

UFP TECHNOLOGIES INC  
Form 10-Q  
November 09, 2007

**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, 2007**

**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)

Delaware

**04-2314970**  
(IRS Employer Identification No.)

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(State or other jurisdiction of  
incorporation or organization)

**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 ; No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ; No

5,374,756 shares of registrant's Common Stock, \$.01 par value, were outstanding as of October 30, 2007.



**UFP Technologies, Inc.**

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**PART I: FINANCIAL INFORMATION**

**ITEM 1: FINANCIAL STATEMENTS**



## UFP Technologies, Inc.

Condensed Consolidated Balance Sheets

|  | 30-Sep-07<br>(unaudited) | 31-Dec-06     |
|--|--------------------------|---------------|
| <b>Assets</b>  |                          |               |
| Current assets:  |                          |               |
| Cash   | \$ 5,686,899             | \$ 1,017,122  |
| Receivables, net   | 12,335,844               | 11,628,639    |
| Inventories  | 5,440,101                | 5,929,677     |
| Prepaid expenses   | 902,396                  | 766,467       |
| Deferred income taxes  | 1,032,281                | 1,032,281     |
| Total current assets   | 25,397,521               | 20,374,186    |
| Property, plant and equipment  | 38,925,404               | 37,212,463    |
| Less accumulated depreciation and amortization   | (29,048,070)             | (27,075,279)  |
| Net property, plant and equipment  | 9,877,334                | 10,137,184    |
| Deferred income taxes  | 478,063                  | 1,387,353     |
| Goodwill   | 6,481,037                | 6,481,037     |
| Other assets   | 780,637                  | 657,252       |
| Total assets   | \$ 43,014,592            | \$ 39,037,012 |
| <b>Liabilities and Stockholders Equity</b>   |                          |               |
| Current liabilities:   |                          |               |
| Current installments of long-term debt   | \$ 713,563               | \$ 1,078,350  |
| Current installments of capital lease obligations  | 691,731                  | 688,991       |
| Accounts payable   | 5,697,023                | 4,620,399     |
| Accrued taxes and other expenses   | 5,639,322                | 5,749,949     |
| Total current liabilities  | 12,741,639               | 12,137,689    |
| Long-term debt, excluding current installments   | 4,837,635                | 4,603,977     |
| Capital lease obligations, excluding current installments  | 1,793,592                | 2,317,072     |
| Minority interest  | 579,184                  | 616,157       |
| Retirement and other liabilities   | 882,163                  | 737,581       |
| Total liabilities  | 20,834,213               | 20,412,476    |
| Commitments and contingencies  |                          |               |
| Stockholders equity:   |                          |               |
| Common stock, \$.01 par value. Authorized 20,000,000 shares; issued and outstanding 5,374,756 shares at September 30, 2007 and 5,156,764 shares at December 31, 2006 | 53,748                   | 51,568        |
| Additional paid-in capital   | 11,483,679               | 10,311,682    |
| Retained earnings  | 10,642,952               | 8,261,286     |
| Total stockholders equity  | 22,180,379               | 18,624,536    |
| Total liabilities and stockholders equity  | \$ 43,014,592            | \$ 39,037,012 |

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

UFP Technologies, Inc.

**Condensed Consolidated Statements of Income**

(Unaudited)

|  | Three Months Ended |               | Nine Months Ended |               |
|--|--------------------|---------------|-------------------|---------------|
|  | 30-Sep-07          | 30-Sep-06     | 30-Sep-07         | 30-Sep-06     |
| Net sales  | \$ 22,937,289      | \$ 21,737,107 | \$ 68,130,065     | \$ 70,411,795 |
| Cost of sales                                      | 17,635,012         | 17,560,308    | 52,443,351        | 56,066,869    |
| Gross profit                                       | 5,302,277          | 4,176,799     | 15,686,714        | 14,344,926    |
| Selling, general & administrative expenses         | 3,752,660          | 3,293,301     | 11,423,120        | 10,822,587    |
| Operating income                                   | 1,549,617          | 883,498       | 4,263,594         | 3,522,339     |
| Interest expense, net                              | 99,541             | 219,366       | 401,713           | 758,625       |
| Minority interest earnings                         | 25,432             | 26,297        | 68,021            | 85,855        |
| Other income                                       |                    |               | (47,538)          | (15,037)      |
| Income before income tax expense                   | 1,424,644          | 637,835       | 3,841,398         | 2,692,896     |
| Income tax expense                                 | 541,365            | 242,320       | 1,459,732         | 1,023,243     |
| Net income   | \$ 883,279         | \$ 395,515    | \$ 2,381,666      | \$ 1,669,653  |
| <i>Net income per share:</i>                       |                    |               |                   |               |
| Basic  | \$ 0.17            | \$ 0.08       | \$ 0.45           | \$ 0.33       |
| Diluted  | \$ 0.15            | \$ 0.07       | \$ 0.41           | \$ 0.31       |
| <i>Weighted average common shares outstanding:</i> |                    |               |                   |               |
| Basic  | 5,358,110          | 5,097,647     | 5,285,430         | 4,984,237     |
| Diluted  | 5,908,558          | 5,721,614     | 5,822,768         | 5,445,676     |

