreement and on parent roll sales. A strong U.S. dollar exchange rate with the Mexican peso, coupled with SKU optimization and price increases in the “away-from-home” business improved the margins under the Supply Agreement in the three months ended September 30, 2015 compared with the same quarter of 2014. Lower paper production costs in Oklahoma, along with a 17% increase in parent roll selling price per ton improved parent roll margins. These factors were partially offset by higher fiber costs, as discussed above.

Selling, General and Administrative Expenses

	Three Months Ended September 30, 2015 2014 (in thousands, except SG&A as a % of net sales)	
Commission expense	\$280	\$371

Other S,G&A expenses	2,157	2,170
Selling, General & Adm exp	\$2,437	\$2,541
SG&A as a % of net sales	5.2 %	5.7 %

Selling, general and administrative expenses include salaries, commissions to brokers and other miscellaneous expenses. Selling, general and administrative expenses decreased \$104,000, or 4%, in the quarter ended September 30, 2015 as compared to the same period in 2014 primarily due to \$84,000 of costs related to the Fabrica Transaction incurred in 2014, a \$365,000 decrease in non-cash compensation expense related to options granted and a decrease in commissions due to the mix of products sold. These decreases were partially offset by increased professional fees and increased artwork costs. As a percentage of net sales, selling, general and administrative expenses decreased to 5.2% in the third quarter of 2015 compared to 5.7% in the same period of 2014.

Amortization of Intangibles

The Company recognized \$376,000 and \$322,000 of amortization expense related to the intangible assets acquired in the Fabrica Transaction during the quarter ended September 30, 2015 and 2014, respectively.

Operating Income

As a result of the foregoing factors, operating income for the quarter ended September 30, 2015, was \$7.0 million compared to operating income of \$5.9 million for the same period of 2014.

Interest Expense and Other Income

	Three Months Ended September 30, 2015 2014 (in thousands)	
Interest expense	\$11	\$90
Other (income) expense, net	\$(169)	\$147
Income before income taxes	\$7,190	\$5,684

Interest expense includes interest on all debt and amortization of deferred debt issuance costs. Interest expense for the third quarter of 2015 totaled \$11,000 compared to interest expense of \$90,000 in the same period in 2014. Interest expense for 2015 and 2014 excludes \$299,000 and \$43,000, respectively of interest capitalized on significant projects during the quarter. The higher level of total interest in 2015 resulted from higher debt balances due primarily to additional debt incurred in conjunction with the Fabrica Transaction and additional borrowings to finance capital expenditures.

Other (income) expense for the three months ended September 30, 2015 and 2014 includes \$169,000 and \$56,000, respectively, of income related to the Company's pooled financing agreement with the Oklahoma Development Financing Authority (ODFA). The increase in other income for the 2015 period is due to the fact that the agreement with the ODFA was effective on September 1, 2014 and was in effect for the entire three-month period in 2015 rather than the one-month of September in 2014. Other (income) expense for the three months ended September 30, 2014 includes \$207,000 of expense related to the demolition of two paper machines.

Income Before Income Taxes

As a result of the foregoing factors, income before income taxes increased \$1.5 million to \$7.2 million in the quarter ended September 30, 2015, compared to \$5.7 million in the same period in 2014.

Income Tax Provision

As of September 30, 2015, our annual estimated effective tax rate for the full year is estimated to be 33.9%, as compared to the 33.8% effective tax rate estimated at the end of the second quarter of 2015. The actual effective tax rate for the quarter ended September 30, 2015 was 34.0%. The annual estimated effective tax rate for 2015 differs from the statutory rate due primarily to U.S. manufacturing tax credits and foreign and state income taxes. As of September 30, 2014, our annual estimated effective income tax rate is 32.4%. The actual effective tax rate for the quarter ended September 30, 2014 was 32.6%. The annual estimated effective tax rate for 2014 differs from the statutory rate due primarily to U. S. manufacturing tax credits.

Comparative Nine-Month Periods Ended September 30, 2015 and 2014**Net Sales**

	Nine Months Ended September 30, 2015 2014 (in thousands, except tons)	
Converted product net sales	\$120,877	\$97,042
Parent roll net sales	5,665	4,342
Net sales	\$126,542	\$101,384
Converted product tons shipped	62,172	47,006
Parent roll tons shipped	5,682	4,922
Total tons shipped	67,854	51,928

Net sales increased 25% to \$126.5 million in the nine months ended September 30, 2015, compared to \$101.4 million in the same period of 2014. Net sales figures represent gross selling price, including freight, less discounts and pricing allowances. The increase in net sales is due to a \$23.8 million increase in the sales of converted products and a \$1.3 million increase in the net sales of parent rolls.

