

MOD-PAC CORP.
Fourth Quarter and Fiscal Year 2007 Earnings Conference Call
February 7, 2008

Operator: Greetings ladies and gentlemen and welcome to the MOD-PAC CORP.'s fourth quarter and fiscal year 2007 conference call. It is now my pleasure to introduce your host, Mr. James Culligan. Thank you Mr. Culligan, you may now begin.

James Culligan: Thank you and good morning everyone. We appreciate your joining us here today. On the call, I have with me, Dan Keane, President and CEO of MOD-PAC, and Dave Lupp, Chief Financial Officer. They will be reviewing the results of the fourth quarter and 2007 year-end, as well as progress on the company's strategies.

You should have a copy of the earnings release that went out this morning. If not, you can access it at the company's 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 it states 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, also at www.sec.gov.

So with that, let me turn it over to Dan.

Dan Keane: Thank you, Jim, and good morning everyone. We ended the year with sales just slightly above the prior year's levels. In custom folding cartons, we had a variety of events occur with a couple of our larger customers that caused their sales to decline. But this was completely offset by sales to new customers and growing sales with other existing accounts. After a lackluster first half, sales rebounded in the third quarter only to remain flat for the fourth quarter.

For the print services products, which grew \$1.7 million, or 115%, direct mail services added approximately \$1.4 million in sales. We added some additional printing and finishing equipment in the latter half of the year to be able to address several opportunities on which we are working. Some of these include providing print and mail to class-action lawsuit administrators and advertising agencies managing political campaigns, as well as building relationships with local and national businesses to support their marketing activities.

We began implementation of an aggressive cost-reduction program in the latter third of the year. This included work-force realignment and reductions, which we expect to result in an annual savings of approximately \$1.2 million. Many other company-wide initiatives were, and continue to be, put into place, such as holding down the inflationary impact of variable cost changes, a paperboard waste-reduction program, a more aggressive recycling effort, productivity enhancements in our operations, and more proactive management of certain fixed costs, such as repair expense.

We believe we will see the positive effects of our efforts in 2008 with improvements to both gross margins and operating margins. Although we have eliminated some sales positions, we are also hiring new sales personnel with experience and relationships that will help to grow our businesses. We continue to innovate to address the complex folding carton design requirements of customers and add advanced equipment that enables the fast work flow for just-in-time delivery.

Strategically, we believe that we have the foundation to expand our business and a valuable asset base which we can leverage. Our day-to-day efforts are directed toward reducing cost and bringing in new orders.

Dave, I'll turn it over to you now for more detailed review of the financials.

David Lupp: Thanks, Dan, and good morning everyone. I will begin my discussion with a review of the fourth quarter and year-end income statement and then provide some comments on the balance sheet and cash flow statement.

Revenue for the fourth quarter was \$12.9 million compared with revenue of \$12.6 million in the same period the prior year. Revenue for the full year was \$48.2 million compared with \$46.6 million for the full year of 2006.

Sales of our folding carton line, including custom folding cartons and stock boxes, were \$10.8 million in the fourth quarter of 2007, which was a slight decrease from sales of \$10.9 million in the fourth quarter of the prior year. Custom folding cartons contributed \$7.0 million of the total, and stock boxes contributed \$3.9 million. For the full year, folding carton sales were \$39.9 million, compared with \$39.8 million in 2006.

After a lag in the first half of the year and a 15% increase in the third quarter of 2007 over the third quarter of 2006, overall custom folding carton sales ended up flat at \$29 million for both 2007 and

2006. Stock box sales also remained flat year-over-year, with sales of \$10.9 million in 2007 compared with \$10.8 million in the prior year.

Print services sales, which include commercial and personalized print, were \$2.0 million in the fourth quarter of 2007, up 29% compared with sales of \$1.5 million in the fourth quarter of the prior year. Commercial print sales almost doubled from \$472 thousand in the fourth quarter of 2006 to \$927 thousand this past quarter. Personalized print sales remained flat year-over-year in fourth quarter at about \$1.0 million. For the full year, print services sales were \$7.8 million, up 25% from sales of \$6.3 million in 2006. Commercial print sales contributed \$3.1 million to the full year sales and increased 115%, year-over-year, from sales of \$1.4 million the prior year. This increase was primarily driven by sales of our direct mail services, which we began with the purchase of DDM assets in the second quarter of 2007. Personalized print sales decreased slightly in 2007 to \$4.7 million from \$4.8 million in 2006. Internet-based sales grew to \$1.8 million compared with \$1.6 million in 2006. Our personalized print product line supplies a number of Internet stores with our products.

Gross margin was 11.8% in the fourth quarter of 2007, up from gross margin of 11.4% in the same period the prior year. Year-over-year, lower repairs cost and depreciation expense were partially offset by higher paperboard costs and higher direct labor related costs. For the full year, gross margin remained unchanged at 9.3%, with improvements in product yield and lower depreciation expense being offset by higher labor, repair, paperboard and utility costs.