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



## UFP Technologies, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

|  | Nine Months Ended |              |
|--|-------------------|--------------|
|  | 30-Sep-07         | 30-Sep-06    |
| Cash flows from operating activities:                                      |                   |              |
| Net income   | \$ 2,381,666      | \$ 1,669,653 |
| Adjustments to reconcile net income to net cash from operating activities: |                   |              |
| Depreciation and amortization  | 2,073,607         | 2,274,041    |
| Minority interest earnings   | 68,027            | 85,855       |
| Equity in net income of unconsolidated affiliate                           | (15,038)          | (15,038)     |
| Stock issued in lieu of cash compensation                                  | 256,075           | 144,247      |
| Share-based compensation   | 533,500           | 348,562      |
| Deferred income taxes  | 909,290           | 647,534      |
| Gain on disposal of fixed assets   | (32,500)          |              |
| Changes in operating assets and liabilities:                               |                   |              |
| Receivables, net   | (707,205)         | 2,679,348    |
| Inventories, net   | 489,576           | 567,317      |
| Prepaid expenses and other current assets                                  | (135,929)         | (55,033)     |
| Accounts payable   | 471,853           | (64,021)     |
| Accrued expenses and payroll withholdings                                  | (110,627)         | 205,005      |
| Retirement and other liabilities   | 144,582           | 4,611        |
| Other assets   | (175,189)         | (20,999)     |
| Net cash provided by operating activities                                  | 6,151,688         | 8,471,082    |
| Cash flows from investing activities:                                      |                   |              |
| Additions to property, plant and equipment                                 | (1,761,953)       | (912,966)    |
| Acquisition of assets of Stephens Packaging                                |                   | (309,229)    |
| Proceeds from fixed asset disposals  | 32,500            |              |
| Payments from affiliated company   | 15,038            | 15,038       |
| Net cash used in investing activities                                      | (1,714,415)       | (1,207,157)  |
| Cash flows from financing activities:                                      |                   |              |
| Payments of notes payable  |                   | (6,024,059)  |
| Change in book overdrafts  | 604,771           | (927,216)    |
| Proceeds from long-term debt   | 786,000           |              |
| Principal repayments of long-term debt                                     | (917,129)         | (519,225)    |
| Proceeds from exercise of stock options                                    | 269,997           | 498,271      |
| Tax benefit from exercise of non-qualified stock options                   | 90,710            | 168,391      |
| Principal repayments of capital lease obligations                          | (520,740)         | (1,844,646)  |
| Proceeds from long-term capital lease obligations                          |                   | 1,359,000    |
| Distribution to United Development Company partners                        | (105,000)         | (105,000)    |
| Net proceeds from sale of common stock                                     | 23,895            | 47,318       |
| Net cash used in financing activities                                      | 232,504           | (7,347,166)  |
| Net increase (decrease) in cash  | 4,669,777         | (83,241)     |
| Cash at beginning of period  | 1,017,122         | 265,352      |
| Cash at end of period  | \$ 5,686,899      | \$ 182,111   |

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



**NOTES TO INTERIM**

**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**



(1) **Basis of Presentation**



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The interim condensed consolidated financial statements of UFP Technologies, Inc. (the Company) presented herein, without audit, 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, 2006, included in the Company's 2006 Annual Report on Form 10-K as filed with the Securities and Exchange Commission.

The condensed consolidated balance sheet as of September 30, 2007, the condensed consolidated statements of income for the three- and nine-month periods ended September 30, 2007 and 2006, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2007 and 2006, are unaudited but, in the opinion of management, include all adjustments (consisting of normal, recurring adjustments) necessary for 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, 2007, are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2007.

### (2) **Investment in Affiliated Partnership**





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The Company has a 26.32% ownership interest in a realty limited partnership, United Development Company Limited ( UDT ). In accordance with the provisions of FIN 46R, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, the Company has consolidated the financial statements of UDT because it has determined that UDT is a variable interest entity ( VIE ) pursuant to Paragraph 5.a of FIN 46R, and the Company is the primary beneficiary. Included in the Condensed Consolidated Balance Sheets are the following UDT amounts:

|                                    | 30-Sep-07 |           | 31-Dec-06 |           |
|------------------------------------|-----------|-----------|-----------|-----------|
| Cash                               | \$        | 148,096   | \$        | 196,465   |
| Net property, plant, and equipment | \$        | 1,445,968 | \$        | 1,084,241 |
| Accrued expenses                   | \$        | 31,404    | \$        | 48,666    |
| Current and long-term debt         | \$        | 776,579   | \$        | 395,779   |

(3) **New Accounting Pronouncements**



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In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ) which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 will be effective for the Company on January 1, 2008. The Company is currently evaluating the impact of adopting SFAS 159, but does not believe that the adoption of SFAS 159 will have any material impact on its financial position, cash flows, and results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS 157 ), which clarifies the definition of fair value, establishes guidelines for measuring fair value, and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 will be effective for the Company on January 1, 2008. The Company is currently evaluating the impact of adopting SFAS 157 but does not believe that the adoption of SFAS 157 will have any material impact on its financial position, cash flows, or results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109) which is effective for fiscal years beginning after December 15, 2006 with earlier adoption encouraged. This interpretation was issued to clarify the accounting for uncertainty in income taxes recognized in the financial statements by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The adoption of FASB Interpretation No. 48 did not have a material effect on the condensed consolidated financial statements.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. The Company has not been audited by the Internal Revenue Service ( IRS ) since 2001 or any states in connection with income taxes, with the exception of returns filed in the state of Michigan, which have been audited through 2004. The periods from 2002 through 2006 remain open to examination by the IRS and various periods between 1999 and 2006 remain open to examination by state jurisdictions.

