

UFP TECHNOLOGIES INC  
Form 10-K  
March 27, 2007

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-K

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

For the fiscal year ended December 31, 2006

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**

(State or other jurisdiction of incorporation or organization)

**04-2314970**

(I.R.S. Employer Identification No.)

**172 East Main Street, Georgetown,  
Massachusetts USA**

(Address of principal executive offices)

**01833-2107**

(Zip Code)

**(978) 352-2200**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.01 par value per share	The NASDAQ Stock Market L.L.C.
Preferred Share Purchase Rights	The NASDAQ Stock Market L.L.C.
Securities registered pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-K

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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.

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

As of June 30, 2006, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$20,646,007, based on the closing price of \$6.01 on that date as reported on the Nasdaq Capital Market.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at February 28, 2007
Common Stock, \$0.01 par value per share	5,186,593 shares

### DOCUMENTS INCORPORATED BY REFERENCE

Document	Parts Into Which Incorporated
Portions of the registrant's Proxy Statement involving the election of directors at the registrant's 2006 annual meeting of stockholders, which is expected to be filed within 120 days after the end of the registrant's fiscal year.	Part III

**PART I**

This report contains certain statements that are forward-looking statements as that term is defined under the Private Securities Litigation Reform Act of 1995 (the Act ) and releases issued by the Securities and Exchange Commission. The words believe, expect, anticipate, intend, 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. 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.

Examples of these risks, uncertainties, and other factors include, without limitation, the following: (i) economic conditions that affect sales of the products of the Company s packaging customers, (ii) actions by the Company s competitors and the ability of the Company to respond to such actions, (iii) the ability of UFP Technologies, Inc. (the Company or UFPT ) to obtain new customers and (iv) the ability of the Company to fulfill its obligations on long-term contracts, and (v) the ability of the Company to execute and integrate favorable acquisitions. 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 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. 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.

**ITEM 1. BUSINESS**

The Company s principal executive offices are located at 172 East Main Street, Georgetown, Massachusetts 01833; telephone number 978-352-2200; corporate web site www.ufpt.com. We make available through our website, our annual report on Form 10-K, current reports on Form 10-Q and Form 8-K, and amendments to these reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934 as soon as practicable after we electronically file such material with, or furnish it to the Securities and Exchange Commission. The information found on our website is not part of this or any other report we file with or furnish to the SEC.

The Company designs and manufactures engineered packaging solutions utilizing molded fiber, vacuumformed plastics, and molded and fabricated foam plastic products. The Company also designs and manufactures engineered component products using laminating, molding, and fabricating technologies. The Company serves a myriad of manufacturing sectors, but specifically targets opportunities in the automotive, computer and electronics, medical, aerospace and defense, industrial, and consumer markets.

The Company s high-performance cushion packaging products are made primarily from polyethylene and polyurethane foams, and a wide range of sheet plastics. These products are custom designed and fabricated or molded to provide protection for fragile and valuable items, and are sold primarily to original equipment and component manufacturers. Molded fiber products are made primarily from 100% recycled paper principally derived from waste newspaper. These products are custom designed, engineered and molded into shapes for

packaging high volume consumer goods, including computer components, medical devices, other light electronics, scented candles, and health and beauty products.

In addition to packaging products, the Company fabricates and molds component products made from cross-linked polyethylene foam and other materials. The Company also laminates fabrics and other materials to cross-linked polyethylene foams, polyurethane foams and other substrates. The Company's component products include automotive interior trim, athletic and industrial safety belts, components for medical diagnostic equipment, nail files and other beauty aids, and shock absorbing inserts used in athletic and leisure footwear.

Unless the context otherwise requires, the term "Company" or "UFPT" refers to UFP Technologies, Inc. and its wholly-owned subsidiaries: Moulded Fibre Technology, Inc. ("MFT"), Simco Technologies, Inc. and Simco Automotive Trim, Inc. (collectively "Simco"), and United Development Company Limited, of which the Company owns 26.32%.

