

UFP TECHNOLOGIES INC  
Form 10-Q  
November 09, 2012  
[Table of Contents](#)

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

## FORM 10-Q

(Mark one)

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

For the quarterly period ended **SEPTEMBER 30, 2012**

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: **001-12648**

**UFP Technologies, Inc.**

(Exact name of registrant as specified in its charter)

Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

**Delaware**

(State or other jurisdiction of incorporation or organization)

**04-2314970**

(IRS Employer Identification No.)

**172 East Main Street, Georgetown, Massachusetts 01833, USA**

(Address of principal executive offices) (Zip Code)

**(978) 352-2200**

(Registrant's telephone number, including area code)

(Former name, former address, and former fiscal year, if changed since last report)

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 requirements for the past 90 days. Yes x; No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x; No o

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

[Do not check if a 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 o; No x

6,731,929 shares of registrant's Common Stock, \$.01 par value, were outstanding as of November 1, 2012.



Table of Contents

**UFP Technologies, Inc.**

**Index**

|   | <b>Page</b> |
|---|-------------|
| <b><u>PART I - FINANCIAL INFORMATION</u></b>  | <b>3</b>    |
| <b><u>Item 1. Financial Statements</u></b>  | <b>3</b>    |
| <u>Condensed Consolidated Balance Sheets as of September 30, 2012 (unaudited) and December 31, 2011</u>                                       | 3           |
| <u>Condensed Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2012, and September 30, 2011 (unaudited)</u> | 4           |
| <u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012, and September 30, 2011 (unaudited)</u>       | 5           |
| <u>Notes to Interim Condensed Consolidated Financial Statements</u>   | 6           |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>  | 11          |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>   | 14          |
| <u>Item 4. Controls and Procedures</u>  | 14          |
| <b><u>PART II - OTHER INFORMATION</u></b>   | <b>15</b>   |
| <u>Item 1A. Risk Factors</u>  | 15          |
| <u>Item 6. Exhibits</u>   | 15          |
| <b><u>SIGNATURES / EXHIBIT INDEX</u></b>  | <b>16</b>   |
| Exhibits  | 17          |

Table of Contents**PART I: FINANCIAL INFORMATION****ITEM 1: FINANCIAL STATEMENTS****UFP Technologies, Inc.****Condensed Consolidated Balance Sheets**

|   | <b>30-Sep-12</b><br><b>(unaudited)</b> | <b>31-Dec-11</b> |
|---|--|------------------|
| <b>Assets</b>   |  |                  |
| Current assets:   |  |                  |
| Cash and cash equivalents (UDT: \$278,475 at December 31, 2011)   | \$ 31,155,308                          | \$ 29,848,798    |
| Receivables, net  | 16,968,159                             | 15,618,717       |
| Inventories   | 9,019,272                              | 9,758,623        |
| Prepaid expenses  | 597,079                                | 558,875          |
| Refundable income taxes   | 798,514                                | 1,086,632        |
| Deferred income taxes   | 1,249,749                              | 1,168,749        |
| Total current assets  | 59,788,081                             | 58,040,394       |
| Property, plant, and equipment (UDT: \$2,099,960 at December 31, 2011)  | 55,672,918                             | 47,635,907       |
| Less accumulated depreciation and amortization (UDT: \$1,448,928 at December 31, 2011)  | (36,271,481)                           | (34,289,450)     |
| Net property, plant, and equipment  | 19,401,437                             | 13,346,457       |
| Goodwill  | 6,481,037                              | 6,481,037        |
| Intangible assets, net  | 274,892                                | 398,499          |
| Other assets  | 1,582,894                              | 1,454,867        |
| Total assets  | \$ 87,528,341                          | \$ 79,721,254    |
| <b>Liabilities and Stockholders Equity</b>  |  |                  |
| Current liabilities:  |  |                  |
| Accounts payable  | \$ 3,644,959                           | \$ 3,344,480     |
| Accrued expenses (UDT: \$14,400 at December 31, 2011)   | 5,631,124                              | 5,540,163        |
| Current installments of long-term debt  | 580,661                                | 580,661          |
| Total current liabilities   | 9,856,744                              | 9,465,304        |
| Long-term debt, excluding current installments  | 5,203,162                              | 5,638,658        |
| Deferred income taxes   | 1,519,334                              | 1,292,378        |
| Retirement and other liabilities  | 1,576,467                              | 1,340,131        |
| Total liabilities   | 18,155,707                             | 17,736,471       |
| Commitments and contingencies   |  |                  |
| Stockholders equity:  |  |                  |
| Preferred stock, \$.01 par value. Authorized 1,000,000 shares; no shares issued or outstanding  |  |                  |
| Common stock, \$.01 par value. Authorized 20,000,000 shares; issued and outstanding 6,731,929 at September 30, 2012, and 6,554,746 at December 31, 2011 | 67,319                                 | 65,547           |
| Additional paid-in capital  | 18,554,168                             | 18,185,912       |
| Retained earnings   | 50,751,147                             | 43,059,074       |
| Total UFP Technologies, Inc. stockholders equity  | 69,372,634                             | 61,310,533       |
| Non-controlling interests   |  | 674,250          |
| Total stockholders equity   | 69,372,634                             | 61,984,783       |
| Total liabilities and stockholders equity   | \$ 87,528,341                          | \$ 79,721,254    |

The accompanying notes are an integral part of these condensed consolidated financial statements.