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the quarter.

### (4) **Share-Based Compensation**



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Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), ( SFAS 123R ) Share-Based Payment, which establishes accounting for equity instruments exchanged for employee services. Under the provisions of SFAS 123R, 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).

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The provisions of SFAS 123R apply to share-based payments made through several plans, which are described below. The compensation cost that has been charged against income for those plans is as follows:

|   | Three Months Ended |            | Nine Months Ended |            |
|---|--------------------|------------|-------------------|------------|
|   | 30-Sep-07          | 30-Sep-06  | 30-Sep-07         | 30-Sep-06  |
| Cost of sales                             | \$                 | \$         | \$                | \$         |
| Selling, general & administrative expense | 168,792            | 109,811    | 533,500           | 348,562    |
| Total share-based compensation expense    | \$ 168,792         | \$ 109,811 | \$ 533,500        | \$ 348,562 |

The Company recorded compensation expense of \$105,938 and \$114,950 for options granted during the nine-month periods ended September 30, 2007 and 2006, respectively. No compensation expense was recorded during the three-month periods ended September 30, 2007 and 2006, respectively, since the service period for those options took place in prior quarters. The compensation expense was determined as the intrinsic fair value of the options using a lattice-based option valuation model with the following assumptions:

|                         | Three Months Ended    |                       | Nine Months Ended     |                       |
|-------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                         | 30-Sep-2007           | 30-Sep-2006           | 30-Sep-2007           | 30-Sep-2006           |
| Expected volatility     | 89.3%                 | 92.7%                 | 89.3%                 | 92.7%                 |
| Expected dividends      |                       |                       |                       |                       |
| Risk free interest rate | 5.0%                  | 5.1%                  | 5.0%                  | 5.1%                  |
| Imputed life            | 7.9 years             | 8.0 years             | 7.9 years             | 8.0 years             |
| Exercise price          | Closing on grant date | Closing on grant date | Closing on grant date | Closing on grant date |

The Company has recorded compensation expense of \$27,216 and \$81,778, respectively, during the three- and nine-month periods ended September 30, 2007 for options granted in prior periods.

The total income tax benefit recognized in the income statement for share-based compensation arrangements was approximately \$64,141 and \$202,730 for the three- and nine-month periods ended September 30, 2007, and approximately \$41,700 and \$132,500 for the respective periods in 2006.

### Employee Stock Option Plan





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The Company's 1993 Employee Stock Option Plan ( "Employee Stock Option Plan" ), which is stockholder approved, provides long-term rewards and incentives in the form of stock options to the Company's key employees, officers, employee directors, consultants, and advisors. The plan provides for either non-qualified stock options or incentive stock options for the issuance of up to 1,550,000 shares of common stock. The exercise price of the incentive stock options may not be less than the fair market value of the common stock on the date of grant, and the exercise price for non-qualified stock options shall be determined by the Compensation Committee. These options expire over five- to ten-year periods.

Options granted under the plan generally become exercisable with respect to 25% of the total number of shares subject to such options at the end of each 12-month period following the grant of the options, except for options granted to officers, which may vest on a different schedule. At September 30, 2007, there were 713,750 options outstanding under the Employee Stock Option Plan. Should stock options be issued under the Employee Stock Option Plan in the future, the Company will record compensation expense based upon the intrinsic fair market value of the stock options, using a lattice-based option valuation model.

**Equity Incentive Plan**



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In June 2003, the Company formally adopted the 2003 Equity Incentive Plan (the "Equity Incentive Plan"). The Plan is intended to benefit the Company by offering equity-based incentives to certain of the Company's executives and employees, thereby giving them a permanent stake in the growth and long-term success of the Company and encouraging the continuance of their involvement with the Company's businesses. Two types of awards may be granted to participants under the Equity Incentive Plan: restricted shares or other stock awards. Restricted shares are shares of common stock awarded subject to restrictions and to possible forfeiture upon the occurrence of specified events. Other stock awards are awards that are denominated or payable in, valued in whole or in part by reference to or otherwise based on or related to shares of common stock. Such awards may include, Restricted Stock Unit Awards ("RSUs"), unrestricted or restricted stock, nonqualified options, performance shares, or stock appreciation rights. The Company determines the form, terms, and conditions, if any, of any awards made under the Equity Incentive Plan. The maximum number of shares of common stock, in the aggregate, that may be delivered in payment or in respect of stock issued under the Plan was increased by 750,000 shares to 1,250,000 shares, effective June 6, 2007. Through September 30, 2007, 287,355 shares of common stock have been issued under the Equity Incentive Plan, none of which have been restricted; an additional 272,000 shares are being reserved for outstanding grants of RSUs and other share-based compensation that are subject to various performance and time-vesting contingencies.

