

Orchids Paper Products CO /DE  
Form 10-Q  
July 31, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2013**

**OR**

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

**Commission File Number 001-32563**

**Orchids Paper Products Company**

(Exact name of Registrant as Specified in its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**23-2956944**  
(I.R.S. Employer  
Identification No.)

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**4826 Hunt Street**

**Pryor, Oklahoma 74361**

(Address of Principal Executive Offices and Zip Code)

**(918) 825-0616**

(Registrant's Telephone Number, Including Area Code)

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 requirement for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months. Yes ☒ No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Number of shares outstanding of the issuer's Common Stock, par value \$.001 per share, as of July 26, 2013: 7,949,225 shares.

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ORCHIDS PAPER PRODUCTS COMPANY

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	June 30, 2013 (Unaudited)	December 31, 2012
<b>ASSETS</b>		
Current assets:		
Cash	\$ 2,565	\$ 5,734
Accounts receivable, net of allowance of \$120 in 2013 and \$125 in 2012	8,916	5,406
Inventories, net	11,291	10,275
Income taxes receivable	805	607
Short-term investments	5,031	5,027
Prepaid expenses	1,030	637
Other current assets		44
Deferred income taxes	319	393
Total current assets	29,957	28,123
Property, plant and equipment	131,132	125,579
Accumulated depreciation	(38,166)	(34,391)
Net property, plant and equipment	92,966	91,188
Deferred debt issuance costs, net of accumulated amortization of \$14 in 2013 and \$11 in 2012	44	47
Total assets	\$ 122,967	\$ 119,358
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 3,734	\$ 3,685
Accrued liabilities	3,256	2,832
Current portion of long-term debt	1,152	1,152
Total current liabilities	8,142	7,669
Long-term debt, less current portion	14,503	15,079
Deferred income taxes	19,530	19,432
Stockholders' equity:		
Common stock, \$.001 par value, 25,000,000 shares authorized, 7,881,475 and 7,642,475 shares issued and outstanding in 2013 and 2012, respectively	8	8
Additional paid-in capital	43,700	41,238
Retained earnings	37,084	35,932
Total stockholders' equity	80,792	77,178
Total liabilities and stockholders' equity	\$ 122,967	\$ 119,358

See notes to unaudited interim financial statements.

Table of Contents**ORCHIDS PAPER PRODUCTS COMPANY****STATEMENTS OF INCOME****(Dollars in thousands, except share and per share data)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>	<b>(unaudited)</b>	<b>(unaudited)</b>
Net sales	\$ 29,232	\$ 25,279	\$ 55,841	\$ 51,006
Cost of sales	22,236	19,675	42,318	39,269
Gross profit	6,996	5,604	13,523	11,737
Selling, general and administrative expenses	2,517	2,112	4,790	4,399
Operating income	4,479	3,492	8,733	7,338
Interest expense	95	102	188	209
Other (income) expense	(7)	323	(12)	316
Income before income taxes	4,391	3,067	8,557	6,813
Provision for income taxes:				
Current	1,144	613	2,149	2,039
Deferred	104	217	172	15
	1,248	830	2,321	2,054
Net income	\$ 3,143	\$ 2,237	\$ 6,236	\$ 4,759
Net income per common share:				
Basic	\$ 0.40	\$ 0.30	\$ 0.80	\$ 0.63
Diluted	\$ 0.39	\$ 0.29	\$ 0.78	\$ 0.61
Shares used in calculating net income per common share:				
Basic	7,799,496	7,546,901	7,737,269	7,539,798
Diluted	7,983,808	7,843,707	7,914,189	7,842,598
Dividends per share	\$ 0.35	\$ 0.20	\$ 0.65	\$ 0.40

See notes to unaudited interim financial statements.

Table of Contents**ORCHIDS PAPER PRODUCTS COMPANY****STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

	<b>Six Months Ended June 30, 2013 (unaudited)</b>	<b>Six Months Ended June 30, 2012 (unaudited)</b>
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 6,236	\$ 4,759
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,778	3,651
Provision for doubtful accounts	(5)	(20)
Deferred income taxes	172	15
Stock compensation expense	333	291
Loss on disposal of property, plant and equipment		336
Changes in cash due to changes in operating assets and liabilities:		
Accounts receivable	(3,505)	(718)
Inventories	(1,016)	(1,490)
Income taxes receivable	(198)	285
Prepaid expenses	(393)	31
Other current assets	44	338
Accounts payable	49	(15)
Accrued liabilities	424	455
Net cash provided by operating activities	5,919	7,918
<b>Cash Flows From Investing Activities</b>		
Purchases of property, plant and equipment	(5,553)	(3,147)
Purchases of short-term investments	(4)	(3,003)
Net cash used in investing activities	(5,557)	(6,150)
<b>Cash Flows From Financing Activities</b>		
Principal payments on long-term debt	(576)	(576)
Dividends paid to stockholders	(5,083)	(3,018)
Proceeds from the exercise of stock options	1,649	289
Excess tax benefit of stock options exercised	479	5
Net cash used in financing activities	(3,531)	(3,300)
Net decrease in cash	\$ (3,169)	\$ (1,532)
Cash, beginning	5,734	4,297
Cash, ending	\$ 2,565	\$ 2,765
<b>Supplemental Disclosure:</b>		
Interest paid	\$ 187	\$ 208
Income taxes paid	\$ 1,869	\$ 1,660
Tax benefits realized from stock options exercised	\$ 183	\$ 11

See notes to unaudited interim financial statements.





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**ORCHIDS PAPER PRODUCTS COMPANY**

**NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS**

**Note 1 Basis of Presentation**

Orchids Paper Products Company ( Orchids or the Company ) was formed in 1998 to acquire and operate the paper manufacturing facility, built in 1976, in Pryor, Oklahoma. Orchids Acquisition Group, Inc. ( Orchids Acquisition ) was established in November 2003, for the purpose of acquiring the common stock of Orchids. The sale of equity and debt securities closed in March 2004 and Orchids Acquisition Group, Inc. acquired Orchids for a price of \$21.6 million. Orchids Acquisition was subsequently merged into Orchids. In July 2005, the Company completed its initial public offering of its common stock. The Company's stock trades on the NYSE MKT under the ticker symbol TIS.

