

MOD-PAC Corp.
First Quarter 2010 Financial Results
Teleconference and Webcast
May 4, 2010



Operator: Greetings and welcome to the first quarter 2010 financial results conference call. It is now my pleasure to introduce your host, Deborah Pawlowski, Investor Relations for MOD-PAC Corporation.

Deborah Pawlowski: Thank you, Katie and good afternoon, everyone. Joining me on the call today are Dan Keane, President and CEO of MOD-PAC and Dave Lupp, Chief Operating Officer and CFO. The gentlemen will be reviewing results of the 2010 first quarter, as well as outlining progress they have made on the Company's strategy.

You should have a copy of the financial results that were released 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.

So with that, let me turn the call over to Dan.

Daniel Keane: Thank you, Debbie. Good afternoon everyone. Thank you for joining us today. We got off to a solid start in 2010 and are energized by the prospects we see ahead of us. Despite the fact that the first half of the year is typically softer, we had good results in the first quarter. In fact, we posted our third consecutive quarter of positive earnings, testament to the effectiveness of our actions last year to focus on our core product lines. We are realizing the benefits of having successfully turned around our operations.

As you know, we rationalized Specialty Print and Direct Mail line in June of 2009, which enabled us to refine our focus on our core businesses. We believe our current operating structure and product line focus is a primary driver for strengthening our earnings power. When you exclude last year's Specialty Print and Direct Mail product line sales, total revenue in the first quarter of 2010 grew by \$0.5 million, or 4%, when compared with our 2009 first quarter. Our customers value the cost-effective, on-demand short runs of folding cartons that we provide. Our flexibility in size enables us to meet our customers' needs in a unique way that larger folding carton operations haven't matched and it remains a leading competitive advantage for us.

We have made solid progress in operational and sales improvements and will work to maintain our momentum into the future. With the changes that we have made to the organization, we have focused our resources on our core products and plan to operate a flexible business model with a goal to expand and generate operating leverage. Importantly, we have strong value propositions that we believe enable us to be leaders in the markets we serve. Given the leverage we have to gain from our operations, we are looking to increase the opportunities available to us to grow the top line. We are well-positioned to continue to grow our Custom Folding Carton line as we expand our relationships with existing customers and target prospects that would benefit from our short-run, high quality manufacturing capabilities.

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

David Lupp: Thanks, Dan, and good afternoon, everyone. As Dan discussed, while revenue was down for the quarter, we posted our third consecutive quarter of positive earnings. The strategy of directing our resources to our core product lines and rationalizing the Specialty Print and Direct Mail line, coupled with our fiscal discipline and emphasis on aggressive cost management and production efficiency, is paying off with sustainable improvements in the business model.

The folding carton product line remains a strong contributor to the business. During the first quarter, increased demand in the custom folding carton product line led to a growth in our market share as we expanded and continued to grow relationships with existing customers. In addition, we are seeing a rebound in our stock packaging market which had been heavily affected by the weak economy.



For the first quarter of 2010 sales of folding cartons, which include custom folding cartons and stock packaging, were \$11.2 million, up 4.8% from \$10.7 million in the first quarter of 2009.

Custom folding carton sales in the first quarter of 2010 were \$8.7 million, up 2.2% from \$8.5 million in the first quarter of 2009, reflecting the increased market share we are gaining in our existing customer base. We believe we can continue to penetrate this market due to our competitive advantages as our flexibility and size allows us to provide on-demand short runs of customized cartons in a cost effective manner.

First quarter 2010 stock packaging sales of \$2.5 million rebounded 15% from \$2.2 million in the first quarter of 2009. Until recently, the recession greatly hampered the stock packaging line as our primary customer base was made up of small, retail confectionary companies. The improving economy helped bolster the first quarter. We would expect to continue to see a modest growth in this line as the economy further improves.

Print services which now only include personalized print due to product line rationalization, continued to be impacted by the current economic conditions as customers curtailed spending. Print services sales for the first quarter of 2010 were \$703,000, down 54.5% from \$1.5 million in the first quarter of 2009. Of the decline, \$772,000 was due to Specialty Print and Direct Mail sales in the prior year first quarter.

Personalized print sales were down \$70,000 from last year's first quarter. As noted, the decrease was primarily due to the current economic conditions. We continue to implement more aggressive marketing plans for personalized print and are targeting customers in various channels, including directly through our personalized print online store, and our retail outlet store which is located in the front of our main facility.

Once again, gross profit and margin improved, primarily driven by the realignment of our cost structure, implementation of productivity improvements and better operational leverage realized from the rationalization of our product lines and elimination of losses associated with Specialty Print and Direct Mail. Also, utility costs were reduced, resulting from lower fuel costs and the recycled paperboard market was better this quarter. Gross profit increased to \$1.8 million in the first quarter of 2010 compared with \$1.4 million in the 2009 first quarter. Gross margin was 14.9% in the first quarter of 2010 compared with 11.5% in the first quarter of 2009.

First quarter 2010 selling, general and administrative expense was \$1.8 million, or 14.8% of revenue, compared with \$2 million or 16.2% of revenue in the first quarter of 2009. Our fiscal discipline, strict cost management and process improvement initiatives drove this decline. In short, we continued to do more with less, the result of which is a continued strengthening of our overall earnings power.

Operating income for the first quarter of 2010 of \$19,000 was up \$598,000 when compared with the 2009 first quarter. On a year-over-year basis, first quarter 2010 operating margin improved 0.2% compared with negative 4.7% in the year ago period.