### **Stock Purchase Plan**



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On April 18, 1998, the Company adopted the 1998 Stock Purchase Plan (the "Stock Purchase Plan"), which provides that all employees of the Company (who work more than twenty hours per week and more than five months in any calendar year, and who are employees on or before the applicable offering period) are eligible to participate. The Stock Purchase Plan is intended to qualify as an "Employee Stock Purchase Plan" under Section 423 of the Internal Revenue Code of 1986. Under the Stock Purchase Plan participants may have up to 10% of their base salaries withheld for the purchase of the Company's common stock at 95% of the market value of the common stock on the last day of the offering period. The offering periods are from January 1 through June 30 and from July 1 through December 31 of each calendar year. The 1998 Stock Purchase Plan provides for the issuance of up to 400,000 shares of common stock. Through September 30, 2007, there were 303,049 shares issued under this plan.

### **Director Plans**



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Through July 15, 1998, the Company maintained a stock option plan covering non-employee directors (the 1993 Director Plan ). Effective July 15, 1998, with the formation



of the 1998 Director Stock Option Incentive Plan (the 1998 Director Plan ), the 1993 Director Plan was frozen. The 1993 Director Plan provided for options for the issuance of up to 110,000 shares of common stock. On July 1 of each year, each individual who at the time was serving as a non-employee director of the Company received an automatic grant of options to purchase 2,500 shares of common stock. These options became exercisable in full the date of the grant and expire ten years from the date of grant. The exercise price was the fair market value of the common stock on the date of grant. At September 30, 2007, there were 5,000 options outstanding under the 1993 Director Plan.

Effective July 15, 1998, the Company adopted the 1998 Director Plan ( 1998 Director Plan ) for the benefit of non-employee directors of the Company. The 1998 Director Plan provided for options for the issuance of up to 425,000 shares of common stock. On June 2, 2004, the Company amended the 1998 Director Plan to increase the allowable amount to 725,000 shares. These options become exercisable in full at the date of grant and expire ten years from the date of grant. In connection with the adoption of the 1998 Director Plan, the 1993 Director Plan was frozen; however, the options outstanding under the 1993 Director Plan were not affected by the adoption of the new plan. At September 30, 2007, there were 375,744 options outstanding under the 1998 Director Plan.

The following is a summary of stock option activity under all plans:

|   | Shares Under<br>Options | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic Value |
|---|-------------------------|--|------------------------------|
| Outstanding December 31, 2006             | 1,156,059               | \$ 2.40                                  |                              |
| Granted                                   | 55,517                  | 5.12                                     |                              |
| Exercised                                 | (117,082)               | 2.31                                     |                              |
| Cancelled or expired                      |                         |  |                              |
| Outstanding September 30, 2007            | 1,094,494               | \$ 2.55                                  | \$ 2,882,995                 |
| Options exercisable at September 30, 2007 | 1,035,869               | \$ 2.47                                  | \$ 2,808,754                 |

During the nine months ended September 30, 2007, the total intrinsic value of all options exercised (i.e., the difference between the market price and the price paid by the employees to exercise the options) was \$362,817 and the total amount of consideration received from the exercise of these options was \$269,997.

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The following is a summary of information relating to stock options outstanding and exercisable by price range as of September 30, 2007:

| Range of exercise prices | Outstanding as of 9/30/07 | Options Outstanding Weighted average remaining contractual life | Weighted average exercise price | Options Exercisable Exercisable as of 9/30/07 | Weighted average exercise price |
|--------------------------|---------------------------|---|---------------------------------|---|---------------------------------|
| \$0.00 - \$0.99          | 50,000                    | 4.4 years   | \$ 0.81                         | 50,000  | \$ 0.81                         |
| \$1.00 - \$1.99          | 334,956                   | 4.2 years   | 1.23                            | 334,581                                       | 1.23                            |
| \$2.00 - \$2.99          | 347,184                   | 5.3 years   | 2.50                            | 347,184                                       | 2.50                            |
| \$3.00 - \$3.99          | 239,460                   | 4.8 years   | 3.33                            | 198,710                                       | 3.32                            |
| \$4.00 - \$4.99          | 7,500                     | 3.1 years   | 4.71                            | 2,500   | 4.25                            |
| \$5.00 - \$5.99          | 65,517                    | 8.5 years   | 5.15                            | 53,017  | 5.14                            |
| \$6.00 - \$6.99          | 49,877                    | 8.7 years   | 6.07                            | 49,877  | 6.07                            |
|                          | 1,094,494                 | 5.1 years   | \$ 2.55                         | 1,035,869                                     | \$ 2.47                         |

The total grant date fair value of stock options that vested during the nine months ended September 30, 2007 was approximately \$400,000 with a weighted average remaining contractual term of approximately four years.

On February 26, 2007, the Company's Compensation Committee approved the issuance of 25,000 shares of unrestricted common stock to the Company's Chairman, Chief Executive Officer, and President under the 2003 Equity Incentive Plan. The shares will be issued on January 1, 2008. Based upon the provisions of SFAS 123R, the Company has recorded compensation expense of \$29,100 and \$86,900 during the three- and nine-month periods ended September 30, 2007, respectively, based on the grant date price of \$4.64 at February 26, 2007.