The accompanying financial statements have been prepared without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted ( GAAP ) in the United States have been condensed or omitted pursuant to the rules and regulations. However, the Company believes that the disclosures made are adequate to make the information presented not misleading when read in conjunction with the audited financial statements and the notes in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, filed with the SEC on March 11, 2013. Management believes that the financial statements contain all adjustments necessary for a fair presentation of the results for the interim periods presented. All adjustments were of a normal, recurring nature. The results of operations for the interim period are not necessarily indicative of the results for the entire fiscal year.

**Note 2 Fair Value Measurements**

The Company does not report any assets or liabilities at fair value in the financial statements. However, the estimated fair value of the Company's short-term investments, which consist of commercial deposits, was \$5,031,000 and \$5,027,000 at June 30, 2013 and December 31, 2012, respectively. These short-term investments are considered Level 1 measurements in the fair value valuation hierarchy. The fair value of the Company's long-term debt is estimated by management to approximate the carrying value of \$15,655,000 and \$16,231,000 at June 30, 2013 and December 31, 2012, respectively. Management's estimates are based on periodic comparisons of the characteristics of the Company's obligations, including floating interest rate, credit rating, maturity and collateral, to current market conditions as stated by an independent third-party financial institution. Such valuation inputs are considered a Level 2 measurement in the fair value valuation hierarchy.

There were no transfers among Level 1, Level 2 or Level 3 assets or liabilities during the first six months in 2013 or 2012.

Table of Contents**ORCHIDS PAPER PRODUCTS COMPANY****NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS (continued)****Note 3 Commitments and Contingencies**

The Company may be involved from time to time in litigation arising from the normal course of business. In management's opinion, as of the date of this report, the Company is not engaged in legal proceedings which individually or in the aggregate are expected to have a materially adverse effect on the Company's results of operations or financial condition.

In October 2008, the Company entered into a contract to purchase 334,000 MMBTU per year of natural gas. This contract has been extended through December 2016 and provides for approximately 60% to 70% of the Company's natural gas requirements through December 31, 2016 as follows:

<b>Period</b>	<b>MMBTUs</b>	<b>Price per MMBTU</b>	<b>Management fee per MMBTU</b>
April 2011 - March 2012	334,207	\$ 6.50	\$ 0.07
April 2012 - March 2013	334,207	\$ 5.50	\$ 0.07
April 2013 - December 2014	556,886	\$ 4.905	\$ 0.07
April 2013 - September 2013	additional 5,000/month	\$ 4.70	\$ 0.07
October 2013 - March 2014	additional 5,000/month	\$ 4.75	\$ 0.07
April 2014 - December 2014	additional 5,000/month	\$ 4.70	\$ 0.07
January 2015 - March 2015	95,900	\$ 4.50	\$ 0.07
April 2015 - June 2015	93,600	\$ 4.30	\$ 0.07
July 2015 - September 2015	92,300	\$ 4.35	\$ 0.07
October 2015 - December 2015	91,900	\$ 4.50	\$ 0.07
January 2016 - March 2016	95,900	\$ 4.53	\$ 0.07
April 2016 - June 2016	93,600	\$ 4.17	\$ 0.07
July 2016 - September 2016	92,300	\$ 4.26	\$ 0.07
October 2016 - December 2016	91,900	\$ 4.42	\$ 0.07

Purchases under the gas contract were \$0.5 million and \$0.4 million for the three months ended June 30, 2013 and 2012, respectively, and \$1.0 million for each of the six-month periods ended June 30, 2013 and 2012, respectively. If the Company is unable to purchase the contracted amounts and the market price at that time is less than the contracted price, the Company would be obligated under the terms of the agreement to reimburse an amount equal to the difference between the contracted amount and the amount actually purchased, multiplied by the difference between the contract price and current spot price.

**Note 4 Inventories**

Inventories at June 30, 2013 and December 31, 2012 were as follows:

	June 30, 2013	December 31, 2012
	(in thousands)	
Raw materials	\$ 3,784	\$ 2,879
Bulk paper rolls	1,780	2,111
Converted finished goods	5,858	5,463
Inventory valuation reserve	(131)	(178)
	\$ 11,291	\$ 10,275

Table of Contents**ORCHIDS PAPER PRODUCTS COMPANY****NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS (continued)****Note 5 Income Taxes**

As of June 30, 2013, our annual effective income tax rate is estimated to be 29.7%. For the quarter ended June 30, 2013, our effective income tax rate was 28.4%. For the six months ended June 30, 2013, our effective income tax rate was 27.1%. This rate differs from the annual effective income tax rate due to recognition of \$222,000 of an Indian employment tax credit ( IEC ) for 2012 during the first quarter of 2013. Recognition of the IEC for 2012 was deferred until the first quarter of 2013 as the American Taxpayer Relief Act of 2012, which extended the IEC, was not signed into law by the President of the United States until 2013. For the quarter and six months ended June 30, 2012, our effective income tax rate was 27.1% and 30.1%, respectively. The estimated annual effective tax rate for 2013 and 2012 is lower than the statutory rate because of manufacturing tax credits, IECs and Oklahoma Investment Tax Credits primarily associated with our investments in a new paper machine in 2006 and new converting warehouse and new converting line that were completed in 2010.

**Note 6 Earnings per Share**

During the first quarter of 2013, the Company granted restricted stock to certain employees. These awards include a nonforfeitable right to receive dividends and therefore are considered to participate in undistributed earnings with common shareholders. Therefore, the Company calculates basic and diluted earnings per common share using the two-class method, under which net earnings are allocated to each class of common stock and participating security. We expect all of the restricted stock will ultimately vest, and therefore, we have not estimated any forfeitures of restricted stock.

The computation of basic and diluted net income per common share for the three-month and six-month periods ended June 30, 2013 and 2012 is as shown in the following table. The presentation of 2012 net income per share has been conformed to presentation under the two-class method.

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Net income - (\$ thousands)	\$ 3,143	\$ 2,237	\$ 6,236	\$ 4,759
Less: distributed earnings allocable to participating securities	(6)		(10)	
Less: undistributed earnings allocable to participating securities	(1)		(2)	
Distributed and undistributed earnings allocable to common shareholders	\$ 3,136	\$ 2,237	\$ 6,224	\$ 4,759
Weighted average shares outstanding	7,799,496	7,546,901	7,737,269	7,539,798
Dilutive effect of stock options	184,312	296,806	176,920	302,800
Weighted average shares outstanding - assuming dilution	7,983,808	7,843,707	7,914,189	7,842,598
Net income per common share:				
Basic	\$ 0.40	\$ 0.30	\$ 0.80	\$ 0.63

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Diluted	\$	0.39	\$	0.29	\$	0.78	\$	0.61
Stock options not considered above because they were anti-dilutive			106,750			37,000		

## **Note 7 Stock Incentive Plan**

In April 2005, the board of directors and the stockholders approved the 2005 Stock Incentive Plan (the Plan). The Plan provides for the granting of stock options and other stock based awards to employees and board members selected by the board's compensation committee. The Plan is authorized to distribute up to 1,097,500 shares.