Table of Contents

## UFP Technologies, Inc.

Condensed Consolidated Statements of Income

(Unaudited)

|   | Three Months Ended |               | NineMonths Ended |               |
|---|--------------------|---------------|------------------|---------------|
|   | 30-Sep-2012        | 30-Sep-2011   | 30-Sep-2012      | 30-Sep-2011   |
| Net sales   | \$ 31,966,826      | \$ 30,761,959 | \$ 97,591,654    | \$ 95,766,541 |
| Cost of sales   | 22,740,944         | 22,277,661    | 69,473,855       | 68,477,211    |
| Gross profit  | 9,225,882          | 8,484,298     | 28,117,799       | 27,289,330    |
| Selling, general & administrative expenses                          | 5,155,712          | 5,219,840     | 16,065,994       | 16,628,156    |
| Gain on sale of fixed assets  |                    |               | (12,363)         | (833,792)     |
| Operating income  | 4,070,170          | 3,264,458     | 12,064,168       | 11,494,966    |
| Interest expense, net   | (13,739)           | (5,776)       | (43,247)         | (18,928)      |
| Other income (expenses)   |                    |               | (2,058)          |               |
| Income before income tax expense                                    | 4,056,431          | 3,258,682     | 12,018,863       | 11,476,038    |
| Income tax expense  | 1,460,158          | 819,079       | 4,326,790        | 3,700,776     |
| Net income from consolidated operations                             | 2,596,273          | 2,439,603     | 7,692,073        | 7,775,262     |
| Net income attributable to noncontrolling interests                 |                    | (4,415)       |                  | (433,399)     |
| Net income attributable to UFP Technologies, Inc.                   | \$ 2,596,273       | \$ 2,435,188  | \$ 7,692,073     | \$ 7,341,863  |
| <i>Net income per share attributable to UFP Technologies, Inc.:</i> |                    |               |                  |               |
| Basic   | \$ 0.39            | \$ 0.37       | \$ 1.15          | \$ 1.14       |
| Diluted   | \$ 0.37            | \$ 0.35       | \$ 1.09          | \$ 1.05       |
| <i>Weighted average common shares outstanding:</i>                  |                    |               |                  |               |
| Basic   | 6,720,756          | 6,510,523     | 6,667,895        | 6,457,099     |
| Diluted   | 7,074,631          | 6,999,224     | 7,055,397        | 6,985,332     |

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

## UFP Technologies, Inc.

**Condensed Consolidated Statements of Cash Flows**

(Unaudited)

|   | Nine Months Ended    |                      |
|---|----------------------|----------------------|
|   | 30-Sep-2012          | 30-Sep-2011          |
| <b>Cash flows from operating activities:</b>  |                      |                      |
| Net income from consolidated operations   | \$ 7,692,073         | \$ 7,775,262         |
| Adjustments to reconcile net income to net cash provided by operating activities:               |                      |                      |
| Depreciation and amortization   | 2,117,538            | 1,981,775            |
| Gain on sale of fixed assets  | (12,363)             | (833,792)            |
| Stock issued in lieu of cash compensation   |                      | 55,000               |
| Share-based compensation  | 679,340              | 860,006              |
| Excess tax benefit on share-based compensation  | (327,707)            | (419,452)            |
| Deferred income taxes   | 337,956              | (7,125)              |
| Changes in operating assets and liabilities:  |                      |                      |
| Receivables, net  | (1,349,442)          | (481,672)            |
| Inventories   | 739,351              | (961,921)            |
| Taxes receivable  | 288,118              | 559,458              |
| Prepaid expenses  | (38,204)             | 262,154              |
| Accounts payable  | 300,479              | 849,153              |
| Accrued taxes and other expenses  | 418,668              | (33,567)             |
| Retirement and other liabilities  | 236,336              | (57,917)             |
| Other assets  | (259,647)            | 61,396               |
| <b>Net cash provided by operating activities</b>  | <b>10,822,496</b>    | <b>9,608,758</b>     |
| <b>Cash flows from investing activities:</b>  |                      |                      |
| Additions to property, plant, and equipment   | (8,048,911)          | (2,638,297)          |
| Proceeds from sale of fixed assets  | 12,363               | 1,217,694            |
| Redemption of cash value life insurance   | 131,621              |                      |
| <b>Net cash used in investing activities</b>  | <b>(7,904,927)</b>   | <b>(1,420,603)</b>   |
| <b>Cash flows from financing activities:</b>  |                      |                      |
| Principal repayments of long-term debt  | (435,496)            | (1,136,794)          |
| Proceeds from exercise of stock options, net of attestation                                     | 365,237              | 234,063              |
| Excess tax benefit on share-based compensation  | 327,707              | 419,452              |
| Payment of statutory withholdings for stock options exercised and restricted stock units vested | (672,284)            | (829,995)            |
| Distribution to United Development Company Limited (non-controlling interests)                  | (1,196,223)          | (289,183)            |
| <b>Net cash used in financing activities</b>  | <b>(1,611,059)</b>   | <b>(1,602,457)</b>   |
| Net increase in cash and cash equivalents   | 1,306,510            | 6,585,698            |
| <b>Cash and cash equivalents at beginning of period</b>   | <b>29,848,798</b>    | <b>22,102,634</b>    |
| <b>Cash and cash equivalents at end of period</b>   | <b>\$ 31,155,308</b> | <b>\$ 28,688,332</b> |

The accompanying notes are an integral part of these condensed consolidated financial statements.



