MOD-PAC Corp.
Fourth Quarter 2009 Financial Results
Teleconference and Webcast
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Operator: Greetings, ladies and gentlemen, and welcome to the Fourth Quarter 2009 Financial Results Conference Call. It is now my pleasure to introduce your host, Mr. Craig Mychajluk, IR for MOD-PAC Corporation. Thank you, Mr. Mychajluk, you may begin.

Craig Mychajluk: Thank you. Good afternoon, everyone. On the call, I have with me Dan Keane, President and CEO of MOD-PAC, and Dave Lupp, Chief Operating Officer and CFO. They will be reviewing the results of the fourth quarter and 2009 year-end and progress on the Company's strategy. You should have a copy of the financial results that went out this morning, and if not, you can access it at the Company website, www.modpac.com.

As you are aware, we may make some forward-looking statements during the formal discussion, as well as during the Q&A. These statements apply to future events and are subject to risks and uncertainties, as well as other factors that could cause actual results to differ from what is stated here today. These risks and uncertainties and other factors are provided in the earnings release, as well as other documents filed by the Company with the Securities and Exchange Commission. These documents can be found at the Company's website or also at www.sec.gov.

With that, let me turn the call over to Dan.

Dan Keane: Thank you, Craig. Good afternoon, everyone. Thank you for joining us today. I believe that 2009 was a very good year for MOD-PAC, given the weak state of the economy. We grew our core product line, refocused our business by rationalizing the Specialty Print and Direct Mail product line, and aligned roles and responsibilities to build shareholder value and move the Company forward.

Rationalizing the Specialty Print and Direct Mail line in June of 2009 enabled us to achieve positive earnings the last two quarters and is further evidence that we have successfully turned around our operations. When you exclude the Specialty Print and Direct Mail product lines from both years, total net sales were $46.83 million for the year, up almost 6%. Even including the rationalized product line, which had just six months of sales in 2009, revenue was flat. We believe this demonstrates our ability to provide our customers with cost-effective, on-demand short runs of customized cartons. Our flexibility and size enables us to meet our customers' needs in a way that the larger custom folding carton operations haven't been able to and is a leading competitive advantage for us.

For the fourth quarter of 2009, revenue was down $850,000, or a little over 6%. But again, by comparing apples-to-apples and excluding Specialty Print and Direct Mail sales from the 2008 fourth quarter, total revenue in the recent quarter grew by $139,000, or 1.1%, compared with the fourth quarter of 2008.

The real story is the bottom line number for the quarter. We earned $0.36 per diluted share in the fourth quarter of 2009, an increase of 800% over the $0.04 earned in the 2008 fourth quarter. For the full year of 2009, we reported a GAAP net loss of $2 million, or $0.58 per diluted share. However, if we exclude the one-time charges associated with the product line rationalization and the write-down of other assets in 2009, which helps to provide an understanding of the operating performance, net income would have been $12,000.

We continue to find ways to improve our operations as we focus on gaining increasing share of our existing customers while developing our pipeline of prospects in order to grow the top line.

I will now turn it over to Dave for a more detailed review of our operating and financial performance.

Dave Lupp: Thanks, Dan, and good afternoon, everyone. As Dan discussed, our emphasis on aggressive cost management, production efficiency, and the effectiveness of the product line rationalization achieved the sustainable improvements we sought in our business. However, our top line has been dampened a bit by economic conditions because the stock packaging and personalized print product lines are definitely not recession-proof and are impacted by the major decline in discretionary consumer spending.

Our resilient custom folding carton line has proven its “recession resistance” in this downturn. I hesitate to call anything recession-proof, but we have seen very good growth in this product line. Some of our largest customers tend to be those that provide food or health products for consumers that are private labels, or what would be known as non-discretionary products.

For the fourth quarter of 2009, custom folding carton sales growth of 6%, or $0.5 million, helped to offset the 6.6%, or $0.2 million, of lower sales of stock packaging, which primarily serves the confectionary industry. In total, folding cartons, which combined custom folding cartons and stock packaging were $12 million in the fourth quarter of 2009, up 2.5% or $0.3 million.

Print services sales, which are now solely comprised of personalized print, were down $1.2 million to $0.6 million in the fourth quarter of 2009. The 2008 fourth quarter included $1 million in Specialty Print and Direct Mail revenue. Looking at just personalized print, it had sales of $0.6 million in the 2009 fourth quarter compared with $0.8 million in the prior year period.

Gross profit increased $0.9 million, or 40.7%, to $3 million in the fourth quarter. Furthermore, gross margin expanded to 23.4% from the 15.6% that was reported in the 2008 fourth quarter. The product line rationalization, which resulted in reduced labor costs and depreciation, as well as lower supply costs, was the primary driver for the gross profit and margin gains. Also contributing to the improved margin were lower freight and utility costs and improvements in productivity.