The Company uses the Black-Scholes option valuation model to estimate the grant date fair value of its options. Option valuation models require the input of highly subjective assumptions including the expected stock price volatility. The following table details the options granted to certain members of the board of directors and management during the six months ended June 30, 2013 and 2012.

May-13	40,000	\$	22.95	\$	5.28	1.87%	43%	5.88%	5 years
May-12	38,500	\$	17.845	\$	4.78	1.70%	44%	4.48%	5 years

The Company expenses the cost of options granted over the vesting period of the option based on the grant-date fair value of the award. The Company recognized expense of \$236,000 and \$215,000 for the three months ended June 30, 2013 and 2012, respectively, and \$285,000 and \$291,000 for the six months ended June 30, 2013 and 2012, respectively, related to options granted under the Plan.

Table of Contents**ORCHIDS PAPER PRODUCTS COMPANY****NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS (continued)**

During the six months ended June 30, 2013, the Company granted 16,000 shares of restricted stock to certain employees under the Plan. These awards were valued at the arithmetic mean of the high and low market price of the Company's stock on the grant date, which was \$21.695 per share, and vest ratably over a 3 year period beginning on the first anniversary of the grant date. The Company expenses the cost of restricted stock granted over the vesting period of the shares based on the grant-date fair value of the award. The Company recognized expense of \$29,000 and \$48,000 for the three and six month periods ended June 30, 2013, respectively, related to the shares granted under the Plan.

**Note 8 Major Customers and Concentration of Credit Risk**

The Company sells its paper production in the form of parent rolls and converted products. Revenues from converted product sales and parent roll sales in the three months and six months ended June 30, 2013 and 2012 were:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(in thousands)</b>		<b>(in thousands)</b>	
Converted product net sales	\$ 27,803	\$ 22,330	\$ 52,411	\$ 45,935
Parent roll net sales	1,429	2,949	3,430	5,071
Net sales	\$ 29,232	\$ 25,279	\$ 55,841	\$ 51,006

Credit risk for the Company in the three months and six months ended June 30, 2013 and 2012 was concentrated in the following customers who each comprised more than 10% of the Company's total net sales:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Converted product customer 1	52%	41%	52%	43%
Converted product customer 2	11%	15%	10%	14%
Converted product customer 3	*	11%	*	11%
Parent roll customer 1	*	11%	*	*
Total percent of net sales	63%	78%	62%	68%

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\* Customer did not account for more than 10% of sales during the period indicated

At June 30, 2013 and December 31, 2012 the four significant customers accounted for the following amounts of the Company's accounts receivable (in thousands):

	June 30, 2013			December 31, 2012	
Converted product customer 1	\$	4,654	52%	\$	1,318 24%
Converted product customer 2	\$	1,439	16%	\$	1,601 30%
Converted product customer 3		*	*	\$	589 11%
Total of accounts receivable	\$	6,093	68%	\$	3,508 65%

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\* Customer did not account for more than 10% of sales during the period indicated

#### Note 9 New Accounting Pronouncements

The Financial Accounting Standards Board ( FASB ) periodically issues new accounting standards in a continuing effort to improve standards of financial accounting and reporting. We have reviewed the recently issued pronouncements and concluded that there are no recently issued accounting pronouncements that the Company has yet to adopt that are expected to have a material effect on the Company's financial position, results of operations or cash flows.

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**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Forward-Looking Information**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. These statements relate to, among other things:

- our business strategy;
- the market opportunity for our products, including expected demand for our products;
- our estimates regarding our capital requirements; and
- any of our other plans, objectives, and intentions contained in this report that are not historical facts.

These statements relate to future events or future financial performance, and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, should, could, expects, plans, intends, anticipates, believes, estimates, potential or continue or the negative of such terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. These statements are only predictions.

You should not place undue reliance on forward-looking statements because they involve known and unknown risks, uncertainties, and other factors that are, in some cases, beyond our control and that could materially affect actual results, levels of activity, performance or achievements. Factors that could materially affect our actual results, levels of activity, performance or achievements include, without limitation, those detailed under the caption Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the SEC on March 11, 2013, and include the following items:

- intense competition in our markets and aggressive pricing by our competitors could force us to decrease our prices and reduce our profitability;
- a substantial percentage of our converted product revenues are attributable to a small number of customers who may decrease or cease purchases at any time;
- disruption in our supply or increase in the cost of fiber;
- increased competition in our region;



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- changes in our retail trade customers' policies and increased dependence on key retailers in developed markets;
- excess supply in the market may reduce our prices;
- the availability of and prices for energy;
- failure to purchase the contracted quantity of natural gas may result in financial exposure;
- our exposure to variable interest rates;
- the loss of key personnel;
- labor interruption;
- natural disaster or other disruption to our facilities;
- ability to finance the capital requirements of our business;
- cost to comply with existing and new laws and regulations;
- failure to maintain an effective system of internal controls necessary to accurately report our financial results and prevent fraud;
- the parent roll market is a commodity market and subject to fluctuations in demand and pricing;
- indebtedness limits our free cash flow and subjects us to restrictive covenants relating to the operation of our business;
- an inability to continue to implement our business strategies; and
- inability to sell the capacity generated from our converting lines.

If any of these risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary significantly from what we projected. Any forward-looking statement you read in the following Management's Discussion and Analysis of Financial Condition and Results of Operations reflects our current views with respect to future events and is subject to the risks listed above and other risks, uncertainties, and assumptions relating to our operations, results of operations, growth strategy, and liquidity. We assume no obligation to publicly update or revise these forward-looking statements for any reason, whether as a result of new information, future events, or otherwise.