Net sales of converted product for the nine months ended September 30, 2015 increased by \$23.8 million, or 25%, to \$120.9 million compared to \$97.0 million in the same period last year. The increase in net sales of converted products is primarily due to a 32% increase in converted product tonnage shipped, which was partially offset by a 6% decrease in net selling price per ton. Converted product tons shipped increased due to higher shipment volumes from our Pryor location and due to the effect of the U.S. business acquired from Fabrica, which accounted for 72% of the increase in tonnage shipped. Net selling price per ton decreased due to the mix of products sold.

Net sales of parent rolls increased \$1.3 million, or 30%, to \$5.7 million in the nine months ended September 30, 2015, compared to \$4.3 million in the same period last year. Net sales of parent rolls increased due to a 15% increase in parent roll tonnage shipped and a 13% increase in net selling price per ton. The increase in parent roll tonnage shipped was due to the start-up of our new Oklahoma paper machine in March 2015. The increase in selling price per ton is primarily due to a stronger market for our parent rolls and higher quality from our new paper machine.

Cost of Sales

	Nine Months Ended September 30, 2015 2014 (in thousands, except gross profit margin %)			
Cost of goods sold	\$97,216		\$74,282	
Depreciation	6,976		6,810	
Cost of sales	\$104,192		\$81,092	
Gross profit	\$22,350		\$20,292	
Gross profit margin %	17.7	%	20.0	%

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, depreciation, and the cost of converted products purchased under the Supply Agreement with Fabrica.

Cost of sales increased approximately \$23.1 million, or 28%, to \$104.2 million for the nine months ended September 30, 2015, compared to \$81.1 million in the same period of 2014, due primarily to increased sales, the effects of the Oklahoma paper machine project on our first quarter results, higher fiber costs, and higher labor and maintenance and repair costs in our converting operation. As a percentage of net sales, cost of sales increased to 82.3% of net sales in the nine-month period ended September 30, 2015, compared to 80.0% of net sales in the nine-month period ended September 30, 2014. The increase in cost of sales as a percentage of net sales in the nine months ended September 30, 2015, was primarily attributed to the costs mentioned above.

In the nine months ended September 30, 2015, paper production costs in Oklahoma increased primarily due to the effects of our new paper machine project in Oklahoma on our first quarter results, which included the consumption of approximately 3,000 tons of purchased parent rolls at a cost of approximately \$3.4 million as we ramped up production on the new paper machine, and higher fiber costs. Average fiber prices across our fiber basket increased by 6% compared to the same period in 2014, resulting in an approximate \$2.2 million decrease in gross profit.

Gross Profit

Gross profit in the nine months ended September 30, 2015 increased \$2.1 million, or 10%, to \$22.4 million compared to \$20.3 million in the same period last year. Gross profit as a percentage of net sales in the 2015 period was 17.7% compared to 20.0% in the 2014 period. The gross profit decrease as a percent of net sales was primarily the result of the effects of our new paper machine project as discussed above, including external paper purchases, and higher fiber costs.

Selling, General and Administrative Expenses

	Nine Months Ended September 30, 2015 2014 (in thousands, except SG&A as a % of net sales)			
Commission expense	\$911		\$1,204	
Other S,G&A expenses	6,263		7,923	
Selling, General & Adm exp	\$7,174		\$9,127	
SG&A as a % of net sales	5.7	%	9.0	%

Selling, general and administrative expenses include salaries, commissions to brokers and other miscellaneous expenses. Selling, general and administrative expenses decreased \$2.0 million, or 21%, in the nine-month period ended September 30, 2015 as compared to the same period in 2014 primarily due to \$1.6 million of costs related to the Fabrica Transaction incurred in 2014 and a \$725,000 decrease in non-cash compensation expense related to options granted. Commissions also decreased due to the mix of products sold. As a percentage of net sales, selling, general and administrative expenses decreased to 5.7% in the nine-month period of 2015 compared to 9.0% in the same period of 2014.

Amortization of Intangibles

The Company recognized \$1.1 million and \$430,000 of amortization expense related to the intangible assets acquired in the Fabrica Transaction during the nine-month period ended September 30, 2015 and 2014, respectively.

Operating Income

As a result of the foregoing factors, operating income for the nine months ended September 30, 2015 was \$14.0 million compared to operating income of \$10.7 million for the same period of 2014.