Fourth quarter 2009 SG&A was down 6.7% to $1.8 million, or 13.7% of total revenue, compared with $1.9 million, or 13.8% of total revenue in the 2008 fourth quarter. Lower professional service fees, labor costs, and bad debt expense impacted the decline.

It is important to note that, in addition to the rationalization, our overall improvement was also positively impacted by our aggressive cost reduction program and process improvement efforts. It included workforce realignment and reductions and other productivity and efficiency initiatives, such as proactive management of repair expenses, restructuring and relocation of the personalized print business, and moving our information technology infrastructure in-house. As a result, we are doing more with less and strengthening our overall earnings power. We employed 363 people at the end of 2009, compared with 390 at the end of 2008.

Operating income for the fourth quarter of 2009 was $1.2 million, a $1 million improvement when compared with the 2008 fourth quarter. Operating margin expanded by 810 basis points to 9.9% in the quarter.

Adjusted EBITDA, or earnings before interest, asset impairment, taxes, depreciation, amortization, and non-cash option expense, was $2 million in the fourth quarter of 2009, a significant improvement when compared with $1.2 million in the fourth quarter of 2008. We believe that adjusted EBITDA, although not a generally accepted accounting principle measure, is a good indicator of our business performance as if reflects our ability to generate cash from our operations.

We have recorded a full valuation allowance in our net deferred tax asset due to the uncertainty with respect to utilizing it in the future based on a past trend of operating losses in the second quarter of 2009. As a result, the effective tax rate for the fourth quarter of 2009 was 0% compared with the prior year's fourth quarter effective tax rate of 43.2%. We currently have approximately $0.64 million in net operating loss carry-forwards that can be applied to future income.

This was our second straight quarter posting positive net income, which was $1.3 million in the recent quarter, up 880% over the $0.1 million recorded in the fourth quarter of 2008. Fourth quarter 2009 earnings per share were $0.36 compared with $0.04 per diluted share in the prior year period.

Our cash balance increased significantly in the fourth quarter. Cash and cash equivalents were $3.8 million at December 31, 2009, up from $0.3 million at October 3, 2009, and $0.2 million at the end of 2008. We generated $2.3 million in cash from our operations in the fourth quarter from higher net income and non-cash depreciation and amortization expense and lower working capital requirements. The other primary source of cash this quarter was from the sale of our Blasdell, New York facility, which netted $1.4 million, plus an additional $0.6 million from the sale of equipment associated with our rationalized product line.

Those proceeds were also used to pay down our debt. The line of credit was paid in full, a decrease of $0.6 million from the October 3, 2009, balance, and $1 million from the 2008 year end balance. Our current line of credit expires in March 2010. We are in negotiations with several financial lenders regarding a new line of credit and our strengthened operational position definitely puts us in a much better position than we had been a year ago. Our long-term debt-to-equity improved measurably, dropping from 13.6% at the end of 2008 to 9.8% at December 31, 2009.

Capital expenditures were $1 million in 2009 compared with $2 million in 2008. Capex spending in 2009 was focused on equipment upgrades and systems improvements. We are planning capital expenditures of about $1.2 million in fiscal year 2010.

Depreciation and amortization expense was down $0.5 million to $3.2 million for 2009, due primarily to a reduced asset base resulting from our second quarter 2009 write-down of assets for the Specialty Print and Direct Mail product line. We currently have authorization to purchase up to 75,885 additional common shares. Our book value at December 31, 2009, was $6.79.

I will now briefly review the full year 2009 results. Product sales for 2009 were down slightly to $48.4 million compared with 2008. Included in 2008 was $4.2 million in Specialty Print and Direct Mail sales compared with $1.5 million in the first half of this year. Excluding this product line from both years, total product sales increased $2.6 million, or 5.9%, to $46.8 million for 2009 compared with $44.2 million for 2008.

For 2009, custom folding cartons improved by $4.2 million, or 13.7%, to $34.9 million. The gains were the result of additional business from several of our existing customers and a few new custom folding carton customers. Offsetting this was the decline in sales within the stock packaging and personalized print product lines. Both were negatively impacted by economic conditions, as both Dan and I previously mentioned.

Gross margin was expanded appreciably to 15.1% for 2009 when compared with 13.8% for 2008. The product line rationalization and productivity enhancements were the contributing factors for the margin expansion.

SG&A expense decreased 4.1% to $7.5 million, or 15.4% of total revenue, for 2009, compared with $7.9 million or 16.1% of total revenue, for 2008. Primarily lower professional service fees, reduced advertising, and lower bad-debt expense drove the decrease. We also had a $1.8 million charge in 2009 that was associated with the write-down of impaired assets due to the Company's rationalization of the Specialty Print and Direct Mail product line. Adjusted EBITDA for 2009 was up to $3.5 million compared with $3 million in 2008.