Table of Contents

**NOTES TO INTERIM**

**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(1) Basis of Presentation

The interim condensed consolidated financial statements of UFP Technologies, Inc. (the Company) presented herein, have been prepared pursuant to the rules of the Securities and Exchange Commission for quarterly reports on Form 10-Q and do not include all the information and note disclosures required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2011, included in the Company's 2011 Annual Report on Form 10-K as filed with the Securities and Exchange Commission.

The condensed consolidated balance sheet as of September 30, 2012, the condensed consolidated statements of income for the three- and nine-month periods ended September 30, 2012, and 2011, and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2012, and 2011, are unaudited but, in the opinion of management, include all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of results for these interim periods.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

The results of operations for the three- and nine-month periods ended September 30, 2012, are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2012.

(2) Supplemental Cash Flow Information

Cash paid for interest and income taxes is as follows:

|                              | <b>Nine Months Ended</b> |                  |
|------------------------------|--------------------------|------------------|
|                              | <b>30-Sep-12</b>         | <b>30-Sep-11</b> |
| Interest                     | \$ 24,747                | \$ 19,957        |
| Income taxes, net of refunds | \$ 3,371,507             | \$ 2,856,998     |

During the nine-month periods ended September 30, 2012, and 2011, the Company permitted the exercise of stock options with exercise proceeds paid with the Company's stock (cashless exercises) totaling \$125,799 and \$93,879, respectively.

(3) Investment in Affiliated Partnership

In prior periods the Company had a 26.32% ownership interest in a realty limited partnership, United Development Company Limited ( UDT ). The Company had consolidated the financial statements of UDT for prior periods because it determined that UDT was a VIE. On February 29, 2012, the Company purchased the manufacturing building that it leased from UDT for \$1,350,000, which approximates fair market value. Since this transaction took place among commonly controlled companies, the building was recorded by the Company at UDT 's carrying value. Thus, in effect, the Company has acquired the remaining 73.68% ownership interest in UDT, eliminating the VIE. Subsequently, UDT was dissolved and its assets were distributed. The non-controlling interests' portion of the excess of the amount paid for the building over UDT 's carrying value, totaling \$521,972, has been recorded in stockholders' equity as a reduction to additional paid-in capital. The transaction did not impact the consolidated results of operations.

## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

### Table of Contents

Included in the condensed consolidated balance sheet as of December 31, 2011, are the following amounts related to UDT:

|                                    |    | <b>31-Dec-2011</b> |
|------------------------------------|----|--------------------|
| Cash                               | \$ | 278,475            |
| Net property, plant, and equipment |    | 651,032            |
| Accrued expenses                   |    | 14,400             |
| Current and long-term debt         |    |                    |

(4) Fair Value Accounting

The Company has other financial instruments, such as accounts receivable, accounts payable, and accrued expenses, which are stated at carrying amounts that approximate fair value because of the short maturity of those instruments. The carrying amount of the Company's long-term debt approximates fair value as the interest rate on the debt approximates the Company's current incremental borrowing rate.

(5) Share-Based Compensation

Share-based compensation cost is measured at the grant date based on the calculated fair value of the award and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant).

The Company issues share-based payments through several plans that are described in detail in the notes to the consolidated financial statements for the year ended December 31, 2011. The compensation cost charged against income for those plans is as follows:

|   | Three Months Ended |             | Nine Months Ended |             |
|---|--------------------|-------------|-------------------|-------------|
|   | 30-Sep-2012        | 30-Sep-2011 | 30-Sep-2012       | 30-Sep-2011 |
| Cost of sales                             | \$                 | \$          | \$                | \$          |
| Selling, general & administrative expense |                    | 182,286     | 228,647           | 679,340     |
| Total share-based compensation expense    | \$                 | 182,286     | \$ 228,647        | \$ 679,340  |
|   |                    |             |                   | 860,006     |
|   |                    |             |                   | 860,006     |

Share-based compensation for the three-and nine-month periods ended September 30, 2012, and September 30, 2011, include approximately \$60,000 representing the fair value of the Company's stock granted to the Board of Directors in lieu of fees.

The total income tax benefit recognized in the condensed consolidated statements of income for share-based compensation arrangements was approximately \$55,000 and \$71,000 for the three-month periods ended September 30, 2012, and 2011, respectively, and approximately \$227,000 and \$272,000 for the nine-month periods ended September 30, 2012, and 2011, respectively.

## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

The following is a summary of stock option activity under all plans for the nine-month period ended September 30, 2012:

|   | Shares Under<br>Options | Weighted<br>Average<br>Exercise Price | Aggregate<br>Intrinsic Value |
|---|-------------------------|---------------------------------------|------------------------------|
| Outstanding at December 31, 2011                  | 638,521                 | \$ 4.98                               |                              |
| Granted   | 7,770                   | 16.32                                 |                              |
| Exercised   | (139,579)               | 3.51                                  |                              |
| Cancelled or expired                              | (11,250)                | 9.09                                  |                              |
| Outstanding at September 30, 2012                 | 495,462                 | \$ 5.48                               | \$ 5,999,199                 |
| Options exercisable at September 30, 2012         | 462,962                 | \$ 5.11                               | \$ 5,774,249                 |
| Vested and expected to vest at September 30, 2012 | 495,462                 | \$ 5.48                               | \$ 5,999,199                 |

## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

### Table of Contents

On June 14, 2012, the Company granted to its directors options for the purchase of 7,770 shares of its common stock at that day's closing price of \$16.32. The compensation expense was determined as the intrinsic fair market value of the options using the Black Scholes option pricing model based on the following assumptions:

|                         |         |
|-------------------------|---------|
| Expected volatility     | 56%     |
| Expected dividends      | none    |
| Risk free interest rate | 0.39%   |
| Expected term           | 5 years |

The stock volatility for each grant is determined based on a review of the experience of the weighted average of historical daily price changes of the Company's common stock over the expected option term, and the risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option. The weighted average grant date fair value of options granted during the nine-month period ended September 30, 2012, was \$7.72.