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**Overview**

We are an integrated manufacturer of tissue products serving the private label segment of the at-home market. We produce bulk tissue paper, known as parent rolls, and convert parent rolls into finished products, including paper towels, bathroom tissue and paper napkins. We sell any remaining parent rolls to other converters. Our core customer base consists of dollar stores and other discount retailers. By dollar stores, we mean retailers that offer a limited selection across a broad range of products at everyday low prices in a smaller store format. We have focused on the dollar stores (which are also referred to as discount retailers) and the broader discount retail market because of their overall market growth, consistent order patterns and low number of stock keeping units ( SKUs ). The at-home tissue market consists of several quality levels, including a value tier, mid-tier and premium tier. Our historical business strategy has focused on the value tier market, primarily due to the dollar stores concentration of product offerings in that market and, to some extent, limitations of certain manufacturing equipment. As part of our growth strategy, we began to systematically invest in manufacturing assets to improve quality, expand our product offerings and strengthen our position as a low cost manufacturer. This began with the investment in a new paper machine in 2006 which provided the opportunity to produce parent rolls for value tier, mid-tier and premium tier converted products and improved our cost structure. Further, we undertook an expansion project that included the purchase and installation of a new converting line and the construction of a new converted product warehouse in mid-2010. This project had three main objectives: increase the capacity of our converting operation, provide the capability to produce higher-quality mid-tier and premium tier converted products and reduce warehousing costs by centralizing all warehousing and shipping. While we have customers located throughout the United States, most of our products are distributed within an approximate 900-mile radius of our Oklahoma facility. However, our sales efforts are focused on an area within approximately 500 miles of our facility in northeast Oklahoma, which includes Texas, Oklahoma, Kansas, Missouri, Arkansas, Nebraska and Iowa, as we believe this radius maximizes our freight cost advantage over our competitors. Because we are one of the few tissue paper manufacturers in this area, we typically have lower freight costs to our customers distribution centers located in our target region. At-home tissue market growth has historically been closely correlated to population growth and as such, performs well in a variety of economic conditions. Our target region has experienced strong population growth in the past ten years relative to the national average, and these trends are expected to continue.

Our products are sold primarily under our customers private labels and, to a lesser extent, under our brand names such as Colortex®, My Size®, Velvet®, Big Mopper®, Soft & Fluffy®, Tackle®, Noble® and Linen Soft®. All of our converted product revenue is derived through truck load purchase orders from our customers. Parent roll revenue is derived from purchase orders that generally cover a one-month time period. We do not have supply contracts with any of our customers, which is normal practice within our industry. Because our product is a daily consumable item, the order stream from our customer base is fairly consistent with no significant seasonal fluctuations. Changes in the national economy, in general, do not materially affect the market for our converted products.

Our profitability depends on several key factors, including:

- the market price of our product;
- the cost of fiber used in producing paper;
- the efficiency of operations in both our paper mill and converting facility; and
- the cost of energy.

The private label market of the tissue industry is highly competitive, and discount retail customers are extremely price sensitive. As a result, it is difficult to affect price increases. We expect these competitive conditions to continue.

## Background

Since June 2006, when we began operations of a new paper machine, our paper-making capacity of approximately 57,000 tons per year has exceeded the demand requirements of our converting operations. We sell the excess supply into the market in the form of parent rolls. We adjust our paper making production based on our internal converting needs for parent rolls and the open market demand for parent rolls. Parent rolls are a commodity product and thus are subject to market pricing. We plan to continue to sell any excess parent roll capacity on the open market as long as market pricing is profitable. When converting production requirements exceed paper mill capacity, we will purchase bulk rolls in the open market to meet those converting requirements.

Our parent rolls are converted into paper towels, bathroom tissue and napkins in our adjacent converting facility. Our eleven converting lines currently have a total annual estimated capacity of approximately 11.5 million cases of finished tissue products, depending upon the mix of converted products produced, including the product configurations. Our strategy is to sell all of our parent roll capacity as converted products, which generally carry higher margins than parent rolls. To help achieve that goal, we are placing significant focus on improving our sales efforts to sell all of our converting capacity. In addition, we continue to focus considerable efforts to improve our converting efficiencies.

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Our strategy is to expand our position as a low cost provider of high-quality private label tissue products to the growing discount retail channel while leveraging our competitive advantages to increase our presence in the mid-tier and premium tier markets with the discount retail channel as well as other retail channels. This will be accomplished through the expansion of our product offerings through new product development, our continued high service levels and increased total manufacturing capacity.

We are implementing this strategy through our key initiatives set forth below:

- maintain and strengthen our core customer relationships;
- improve the product quality of our higher tier offerings to meet and or exceed customers required attributes;
- increase our flexibility to meet a wider array of customer needs;
- further expand our customer base in other retail channels; and
- continue to improve operating efficiencies and reduce manufacturing costs.

We continue to focus our efforts on growth of our converted product sales and expansion of our product offerings through development of mid-tier and premium tier products. The following graph shows shipments of our mid-tier and premium tier products as a percentage of total cases shipped:

Since our inception in 1998, we have strategically expanded capacity and capability in both paper manufacturing and finished product converting to meet market demand and customers quality requirements. In 2010, we increased our annual converting capacity with the

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installation of a new converting line, which, along with other strategic investments, increased our annual converting capacity to 11.5 million cases per year, depending upon the mix of converted products produced, including the product configurations. This additional converting capacity will enable us to both increase sales of existing products and to provide the flexibility to manufacture higher tier products for sales to our core customer base and into new retail channels.

Although we have an annual estimated converting capacity of approximately 11.5 million cases, our in-house supply of parent rolls provides enough to convert approximately 9.5 million cases. In order to convert at an annual capacity above approximately 9.5 million cases, we would have to supplement our supplies by purchasing parent rolls in the open market, which we believe would have an unfavorable impact on our gross profit margin.

### Comparative Three-Month Periods Ended June 30, 2013 and 2012

#### Net Sales

	<b>Three Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in thousands, except tons)</b>	
Converted product net sales	\$ 27,803	\$ 22,330
Parent roll net sales	1,429	2,949
Net sales	\$ 29,232	\$ 25,279
Converted product tons shipped	13,354	10,901
Parent roll tons shipped	1,364	3,014
Total tons shipped	14,718	13,915

Net sales in the quarter ended June 30, 2013, increased 16% to \$29.2 million, compared to \$25.3 million in the same period of 2012. Net sales figures represent the gross selling price, including freight, less discounts and pricing allowances. The increase in net sales is due to a \$5.5 million increase in net sales of converted product which was partially offset by a \$1.5 million decrease in parent roll net sales.