## Market Overview

### Packaging Products

The interior cushion packaging market is characterized by three primary sectors: (1) custom fabricated or molded products for low volume, high fragility products; (2) molded or die-cut products for high volume, industrial and consumer goods; and (3) loose fill and commodity packaging materials for products which do not require custom-designed packaging. Packaging products are used to contain, display and/or protect their contents during shipment, handling, storage, marketing, and use. The Company serves both the low volume, high fragility market and the high volume industrial and consumer market with a range of product offerings, but does not materially serve the commodity packaging market.

The low volume, high fragility market is generally characterized by annual production volumes of less than 50,000 pieces. Typical goods in this market include precision instruments, medical devices, sensitive electronic components, and other high value industrial products that are very sensitive to shock, vibration, and other damage that may occur during shipment and distribution. The principal materials used to package these goods include polyethylene and polyurethane foams, foam-in-place polyurethane, and molded expanded polystyrene. Polyurethane foams and polyethylene foams have high shock absorbency, high resiliency, and vibration damping characteristics.

The higher volume consumer packaging market is generally characterized by annual production volumes in excess of 50,000 pieces. Typical goods in this market include toys, light electronics, computers and computer peripherals, stereo equipment, and small appliances. These goods generally do not require as high a level of shock and vibration protection as goods in the low volume, high fragility market. The principal materials used to package these goods include various molded, rigid and foamed plastics, such as expanded polystyrene foam (EPS), vacuum-formed polystyrene (PS) and polyvinyl chloride (PVC), and corrugated die-cut inserts, which generally are less protective and less expensive than resilient foams and molded fiber.

2

---

### **Component Products**

Component applications of foam and other types of plastics are numerous and diverse. Examples include automotive interior components, medical devices, toys, gaskets, health and beauty products, and carrying cases. Cross-linked polyethylene foams have many of the same properties as traditional polyethylene foams, including light weight, durability, resiliency and flexibility. Cross-linked foams have many advantages over traditional foams, including the ability to be thermoformed (molded), availability in vibrant colors, a fine cell structure providing improved esthetics and lower abrasiveness, and enhanced resistance to chemicals and ultraviolet light. Certain grades of cross-linked foams can be radiation sterilized and have been approved by the U.S. Food and Drug Administration for open wound skin contact.

Cross-linked foam can be combined with other materials to increase product applications and market applications. For example, cross-linked foams can be laminated to fabrics to produce light weight, flexible and durable insoles for athletic and walking shoes, weight lifting and industrial safety belts, gun holsters, backpacks, and other products for the leisure, athletic and retail markets. The Company believes that, as a result of their many advantages, cross-linked foam and cross-linked foam laminated products are being used in a wide range of markets as substitutes for traditional rubber, leather and other product material alternatives.

### **Regulatory Climate**

The packaging industry has been subject to user, industry, and legislative pressure to develop environmentally responsible packaging alternatives that reduce, reuse and recycle packaging materials. Government authorities have enacted legislation relating to source reduction, specific product bans, recycled content, recyclability requirements and green marketing restrictions.

In order to provide packaging that complies with all regulations regardless of a product's destination, manufacturers seek packaging materials that meet both environmentally related demands and performance specifications. Some packaging manufacturers have responded by: reducing product volume and ultimate waste product disposal through reengineering traditional packaging products; adopting new manufacturing processes; participating in recovery and reuse systems for resilient materials that are inherently reusable; creating programs to recycle packaging following its useful life; and developing materials that use a high percentage of recycled content in their manufacture.

### **Products**

The Company's products include foam, plastic, and fiber packaging products, and component products.

### **Packaging Products**

The Company designs, manufactures and markets a broad range of packaging products primarily using polyethylene, polyurethane and cross-linked polyethylene foams and rigid plastics. These products are custom designed and fabricated or molded to provide protection for less durable, higher value items, and are primarily sold to original equipment and component manufacturers. Examples of the Company's packaging products include end-cap packs for computers, corner blocks for telecommunications consoles, anti-static foam packs for printed circuit boards, die-cut

or routed inserts for attaché cases and plastic trays for medical devices and components. Markets for these products are typically characterized by lower to moderate volumes where performance, such as shock absorbency and vibration damping, is valued.