Interest Expense and Other Income

**Nine Months
Ended
September 30,
2015 2014
(in thousands)**

Interest expense	\$289	\$215
Other (income) expense, net	\$(507)	\$141
Income before income taxes	\$14,264	\$10,379

Interest expense includes interest on all debt and amortization of deferred debt issuance costs. Interest expense for the nine-month period ended September 30, 2015 totaled \$289,000 compared to interest expense of \$215,000 in the same period in 2014. Interest expense for 2015 and 2014 excludes \$423,000 and \$153,000, respectively, of interest capitalized on significant projects during the period. The higher level of total interest in 2015 resulted from higher debt balances due primarily to additional debt incurred in conjunction with the Fabrica Transaction and additional borrowings to finance capital expenditures.

The Company recognized \$514,000 and \$56,000 of other income in the consolidated statements of income for the nine-month periods ended September 30, 2015 and 2014, respectively, related to the ODFA pooled financing agreement. The increase in other income related to the ODFA agreement for the 2015 period is due to the fact that the agreement with the ODFA was effective on September 1, 2014 and was in effect for the entire nine-month period in 2015 rather than the one-month of September in 2014. Other (income) expense for the nine months ended September 30, 2014 includes \$207,000 of expense related to the demolition of two paper machines.

Income Before Income Taxes

As a result of the foregoing factors, income before income taxes increased \$3.9 million to \$14.3 million in the nine months ended September 30, 2015, compared to \$10.4 million in the same period in 2014.

Income Tax Provision

As of September 30, 2015, our annual estimated effective tax rate for the full year is estimated to be 33.9%, as compared to the 33.8% effective tax rate estimated at the end of the second quarter of 2015. Primarily as a result of a change in our estimated state tax liabilities, the actual effective tax rate for the first nine months of 2015 was 30.9%. The annual estimated effective tax rate for 2015 differs from the statutory rate due primarily to U.S. manufacturing tax credits and foreign and state income taxes. As of September 30, 2014, our annual estimated effective income tax rate is 32.4%. The actual effective tax rate for the nine-month period ended September 30, 2014 was 32.4%. The annual estimated effective tax rate for 2014 differs from the statutory rate due primarily to U. S. manufacturing tax credits.

Future Expected Stock Option Expense

In 2015 and 2014, the Board of Directors granted options to purchase 28,600 and 145,000 shares, respectively, of the Company's common stock to certain members of management. Additionally, on April 9, 2014, the Company's shareholders approved the option to purchase 400,000 shares of the Company's common stock granted to Mr. Jeffrey S. Schoen, the Company's President and Chief Executive Officer, on November 8, 2013. These options will become exercisable in four equal tranches, if at all, if and when the share price of the common stock closes at a certain percentage of the purchase price of the option for three consecutive business days, in accordance with the following vesting schedule:

Share price required to achieve vesting	2014 options	2015 options
Tranche 1	\$34.788	\$29.560
Tranche 2	\$42.350	\$36.000
Tranche 3	\$51.425	\$43.710
Tranche 4	\$60.500	\$51.430

The grant of these options will have a material impact on the Company's future results of operations and on the comparability of the Company's results from period to period. The Company expenses the cost of these options granted on a straight-line basis over the implicit, or derived, service period of the option based on the grant-date fair value of the award. The Company expects to expense the compensation cost associated with these options based on the following schedule:

	2015 (in thousands)				2015 Total	2016 Total	2017 Total
	Q1	Q2	Q3	Q4			
Tranche 1	\$-	\$-	\$-	\$26	\$26	\$5	\$ -
Tranche 2	134	104	1	10	249	19	\$ -
Tranche 3	73	72	47	73	265	73	\$ 3
Tranche 4	47	48	30	48	173	138	\$ 5
Total expense	\$254	\$224	\$78	\$157	\$713	\$235	\$ 8

However, if the market condition is achieved for any tranche of these options prior to the end of the derived service period, all remaining expense related to that tranche would be recognized in the period in which the market condition is achieved.

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 credit facility. Our cash requirements have historically been satisfied through a combination of cash flows from operations and debt and equity financings. We expect this trend to continue.

On April 24, 2015, we issued and sold 1,500,000 shares at \$23.00 per share in an underwritten public offering resulting in aggregate net proceeds to us of approximately \$32.2 million, after giving effect to the underwriting discount and estimated expenses. We have been using and intend to continue to use the net proceeds from the offering, together with new bank financing and cash on hand, to construct an integrated paper mill in Barnwell, South Carolina, consisting of a new facility to house a new paper machine and converting equipment to convert the parent rolls into finished product and to provide warehouse space for finished product and raw materials. On June 25, 2015, we entered into an agreement with US Bank National Association (“US Bank”) which: (i) combined our existing \$20 million revolving line of credit designated for the purchase and construction of a paper machine and converting line in Pryor, Oklahoma and \$27.3 million currently outstanding under our existing term loan into a \$47.3 million term loan due in 2020; (ii) increased our delayed draw term loan facility from \$40 million to \$115 million; (iii) extended the maturity of the delayed draw facility from August 2015 to June 2020; and (iv) added a \$50 million accordion feature. Proceeds from the delayed draw term loan must be used solely to finance the acquisition and construction of buildings and equipment at our Barnwell facility. Advances under the facility bear interest at variable rates. The term loan is payable in quarterly installments of \$675,000 through June 2016 and \$1 million per quarter thereafter, while borrowings against the delayed draw term loan facility are payable in quarterly installments of 1.5% of the June 30, 2017 outstanding balance beginning in September 2017.