Net sales of converted product increased in the quarter ended June 30, 2013, by \$5.5 million, or 25%, to \$27.8 million compared to \$22.3 million in the same period last year. The increase in net sales of converted product is primarily the result of a 23% increase in the tonnage shipped and a 2% increase in the net selling price per ton. The increase in converted product tonnage shipped is primarily due to increased sales of our mid and premium tier product lines to both existing and new customers. The increase in net selling price per ton is primarily due to a change in product mix towards the mid and premium tier markets.

Net sales of parent rolls decreased \$1.5 million, or 52%, to \$1.4 million in the quarter ended June 30, 2013, compared to \$2.9 million in the same period last year. Net sales of parent rolls decreased due to the higher requirements by our converting operation resulting in less excess paper available to sell in parent roll form. The higher converting requirements are due to the increased sales of converted product. Tonnage shipments decreased 55%, which was somewhat offset by a 7% increase in the net selling price per ton of parent rolls. The improvement in parent roll net selling prices is due to the stronger parent roll market and market reaction to higher virgin fiber prices.

Table of Contents**Cost of Sales**

	<b>Three Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>(in thousands, except gross profit margin % and paper cost per ton consumed)</b>		
Cost of paper	\$ 10,691	\$ 10,664
Non-paper materials, labor, supplies, etc.	9,664	7,178
Sub-total	20,355	17,842
Depreciation	1,881	1,833
Cost of sales	\$ 22,236	\$ 19,675
Gross profit	\$ 6,996	\$ 5,604
Gross profit margin %	23.9%	22.2%
Total paper cost per ton consumed	\$ 771	\$ 769

The major components of cost of sales are the cost of internally produced paper, raw materials, direct labor and benefits, freight costs of products shipped to customers, insurance, repairs and maintenance, energy, utilities and depreciation.

Cost of sales increased 13% to \$22.2 million, compared to \$19.7 million in the same period of 2012, due to the previously discussed higher net sales amounts. Outside warehousing expense and increased fiber costs due to mix were offset by reduced paper production costs. As a percentage of net sales, cost of sales decreased to 76.1% in the 2013 quarter from 77.8% in the 2012 quarter. Cost of sales as a percentage of net sales for the second quarter of 2013 was favorable to the prior year quarter due to a higher percentage of converted product sales, lower paper production costs and lower recycled fiber costs being partially offset by external warehousing costs.

Our overall cost of paper in the second quarter of 2013 was \$771 per ton, an increase of \$2 per ton compared to the same period in 2012. Paper production costs increased primarily due to a higher percentage of virgin fiber utilized to meet the quality characteristics of our mid and premium tier products which was partially offset by lower maintenance and repair costs and the effects of favorable production rates on fixed cost absorption. Average recycled fiber prices decreased approximately 8% in the second quarter of 2013 compared to the same quarter in 2012, thereby decreasing our cost of sales by approximately \$251,000 in the quarter-over-quarter comparison. Virgin fibers represented approximately 18% of our fiber consumption in the 2013 quarter compared with approximately 1% in the prior year quarter. Maintenance and repair costs in the paper mill were approximately \$246,000 lower in the 2013 quarter than in the prior year quarter.

Excluding the effects of depreciation and external warehousing costs, converting production costs on a per unit basis were flat in the 2013 quarter compared to the 2012 quarter. The Company incurred \$448,000 of outside warehousing expense during the 2013 quarter; costs that were not incurred during the 2012 quarter. As previously discussed, the percentage of our parent roll production sold as converted products increased in the second quarter of 2013 compared to the same quarter last year, which had a positive effect on our gross margin percentage as converted product sales generally generate a higher margin than the sale of parent rolls.

**Gross Profit**

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Gross profit in the quarter ended June 30, 2013, increased \$1.4 million, or 25%, to \$7.0 million compared to \$5.6 million in the same period last year. Gross profit as a percentage of net sales in the 2013 quarter was 23.9% compared to 22.2% in the 2012 quarter. The gross profit increase as a percent of net sales was primarily the result of a higher percentage of converted product sales, lower paper production costs, and lower recycled fiber costs.

**Three Months Ended June 30,**  
**2013** **2012**  
**(in thousands, except SG&A as a % of net sales)**

Commission expense	\$	492	\$	339
Other S,G&A expenses		2,025		1,773
Selling, General & Adm exp	\$	2,517	\$	2,112
SG&A as a % of net sales		8.6%		8.4%

Selling, general and administrative expenses include salaries, commissions to brokers and other miscellaneous expenses. Selling, general and administrative expenses increased \$405,000, or 19%, in the quarter ended June 30, 2013 as compared to the same period in 2012 primarily due to: (i) higher commission expense due to the improved level of converted product sales, (ii) higher artwork and packaging related expenditures, (iii) higher director related fees and expenses, including higher stock option expense resulting from increased options issued and a higher market price of the Company's stock and (iv) higher recruitment and relocation expenses, which were partially offset by lower professional fees. As a percentage of net sales, selling, general and administrative expenses increased to 8.6% in the second quarter of 2013 compared to 8.4% in the same period of 2012.

As a result of the foregoing factors, operating income for the quarter ended June 30, 2013, was \$4.5 million compared to operating income of \$3.5 million for the same period of 2012.

**Three Months Ended June 30,**  
**2013** **2012**  
**(in thousands)**

	(in thousands)			
Interest expense	\$	95	\$	102
Other (income) expense, net	\$	(7)	\$	323
Income before income taxes	\$	4,391	\$	3,067

Interest expense includes interest on all debt and amortization of deferred debt issuance costs. Interest expense decreased \$7,000 to \$95,000 in the quarter ended June 30, 2013, compared to \$102,000 in the quarter ended June 30, 2012. The decrease in interest expense resulted from lower average borrowing levels. Other expense for the quarter ended June 30, 2012 included a loss of approximately \$336,000 due to the disposal of several pieces of converting equipment, including a wrapper and two case packers, following the completion of three capital expenditure projects totaling \$2.1 million during the quarter.



**Income Before Income Taxes**

As a result of the foregoing factors, income before income taxes increased \$1.3 million to \$4.4 million in the quarter ended June 30, 2013, compared to \$3.1 million in the same period in 2012.