The Company's engineering personnel collaborate directly with customers to study and evaluate specific customer requirements. Based on the results of this evaluation, packaging products are engineered to customer specifications using various types and densities of materials with the goal of providing the desired protection for the lowest cost and with the lowest physical package volume. The Company believes that its engineering expertise and breadth of product and manufacturing capabilities have enabled it to provide unique solutions to achieve these goals.

The markets for the Company's molded fiber packaging and vacuum-formed trays are characterized by high volume production runs and require rapid manufacturing turnaround times. Raw materials used in the manufacture of molded fiber are primarily recycled newspaper, a variety of other grades of recycled paper and water. Raw materials used in vacuum-formed plastics include polystyrene (PS) and polyvinyl chloride (PVC). These products compete with expanded polystyrene (EPS) and manually assembled corrugated die-cut inserts.

The Company's molded fiber products provide customers with packaging solutions that are more responsive to stringent environmental packaging regulations worldwide and meet the demands of environmentally-aware consumers, while simultaneously meeting customer cost and performance objectives.

### **Component Products**

The Company specializes in engineered products that use the Company's close tolerance manufacturing capabilities and its expertise in various foam materials and lamination techniques, and the Company's ability to manufacture in clean room environments. The Company's component products are sold primarily to customers in the automotive, sporting goods, medical, beauty, leisure and footwear industries. These products include interior trim parts for automobiles and medical diagnostic equipment, abrasive nail files and anti-fatigue mats, and shock absorbing inserts used in athletic and leisure footwear.

The Company believes that it is one of the largest purchasers of cross-linked foam in the United States and as a result it has been able to establish important relationships with the relatively small number of suppliers of this product. Through its strong relationships with cross-linked foam suppliers, the Company believes that it is able to offer customers a wide range of cross-linked foam products.

The Company benefits from its ability to custom design its own proprietary manufacturing equipment in conjunction with its machinery suppliers. For example, the Company has custom designed its own lamination machines allowing the Company to achieve adhesive bonds between cross-linked foam and fabric and other materials that do not easily combine. These specialty laminates typically command higher prices than traditional foam products.

### **Marketing and Sales**

The Company markets and sells its packaging and specialty products in the United States principally through direct regional sales forces comprised of skilled engineers. The Company

also uses independent manufacturer representatives to sell its products. The Company's sales engineers collaborate with customers and the Company's design and manufacturing experts to develop custom engineered solutions on a cost-effective basis. The Company also markets its products through attendance by in-house market specialists at trade shows and expositions. The Company markets a line of products to the health and beauty industry, primarily through distributors. The Company believes that its sales are somewhat seasonal, with increased sales in the second and fourth quarters.

The top two customers in the Company's Component Products segment, Recticel Interiors North America and Inalfa Roof Systems, comprise 30% and 11%, respectively, of that segment's total sales and 18% and 7%, respectively, of the Company's total sales for the year ended December 31, 2006. The loss of Recticel or Inalfa as a customer would have a material adverse effect on the Company. No one customer accounted for more than 10% of the Packaging segment sales for the year ended December 31, 2006.

### **Manufacturing**

The Company's manufacturing operations consist primarily of cutting, molding, vacuum forming, laminating and assembly. For custom molded foam products, the Company's skilled engineering personnel analyze specific customer requirements to design and build prototype products to determine product functionality. Upon customer approval, prototypes are converted to final designs for commercial production runs.

Molded cross-linked foam products are produced in a thermoforming process using heat, pressure, and precision metal tooling.

Cushion foam packaging products that do not utilize cross-linked foam are fabricated by cutting shapes from blocks of foam using specialized cutting tools, routers, waterjets, and hot wire equipment and assembling these shapes into the final product using a variety of foam welding or gluing techniques. Products can be used on a stand-alone basis or bonded to another foam product or other material such as a corrugated medium.

Laminated products are produced through a process whereby the foam medium is heated to the melting point. The heated foam is then typically bonded to a non-foam material through the application of mechanical pressure.