In prior years, the Company used a lattice-based model to determine fair value.

During the nine-month periods ended September 30, 2012, and 2011, the total intrinsic value of all options exercised (i.e., the difference between the market price on the exercise date and the price paid by the employees to exercise the options) was \$2,028,138 and \$2,183,912, respectively, and the total amount of consideration received from the exercised options was \$491,036 and \$327,942, respectively.

During the three-month periods ended September 30, 2012, and 2011, the Company recognized compensation expenses related to stock options granted to directors and employees of \$18,186 and \$19,440, respectively. During the nine-month periods ended September 30, 2012, and 2011, the Company recognized compensation expenses related to stock options granted to directors and employees of \$115,809 and \$124,189, respectively.

On February 17, 2012, the Company's Compensation Committee approved the award of \$300,000 payable in shares of common stock to the Company's Chairman, Chief Executive Officer, and President under the 2003 Incentive Plan. The shares will be issued on or before December 31, 2012. The Company has recorded compensation expense associated with the award of \$75,000 and \$225,000 during the three- and nine-month periods ended September 30, 2012. During the three- and nine-month periods ended September 30, 2011, \$106,251 and \$318,753 of compensation expense was recognized for a similar award.

The following table summarizes information about Restricted Stock Units (RSUs) activity during the nine-month period ended September 30, 2012:

|                               | Restricted Stock<br>Units | Weighted Average<br>Award Date<br>Fair Value |
|-------------------------------|---------------------------|--|
| Unvested at December 31, 2011 | 176,209                   | \$ 6.98                                      |

Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

|                                |          |         |
|--------------------------------|----------|---------|
| Awarded                        | 13,553   | 15.62   |
| Shares vested                  | (80,896) | 5.96    |
| Forfeited / cancelled          |          |         |
| Unvested at September 30, 2012 | 108,866  | \$ 8.77 |

During the three- and nine-month periods ended September 30, 2012, the Company recorded compensation expense related to RSUs of \$89,100 and \$278,531, respectively. The Company recorded \$102,956 and \$357,106, respectively, for the same periods ended September 30, 2011.

At its discretion, the Company allows option and RSU holders to surrender previously owned common stock in lieu of paying the minimum statutory withholding taxes due upon the exercise of options or the vesting of RSUs. During the nine-month periods ended September 30, 2012, and 2011, 39,700 and 46,090 shares were surrendered at an average market price of \$16.93 and \$18.01, respectively.

At September 30, 2012, unrecognized compensation expense of \$628,156 is expected to be recognized over a weighted average period of 1.72 years.

Table of Contents

## (6) Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market, and consist of the following at the stated dates:

|                 | 30-Sep-2012 |           | 31-Dec-2011 |           |
|-----------------|-------------|-----------|-------------|-----------|
| Raw materials   | \$          | 5,392,759 | \$          | 5,425,773 |
| Work in process |             | 1,009,529 |             | 1,513,794 |
| Finished goods  |             | 2,616,984 |             | 2,819,056 |
| Total inventory | \$          | 9,019,272 | \$          | 9,758,623 |

## (7) Preferred Stock

On March 18, 2009, the Company declared a dividend of one preferred share purchase right (a Right) for each outstanding share of common stock, par value \$0.01 per share, to the stockholders of record on March 20, 2009. Each Right entitles the registered holder to purchase from the Company one one-thousandth of a share of Series A Junior Participating Preferred Stock, par value \$0.01 per share (the Preferred Share) of the Company, at a price of \$25 per one one-thousandth of a Preferred Share subject to adjustment and the terms of the Rights Agreement. The Rights expire on March 19, 2019.

## (8) Income Per Share

Basic income per share is based on the weighted average number of shares of common stock outstanding. Diluted income per share is based upon the weighted average of common shares and dilutive common stock equivalent shares outstanding during each period.

The weighted average number of shares used to compute basic and diluted net income per share consisted of the following:

|   | Three Months Ended |             | Nine Months Ended |             |
|---|--------------------|-------------|-------------------|-------------|
|   | 30-Sep-2012        | 30-Sep-2011 | 30-Sep-2012       | 30-Sep-2011 |
| Weighted average common shares outstanding, basic                       | 6,720,756          | 6,510,523   | 6,667,895         | 6,457,099   |
| Weighted average common equivalent shares due to stock options and RSUs | 353,875            | 488,701     | 387,502           | 528,233     |
| Weighted average common shares outstanding, diluted                     | 7,074,631          | 6,999,224   | 7,055,397         | 6,985,332   |

The computation of diluted earnings per share excludes the effect of the potential exercise of stock awards, including stock options, when the average market price of the common stock is lower than the exercise price of the related options during the period. These outstanding stock awards are not included in the computation of diluted income per share because the effect would have been antidilutive. For the three- and nine-month periods ended September 30, 2012, the number of stock awards excluded from the computation was 10,000 and 17,700, respectively. For the same three- and nine-month periods in 2011, the number of stock awards excluded from the computation was zero.