Beginning in 2006, RSUs have been granted under the 2003 Equity Incentive Plan to the executive officers of the Company. The stock unit awards are subject to various time based vesting requirements, and certain portions of these awards are subject to performance criteria of the Company. Compensation expense on these awards is recorded based on the fair value of the award at the date of grant, which is equal to the Company's stock price, and is charged to expense ratably during the service period. No compensation expense is taken on awards that do not become vested, and the amount of compensation expense recorded is adjusted based on management's determination of the probability that these awards will become vested. The following table summarizes information about stock unit award activity during the nine-month period ended September 30, 2007:

|                                   | Restricted Stock Units | Weighted Average Award Date Fair Value |
|-----------------------------------|------------------------|--|
| Outstanding at December 31, 2006  | 144,000                | \$ 6.15                                |
| Awarded                           | 144,000                | 4.91                                   |
| Shares distributed                | (16,000)               | 6.15                                   |
| Forfeited / cancelled             | 0                      | 0                                      |
| Outstanding at September 30, 2007 | 272,000                | \$ 5.50                                |

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The Company recorded \$257,870 and \$142,867 in compensation expense related to these SUAs during the nine-month periods ended September 30, 2007 and 2006, respectively.

The following summarizes the future share-based compensation expense the Company will record as the equity securities granted through September 30, 2007 vest:

|      | Options    | Common<br>Stock | Restricted<br>Stock Units | Total        |
|------|------------|-----------------|---------------------------|--------------|
| 2007 | \$ 23,496  | \$ 29,100       | \$ 106,906                | \$ 159,502   |
| 2008 | 91,300     | 0               | 427,624                   | \$ 518,924   |
| 2009 | 33,011     | 0               | 379,754                   | \$ 412,765   |
| 2010 | 13,290     |                 | 223,318                   | \$ 236,608   |
| 2011 | 1,689      |                 | 57,376                    | 59,065       |
|      | \$ 162,786 | \$ 29,100       | \$ 1,194,978              | \$ 1,386,864 |

### (5) Inventories

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

|                           | <b>30-Sep-07</b> | <b>31-Dec-06</b> |
|---------------------------|------------------|------------------|
| Raw materials             | \$ 3,724,569     | \$ 3,796,380     |
| Work in process           | 386,059          | 293,580          |
| Finished goods            | 1,755,565        | 2,080,537        |
| Reserves for obsolescence | \$ (426,092)     | \$ (240,820)     |
| Total inventory           | \$ 5,440,101     | \$ 5,929,677     |

(6) **Earnings Per Share**



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Basic earnings per share computations are based on the weighted average number of shares of common stock outstanding. Diluted earnings 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 diluted net income per share consisted of the following:

|  | Three Months Ended |           | Nine Months Ended |           |
|--|--------------------|-----------|-------------------|-----------|
|  | 30-Sep-07          | 30-Sep-06 | 30-Sep-07         | 30-Sep-06 |
| Weighted average common shares outstanding, basic              | 5,358,110          | 5,097,647 | 5,285,430         | 4,984,237 |
| Weighted average common equivalent shares due to stock options | 550,548            | 623,967   | 537,338           | 461,439   |
| Weighted average common shares outstanding, diluted            | 5,908,658          | 5,721,614 | 5,822,768         | 5,445,676 |

(7) **Segment Reporting**





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The Company is organized based on the nature of the products and services that 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 foam to provide customers in the automotive, athletic, leisure, and health and beauty industries with engineered product for numerous purposes.

The accounting policies of the segments are the same as those described in Note 1 of the Company's annual report on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission. The Company evaluates the performance of its operating segments based on net income.

Inter-segment transactions are uncommon and not material. Therefore, they have not been separately reflected in the financial table below. The totals of the reportable segments' revenues and net income agree with the Company's comparable amount contained in the interim financial statements. Revenues from customers outside of the United States are not material. One customer in the Component Products group comprised 18.2% of the Company's consolidated revenues during the nine-month period ended September 30, 2007. All of the Company's assets are located in the United States.

|            | Three Months Ended 9/30/07 |                    |               | Three Months Ended 9/30/06 |                    |               |
|------------|----------------------------|--------------------|---------------|----------------------------|--------------------|---------------|
|            | Engineered Packaging       | Component Products | Total UFPT    | Engineered Packaging       | Component Products | Total UFPT    |
| Net sales  | \$ 9,672,787               | \$ 13,264,502      | \$ 22,937,289 | \$ 8,797,410               | \$ 12,939,697      | \$ 21,737,107 |
| Net income | 263,292                    | 619,987            | 883,279       | 342,652                    | 52,863             | 395,515       |

|            | Nine Months Ended 9/30/07 |                    |               | Nine Months Ended 9/30/06 |                    |               |
|------------|---------------------------|--------------------|---------------|---------------------------|--------------------|---------------|
|            | Engineered Packaging      | Component Products | Total UFPT    | Engineered Packaging      | Component Products | Total UFPT    |
| Net sales  | \$ 28,031,324             | \$ 40,098,741      | \$ 68,130,065 | \$ 27,653,995             | \$ 42,757,800      | \$ 70,411,795 |
| Net income | 596,932                   | 1,784,734          | 2,381,666     | 729,809                   | 939,844            | 1,669,653     |

### (8) **Indebtedness**



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As a component of consolidating UDT's assets, the Company included \$148,096 and \$196,465 in cash at September 30, 2007 and December 31, 2006, respectively. Although this cash balance is not legally restricted, the Company does not use this cash in its operations.