Molded fiber products are manufactured by vacuum forming a pulp of recycled or virgin paper materials onto custom engineered molds. With the application of vacuum and air, the molded parts are pressed and transferred to an in-line conveyORIZED dryer, from which they exit ready for packing or subsequent value added operations.

The Company does not manufacture any of the raw materials used in its products. With the exception of certain grades of cross-linked foam, these raw materials are available from multiple supply sources. Although the Company relies upon a limited number of suppliers for cross-linked foam, the Company's relationships with such suppliers are good, and the Company expects that these suppliers will be able to meet the Company's requirements for cross-linked foam. Any delay or interruption in the supply of raw materials could have a material adverse effect on the Company's business.

## Research and Development

The Company's engineering personnel continually explore design and manufacturing techniques as well as new innovative materials to meet the unique demands and specifications of its customers. In addition, the Company regularly undertakes customer-initiated engineering feasibility studies for which the Company is generally compensated regardless of whether such projects result in commercial production contracts. Because the Company's products tend to have relatively short life cycles, research and development is an integral part of the Company's ongoing cost structure.

## Competition

The packaging products industry is highly competitive. While there are several national companies that sell interior packaging, the Company's primary competition to date for its packaging products has been from smaller independent regional manufacturing companies. These companies generally market their products in specific geographic areas from neighboring facilities. In addition, the Company's foam and fiber packaging products compete against products made from alternative materials, including expanded polystyrene foams, die-cut corrugated, plastic peanuts, plastic bubbles and foam-in-place urethane.

The component products industry is highly competitive. The Company's component products face competition primarily from smaller companies that typically concentrate on production of component products for specific industries. The Company expects that additional companies will enter the market as it expands. The Company believes that its access to a wide variety of materials, its engineering expertise, its ability to combine foams with other materials such as plastics and laminates, and its ability to manufacture products in a clean room environment will enable it to continue to compete effectively in the engineered component products market. The Company's component products also compete with products made from a wide range of other materials, including rubber, leather and other foams.

The Company believes that its customers typically select vendors based on price, product performance, product reliability and customer service. The Company believes that it is able to compete effectively with respect to these factors in each of its targeted markets.

## Patents and Other Proprietary Rights

The Company relies upon trade secret, patents, and trademarks to protect its technology and proprietary rights. The Company believes that the improvement of existing products, reliance upon trade secrets and unpatented proprietary know-how, and the development of new products are generally as important as patent protection in establishing and maintaining a competitive advantage. Nevertheless, the Company has obtained patents and may continue to make efforts to obtain patents, when available, although there can be no assurance that any patent obtained will provide substantial protection or be of commercial benefit to the Company, or that its validity will be upheld if challenged.

The Company has four U.S. patents relating to its molded fiber technology (including certain proprietary machine designs), and has patents with respect to such technology in certain foreign countries. The Company also has a total of twelve U.S. patents relating to technologies including foam and packaging, rubber mat, patterned nail file, and superforming process technologies.

There can be no assurance that any patent or patent application of the Company will provide significant protection for the Company's products and technology, or will not be challenged or circumvented by others. The expiration dates for the Company's patents range from 2008 through 2024.

### **Environmental Considerations**

In addition to offering molded fiber packaging products made from recycled paper derived primarily from post-consumer newspaper waste, the Company actively promotes its philosophy of reducing product volume and resulting post-user product waste. The Company designs products to provide optimum performance with minimum material. In addition, the Company actively participates in a recovery and reuse program for certain of its plastic packaging products. The Company is aware of public support for environmentally responsible packaging and other products. Future government action may impose restrictions affecting the industry in which the Company operates. There can be no assurance that any such action will not adversely impact the Company's products and business.

### **Backlog**

The Company's backlog, as of February 16, 2007 and February 17, 2006, totaled approximately \$7.1 million and \$6.4 million, respectively, for the Packaging segment, and \$25.3 million and \$23.6 million, respectively, for the Component Products segment. The backlog consists of purchase orders for which a delivery schedule within the next twelve months has been specified by customers. Orders included in the backlog may be canceled or rescheduled by customers without significant penalty. The backlog as of any particular date should not be relied upon as indicative of the Company's revenues for any period.