During the nine months ended September 30, 2015, cash increased \$7.5 million, to \$8.6 million at September 30, 2015, compared to \$1.0 million at December 31, 2014. During the 2015 period, we incurred \$35.5 million of capital expenditures, received \$32.2 million of net proceeds from the follow-on stock offering discussed above, received \$20.0 million of borrowings under our term loan, repaid \$2.0 million of debt principal, decreased bank overdrafts by \$1.7 million, paid \$10.3 million in dividends to stockholders and made net repayments of \$7.7 million under our revolving line of credit.

As of September 30, 2015, total debt outstanding was \$46.6 million. Cash as of September 30, 2015, totaled \$8.6 million, resulting in a net debt level of \$38.1 million. This compares to \$36.4 million in total debt and a net cash overdraft of \$685,000 as of December 31, 2014, resulting in a net debt level of \$37.0 million. There were no amounts outstanding under our \$25.0 million revolving line of credit or our \$115.0 million delayed draw term loan as of September 30, 2015.

The following table summarizes key cash flow information for the nine-month periods ended September 30, 2015 and 2014:

	Nine Months Ended September 30, 2015 2014 (in thousands)	
Cash flows provided by (used in):		
Operating activities	\$ 13,183	\$ 15,871
Investing activities	\$(35,485)	\$(25,011)
Financing activities	\$ 29,831	\$ 5,426

Cash flows provided by operating activities was \$13.2 million in the nine-month period ended September 30, 2015, which primarily resulted from earnings before non-cash charges, including depreciation and amortization, and an increase in accrued liabilities, which were partially offset by increases in accounts receivable and inventories and a decrease in accounts payable. The increase in accrued liabilities is primarily due to timing of payments of liabilities. The increase in accounts receivable is primarily related to the timing of sales and related cash receipts. The increase in inventories is primarily due to higher finished goods inventories due to anticipation of sales levels during the second half of 2015 and higher parent roll inventories with the start-up of the new, more efficient paper machine in March 2015. The decrease in accounts payable is primarily related to the timing of purchases and cash payments.

Cash flows used in investing activities in the first nine months of 2015 consisted entirely of \$35.5 million in expenditures on capital projects during the period.

Cash flows provided by financing activities was \$29.8 million in the nine-month period ended September 30, 2015, primarily due to \$32.2 million of net proceeds received from our follow-on stock offering in April 2015, and \$12.3 million of net borrowings under our credit facility, which were partially offset by \$10.3 million of cash dividends paid to stockholders, \$2.0 million of debt principal repayments, and a \$1.7 million reduction in bank overdrafts. 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 many factors, including our financial condition, earnings, cash requirements of our business, legal requirements, regulatory constraints, industry practice and other factors that the Board deems relevant. Our credit agreement contains an indirect restriction on the amount of cash dividends we pay in that the amount of dividends paid is included in the calculation of our fixed charge coverage ratio.

Cash flows provided by operating activities was \$15.9 million in the nine-month period ended September 30, 2014, which primarily resulted from earnings before non-cash charges and an increase in accounts payable, which were partially offset by increases in accounts receivable and other receivables. The increase in accounts payable is primarily related to the timing of purchases and cash payments, while the increase in accounts receivable is primarily related to increased sales from the Fabrica acquisition, the timing of sales and related cash receipts. The increase in other receivables is primarily due to the timing of value-added tax ("VAT") payments, which are primarily due to equipment purchased from Fabrica.

Cash flows used in investing activities was \$25.0 million in the first nine months of 2014 as a result of \$16.7 million of cash paid in the Fabrica Transaction and \$13.3 million in expenditures on capital projects, which was partially offset by \$5.0 million of proceeds from the sale of short-term investments.

Cash flows provided by financing activities was \$5.4 million in the nine-month period ended September 30, 2014, primarily as a result of \$30.0 million of net borrowings under our new credit facility, which was partially offset by \$15.8 million of debt payments, including the payoff of \$14.6 million when our debt was refinanced with a new creditor, and \$8.7 million of cash dividends paid to stockholders.