(9) Segment Reporting

The Company is organized based on the nature of the products and services it offers. Under this structure, the Company produces products within two distinct segments: Engineered Packaging and Component Products. Within the Engineered Packaging segment, the Company primarily uses polyethylene and polyurethane foams, sheet plastics, and pulp fiber to provide customers with cushion packaging for their products. Within the Component Products segment, the Company primarily uses cross-linked polyethylene and technical urethane foams to provide customers in the medical, aerospace and defense, automotive, athletic, and leisure industries with custom-designed products for numerous purposes.



## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

### Table of Contents

The accounting policies of the segments are the same as those described in Note 1 to the consolidated financial statements contained in the Company's annual report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission. The Company evaluates the performance of its operating segments based on operating income.

Inter-segment transactions are uncommon and not material. Therefore, they have not been reflected separately in the financial table below. Revenues from customers outside of the United States are not material. No customer comprised more than 10% of the Company's consolidated revenues for the nine-month period ended September 30, 2012. All of the Company's assets are located in the United States.

|                             | Three Months Ended 9/30/12 |                          |                  | Three Months Ended 9/30/11 |                          |                  |
|-----------------------------|----------------------------|--------------------------|------------------|----------------------------|--------------------------|------------------|
|                             | Engineered Packaging<br>\$ | Component Products<br>\$ | Total UFPT<br>\$ | Engineered Packaging<br>\$ | Component Products<br>\$ | Total UFPT<br>\$ |
| Net sales                   | 11,009,769                 | 20,957,057               | 31,966,826       | 10,905,820                 | 19,856,139               | 30,761,959       |
| Operating income            | 982,942                    | 3,087,228                | 4,070,170        | 461,936                    | 2,802,522                | 3,264,458        |
| Depreciation / amortization | 339,238                    | 373,461                  | 712,699          | 243,141                    | 335,142                  | 578,283          |
| Capital expenditures        | 3,053,238                  | (33,601)                 | 3,019,637        | 970,247                    | 663,794                  | 1,634,041        |

|                             | Nine Months Ended 9/30/12  |                          |                          | Nine Months Ended 9/30/11 |                            |                          |                          |                  |
|-----------------------------|----------------------------|--------------------------|--------------------------|---------------------------|----------------------------|--------------------------|--------------------------|------------------|
|                             | Engineered Packaging<br>\$ | Component Products<br>\$ | Unallocated Assets<br>\$ | Total UFPT<br>\$          | Engineered Packaging<br>\$ | Component Products<br>\$ | Unallocated Assets<br>\$ | Total UFPT<br>\$ |
| Net sales                   | 31,233,197                 | 66,358,457               |                          | 97,591,654                | 31,590,084                 | 64,176,457               |                          | 95,766,541       |
| Operating income            | 1,990,671                  | 10,073,497               |                          | 12,064,168                | 1,874,537                  | 9,620,429                |                          | 11,494,966       |
| Total assets                | 27,686,738                 | 28,686,295               | 31,155,308               | 87,528,341                | 19,981,754                 | 28,205,343               | 28,688,332               | 76,875,429       |
| Depreciation / amortization | 1,061,483                  | 1,056,055                |                          | 2,117,538                 | 924,368                    | 1,057,407                |                          | 1,981,775        |
| Capital expenditures        | 6,385,763                  | 1,663,148                |                          | 8,048,911                 | 1,680,918                  | 957,379                  |                          | 2,638,297        |

(10) Plant Consolidation

On September 18, 2012, the Company committed to move forward with a plan to close its Ventura (California) facility, and consolidate operations into its Rancho Dominguez, California, and El Paso, Texas, facilities. The Company expects to incur restructuring charges of approximately \$325,000 in one-time, pre-tax expenses and to invest approximately \$150,000 in building improvements, principally in the fourth quarter of 2012.

Through the period ended September 30, 2012, the Company has not incurred any expenses.

(11) Subsequent Event

Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

On October 11, 2012, the Company entered a loan agreement with US Bank Equipment Finance to finance the purchase of two new molded fiber machines. One of the machines is operational and the other will be installed in the fourth quarter. The value of the loan is approximately \$5.0 million and will be funded in the fourth quarter of 2012.

Table of Contents

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Forward-looking Statements**

This report contains certain statements that are forward-looking statements as that term is defined under the Private Securities Litigation Reform Act of 1995 and releases issued by the Securities and Exchange Commission. The words believe, expect, anticipate, intend, plan, estimate, and other expressions, which are predictions of or indicate future events and trends and that do not relate to historical matters, identify forward-looking statements. Examples of forward-looking statements included in this report include, without limitation, statements regarding the anticipated financial performance and/or future business prospects of the Company, anticipated trends in the different markets in which the Company competes, including the molded fiber, medical and military markets, anticipated advantages the Company expects to realize from its investments and capital expenditures, including the development of and investments in its molded fiber product line, expectations regarding the manufacturing capacity of the Company's new production equipment, anticipated advantages relating to the Company's decision to cease operations at its Ventura, California plant and to consolidate manufacturing in other facilities, the anticipated impact on the Company and its revenues of the conclusion of a substantial portion of its large automotive door panel program, expected methods of growth for the Company, and the overall economy.

Forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the actual results, performance, or achievements of the Company to differ materially from anticipated future results, performance, or achievements expressed or implied by such forward-looking statements. Other examples of these risks, uncertainties, and other factors include, without limitation, the following: economic conditions that affect sales of the products of the Company's customers, risks associated with the identification of suitable acquisition candidates and the successful, efficient execution and integration of such acquisitions, the implementation of new production equipment in a timely, cost-efficient manner, risks that any benefits from such new equipment may be delayed or not fully realized, or that the Company may be unable to fully utilize its expected production capacity, actions by the Company's competitors, and the ability of the Company to respond to such actions, the ability of the Company to obtain new customers, the ability of the Company to offset lost revenues, evolving customer requirements, difficulties associated with the roll-out of new products, decisions by customers to cancel or defer orders for the Company's products that previously had been accepted, risks and uncertainties associated with plant closures and expected efficiencies from consolidating manufacturing, the costs of compliance with the requirements of Sarbanes-Oxley, and general economic and industry conditions and other factors. In addition to the foregoing, the Company's actual future results could differ materially from those projected in the forward-looking statements as a result of the risk factors set forth elsewhere in this report and changes in general economic conditions, interest rates and the assumptions used in making such forward-looking statements. All of the forward-looking statements are qualified in their entirety by reference to the risk factors and other disclaimers described in the Company's filings with the Securities and Exchange Commission, in particular its most recent Annual Report on Form 10-K. The Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

**Overview**

UFP Technologies is a producer of innovative custom-engineered components, products, and specialty packaging. The Company serves a myriad of markets, but specifically targets opportunities in the medical, automotive, aerospace & defense, electronics, consumer, and industrial markets.

## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

In the first nine months of 2012, the Company experienced organic sales growth of 2%, reflecting increased demand from most end-use markets. The increase in sales from these markets was substantially offset by a decrease in sales to the automotive market primarily due to the phase-out of a significant portion of the Company's large door panel program in the Southeast. Excluding the door panel program sales from our results for the nine-month period ended September 30, 2011, our revenues for the nine-month period ended September 30, 2012, grew 6.3%.

In prior periods the Company had a 26.32% ownership interest in a realty limited partnership, United Development Company Limited ( UDT ). The Company had consolidated the financial statements of UDT for prior periods because it determined that UDT was a VIE. On February 29, 2012, the Company purchased the manufacturing building that it leased from UDT for \$1,350,000, which management believes approximates fair market value. Since this transaction took place among commonly controlled companies, the building was recorded by the Company at UDT's carrying value. Thus, in effect, the Company has acquired the remaining 73.68% ownership interest in UDT, eliminating the VIE. Subsequently, UDT was dissolved and its assets were distributed. The non-controlling interests' portion of the excess of the amount paid for the building over UDT's carrying value, totaling \$521,972, has been

Table of Contents

recorded in stockholders' equity as a reduction to additional paid-in capital. The transaction did not impact the consolidated results of operations.

Due to a redesigned model vehicle, a substantial portion of a large automotive door panel program ended on June 30, 2011, although the Company is still supplying door panels to the customer for other model vehicles. Sales of door panels for the discontinued model vehicle were approximately \$2.15 million and \$4.0 million, respectively, in the three- and nine-month periods ended September 30, 2011.

The Company's current strategy includes organic growth and growth through strategic acquisitions.

**Sales**

Sales for the three-month period ended September 30, 2012, increased approximately 4% to \$32.0 million from sales of \$30.8 million for the same period in 2011. Sales for the nine-month period ended September 30, 2012, increased approximately 2% to \$97.6 million from sales of \$95.8 million for the same period in 2011. The increase in sales for the three-month period ended September 30, 2012, is primarily due to increased sales to the medical industry of approximately \$556,000 (Component Products segment) as well as an increase in sales of molded fiber packaging of approximately \$460,000 (Packaging segment). The increase in sales for the nine-month period ended September 30, 2012, is primarily due to increased sales to the medical industry of approximately \$1.7 million (Component Products segment) as well as an increase in sales of molded fiber packaging of approximately \$2.0 million (Packaging segment), partially offset by a decrease in sales to the automotive industry of approximately \$2.0 million. The decline in sales to the automotive industry for the nine-month period ended September 30, 2012, is due to the phase-out of a significant portion of the Company's large door panel program in the Southeast. Excluding the door panel program sales from our results for the nine-month period ended September 30, 2011, our revenues for the nine-month period ended September 30, 2012, grew 6.3%.

**Gross Profit**

Gross profit as a percentage of sales (gross margin) increased to 28.9% for the three-month period ended September 30, 2012, from 27.6% in the same period in 2011. Gross margin increased to 28.8% for the nine-month period ended September 30, 2012, from 28.5% in the same period in 2011. The increase in gross margin for the three-month period ended September 30, 2012, is primarily due to an improved mix of business (material and labor collectively declined 1.0% as a percentage of sales) as well as a slight decline in fixed overhead as a percentage of sales due to organic sales growth. In addition, gross margin for the three-month period ended September 30, 2012, improved from the efficiencies gained by the closure in 2011 of the Company's plant in Alabama and the absence of related moving costs in the current period (operating income in the Company's Packaging segment increased approximately \$520,000 during the current period compared to the same period in 2011). The increase in gross margin for the nine-month period ended September 30, 2012, is primarily due to improved mix of business (material and labor collectively declined 0.7% as a percentage of sales) partially offset by slightly higher fixed components of cost of sales as a percentage of sales.

**Selling, General and Administrative Expenses**

## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

Selling, general, and administrative expenses ( SG&A ) decreased approximately \$64,000 or 1.2% to \$5.16 million for the three-month period ended September 30, 2012, from \$5.22 million for the same period in 2011. SG&A decreased approximately \$562,000 or 3.5% to \$16.1 million for the nine-month period ended September 30, 2012, from \$16.6 million for the same period in 2011. The slight decrease in SG&A for the three- and nine-month periods ended September 30, 2012, is primarily due to a decrease in professional fees of approximately \$80,000 and \$420,000, respectively, due to prior year initiatives as well as the timing of recurring services.