Adjusted EBITDA or earnings before interest, taxes, depreciation, amortization and non-cash option expense was \$906,000 in the first quarter of 2010, more than double when compared with the same period the prior year, reflecting the leverage obtained from improving the Company's cost structure. We believe that adjusted EBITDA, although not a generally accepted accounting principle measure is a good indicator of our business performance as it reflects our ability to generate cash from our operations.

Our effective tax rate for the first quarter of 2010 was 33.3% and tax expense related solely to both federal and state minimum taxes. We currently have approximately \$0.57 million in net operating loss carry-forwards that can be applied to future income.

As we pointed out earlier, we have now posted positive net income for three consecutive quarters. Net income for the first quarter of 2010 was around \$20,000, or \$0.01 per diluted share, a significant



improvement when compared with a net loss of \$533,000, or \$0.16 per diluted share reported in the first quarter of 2009. The improvement in net income reflects the effectiveness of product line rationalization which eliminated an unprofitable product line, combined with ongoing productivity enhancements and cost reductions.

Our balance sheet remains very solid. For the period ended April 3, 2010 we have long term debt-to-equity at 9.3% and cash and cash equivalents worth \$3.11 million, compared with \$3.78 million at December 31, 2009. The decrease in cash and cash equivalents was primarily the result of capital expenditures, pay down of an equipment loan, increase in restricted cash designated for a standby letter of credit and working capital requirements, all of that partially offset by net income, non-cash depreciation, and non-cash stock option expense and proceeds from the sale of equipment.

Capital expenditures in the first quarter of 2010 were \$263,000 compared with \$345,000 in the same period of the prior year. We continued to focus our capital spending on equipment and systems improvements. Capital expenditures are expected to be between approximately \$1.6 million and \$1.8 million in fiscal year 2010.

As we noted last quarter, our line of credit was paid in full in the fourth quarter of 2009, a decrease of \$1 million from the 2008 year-end balance. The line expired in March of 2010 and we now have a commitment to secure a new line of credit which we expect to have closed by the end of the second quarter.

Depreciation and amortization for the first three months of 2010 were \$688,000 compared with \$914,000 in the first quarter of 2009. We currently have authorization to purchase up to 75,885 additional common shares.

In summary, we have made significant progress by continuing our prudent cost management, refocusing our energies on our core businesses, and ultimately setting a framework and building a platform from which to grow. It is our objective to grow sales to realize the true operating leverage and strong cash generation inherent in the business while maintaining a lean operating structure. Our objective in 2010 is to continually improve our productivity and maintain our cost discipline as we refine and focus our sales and marketing efforts.

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

Daniel Keane: Thank you, Dave. We'd now like to open up the call for questions.

Operator: Thank you. Our first question is from David Starkey with Morgan Stanley Smith Barney.

David Starkey: You had said you expect the second half of the year to be stronger than the first half. Does that follow that the second quarter is usually stronger than the first, or do we have a soft first half followed by a stronger second half?

Daniel Keane: Typically it's a soft first half with the second half strengthening and that's due to the mix of our product sales. Our high margin stock boxes are tilted to the second half of the year and just general product sales across all lines are heavier in the second half.

David Starkey: Is there a point where the stock starts to get back. Do you have a certain place that you will be buying from? It looks like you've got a large authorization there and we've got almost 20% drop in price today.

Daniel Keane: Yes, we mentioned we did not purchase any shares in the last quarter, and we'll certainly keep that option open as we go forward throughout the year.



David Starkey: Your fourth quarter was pretty strong from a profit standpoint. With the restructuring or with an improved economy, should you be able to beat that number in the fourth quarter this year by a halfway decent amount?

Daniel Keane: We don't give guidance in that way. We'll attempt to continue to run as efficiently as possible and to grow our top line. But we don't give guidance on projections.

David Starkey: Was there a big order in the fourth quarter of last year then that would have skewed those numbers up so much?

David Lupp: No, there wasn't anything that would have skewed it.

Daniel Keane: To give you an idea, Q4 of 2009 for our custom folding cartons, which is our largest line, was \$8.9 million. In 2008 it was \$8.4 million. So, what is that? Five percent growth, so no big one-time events happened.

David Lupp: Yes, one of the things you'll note in our last several years' results is that Q4 is seasonally strongest in stock packaging and Q2 is seasonally weakest in stock packaging. So, to your question regarding Q4, that also had an impact, and based on seasonality, we would expect that to be the case going forward.

David Starkey: It just goes awry until we get to the third quarter. I hope that you see that and with your balance sheet as clean as it is that you're able to take advantage of a price if there is a significant drop. What's the book value as of the latest report, do you know?

Daniel Keane: \$6.83.

David Starkey: Then there's not a big inventory that's part of that or something that could be written off or anything like that? That's a real number?

David Lupp: It's pretty solid, yes.

Operator: There are no further questions at this time. I would like to turn the floor back over to management for any closing comments.

Daniel Keane: At the heart of MOD-PAC's strategy for growth is our value proposition, values that drive our customers and our success. We aim to leverage our capabilities to innovate and aggressively integrate technology into our production operations, providing cost effective solutions for our customers. We believe that we have the expertise to become a leader in North America in packaging and personalized print services.

Thank you for your time today and your interest in MOD-PAC. With that, I'll conclude today's call.