On February 28, 2003, the Company obtained a credit facility, which was amended effective March 24, 2004, June 28, 2004, and November 21, 2005, to reflect, among other things, changes to certain financial covenants. The amended facility is comprised of: (i) a revolving credit facility of \$17 million that is collateralized by the Company's accounts receivable and inventory; (ii) a term loan of \$3.7 million with a 7-year straight-line

amortization that is collateralized by the Company's property, plant and equipment (excluding UDT's property, plant and equipment); and (iii) a term loan of \$2.3 million with a 15-year straight-line amortization that is collateralized by a mortgage on the Company's real estate located in Georgetown, Massachusetts. Extensions of credit under the revolving credit facility are subject to available collateral based upon accounts receivable and inventory levels. Therefore, the entire \$17 million may not be available to the Company. For example, as of September 30, 2007, based upon no revolving credit facility borrowings outstanding and collateral levels, the Company had availability of approximately \$13 million of additional credit under this facility. The amount of availability can fluctuate significantly. The amended credit facility calls for interest of Prime or LIBOR plus a margin that ranges from 1.0 % to 1.5%, depending upon the Company's operating performance. All borrowings at September 30, 2007 had interest computed at Prime or LIBOR plus 1%. Under the amended credit facility, the Company is subject to certain financial covenants including maximum capital expenditures and minimum fixed charge coverage. As of September 30, 2007, the Company was in compliance with all of these covenants. The Company's \$17 million revolving credit facility, as amended, is due February 28, 2009; the \$3.7 million term loan and the \$2.3 million mortgage are due November 21, 2011. At September 30, 2007, the interest rate on these facilities ranged from 6.40% to 7.75%.

As a result of the consolidation of UDT, a mortgage note collateralized by the Alabama and Florida facilities, dated September 4, 2002, originally for \$470,313, was included within long-term debt in the December 31, 2006 Consolidated Financial Statements. On May 22, 2007, this note was refinanced. The remaining principal balance of \$388,356 was paid in full. The new note is secured by the Florida facility and had a principal balance of \$786,000. The note calls for 180 monthly payments of \$7,147. The interest rate is fixed at approximately 7.2%. The additional funds of approximately \$400,000 were used to fund building improvements in the Florida facility. Payments on this note are funded through rent payments that the Company makes on its Alabama and Florida facilities. The Company is not a guarantor and is not subject to any financial covenants under this mortgage note.

At September 30, 2007, the Company also had capital lease obligations of approximately \$2,485,000. At September 30, 2007, the current portion of all debt including the revolving bank loan, term loans and capital lease obligations was approximately \$1,405,000.

The Company had book overdrafts of approximately \$2,279,000 and \$1,675,000 at September 30, 2007 and December 31, 2006, respectively. The Company classifies book overdrafts within Accounts Payable on its Condensed Consolidated Balance Sheets.

The Company believes that its existing resources, including its revolving line of credit facility together with cash expected to be generated from operations and funds expected to be available to it through any necessary equipment financing, will be sufficient to fund its cash flow requirements through at least the next twelve months. However, there can be no assurances that the Company will be able to obtain such financing, or that such financing will be available at favorable terms, if at all.

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



**Forward-looking Statements:**





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This report contains certain statements that are forward-looking statements as that term is defined under the Securities Exchange Act of 1934, as amended (the Act ) 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 which do not relate to historical matters identify forward-looking statements. The Company's belief, described below, that softness in the automotive market will continue in the near future is an example of a forward-looking statement. 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.

Manufacturing companies often take advantage of lower volume months to shut down production to service machinery and tools. This is even more common in the automotive industry where many companies historically have shut down their operations for a portion of the months of July and December. The Company expects this practice to continue. To the extent our customers choose to shut down their operations, for these or other reasons, the Company's quarterly operating results could fluctuate and be materially, adversely affected. Other examples of these risks, uncertainties, and other factors include, without limitation, the following: risks associated with the identification of suitable acquisition candidates and the successful, efficient execution and integration of such acquisitions, the ability of the Company to achieve positive results due to competition, decisions by customers to cancel or defer orders for its products that previously had been accepted, recent increases and possible further increases in the cost of the Company's raw materials and energy that the Company may not be able to pass through to its customers, other economic conditions that affect sales of the products of the Company's packaging customers, the ability of the Company to obtain new customers, evolving customer requirements, difficulties associated with the roll-out of new products, the costs of compliance with Sarbanes-Oxley related requirements 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:**



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UFP Technologies is a leading designer and manufacturer of interior protective packaging solutions using molded fiber, vacuumformed plastics and molded and fabricated foam plastic products. The Company also designs and manufactures engineered component solutions using laminating, molding and fabricating technologies. The Company serves a myriad of markets, but specifically targets opportunities in the automotive, computers and electronics, medical, aerospace and defense, industrial and consumer markets.

During 2006 demand remained strong from customers in the aerospace and defense and medical industries. Military efforts in Iraq and elsewhere have created demand for molded uniform and gear components from the Company's Component Products segment. The aging population needing more medical care has kept demand high for medical packaging products, medical device components, dental products and orthopedic components. The strong demand from customers in these markets, coupled with increased sales from some automotive customers, generated record sales for the Company in 2006.