Critical Accounting Policies and Estimates

The preparation of our financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and judgments that affect our reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going 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 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 a provision 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 provisions established, there can be no assurance that we will continue to experience the same credit loss rates as in the past. During the nine-month period ended September 30, 2015, no accounts receivable not expected to be collected were written off against the allowance for doubtful accounts, and the provision was not increased or decreased based on historical experience and an evaluation of the quality of existing accounts receivable, resulting in no change to the provision. During the nine-month period ended September 30, 2014, no accounts receivable not expected to be collected were written off against the allowance for doubtful accounts, and the provision was not increased or decreased based on historical experience and an evaluation of the quality of existing accounts receivable. Recovery of a \$1,000 receivable previously written off was credited to the provision, resulting in a net increase of \$1,000 in the provision.

Inventory. Our inventory consists of converted finished goods, bulk paper rolls and raw materials and is stated at the lower of cost or market based on standard cost, specific identification, or FIFO (first-in, first-out). Standard costs approximate actual costs on a FIFO basis. Material, labor and factor overhead necessary to produce the inventories are included in the standard cost. 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 nine months of 2015, the inventory allowance was increased \$181,000 based on a specific review of estimated slow moving or obsolete inventory items and was decreased \$139,000 due to actual write-offs of obsolete inventory items, resulting in a net increase in the allowance of \$42,000. During the first nine months of 2014, the inventory allowance was increased \$123,000 based on a specific review of estimated slow moving or obsolete inventory items and was decreased \$95,000 due to actual write-offs of obsolete inventory items, resulting in a net increase in the allowance of \$28,000.

Property, plant and equipment. Significant capital expenditures are required to establish and maintain a paper mill and converting facility. Our property, plant and equipment consists of land, buildings and improvements, machinery and equipment, vehicles, parts and spares and construction-in-process, which are stated at cost, net of accumulated depreciation. Depreciation of property, plant and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Our management regularly reviews estimated useful lives to determine whether any changes are necessary to reflect the related assets' actual productive lives. The lives of our property, plant and equipment currently range from 2.5 to 40 years.

Stock-based Compensation. U.S. GAAP requires equity-classified, share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant and to be expensed over the applicable vesting period. We recognize this expense on a straight-line basis over the options' expected terms. We issue stock options that vest over a specified period (time-based vesting) and stock options that vest when the price of the

Company's common stock reaches a certain price (market-based vesting). We also issue restricted stock.

We granted options to purchase 68,600 and 585,000 shares of our common stock in the first nine months of 2015 and 2014, respectively. We recorded stock-based compensation expense of \$743,000 and \$1,571,000 during the nine-month periods ended September 30, 2015 and 2014, respectively, in connection with the option grants. In February 2013, we granted 16,000 shares of restricted stock. We recorded stock-based compensation expense of \$34,000 and \$38,000 during the nine months ended September 30, 2015 and 2014, respectively, in connection with the restricted stock grants. Grants of restricted stock are valued using the closing market price of our common stock on the date of grant.

We estimate the grant date fair value of time-based stock option awards using the Black-Scholes option valuation model, which requires assumptions involving an estimate of the fair value of the underlying common stock on the date of grant, the expected term of the options, volatility, discount rate and dividend yield. Separate values were determined for options having exercise prices ranging from \$5.18 to \$30.09. For options valued using the Black-Scholes option valuation model, we calculated expected option terms based on the "simplified" method for "plain vanilla" options, due to the Company's limited exercise information. The "simplified method" calculates the expected term as the average of the vesting term and the original contractual term of the options. We calculated volatility using the daily volatilities of our common stock since our Initial Public Offering ("IPO"), while the discount rate was estimated using the interest rate for a treasury note with the same contractual term as the options granted. Dividend yield is estimated at our current dividend rate, with adjustments for any known future changes in the rate.

We have engaged a valuation specialist to estimate the grant date fair value of market-based stock option awards. Separate values were determined for options having exercises prices ranging from \$25.24 to \$31.125. The specialist utilizes a Monte Carlo valuation method to estimate the grant date fair value of the options granted in order to simulate a range of our possible future stock prices. Significant assumptions to the Monte Carlo method include the expected life of the option, volatility and dividend yield. The expected life of the option is based on the average of the service period and the contractual term of the option, using the "simplified" method for "plain vanilla" options. Volatility is calculated based on a mix of historical and implied volatility during the expected life of the options. Historical volatility is considered since our IPO and implied volatility is based on the publicly traded options of a three company peer group within the paper industry. Dividend yield is estimated based on our average historical dividend yield and our current dividend yield as of the grant date. The Monte Carlo analysis is performed under a risk-neutral premise, under which price drift is modeled using treasury note yields matching the expected life of the options.