As a percentage of sales, SG&A decreased to 16.1% for the three-month period ended September 30, 2012, from 17.0% for the same three-month period in 2011. As a percentage of sales, SG&A decreased to 16.5% for the nine-month period ended September 30, 2012, from 17.4% for the same nine-month period in 2011. The decrease in SG&A as a percentage of sales for both the three- and nine-month periods ended September 30, 2012, is primarily due to the reduction in general and administrative expenses against increased sales.

### **Gain on Sale of Fixed Assets**

The gain on sale of fixed assets of approximately \$834,000 in the nine-month period ended September 30, 2011, was derived primarily from the sale of real estate in Alabama by UDT. Of this \$834,000 gain, approximately \$428,000 relates to non-controlling interests that have been deducted to determine net income attributable to UFP Technologies, Inc.

Table of Contents

**Other Expenses**

The Company had net interest expense of approximately \$14,000 and \$6,000 for the three-month periods ended September 30, 2012, and 2011, respectively. The Company had net interest expense of approximately \$43,000 and \$19,000 for the nine-month periods ended September 30, 2012, and 2011, respectively. The increase in interest expense for both the three- and nine-month periods ended September 30, 2012, is primarily due to lower interest earned on cash.

The Company recorded a tax expense of approximately 36% of income before income tax expense for the both the three- and nine-month periods ended September 30, 2012, compared to a tax expense of approximately 25% and 32% (excluding income attributable to non-controlling interests) for the comparable three- and nine-month periods in 2011. The increase in the effective income tax rate for both the three and nine-month periods ended September 30, 2012, is primarily due to the reversal during the three-month period ended September 30, 2011, of approximately \$385,000 in reserves previously established for uncertain tax benefits due to a favorable outcome on a concluded Federal Internal Revenue Service audit and the statute of limitations expiring on certain other federal income tax filings. The non-controlling interest in UDT was not subject to corporate income tax.

**Liquidity and Capital Resources**

The Company funds its operating expenses, capital requirements, and growth plan through internally generated cash and bank credit facilities.

At September 30, 2012, and December 31, 2011, the Company's working capital was approximately \$49.9 million and \$48.6 million, respectively. The increase in working capital for the nine-month period ended September 30, 2012, is primarily due to an increase in cash of approximately \$1.3 million due to strong earnings and an increase in receivables, net of approximately \$1.3 million due to strong September 2012 sales.

Net cash provided by operations for the nine-month period ended September 30, 2012, was approximately \$10.8 million primarily due to net income from consolidated operations of approximately \$7.7 million and depreciation and amortization of approximately \$2.1 million, partially offset by an increase in receivables, net of approximately \$1.3 million due to strong September sales.

Cash used in investing activities during the nine-month period ended September 30, 2012, was approximately \$7.9 million and was primarily the result of additions of manufacturing machinery and equipment and software. Included in the additions to manufacturing machinery and equipment was approximately \$4.0 million in progress payments associated with molded fiber machinery.

Cash used in financing activities was approximately \$1.6 million in both the nine-month periods ended September 30, 2012, and 2011. The cash used in financing activities for the nine-month period ended September 30, 2012, is due primarily to a distribution to the non-controlling interests of UDT of approximately \$1.2 million due to the Company's purchase of the Florida real estate from UDT and subsequent dissolution of UDT.

On January 29, 2009, the Company amended and extended its credit facility with Bank of America, NA. The facility comprises: (i) a revolving credit facility of \$17 million; (ii) a term loan of \$2.1 million with a seven-year straight line amortization; (iii) a term loan of \$1.8 million with a 20-year straight line amortization; and (iv) a term loan of \$4.0 million with a 20-year straight line amortization. Extensions of credit under the revolving credit facility are based in part upon accounts receivable and inventory levels. Therefore, the entire \$17 million may not be available to the Company. At September 30, 2012, the Company had availability of approximately \$16.9 million, based upon collateral levels as of that date. The credit facility calls for interest of LIBOR plus a margin that ranges from 1.0% to 1.5% or, at the option of the Company, the bank's prime rate less a margin that ranges from 0.25% to zero. In both cases the applicable margin is dependent upon Company performance. The loans are collateralized by a first priority lien on all of the Company's assets, including its real estate located in Georgetown, Massachusetts, and in Grand Rapids, Michigan. Under the credit facility, the Company is subject to a minimum fixed charge coverage financial covenant with which it was in compliance at September 30, 2012. The Company's \$17 million revolving credit facility matures November 30, 2013; the term loans are all due on January 29, 2016. The interest rate on these facilities was approximately 1.2% at September 30, 2012.



Table of Contents

On October 11, 2012, the Company entered a loan agreement with US Bank Equipment Finance to finance the purchase of two new molded fiber machines. One of the machines is operational and the other will be installed in the fourth quarter. The value of the loan is approximately \$5.0 million and will be funded in the fourth quarter of 2012.

Through the end of 2012 and into 2013, the Company plans to continue to add capacity to enhance operating efficiencies in its manufacturing plants. The Company may consider additional acquisitions of companies, technologies, or products that are complementary to its business. The Company believes that its existing resources, including its revolving credit facility, together with cash generated from operations and funds expected to be available to it through any necessary equipment financing and additional bank borrowings, will be sufficient to fund its cash flow requirements, including capital asset acquisitions, through the next twelve months.