Selling, general and administrative expenses for the fourth quarter of 2007 were \$2.4 million, or 18.8% of revenue, compared with \$2.3 million, or 17.9% of revenue, in the same period of the prior year. Operating loss for the fourth quarter was \$914 thousand. Affecting the fourth quarter operating loss was \$138 thousand in severance costs associated with workforce reduction actions. Additionally \$223 thousand in additional depreciation expense was recorded, related to the reduction in the useful lives of certain of our software assets. Taking these two factors into consideration, adjusted operating loss would have been \$553 thousand, or a \$275 thousand improvement compared with the operating loss of \$828 thousand in the same period of the prior year, and a \$918 thousand improvement compared with the third quarter of 2007.

For the full year, SG&A was \$9.9 million, or 20.4% of sales, compared with \$9.5 million, also 20.4% of sales in the prior year. In the third and fourth quarters, \$438 thousand in expense was incurred related to workforce reduction actions. Excluding these charges, along with the additional depreciation noted earlier, SG&A was lower than the prior year in absolute dollars as a result of lower

advertising expense, option expense, and bad debt reserve, partially offset by higher wages due to the increased number of employees subsequent to the DDM asset purchase.

Operating loss for the full year was \$5.4 million compared with \$5.2 million in the prior fiscal year. Excluding the workforce reduction costs and the incremental non-cash depreciation expense, adjusted operating loss would have been \$4.7 million in 2007 or approximately \$440 thousand improved from 2006.

We completed the documentation, implementation and testing required for Sarbanes-Oxley compliance during 2007. For the full year, approximately \$110 thousand was spent in order to comply, which was well below our original estimates. Total costs over the two-year period were approximately \$210 thousand, which excludes outside audit related fees. In 2008, we expect these costs to be between \$300 thousand and \$400 thousand, which will include outside audit related fees. We would like to note that it is still possible that Sarbanes-Oxley regulatory requirements for an outside auditor review may be delayed again until 2008 for micro-cap companies like MOD-PAC. If the delay is implemented, our costs in 2008 should be similar to 2007.

Net loss for the fourth quarter was \$1.0 million, or \$0.29 per diluted share, compared with a net loss of \$560,000 or \$0.16 per diluted share, in the fourth quarter of 2006. For the full year, net loss was \$4.1 million, or \$1.19 per diluted share, compared with net loss of \$3.4 million, or \$1 per diluted share in 2006. Impacting net loss in the fourth quarter were the after-tax impact of non-cash charges, a \$318 thousand write-down of goodwill that was associated with the company's purchase of Krepe Kraft many years ago, and a \$97 thousand impaired asset write-down for plant and equipment. If you take these two items and the after-tax impact of the workforce reduction expenses and additional depreciation for the software assets, our adjusted net loss was \$390 thousand, a \$170 thousand improvement compared with net loss of \$560 thousand in the fourth quarter of 2006 and a \$680 thousand improvement from the third quarter of 2007.

Adjusted EBITDA, or earnings before interest, taxes, depreciation and amortization, and non-cash option and impairment expenses was \$493 thousand in the fourth quarter of 2007 compared with \$474 thousand in the same period the prior year. For the full year, adjusted EBITDA was negative \$179 thousand compared with \$308 thousand in 2006.

Cash, cash equivalents, and temporary investments were \$98 thousand at December 31, 2007, down from \$265 thousand at September 29th, 2007 and \$3.4 million at December 31st, 2006. We paid

\$1.4 million on our line of credit in the fourth quarter, with the balance declining to \$400 thousand at December 31st, 2007 from \$1.8 million at the end of the third quarter. Full-year cash used was primarily driven by higher working capital requirements and capital expenditures, including the purchase of the DDM assets in the second quarter of 2007.

With respect to working capital, accounts receivable was up from \$4.1 million at the end of 2006 to \$4.3 million at the end of 2007 due to increased sales. Finished goods inventory was up from \$1.6 million, at the end of 2006, to \$2.2 million at the end of 2007, both as a result of subsequent quarter shipment timing and new customer build. Raw material inventory was down from \$1.5 million at the end of 2006 to \$1.2 million as we began to implement our paperboard consignment program in the fourth quarter of 2007. Accounts payable was \$2.9 million, which was lower than the end of 2006 balance by approximately \$1 million, primarily due to raw material inventory changes and the timing of fourth quarter 2006 capital expenditures.

Capital expenditures for 2007 were \$2.7 million, including \$0.8 million for the DDM asset purchase, compared with \$1.0 million in 2006. Depreciation and amortization in 2007 was \$5 million, and we expect it to be around \$4.0 million for 2008. The company recently reduced its committed line of credit from \$8.0 million to \$5.0 million, which we believe, together with cash and cash equivalents, will be sufficient for our needs in 2008.

Our commercial bank also waived certain financial covenant violations at December 31, 2007, and amended these same financial covenants to more favorable levels for December 31, 2008 and 2009.

The company did not purchase any shares of MOD-PAC in 2007, and the book value at December 31, 2007 was \$7.47 per share.