Under U.S. GAAP, we expense the compensation cost related to the marked-based stock option awards on a straight-line basis over the derived service periods of the options as calculated under the Monte Carlo valuation method. However, if the market condition is achieved for any tranche of these options prior to the end of the derived service period, all remaining expense related to that tranche would be recognized in the period in which the market condition is achieved. Additionally, if the service period is met but the share price target required for the options to become exercisable is never achieved, no compensation cost may be reversed. As such, we may recognize expense for options that never become exercisable.

In addition, we are required to develop an estimate of the number of share-based awards that will be forfeited due to employee turnover. The guidance on stock compensation requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates in order to derive our best estimate of awards ultimately expected to vest. We estimate forfeitures based on historical experience related to our own stock-based awards granted. We anticipate that these estimates will be revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Intangible Assets and Goodwill. We allocate the cost of business acquisitions to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition (commonly referred to as the purchase price allocation). As part of the purchase price allocations for our business acquisitions, identifiable intangible assets are recognized as assets apart from goodwill if they arise from contractual or other legal rights, or if they are capable of being separated or divided from the acquired business and sold, transferred, licensed, rented or exchanged. We have engaged a valuation specialist to estimate the fair value of our purchase price and the related intangible assets acquired.

In June 2014, we acquired certain assets and the U.S. business of Fabrica. Due to these transactions, we separately recognized the fair values of a combined Supply and Lease Agreement, trademarks, a non-compete agreement and customer relationships. The fair value of these assets was determined using an income approach, as follows: Supply and Lease Agreement - discounted cash flows method, trademarks — “relief from royalty” method, non-compete agreement - “with and without” method, and customer relationships - excess earnings method. An income approach requires estimates of future income. Under the discounted cash flow method, we utilized assumptions related to the term of the agreements, the net benefit from the agreements and any changes in that benefit over the term of the agreement, future tax rates and discount rates. Under the relief from royalty method, we estimated the useful lives of the trademarks, future revenues associated with the trademarks, a royalty rate and a discount rate. The with and without method requires assumptions related to the probability of competition in the absence of the non-compete agreement, the loss of future revenues due to competition and discount rates. Under the excess earnings method, we must estimate future revenues, including growth and attrition rates, income tax rates, a rate of return on assets, and discount rates. Future revenues and estimated benefits from the agreements are based on management’s knowledge of the industry, customers, operations and the agreements. Tax rates are based on current effective tax rates. The royalty rate is based on analysis of current royalty rates for corporate and product trademarks for similar products and evaluation of factors such as alternative trademarks available, legal defensibility, remaining useful life, licensing power, net revenue margin, market share, barriers to entry, capital requirements and customers’ bargaining power. The discount rate used to determine the present value of future cash flows was based on the weighted average cost of capital method.

The value assigned to goodwill equals the amount of the purchase price of the business acquired in excess of the sum of the amounts assigned to identifiable acquired assets, both tangible and intangible, less liabilities assumed. At September 30, 2015, we had goodwill of \$7.6 million and identifiable intangible assets, net of accumulated amortization, of \$16.1 million.

Intangible assets are amortized over their respective estimated useful lives ranging from two to twenty years. The useful life of an intangible asset is the period over which the asset is expected to contribute directly or indirectly to our future cash flows rather than the period of time that it would take us to internally develop an intangible asset that would provide similar benefits. The estimate of the useful lives of our intangible asset is based on an analysis of all pertinent factors, in particular:

- the expected use of the asset by the entity;
- the expected useful life of another asset or group of assets to which the useful life of the intangible asset may relate;
- any legal, regulatory or contractual provisions that may limit the useful life;
- any legal, regulatory, or contractual provisions that enable renewal or extension of the asset's legal or contractual life without substantial cost (provided there is evidence to support renewal or extension and renewal or extension can be accomplished without material modifications of the existing terms and conditions);
- the effects of obsolescence, demand, competition and other economic factors (such as the stability of the industry, known technological advances, legislative action that results in an uncertain or changing regulatory environment, and expected changes in distribution channels); and
- the level of regular maintenance expenditures (but not enhancements) required to obtain the expected future cash flows from the asset (for example, a material level of required maintenance in relation to the carrying amount of the asset may suggest a limited useful life).

If no legal, regulatory, contractual, competitive, economic, or other factors limit the useful life of an intangible asset, the useful life of the asset is considered to be indefinite. The term indefinite does not mean infinite. An intangible asset with a finite useful life is amortized over that useful life; an intangible asset with an indefinite useful life is not amortized. We have no intangible assets with indefinite useful lives. Under U.S. GAAP, goodwill is not amortized.