**Income Tax Provision**

As of June 30, 2013, we estimate our annual effective income tax rate to be 29.7%. This compares to the 31.1% we estimated as of the end of the first quarter of 2013. As a result, for the quarter ended June 30, 2013, our effective income tax rate was 28.4%, while our effective income tax rate was 27.1% for the quarter ended June 30, 2012. These rates are lower than the statutory rate because of manufacturing tax credits, Indian employment tax credits ( IECs ) and Oklahoma Investment Tax Credits primarily associated with our investments in a new paper machine in 2006 and new converting warehouse and new converting line that were completed in 2010.

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## Comparative Six-Month Periods Ended June 30, 2013 and 2012

### Net Sales

	Six Months Ended June 30,			
	2013		2012	
	(in thousands, except tons)			
Converted product net sales	\$	52,411	\$	45,935
Parent roll net sales		3,430		5,071
Net sales	\$	55,841	\$	51,006
Converted product tons shipped		25,276		22,188
Parent roll tons shipped		3,305		5,196
Total tons shipped		28,581		27,384

Net sales increased 9% to \$55.8 million in the six months ended June 30, 2013, compared to \$51.0 million in the same period of 2012. Net sales figures represent gross selling price, including freight, less discounts and pricing allowances. The increase in net sales is due to a \$6.5 million increase in the sales of converted products being partially offset by a \$1.6 million decrease in the net sales of parent rolls.

Net sales of converted product increased for the six months ended June 30, 2013, by \$6.5 million, or 14%, to \$52.4 million compared to \$45.9 million in the same period last year. The increase in net sales of converted products is the result of a 14% increase in the tons of product shipped. Net selling price remained flat when compared to the same period last year. Sales of new mid and premium tier products to both existing and new customers and increased demand for existing products from current customers were the primary reasons for the increased shipments.

Net sales of parent rolls decreased \$1.6 million, or 32%, to \$3.4 million in the six months ended June 30, 2013, compared to \$5.1 million in the same period last year. Net sales of parent rolls decreased due to a 36% decrease in parent roll tonnage shipped offset by a 6% increase in net selling prices. Higher converting requirements due to increased sales were the primary reason for the decreased parent roll sales, while net selling prices increased for the same reasons cited in the quarterly discussion.

### Cost of Sales

	Six Months Ended June 30,			
	2013		2012	
(in thousands, except gross profit margin % and paper cost per ton consumed)				
Cost of paper	\$	21,211	\$	20,914
Non-paper materials, labor, supplies, etc.		17,333		14,706
Sub-total		38,544		35,620

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Depreciation		3,774		3,649
Cost of sales	\$	42,318	\$	39,269
Gross profit	\$	13,523	\$	11,737
Gross profit margin %		24.2%		23.0%
Total paper cost per ton consumed	\$	751	\$	750

The major components of cost of sales are the cost of internally produced paper, raw materials, direct labor and benefits, freight costs of products shipped to customers, insurance, repairs and maintenance, energy, utilities and depreciation.



**Operating Income**

As a result of the foregoing factors, operating income for the six months ended June 30, 2013 was \$8.7 million compared to operating income of \$7.3 million for the same period of 2012.

Table of Contents**Interest Expense and Other Income**

	Six Months Ended June 30,	
	2013	2012
	(in thousands)	
Interest expense	\$ 188	\$ 209
Other (income) expense, net	\$ (12)	\$ 316
Income before income taxes	\$ 8,557	\$ 6,813

Interest expense decreased by \$21,000 to \$188,000 in the six months ended June 30, 2013, compared to \$209,000 in the same period in the prior year. The decrease was primarily attributable to lower balances of outstanding debt during 2013 due to regular principal payments made in accordance with our credit agreement. Other expense for the six months ended June 30, 2012 included the previously discussed \$336,000 loss related to equipment disposals.

**Income Before Income Taxes**

As a result of the foregoing factors, income before income taxes increased \$1.7 million to \$8.6 million in the six months ended June 30, 2013, compared to \$6.8 million in the same period in 2012.

**Income Tax Provision**

As of June 30, 2013, our annual effective income tax rate is estimated to be 29.7%. For the six months ended June 30, 2013, our effective income tax rate was 27.1%. This rate differs from the annual effective income tax rate due to recognition of \$222,000 of an IEC for 2012 during the first quarter of 2013. Recognition of the IEC for 2012 was deferred until the first quarter of 2013 as the American Taxpayer Relief Act of 2012, which extended the IEC, was not signed into law by the President of the United States until 2013. For the six months ended June 30, 2012, our effective income tax rate was 30.1%. The effective income tax rates for 2013 and 2012 are lower than the statutory rate because of manufacturing credits, IECs and Oklahoma Investment Tax Credits associated with our investments in a new paper machine in 2006, and a new converting warehouse and new converting line completed in 2010.

**Liquidity and Capital Resources**

Liquidity refers to the liquid financial assets available to fund our business operations and pay for near-term obligations. These liquid financial assets consist of cash and short-term investments as well as unused borrowing capacity under our revolving credit facility. Our cash requirements have historically been satisfied through a combination of cash flows from operations and debt financings.

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During the six months ended June 30, 2013, cash decreased \$3.2 million to \$2.6 million at June 30, 2013. During the 2013 period, we incurred \$5.6 million of capital expenditures and paid \$5.1 million in dividends to stockholders.

As of June 30, 2013, total debt outstanding was \$15.7 million. Cash and short-term investments as of June 30, 2013, totaled \$7.6 million, resulting in a net debt level of \$8.1 million. This compares to \$16.2 million in total debt and \$10.8 million in total cash and short-term investments as of December 31, 2012, resulting in a Net Debt level of \$5.5 million. There are no amounts outstanding under our \$18.0 million revolving line of credit.

The following table summarizes key cash flow information for the six-month periods ended June 30, 2013 and 2012:

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in thousands)</b>	
Cash flows provided by (used in):		
Operating activities	\$ 5,919	\$ 7,918
Investing activities	\$ (5,557)	\$ (6,150)
Financing activities	\$ (3,531)	\$ (3,300)

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Cash flows provided by operating activities was \$5.9 million in the six-month period ended June 30, 2013, which primarily resulted from earnings before non-cash charges, which were partially offset by increases in accounts receivable and inventories. The increase in accounts receivable is primarily related to the timing of sales and related cash receipts. The increase in inventories is primarily related to a change in product mix toward mid and premium tier products, which resulted in higher inventories of kraft fiber and the related increased valuation of finished goods inventories.

Cash flows used in investing activities was \$5.6 million in the first six months of 2013 as a result of \$5.6 million in expenditures on capital projects.