**Commitments, Contractual Obligations, and Off-Balance Sheet Arrangements**

The following table summarizes the Company's commitments, contractual obligations, and off balance sheet arrangements at September 30, 2012, and the effect such obligations are expected to have on its liquidity and cash flow in future periods:

| Payments due in:    | Operating Leases | Grand Rapids Mortgage | Term Loans | Massachusetts Mortgage | Debt Interest | Supplemental Retirement | New Molded Fiber Equipment Purchase Commitment | Total         |
|---------------------|------------------|-----------------------|------------|------------------------|---------------|-------------------------|--|---------------|
| 2012                | \$ 464,672       | \$ 50,001             | \$ 72,090  | \$ 23,075              | \$ 35,695     | \$ 18,750               | \$ 935,400                                     | \$ 1,599,683  |
| 2013                | 1,463,907        | 200,001               | 288,360    | 92,300                 | 133,708       | 75,000                  |  | \$ 2,253,276  |
| 2014                | 1,156,134        | 200,001               | 288,360    | 92,300                 | 119,192       | 45,833                  |  | \$ 1,901,820  |
| 2015                | 587,036          | 200,001               | 288,360    | 92,300                 | 104,675       | 25,000                  |  | \$ 1,297,372  |
| 2016                | 534,060          | 200,000               | 48,062     | 92,300                 | 92,712        | 25,000                  |  | \$ 992,134    |
| 2017 and thereafter | 321,692          | 2,433,329             |            | 1,122,983              | 163,201       | 75,000                  |  | \$ 4,116,205  |
| Total               | \$ 4,527,501     | \$ 3,283,333          | \$ 985,232 | \$ 1,515,258           | \$ 649,183    | \$ 264,583              | \$ 935,400                                     | \$ 12,160,490 |

The Company requires cash to pay its operating expenses, purchase capital equipment, and to service the obligations listed above. The Company's principal sources of funds are its operations and its revolving credit facility. Although the Company generated cash from operations during the nine-month period ended September 30, 2012, it cannot guarantee that its operations will generate cash in future periods.

The Company had no off balance sheet arrangements during the nine-month period ended September 30, 2012, other than operating leases.

**ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

The following discussion of the Company's market risk includes forward-looking statements that involve risk and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. Market risk represents the risk of changes in value of a financial instrument caused by fluctuations in interest rates, foreign exchange rates, and equity prices. At September 30, 2012, the Company's cash and cash equivalents consisted of bank accounts in U.S. dollars, and their valuation would not be affected by market risk. The Company has several debt instruments where interest is based upon either the prime rate or LIBOR and, therefore, future operations could be affected by interest rate changes. However, the Company believes that the market risk of the debt is minimal.

### **ITEM 4: CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, the Company's Chief Executive Officer and Chief Financial Officer performed an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in SEC Rule 13a-15(e) or 15d-15(e)). Based upon that evaluation, they concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the

## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-Q

### Table of Contents

reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II: OTHER INFORMATION**

### **ITEM 1A: RISK FACTORS**

Information regarding risk factors appears in Part I Item 2 of this Form 10-Q in Management's Discussion and Analysis of Financial Condition and Results of Operations under Forward-Looking Statements and in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011, in Part I Item 1A under Risk Factors. There have been no material changes from the risk factors previously disclosed in Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

### **ITEM 6: EXHIBITS**

The following exhibits are included herein:

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 10.61              | Facility lease between the Company and Susana Property Co.*  |
| 31.1               | Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.*  |
| 31.2               | Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.*  |
| 32                 | Certification pursuant to 18 U.S.C., Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.** |
| 101.INS            | XBRL Instance Document.***   |
| 101.SCH            | XBRL Taxonomy Extension Schema Document.***  |
| 101.CAL            | XBRL Taxonomy Calculation Linkbase Document.***  |
| 101.LAB            | XBRL Taxonomy Label Linkbase Document.***  |
| 101.PRE            | XBRL Taxonomy Presentation Linkbase Document.***   |
| 101.DEF            | XBRL Taxonomy Extension Definition Linkbase Document.***   |

---

\* Filed herewith.

\*\* Furnished herewith.

\*\*\* Submitted electronically herewith. Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934.



Table of Contents

**SIGNATURES**

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

UFP TECHNOLOGIES, INC.

Date: November 9, 2012

By: /s/ R. Jeffrey Bailly  
 R. Jeffrey Bailly  
 Chairman, Chief Executive Officer, President, and Director  
 (Principal Executive Officer)

Date: November 9, 2012

By: /s/ Ronald J. Lataille  
 Ronald J. Lataille  
 Chief Financial Officer  
 (Principal Financial Officer)

**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 10.61              | Facility lease between the Company and Susana Property Co.*  |
| 31.1               | Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.*  |
| 31.2               | Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.*  |
| 32                 | Certification pursuant to 18 U.S.C., Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.** |
| 101.INS            | XBRL Instance Document.***   |
| 101.SCH            | XBRL Taxonomy Extension Schema Document.***  |
| 101.CAL            | XBRL Taxonomy Calculation Linkbase Document.***  |
| 101.LAB            | XBRL Taxonomy Label Linkbase Document.***  |
| 101.PRE            | XBRL Taxonomy Presentation Linkbase Document.***   |
| 101.DEF            | XBRL Taxonomy Extension Definition Linkbase Document.***   |

---

\* Filed herewith.

\*\* Furnished herewith.

\*\*\* Submitted electronically herewith. Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934.