Impairment of Goodwill and Other Long-Lived Assets. We review long-lived assets such as property, plant and equipment, intangible assets and goodwill for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, and also review goodwill annually. U.S. GAAP requires that goodwill be tested, at a minimum, annually for each reporting unit. The first step in testing goodwill to assess qualitative factors to determine whether it is more likely than not that goodwill is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test. If the first step indicates a quantitative test must be performed, the second step is to identify any potential impairment by comparing the carrying value of the reporting unit to its fair value. If a potential impairment is identified, the third step is to measure the impairment loss by comparing the implied fair value of goodwill with the carrying value of goodwill of the reporting unit. Alternatively, the Company may bypass the qualitative assessment in any period and proceed directly to performing the second step. As the goodwill on the consolidated balance sheet as of September 30, 2015 is related to the acquisition that occurred in June 2014, the Company plans to perform its initial goodwill impairment test in 2015.

New Accounting Pronouncements

Refer to the discussion of recently adopted/issued accounting pronouncements under Part I, Notes to Unaudited Interim Financial Statements Note 15 — 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. The three non-GAAP financial measures used within this report are: (1) EBITDA, (2) Adjusted EBITDA and (3) Net Debt.

EBITDA and Adjusted EBITDA

We use EBITDA and Adjusted EBITDA as a supplemental measure of our performance that is not required by, or presented in accordance with GAAP. EBITDA and Adjusted 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. Adjusted EBITDA represents EBITDA before non-cash stock compensation expense, expenses related to business acquisitions and costs to

demolish property, plant and equipment. We believe EBITDA and Adjusted EBITDA facilitate 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), the age and book depreciation of facilities and equipment (affecting relative depreciation expense), non-cash compensation and valuation (affecting stock compensation expense), and sporadic expenses (including costs of business acquisitions and demolition costs).

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

- they do not reflect our cash expenditures for capital assets;
- they do not reflect changes in, or cash requirements for, our working capital requirements;
- they do not reflect cash requirements for cash dividend payments;
- they do 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 and Adjusted EBITDA do 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 and Adjusted 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 and Adjusted EBITDA on a supplemental basis.

The following table reconciles EBITDA and Adjusted EBITDA to net income for the three months ended September 30, 2015 and 2014:

	Three Months Ended September 30, 2015 2014 (in thousands, except % of net sales)			
Net income	\$4,742		\$3,830	
Plus: Interest expense, net	11		90	
Plus: Income tax expense	2,448		1,854	
Plus: Depreciation	2,555		2,369	
Plus: Intangibles amortization	376		322	
EBITDA	\$10,132		\$8,465	
% of net sales	21.6	%	19.1	%
Plus: Stock compensation expense	87		437	
Plus: Acquisition costs	-		84	
Plus: Demolition costs	-		207	
Adjusted EBITDA	\$10,219		\$9,193	
% of net sales	21.8	%	20.7	%

Adjusted EBITDA increased \$1.0 million to \$10.2 million in the quarter ended September 30, 2015, compared to \$9.2 million in the same period in 2014. Adjusted EBITDA as a percent of net sales increased to 21.8% in the third quarter of 2015 from 20.7% in the third quarter of 2014. EBITDA increased \$1.7 million to \$10.1 million in the quarter ended September 30, 2015, compared to \$8.5 million in the same period in 2014. EBITDA as a percent of net sales increased to 21.6% in the third quarter of 2015 from 19.1% in the third quarter of 2014. The foregoing factors discussed in the net sales, cost of sales and selling, general and administrative expenses sections are the reasons for the increase.

The following table reconciles EBITDA and Adjusted EBITDA to net income for the nine-month periods ended September 30, 2015 and 2014:

**Nine Months
Ended September
30,**

	2015	2014		
	(in thousands, except % of net sales)			
Net income	\$9,856	\$7,019		
Plus: Interest expense, net	289	215		
Plus: Income tax expense	4,408	3,360		
Plus: Depreciation	6,976	6,810		
Plus: Intangibles amortization	1,130	430		
EBITDA	\$22,659	\$17,834		
% of net sales	17.9	%	17.6	%
Plus: Stock compensation expense	777	1,609		
Plus: Acquisition costs	-	1,572		
Plus: Demolition costs	-	207		
Adjusted EBITDA	\$23,436	\$21,222		
% of net sales	18.5	%	20.9	%

Adjusted EBITDA increased \$2.2 million to \$23.4 million in the nine-month period ended September 30, 2015, compared to \$21.2 million in the same period in 2014. Adjusted EBITDA as a percent of net sales decreased to 18.5% in the 2015 period from 20.9% in the same period of 2014. EBITDA increased \$4.8 million to \$22.7 million in the nine-month period ended September 30, 2015, compared to \$17.8 million in the same period in 2014. EBITDA as a percent of net sales increased slightly to 17.9% in the 2015 period from 17.6% in the third quarter of 2014. The foregoing factors discussed in the net sales, cost of sales and selling, general and administrative expenses sections are the reasons for the increase.