### **Employees**

As of February 8, 2007, the Company had a total of 531 full-time employees (as compared to 533 full-time employees as of February 8, 2006), with 274 full-time employees in the Component Products segment (13 in engineering, 219 in manufacturing operations, 16 in marketing, sales and support services, and 26 in general and administration) and 257 full-time employees in the Packaging segment (12 in engineering, 206 in manufacturing, 21 in marketing, sales and support services, and 18 in general and administration). The Company is not a party to any collective bargaining agreement. The Company considers its employee relations to be good.

## **ITEM 1A.**

# **RISK FACTORS**

You should carefully consider the risks described below and the other information in this report before deciding to invest in shares of our common stock. These are the risks and uncertainties we believe are most important for you to consider. Additional risks and uncertainties not presently known to us, which we currently deem immaterial or which are similar to those faced by other companies in our industry or business in general, may also impair our business operations. If any of the following risks or uncertainties actually occurs, our business, financial condition and operating results would likely suffer. In that event, the market price of our common stock could decline and you could lose all or part of your investment.

7

---

**We depend on a small number of customers for a large percentage of our revenues. The loss of any single customer, or a reduction in sales to any such customer, could have a material adverse effect on our business, financial condition and results of operations.**

A limited number of customers typically represent a significant percentage of our revenues in any given year. Our top ten customers based on revenues represented, in the aggregate, approximately 44% and 46% in 2006 and 2005, respectively, of our total revenues. For example, during the fourth quarter of 2004, we launched our new \$95 million automotive program. This program accounted for approximately 30% and 26%, respectively, of our Component Products segment's sales and approximately 18% and 15%, respectively, of our total sales in 2006 and 2005. Based on our current sales forecasts, we expect this program to account for significant portions of our overall sales over the next 5 to 6 years. However, we cannot guarantee that we will realize the full potential value of this program. The program relies upon a contract that is terminable by the customer for any reason, subject to a cancellation charge. If the customer's needs decrease over the course of the contract, our estimated revenues from this contract may also decrease. Even if we generate revenue from the project, we cannot guarantee that the project will be profitable, particularly if revenues from the contract are less than expected. Moreover, automotive suppliers like this customer often take advantage of lower volume in the summer to shut down production to service machinery and tools, typically during a portion of the month of July. We expect this practice to continue. This could cause our quarterly operating results to fluctuate and have a material adverse effect on our business and financial results. Our revenues are directly dependent on the ability of our customers, to develop, market, and sell their products in a timely, cost-effective manner. The loss of a significant portion of our expected future sales to any of our large customers would, and a material adverse change in the financial condition of any of these customers could, have a material adverse effect on our business, financial condition and financial results.

**Fluctuations in the supply of components and raw materials we use in manufacturing our products could cause production delays or reductions in the number of products we manufacture, which could materially adversely affect our business, financial condition and results of operations.**

Our business is subject to the risk of periodic shortages of raw materials. We purchase raw materials pursuant to purchase orders placed from time to time in the ordinary course of business. Failure or delay by such suppliers in supplying us necessary raw materials could adversely affect our ability to manufacture and deliver products on a timely and competitive basis.

While we believe that we may, in certain circumstances, secure alternative sources of these materials, we may incur substantial delays and significant expense in doing so, the quality and reliability of alternative sources may not be the same and our operating results may be materially adversely affected. Alternative suppliers might charge significantly higher prices for materials than we currently pay. Under such circumstances, the disruption to our business could have a material adverse impact on our customer relationships, business, financial condition and results of operations.