The business climate softened in early 2007, particularly within the automotive market where December holiday plant shutdowns extended well into January and many customer orders were below forecast. The Company has invested in sales resources to target opportunities in the automotive market. At this time, the pipeline of pending quotes is strong. However, there can be no assurance that the Company will benefit from any of these quotes.

Despite the top-line softness, the Company has been able to generate improved profitability through the first nine months of 2007 through initiatives focused on increasing gross margins. These initiatives target cost-cutting, improving manufacturing efficiencies, sharing of best business practices across the Company's manufacturing plants, and improving the overall book of business.

**Sales:**



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Sales for the three-month period ended September 30, 2007 were \$22.9 million or 5.5% above sales of \$21.7 million for the same period in 2006. Sales for the nine-month period ended September 30, 2007 were \$68.1 million or 3.2% below sales of \$70.4 million in the same period of 2006. The increase in sales for the three-month period ended September 30, 2007 is primarily due to increased sales to key accounts within the medical and military markets (Component Products segment) of approximately \$600,000, as well as an increase in sales within the automotive market (Component Products segment) of approximately \$400,000. The Company believes that the increase in sales within the automotive market during the three-month period ended September 30, 2007 is due to a lesser impact of customer plant shut-downs in the month of July, 2007 compared to the impact of such shutdowns in July, 2006. The decline in sales for the nine-month period ended September 30, 2007 is primarily due to declined sales to the automotive market of approximately \$1.6 million. The decline in sales to the automotive market for the nine-month period ended September 30, 2007 reflects a general industry softness that the Company believes will continue for the near future.

### **Gross Profit:**



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Gross profit as a percentage of sales (gross margin) improved to 23.1% and 23.0% for the three- and nine-month periods ended September 30, 2007 from 19.2% and 20.4% in the three- and nine-month periods of 2006, respectively. The improvement in gross margin for both periods is primarily due to manufacturing efficiency initiatives particularly in the Company's automotive operations (Component Products segment). The Company estimates that these initiatives increased gross margins by 2.5% and 1.3%, during the three- and nine-month periods ended September 30, 2007, respectively.

### **Selling, General and Administrative Expenses:**





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Selling, General and Administrative expenses ( SG&A ) increased to \$3.8 million and \$11.4 million for the three- and nine-month periods ended September 30, 2007 from \$3.3 million and

\$10.8 million in the comparable periods of 2006, respectively. As a percentage of sales, SG&A increased to 16.4 % and 16.8 % for the three- and nine-month periods ended September 30, 2007 from 15.1% and 15.4% in the comparable periods of 2006, respectively. The increase in SG&A dollars in both periods reflects normal inflationary activity as well as an investment in additional selling expenses of approximately \$200,000 and \$400,000 for the three- and nine-month periods ended September 30, 2007, respectively. The increase in SG&A as a percentage of sales for the nine-month period ended September 30, 2007 reflects principally fixed SG&A costs measured against lower sales.

**Other Expenses:**



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Minority interest earnings were approximately \$25,000 and \$68,000 for the three- and nine-month periods ended September 30, 2007, compared to approximately \$26,000 and \$86,000 in the same respective periods last year.

Net interest expense declined for the three- and nine-month periods ended September 30, 2007 to approximately \$100,000 and \$400,000, from \$219,000 and \$759,000, respectively. The decline for both periods is primarily due to lower average borrowings and interest income from invested cash.

The Company recorded a tax expense of approximately 38% of pre-tax income for the three- and nine-month periods ended September 30, 2007 and 2006.

### **Liquidity and Capital Resources:**



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

At September 30, 2007 and December 31, 2006, the Company's working capital was approximately \$12.7 million and \$8.2 million, respectively. The improvement in working capital for the nine-month period ended September 30, 2007 is primarily due to an increase in cash of \$4.7 million and higher receivables of approximately \$700,000 partially offset by higher accounts payable of approximately \$1.1 million. The increase in cash reflects the Company's continued strong cash flow from operations. As a component of consolidating UDT's assets, the Company included \$148,096 in cash at September 30, 2007. Although this cash balance is not legally restricted, the Company does not use this cash in its operations.

Net cash provided by operations for the nine-month periods ended September 30, 2007 and 2006 was approximately \$6.2 million and \$8.5 million, respectively. The decrease in cash provided by operations was primarily attributable to a reduction in accounts receivable in the first nine months of 2006 due to payment of aged receivables from a large automotive customer, as well as the payment of accrued compensation and benefit expenses. Cash used in investing activities during the nine-month period ended September 30, 2007 was approximately \$1.7 million, which primarily was the result of additions to property, plant and equipment. The capital expenditures were primarily related to the additions of manufacturing equipment.