Net Debt

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 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 increased from \$37.0 million on December 31, 2014, to \$38.1 million on September 30, 2015, primarily as a result of an increase in long-term debt due to additional borrowings for capital expenditures, which was partially offset by an increase in cash primarily due to cash proceeds received from our follow-on stock offering in April 2015 and cash flows from operations.

The following table presents Net Debt as of September 30, 2015, and December 31, 2014:

	As of	
	September	December
	30,	31,
	2015	2014
	(in thousands)	
Current portion long-term debt	\$3,025	\$ 2,700
Long-term debt	43,600	33,662
Total debt	46,625	36,362
Less: Cash	(8,550)	685
Net debt	\$38,075	\$ 37,047

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, 2014.

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 Rule 13a-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 at a reasonable assurance level as of September 30, 2015.

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 September 30, 2015, 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

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.

ITEM 1A. Risk Factors

We operate in a changing environment that involves numerous known and unknown risks and uncertainties that could materially affect our operations. Factors that could materially affect our actual results, levels of activity, performance or achievements include, but are not limited to, those detailed below, those under the caption "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014, as filed with the SEC on March 9, 2015, and those in our subsequent filings with the SEC. Such risks, uncertainties and other factors 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.

There can be no assurance that we will be able to complete the construction project in Barnwell, South Carolina, on the schedule or terms expected or at all, which could substantially adversely affect our strategic plans and projections.

As described in our filings, construction of a converting facility in Barnwell, South Carolina was started in the second quarter of 2015. However, there can be no assurance that the construction of the building, installation of the paper machine and converting equipment or ramping up of the production will proceed on schedule, in the manner planned, for the anticipated cost or at all. If the equipment suppliers fail to timely deliver the proper equipment or the construction of the facilities is delayed due to weather or structural issues, we may be unable to complete the construction project and bring the facility to full capacity in a timely and cost effective manner, and as a result, our business and projections could be materially and adversely impacted.

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.

(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 months ended September 30, 2015.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

On November 6, 2015, the Company entered into a first amendment to its Second Amended and Restated Credit Agreement (the "Credit Agreement Amendment"). The Credit Agreement Amendment modifies the definition of "Change of Control." The definition of "Change of Control" is now defined as follows (capitalized terms have the meaning prescribed to them in the Credit Agreement):

(i) the acquisition by any Person, or two or more Persons acting in concert, of beneficial ownership (within the meaning of Rule 13d-3 of the U.S. Securities and Exchange Commission under the Securities Exchange Act of 1934) of 30% or more of the outstanding shares of voting stock of the Borrower on a fully diluted basis; (ii) within any twelve-month period, occupation of a majority of the seats (other than vacant seats) on the board of directors of the Borrower by Persons (x) who were not members of the board of directors of the Borrower on the first day of such period, (y) whose election or nomination to that board was not approved by individuals referred to in clause (x) above constituting at the time of such election or nomination at least a majority of that board, or (z) whose election or nomination to that board was not approved by individuals referred to in clauses (x) and (y) above constituting at the time of such election or nomination at least a majority of that board.

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.

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: November 9, 2015

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

Exhibit Index

Exhibit Description

- | | |
|------|--|
| 3.1 | Amended and Restated Certificate of Incorporation of the Registrant dated May 17, 2013, incorporated by reference to Exhibit 3.1 to the Registrant's Form 10-Q (SEC Accession No. 0001104659-13-058279) filed with the SEC on July 31, 2013. |
| 3.2 | Amended and Restated Bylaws of the Registrant amended May 17, 2013, incorporated by reference to Exhibit 3.2 to the Registrant's Form 10-Q (SEC Accession No. 0001104659-13-058279) filed with the SEC on July 31, 2013. |
| 10.1 | Second Amended and Restated Credit Agreement, dated as of June 25, 2015, among Orchids, U.S. Bank National Association, as administrative agent, lead arranger and sole book runner, the lenders named therein, and JPMorgan Chase Bank, N.A., as documentation agent, incorporated by reference to the Registrant's Current Report on Form 8-K (SEC Accession No. 0001144204-15-039721) filed with the SEC on June 29, 2015. |
| 10.2 | Amendment No. 1 to Second Amended and Restated Credit Agreement, dated as of November 6, 2015, among Orchids and U.S. Bank National Association, as administrative agent. |
| 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 September 30, 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Income for the three and nine months ended September 30, 2015 and 2014, (ii) Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014, (iii) Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014, and (iv) Notes to Consolidated Unaudited Interim Financial Statements. |