**Reductions in the availability of energy supplies or an increase in energy costs may increase our operating costs.**

We use electricity and natural gas at our manufacturing facilities and to operate our equipment. Over the past three years, prices for electricity and natural gas have fluctuated significantly. An outbreak or escalation of hostilities between the United States and any foreign power and, in particular, a prolonged armed conflict in the Middle East, or a natural disaster such as the recent hurricanes and related flooding in the oil producing region of the Gulf Coast of the United States, could result in a real or perceived shortage of petroleum and/or natural gas, which could result in an increase in the cost of electricity or energy generally as well as an increase in cost of our raw materials, of which many are petroleum based. In addition, increased energy costs negatively impact our freight costs due to higher fuel prices. Future limitations on the availability or consumption of petroleum products and/or an increase in energy costs, particularly electricity for plant operations, could have a material adverse effect upon our business and results of operations.

**Our Packaging segment may lose business if our customers shift their manufacturing offshore.**

Historically, geography has played a large factor in the packaging business. Manufacturing and other companies shipping products typically buy packaging from companies that are relatively close to their manufacturing facilities to increase shipping efficiency and decrease costs. As many U.S. companies move their manufacturing operations overseas, particularly to the Far East, the associated packaging business often follows. We have in the past and may in the future lose customers as a result of customers moving their manufacturing facilities offshore and then hiring our competitors that operate packaging-production facilities that are perceived to be more territorially advantageous. As a result, our sales may suffer, which could have a materially adverse effect upon our business and results of operations.

**Failure to retain key personnel could impair our ability to execute our business strategy.**

The continuing service of our executive officers and essential engineering, technical and management personnel, together with our ability to attract and retain such personnel, is an important factor in our continuing ability to execute our strategy. There is substantial competition to attract such employees and the loss of any such key employees could have a material adverse effect on our business and operating results. The same could be true if we were to experience a high turnover rate among engineering and technical personnel and we were unable to replace them.

**Members of our board of directors and management who also are our stockholders exert significant influence over us.**

Based on information made available to us, we believe that our executive officers, directors and their affiliates collectively beneficially own approximately 32% of our outstanding shares of common stock as of June 30, 2006. As a result, those stockholders may, if acting together, control or exert substantial influence over actions requiring stockholders' approval, including elections of our directors, amendments to our certificate of incorporation, mergers, sales of assets or other business acquisitions or dispositions.

**If we do not generate sufficient cash flow from operations, we may be unable to service our debt obligations.**

We have established a credit facility with a commercial lender, under which approximately \$5.3 million was outstanding as of December 31, 2006. If we are unable to generate sufficient cash flow from operations in the future, we may be unable to pay principal or interest on our borrowings when due and may be required to refinance all or a portion of our existing debt or to obtain additional financing. We cannot guarantee that we could obtain any additional financing on favorable terms, if at all.

**We may pursue acquisitions or joint ventures that involve inherent risks, any of which may cause us not to realize anticipated benefits.**

Our business strategy includes the potential acquisition of businesses and entering into joint ventures and other business combinations that we expect will complement and expand our business. We may not be able to successfully identify suitable acquisition or joint venture opportunities or complete any particular acquisition, combination, joint venture or other transaction on acceptable terms. Our identification of suitable acquisition candidates and joint venture opportunities involves risks inherent in assessing the values, strengths, weaknesses, risks and profitability of these opportunities including their effects on our business, diversion of our management's attention and risks associated with unanticipated problems or unforeseen liabilities. If we are successful in pursuing future acquisitions or joint ventures, we may be required to expend significant funds, incur additional debt or issue additional securities, which may materially adversely affect our results of operations and be dilutive to our stockholders. If we spend significant funds or incur additional debt, our ability to obtain financing for working capital or other purposes could decline and we may be more vulnerable to economic downturns and competitive pressures. In addition, we cannot guarantee that we will be able to finance additional acquisitions or that we will realize any anticipated benefits from acquisitions or joint ventures that we complete. Should we successfully acquire another business, the process of integrating acquired operations into our existing operations may result in unforeseen operating difficulties and may require significant financial resources that would otherwise be available for the ongoing development or expansion of our existing business. Our failure to identify suitable acquisition or joint venture opportunities may restrict our ability to grow our business.