I have been focusing much of my time on finding ways to drive operational improvements and create an environment of continuous improvement. We have made great strides, and we expect that we can build upon the progress made into 2010. We believe we have a competitive advantage in folding cartons and all of our marketing and sales activities are targeted toward those customers that we believe could benefit from our speed and short run capability. With a much refined focus on our core products and the benefit from the strength of our balance sheet, we now have a solid platform from which we can grow.

Finally, I would like to note that our ability to make the considerable changes that we made during 2009, and to achieve successful results in the second half of 2009, was largely the result of the creativity, hard work and dedication of all of our MOD-PAC employees.

That concludes my remarks and I will now turn the call back to Dan.

Dan Keane: Thank you, Dave. Scott, we'd like to now open up the call for questions.

Operator: Thank you. Our first question is coming from the line of Mr. John Lewis, with Osmium Partners, LLC.

John Lewis: Thank you. Well congratulations. It's been a long time in coming but you put up a great quarter and it seems like you're really on the right track. Could you break out what percent of your revenue is in food and health? You termed it as "non-discretionary and recession resistant." I was just curious if you could give us a percentage.

Dan Keane: No, we really don't break our revenue figures that way.

Dave Lupp: I wouldn't be able to answer that specifically, John.

Dan Keane: On an industry basis, food I believe represents in the neighborhood of 60% of industry revenues.

John Lewis: Fair enough. So you hit just over a 15% EBITDA margin for Q4 and I think you used the term EEC, you're strengthening in your earnings power in the business. Could you give me a feel for the improvements in the model in Q4, how do you see that playing out in 2010?

Dan Keane: A lot of our results were driven by a lot of focus on cost management and operating efficiency. That focus is continuing as we go into 2010, keeping overtime down to minimums and running the factory as efficiently as possible. I think that's the big focus in this soft economy that we're all facing right now. Dave, do you want to add anything to that?

Dave Lupp: Yes. Q4 had pretty decent percentages, as you pointed out, and just to remind everybody, that our business is seasonal. The first half of the year is generally weaker than the second half of the year, at least it has historically been that way. However, Q4 is a good indication of what is possible, and as Dan said, we continue to do things to try to contain and improve our cost structure.

At the same time, as we've mentioned in the past, we still face some inflationary pressures from things like certain benefits like health insurance and wages, and even some of our raw materials. But, we're doing things to work to offset, if not even more than offset that. So overall, I think the most important thing to remember is there is seasonality to the business even as we try to grow.

John Lewis: Although, that was a pretty considerable improvement in margin over what you did in the first half of 2009. Even figuring in for the seasonality, is it possible that you may have 8, 9, or 10% EBITDA margin in the first half?

Dan Keane: We really don't forecast.

Dave Lupp: Yes, we do not provide guidance.

Operator: Thank you. As there are no other questions, I would like to open the floor to, again, Mr. John Lewis from Osmium Partners.

John Lewis: In general terms, what type of growth opportunities do you see in 2010?

Dan Keane: A lot of our growth is in the fourth quarter and what we see in 2010 is just the expansion and continued growth of our existing relationships. We are always looking to add prospects to our pipeline but I think the immediacy issue will be just a continued expansion of relationships that we already have.

Dave Lupp: Yes, and I echo what Dan said. The more solid things that we have in the pipeline are with existing customers. The more difficult things to predict are what would be brand new customers, but we're working both. It's hard to predict with certainty when they'll hit. The cycle time has always been one to two years in order for us to pick up significant new business from either an existing customer or a new customer, and that still seems to play out that way. But we certainly have some good things we're working on, and a few of them have, for the most part, hit almost every year over the last three or four years.

John Lewis: I don't want to jump the gun, but just in terms of your thoughts on returning capital to shareholders, of either a buyback, and/or a dividend policy?

Dave Lupp: We did not purchase any shares in the last quarter, as we mentioned earlier, and we're going to keep that option open as we move throughout 2010 and see how sales and profits are developing in the economy. We'll take that as a very serious option, the share buyback this year. Dividend policy, that is something we'd always consider as well whenever we consider buybacks, so both of those would be under consideration for this year.

John Lewis: Great. Thank you very much and great work, guys.

Operator: There are no further questions.

Dan Keane: Okay, Scott, I'll make a few concluding remarks and then we'll finish up for today.

While we can't predict where the economy will go in 2010, we are cautiously optimistic with the positive signs from our customer base, especially within the custom folding carton line. Expense management will remain paramount while we focus on growing our sales.

Thank you for your time today and your interest in MOD-PAC and have a good day. And, Scott, with that, we'll conclude today's call.