Cash flows used in financing activities was \$3.5 million in the six-month period ended June 30, 2013, primarily as a result of \$5.1 million of cash dividends paid to stockholders, which were partially offset by \$2.1 million of proceeds and excess tax benefits from the exercise of stock options. While we expect to continue to declare quarterly dividends, the payment of future dividends is at the discretion of the Board of Directors and the timing and amount of any future dividends will depend upon earnings, cash requirements and financial condition of the Company.

Cash flows provided by operating activities was \$7.9 million in the six-month period ended June 30, 2012, which primarily resulted from earnings before non-cash charges, collection of other receivables and a decrease in accrued liabilities, partially offset by increases in accounts receivable and inventories. The increase in accounts receivable is primarily related to the timing of sales. The increase in inventories is primarily related to a change in product mix toward mid-tier products and lower than anticipated sales levels in June. The increase in accrued liabilities is primarily due to timing.

Cash flows used in investing activities was \$6.1 million in the first six months of 2012 as the result of \$3.1 million in expenditures on capital projects and the purchase of \$3.0 million of short-term investments.

Cash flows used in financing activities was \$3.3 million in the six-month period ended June 30, 2012, primarily as the result of \$3.0 million of cash dividends paid to stockholders.

**Critical Accounting Policies and Estimates**

The preparation of our financial statements and related disclosures in conformity with GAAP in the United States requires management to make estimates and judgments that affect our reported amounts of assets and liabilities, revenue and expense, and related disclosures of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates and assumptions based upon historical experience and various other factors and circumstances. Management believes that our estimates and assumptions are reasonable under the circumstances; however, actual results may vary from these estimates and assumptions under different future circumstances. We have identified the following critical accounting policies that affect the more significant judgments and estimates used in the preparation of our financial statements:



*Accounts Receivable.* Accounts receivable consist of amounts due to us from normal business activities. Our management must make estimates of accounts receivable that will not be collected. We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's creditworthiness as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain an allowance for estimated losses based on historical experience and specific customer collection issues that we have identified. Trade receivables are written-off when all reasonable collection efforts have been exhausted, including, but not limited to, external third-party collection efforts and litigation. While such credit losses have historically been within management's expectations and the provisions established, there can be no assurance that we will continue to experience the same credit loss rates as in the past. During the six-month period ended June 30, 2013, \$35,000 of accounts receivable not expected to be collected were written off against the allowance for doubtful accounts, while the provision was increased \$30,000 based on historical experience and an evaluation of the quality of existing accounts receivable, resulting in a net decrease of \$5,000 in the provision. During the six-month period ended June 30, 2012, no amounts were written off against the allowance for doubtful accounts and the provision was decreased by \$20,000 based on historical experience and an evaluation of the quality of existing accounts receivable, resulting in a net decrease of \$20,000 in the provision. There were no recoveries credited during the first six months of 2013 or 2012.

*Inventory.* Our inventory consists of converted finished goods, bulk paper rolls and raw materials and is stated at the lower of cost or market. Our management regularly reviews inventory quantities on hand and records a provision for excess and obsolete inventory based on the age of the inventory and forecasts of product demand. A significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand. During the first six months of 2013, the inventory allowance was increased \$2,000 based on a specific review of estimated slow moving or obsolete inventory items and was decreased \$49,000 due to actual write-offs of obsolete inventory items, resulting in a net decrease in the allowance of \$47,000. During the first six months of 2012, the inventory allowance was increased \$36,000 based on a specific review of estimated slow moving or obsolete inventory items and was decreased \$40,000 due to actual write-offs of obsolete inventory items, resulting in a net decrease in the allowance of \$4,000.

*Property, plant and equipment.* Significant capital expenditures are required to establish and maintain a paper mill and converting facility. Our property, plant and equipment consists of land, buildings and improvements, machinery and equipment, vehicles, parts and spares and construction-in-process, which are stated at cost, net of accumulated depreciation. Depreciation of property, plant and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Our management regularly reviews estimated useful lives to determine whether any changes are necessary to reflect the related assets' actual productive lives. The lives of our property, plant and equipment currently range from 2.5 to 40 years.

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**New Accounting Pronouncements**

Refer to the discussion of recently adopted/issued accounting pronouncements under Part I, Notes to Unaudited Interim Financial Statements Note 9 New Accounting Pronouncements.

**Non-GAAP Discussion**

In addition to our GAAP results, we also consider non-GAAP measures of our performance for a number of purposes.

We use EBITDA as a supplemental measure of our performance that is not required by, or presented in accordance with GAAP. EBITDA should not be considered as an alternative to net income, operating income or any other performance measure derived in accordance with GAAP, or as an alternative to cash flows from operating activities or a measure of our liquidity.

EBITDA represents net income before net interest expense, income tax expense, depreciation and amortization. Amortization of deferred debt issuance costs is included in net interest expense. We believe EBITDA facilitates operating performance comparisons from period to period and company to company by eliminating potential differences caused by variations in capital structures (affecting relative interest expense), tax positions (such as the impact on periods or companies of changes in effective tax rates or net operating losses) and the age and book depreciation of facilities and equipment (affecting relative depreciation expense).

EBITDA has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for any of our results as reported under GAAP. Some of these limitations are:

- it does not reflect our cash expenditures for capital assets;
- it does not reflect changes in, or cash requirements for, our working capital requirements;
- it does not reflect cash requirements for cash dividend payments;
- it does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments on our indebtedness;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA does not reflect cash requirements for such replacements; and
- other companies, including other companies in our industry, may calculate these measures differently than we do, limiting their usefulness as a comparative measure.

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Because of these limitations, EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business or to reduce our indebtedness. We compensate for these limitations by relying primarily on our GAAP results and using EBITDA on a supplemental basis.

The following table reconciles EBITDA to net income for the three months ended June 30, 2013 and 2012:

	<b>Three Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in thousands, except % of net sales)</b>	
Net income	\$ 3,143	\$ 2,237
Plus: Interest expense, net	95	102
Plus: Income tax expense	1,248	830
Plus: Depreciation	1,881	1,833
EBITDA	\$ 6,367	\$ 5,002
% of net sales	21.8%	19.8%

EBITDA increased \$1.4 million to \$6.4 million in the quarter ended June 30, 2013, compared to \$5.0 million in the same period in 2012.

EBITDA as a percent of net sales increased to 21.8% in the second quarter of 2013 from 19.8% in the second quarter of 2012. The foregoing factors discussed in the net sales, cost of sales and selling, general and administrative expenses sections are the reasons for the increase.