On February 28, 2003, the Company obtained a credit facility, which was amended effective March 24, 2004, June 28, 2004, and November 21, 2005, to reflect, among other things, changes to certain financial covenants. The amended facility is comprised of: (i) a revolving credit facility of \$17 million that is collateralized by the Company's accounts receivable and

inventory; (ii) a term loan of \$3.7 million with a 7-year straight-line amortization that is collateralized by the Company's property, plant and equipment (excluding UDT's property, plant and equipment); and (iii) a term loan of \$2.3 million with a 15-year straight-line amortization that is collateralized by a mortgage on the Company's real estate located in Georgetown, Massachusetts. Extensions of credit under the revolving credit facility are subject to available collateral based upon accounts receivable and inventory levels. Therefore, the entire \$17 million may not be available to the Company. For example, as of September 30, 2007, based upon no revolving credit facility borrowings outstanding and collateral levels, the Company had availability of approximately \$13 million of additional credit under this facility. The amount of availability can fluctuate significantly. The amended credit facility calls for interest of Prime or LIBOR plus a margin that ranges from 1.0 % to 1.5%, depending upon the Company's operating performance. All borrowings at September 30, 2007 had interest computed at Prime or LIBOR plus 1%. Under the amended credit facility, the Company is subject to certain financial covenants including maximum capital expenditures and minimum fixed charge coverage. As of September 30, 2007, the Company was in compliance with all of these covenants. The Company's \$17 million revolving credit facility, as amended, is due February 28, 2009; the \$3.7 million term loan and the \$2.3 million mortgage are due November 21, 2011. At September 30, 2007, the interest rate on these facilities ranged from 6.40% to 7.75%.

As a result of the consolidation of UDT, a mortgage note collateralized by the Alabama and Florida facilities, dated September 4, 2002, originally for \$470,313, was included within long-term debt in the December 31, 2006 Consolidated Financial Statements. On May 22, 2007, this note was refinanced. The remaining principal balance of \$388,356 was paid in full. The new note is secured by the Florida facility and had a principal balance of \$786,000. The note calls for 180 monthly payments of \$7,147. The interest rate is fixed at approximately 7.2%. The additional funds of approximately \$400,000 were used to fund building improvements in the Florida facility. Payments on this note are funded through rent payments that the Company makes on its Alabama and Florida facilities. The Company is not a guarantor and is not subject to any financial covenants under this mortgage note.

At September 30, 2007, the Company also had capital lease obligations of approximately \$2,485,000. At September 30, 2007, the current portion of all debt including the revolving bank loan, term loans and capital lease obligations was approximately \$1,405,000.

The Company had book overdrafts of approximately \$2,279,000 and \$1,675,000 at September 30, 2007 and December 31, 2006, respectively. The Company classifies book overdrafts within Accounts Payable on its Condensed Consolidated Balance Sheets.

The Company believes that its existing resources, including its revolving line of credit facility together with cash expected to be generated from operations and funds expected to be available to it through any necessary equipment financing, will be sufficient to fund its cash flow requirements through at least the next twelve months. However, there can be no assurances that the Company will be able to obtain such financing, or that such financing will be available at favorable terms, if at all.



**Commitments, Contractual Obligations, and Off-balance Sheet Arrangements:**

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The following table summarizes the Company's commitments, contractual obligations, and off-balance sheet arrangements at September 30, 2007, and the effect such obligations are expected to have on its liquidity and cash flow in future periods:

| <b>Payments due in:</b> | <b>Operating Leases</b> | <b>Capital Leases</b> | <b>Term Loans</b> | <b>Mortgages</b> | <b>Debt Interest</b> | <b>Supplemental Retirement Plan</b> | <b>Total</b>  |
|-------------------------|-------------------------|-----------------------|-------------------|------------------|----------------------|-------------------------------------|---------------|
| 2007                    | 440,536                 | 168,252               | 131,643           | 46,967           | 134,140              | 140,146                             | 1,061,684     |
| 2008                    | 1,044,581               | 704,408               | 526,572           | 187,553          | 475,878              | 77,250                              | 3,016,242     |
| 2009                    | 886,801                 | 702,765               | 526,572           | 189,896          | 376,806              | 107,250                             | 2,790,090     |
| 2010                    | 746,059                 | 671,839               | 526,572           | 192,414          | 279,896              | 104,250                             | 2,521,030     |
| 2011 & thereafter       | 1,794,812               | 238,059               | 1,009,260         | 2,213,749        | 802,738              | 482,083                             | 6,540,701     |
|                         | \$ 4,912,789            | \$ 2,485,323          | \$ 2,720,619      | \$ 2,830,579     | \$ 2,069,458         | \$ 910,979                          | \$ 15,929,747 |

Payments on the UDT mortgage note are funded through rent payments made by the Company on the Company's Alabama and Florida facilities.

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 in the year ended December 31, 2006 and through the first nine months of 2007, it cannot guarantee that its operations will generate cash in future periods.

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



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, 2007, 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 4T: CONTROLS AND PROCEDURES**



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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 or 15d-15). Based upon that evaluation, they concluded that the disclosure controls and procedures were effective.

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 controls over financial reporting.

**PART II: OTHER INFORMATION**

**ITEM 1A: RISK FACTORS**





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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 our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 in Part I Item 1A under Risk Factors and in Part II Item 7 under Management's Discussion and Analysis of Financial Condition and Results of Operations. There has been no material change from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 .

### ITEM 6: **EXHIBITS**



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The following exhibits are included herein:

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 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 |

### 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.

November 9, 2007  
Date

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

November 9, 2007  
Date

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

### EXHIBIT INDEX

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| 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 |