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

Dan Keane: Thank you Dave. I would now like to open the call up for any questions, at this point.

Operator: Thank you. Our first question is from John Lewis with Osmium Partners. Please proceed with your question.

John Lewis: Good morning Dan. Good morning Dave. Can you quantify the cost savings you're targeting in 2008 over 2007 with all the initiatives you mentioned?

Dan Keane: Dave, do you have a ballpark number for that?

David Lupp: It's a range. With respect to holding down inflationary costs, it is our goal to hold those variable costs as steady as possible as opposed to reducing them in a tough market for certain things like paperboard. But, with respect to tightening management of labor costs, \$1.0 million would be a good target.

Tightening, or enhancing, productivity and operations encompasses a whole of things under that category, which could be in the \$500 thousand range this year. Tightening controls on equipment and facility maintenance programs, like repairs and other fixed costs, could be between \$500 thousand and \$1.0 million. The two together would result in approximately a net \$2.0 million range.

John Lewis: That's pretty good. That's a pretty healthy amount of cost cutting. You also mentioned that you're looking to hire new sales people. Can you talk about how many you're looking to hire?

Dan Keane: We have one on board with a history in our region, and we're continuing to review and look for solid candidates. We are looking at a number of regional opportunities and growing our sales force on a regional level.

John Lewis: Okay, but you don't have a specific target of how many you'd ideally like to hire

Dan Keane: We may add one or two more.

John Lewis: What would you expect that they could contribute on an annual basis, or what would be your expectations in terms of potential revenue per sales person?

Dan Keane: In commercial print, historically, a lot of regional people would generate \$1.0 to \$2.0 million in sales. That's lower than my goal. We're looking at ways to leverage the talent. On our packaging side, we have sales associates that can manage \$4.0 to \$6.0 million in packaging accounts. It is early in our process, but I would hope to find a way to leverage the sales force that we're adding to be more like a packaging sales person than a traditional commercial print sales person bringing in \$1.0 to \$2.0 million in sales.

John Lewis: When you look at your overall customer base, how do you gauge the overall health of the customer base or the ordering trends for 2008?

Dan Keane: We have seen some softness in the folding cartons for the year. We experienced very modest growth, or effectively equivalent year-to-year. Putting that in perspective, our current

compound growth rate is 18%. The packaging industry, historically, would grow with GDP in the 2% to 3% range, and we've been far outpacing that for a number of years.

During the fourth quarter, we are subject to customers who are drawing down inventories. Several of the national reports show non-durable consumer goods, such as packaging, as being very resilient. After the 9/11 period, we didn't see a lot of decay. As an example, 60% of folding cartons in volume nationwide is for food related items, such as crackers. Typically, those are not highly cyclical with the economy.

I am cautiously optimistic this year. I know all the scare headlines that are coming out of Wall Street on the economy cause us to be aggressive in our cost reduction planning, but we're still cautiously optimistic on the year as a whole.

On the commercial print side, we are focused on local and national businesses, specializing heavily in direct mail activities for them. The marketing budgets will be reigned in by the economy. A positive that we expect to take advantage of this year is the national political cycle. We do work with a number of ad agencies that typically need election-related printing, whether it is with political action committees or with specific candidates. We do expect there to be a healthy level of activity in this area this year.

Hopefully, that gives you some perspective on my current outlook for the year. Overall, as I said before, I am cautiously optimistic.

John Lewis: That is helpful. As you mentioned, you had a long history of growing in excess of the industry. It looks like, obviously, you had a few bumps in the road here. Do you see a resumption of this trend in 2008?

Dan Keane: That's my current expectation, yes. I don't have the industry numbers, but I would imagine that we probably were equal with the industry this year. The carton industry may even have been down for the year. I don't have those numbers.

John Lewis: On the cost-cutting, do you expect that to be front-loaded or spread throughout the year in the cost savings?

David Lupp: I could comment on that a little bit. We geared up a lot in the latter third of the year with several actions, activities and initiatives. Some things we executed were workforce reductions,

with 7 positions in the third quarter and 12 in the fourth quarter. These reductions will exert their full impact this year. Other cost-cutting measures we hope to get underway as front-end loaded as possible.

John Lewis: What did the 19 people save you in annualized costs?

David Lupp: \$1.2 million.

John Lewis: I'll jump back in, and maybe come back for some more later.

David Lupp: Thank you John.

Operator: We have a follow-up question from Mr. John Lewis.

Dan Keane: Okay, we'll take John's question and then wrap up.

John Lewis: In terms of freeing up additional capital, have you given any consideration to sale lease-backs of any of your underlying property?

Dan Keane: We have not, at this point, entertained that. We do have a lot of real-estate assets. We have two facilities totaling 700 to 800 thousand square feet of real-estate, but we have not entertained that at this point in time.

John Lewis: Okay, thanks again.

Dan Keane: All right, thank you John. Thank you for your time today, and your interest in MOD-PAC. We are steadily making progress in our efforts to return to profitability and to capture our share of the large print market available to us. Have a good day.

Operator: This concludes today's teleconference.