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The following table reconciles EBITDA to net income for the six months ended June 30, 2013 and 2012:

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in thousands, except % of net sales)</b>	
Net income	\$ 6,236	\$ 4,759
Plus: Interest expense, net	188	209
Plus: Income tax expense	2,321	2,054
Plus: Depreciation	3,774	3,649
EBITDA	\$ 12,519	\$ 10,671
% of net sales	22.4%	20.9%

EBITDA increased \$1.8 million to \$12.5 million in the six months ended June 30, 2013, compared to \$10.7 million in the same period of 2012. EBITDA as a percent of net sales increased to 22.4% in the current six-month period from 20.9% in the prior year six-month period. The foregoing factors discussed in the net sales, cost of sales and selling, general and administrative sections are the reasons for these changes.

We use Net Debt as a supplemental measure of our leverage that is not required by, or presented in accordance with GAAP. Net Debt should not be considered as an alternative to total debt, total liabilities or any other performance measure derived in accordance with GAAP. Net Debt represents total debt reduced by cash and short-term investments. We use this figure as a means to evaluate our ability to repay our indebtedness and to measure the risk of our financial structure.

Net Debt represents the amount that cash and short-term investments is less than total debt of the Company. The amounts included in the Net Debt calculation are derived from amounts included in the historical Balance Sheets. We have reported Net Debt because we regularly review Net Debt as a measure of the Company's leverage. However, the Net Debt measure presented in this document may not be comparable to similarly titled measures reported by other companies due to differences in the components of the calculation.

Net Debt increased from \$5.5 million on December 31, 2012, to \$8.1 million on June 30, 2013, as a result of a decrease in total debt being more than offset by a decrease in our total cash and short-term investments. The decrease in total debt is due to the required principal payments of our debt. The decrease in the total cash and short-term investment balances is due to cash received from operating activities being more than offset by capital expenditures and dividends paid to stockholders.

The following table presents Net Debt as of June 30, 2013, and December 31, 2012:

	<b>As of</b>	
	<b>June 30,</b>	<b>December 31,</b>
	<b>2013</b>	<b>2012</b>
	<b>(in thousands)</b>	
Current portion long-term debt	\$ 1,152	\$ 1,152
Long-term debt	14,503	15,079
Total debt	15,655	16,231

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Less: Cash	(2,565)	(5,734)
Less: Short-term investments	(5,031)	(5,027)
Net debt	\$ 8,059	\$ 5,470

**ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

There has been no material change in the information provided in response to Item 7A of the Company's Form 10-K for the year ended December 31, 2012.

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**ITEM 4. Controls and Procedures**

Our management, under the supervision and with the participation of our chief executive officer and our chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended), as of the end of the period covered by this Quarterly Report on Form 10-Q. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Based on such evaluation, our chief executive officer and our chief financial officer have concluded that our disclosure controls and procedures were effective as of June 30, 2013.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended June 30, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

In management's opinion, as of the date of this report, the Company is not engaged in legal proceedings which individually or in the aggregate are expected to have a materially adverse effect on the Company's results of operations or financial condition. Further, management is not aware that any such proceedings are being contemplated or threatened.

**ITEM 1A. Risk Factors**

As of the date of this filing, there have been no material changes from the risk factors disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012 as filed with the SEC on March 11, 2013. We operate in a changing environment that involves numerous known and unknown risks and uncertainties that could materially affect our operations. The risks, uncertainties and other factors set forth in our Annual Report on Form 10-K may cause our actual results, performances and achievements to be materially different from those expressed or implied by our forward-looking statements. If any of these risks or events occur, our business, financial condition or results of operations may be adversely affected.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

*(a) Unregistered Sales of Equity Securities*

None.

*(b) Initial Public Offering and Use of Proceeds from the Sale of Registered Securities*

None.

*(c) Repurchases of Equity Securities*

We do not have any programs to repurchase shares of our common stock and no such repurchases were made during the three or six months ended June 30, 2013.

**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Mine Safety Disclosures**

Not applicable.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

See the Exhibit Index following the signature page to this Form 10-Q, which Exhibit Index is hereby incorporated by reference herein.

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**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.

**ORCHIDS PAPER PRODUCTS COMPANY**

Date: July 31, 2013

By: /s/ Keith R. Schroeder  
Keith R. Schroeder  
Chief Financial Officer  
(On behalf of the registrant and as Chief Accounting Officer)



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**Exhibit Index**

<b>Exhibit</b>	<b>Description</b>
3.1	As amended copy of Amended and Restated Certificate of Incorporation of the Registrant dated April 14, 2005, incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement on Form S-1 (SEC Accession No. 0000950137-05-004608) filed with the SEC on April 19, 2005, which was amended by that Certificate of Amendment to Amended and Restated Certificate of Incorporation of the Registrant dated June 19, 2007, incorporated by reference to Exhibit 3.1.1. to the Registrant's Form 10-Q (SEC Accession No. 0000950137-07-012340) filed with the SEC on August 14, 2007; and which was further amended by that Certificate of Amendment to Amended and Restated Certificate of Incorporation of the Registrant dated May 17, 2013, incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K (SEC Accession No. 0001144204-13-030242) filed with the SEC on May 17, 2013.
3.2	As amended copy of Amended and Restated Bylaws of the Registrant effective April 14, 2005, incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-1 (SEC Accession No. 0000950137-05-004608) filed with the SEC on April 19, 2005, which was amended by that Amendment to Amended and Restated Bylaws of the Registrant, incorporated by reference to Exhibit 3.2 to the Registrant's Form 8-K (SEC Accession No. 0001144204-13-030242) filed with the SEC on May 17, 2013.
31.1	Certification of Chief Executive Officer Pursuant to Section 302.
31.2	Certification of Chief Financial Officer Pursuant to Section 302.
32.1	Certification of Chief Executive Officer Pursuant to Section 906.
32.2	Certification of Chief Financial Officer Pursuant to Section 906.
101	The following financial information from Orchids Paper Products Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Statements of Income for the three months ended June 30, 2013 and 2012 and the six months ended June 30, 2013 and 2012, (ii) Balance Sheets as of June 30, 2013 and December 31, 2012, (iii) Statements of Cash Flows for the six months ended June 30, 2013 and 2012, and (iv) Notes to Unaudited Interim Financial Statements.