**As a public company, we need to comply with the reporting obligations of the Securities Exchange Act of 1934 and Section 404 of the Sarbanes-Oxley Act of 2002. If we fail to comply with the reporting obligations of the Exchange Act and Section 404 of the Sarbanes-Oxley Act, or if we fail to achieve and maintain adequate internal controls over financial reporting, our business, results of operations and financial condition, and investors' confidence in us, could be materially adversely affected.**

As a public company, we are required to comply with the periodic reporting obligations of the Exchange Act, including preparing annual reports, quarterly reports and current reports. Our failure to prepare and disclose this information in a timely manner could subject us to penalties under federal securities laws, expose us to lawsuits and restrict our ability to access financing. In addition, we will be required under applicable law and regulations to integrate our systems of internal controls over financial reporting. We plan to evaluate our existing internal controls with respect to the standards adopted by the Public Company Accounting Oversight Board. During the course of our evaluation, we may identify areas requiring improvement and may be required

to design enhanced processes and controls to address issues identified through this review. This could result in significant delays and cost to us and require us to divert substantial resources, including management time, from other activities. If we fail to achieve and maintain the adequacy of our internal controls, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with the Sarbanes-Oxley Act. Moreover, effective internal controls are necessary for us to produce reliable financial reports and are important to help prevent fraud.

**Provisions of our corporate charter documents, Delaware law and our stockholder rights plan may dissuade potential acquirers, prevent the replacement or removal of our current management and may thereby affect the price of our common stock.**

The board of directors has the authority to issue up to 1,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares, without any further vote or action by the stockholders. The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock, while providing flexibility in connection with possible financings, acquisitions and other corporate purposes, could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock. We have no present plans to issue shares of preferred stock. Further, certain provisions of our certificate of incorporation and bylaws and of Delaware law could delay or make more difficult a merger, tender offer or proxy contest involving us.

We also have a stockholder rights plan, which is designed to protect and maximize the value of our outstanding equity interests in the event of an unsolicited attempt to acquire us in a manner or on terms not approved by the board of directors and that prevent stockholders from realizing the full value of their shares of our common stock. Its purposes are to deter those takeover attempts that the board believes are undesirable, to give the board more time to evaluate takeover proposals and consider alternatives, and to increase the board's negotiating position to maximize value in the event of a takeover. The rights issued pursuant to the plan are not intended to prevent all takeovers of us. However, the rights may have the effect of rendering more difficult or discouraging our acquisition. The rights may cause substantial dilution to a person or group that attempts to acquire us on terms or in a manner not approved by the board of directors, except pursuant to an offer conditioned upon the negation, purchase or redemption of the rights with respect to which the condition is satisfied.

Additional provisions of our certificate of incorporation and by-laws could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting common stock. These include provisions that classify our board of directors, limit the ability of stockholders to take action by written consent, call special meetings, remove a director for cause, amend the by-laws or approve a merger with another company.

We are subject to the provisions of Section 203 of the Delaware General Corporation Law which prohibits a publicly-held Delaware corporation from engaging in a business combination with an interested stockholder for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. For purposes of Section 203, a business combination includes a merger, asset sale or other transaction resulting in a financial benefit to the interested stockholder, and an

interested stockholder is a person who, either alone or together with affiliates and associates, owns (or within the past three years, did own) 15% or more of the corporation's voting stock.

## **ITEM 2. PROPERTIES**

The following table presents certain information relating to each of the Company's properties:

<b>Location</b>	<b>Square Feet</b>	<b>Lease Expiration Date</b>	<b>Principal Use</b>
Georgetown, Massachusetts(2)	57,600	(owned by the Company)	Headquarters, fabrication, molding, test lab, clean-room, and engineering for Component Products segment
Decatur, Alabama(1), (2)	47,250	12/31/11	Fabrication and engineering for Packaging segment
Decatur, Alabama	14,000	10/31/07	Warehousing and fabrication for Packaging segment
Kissimmee, Florida(1), (2)	49,400	12/31/11	Fabrication, molding, test lab, and engineering for Packaging segment
Miami, Florida	7,000	11/30/09	Warehousing and fabrication for Packaging segment.
Haverhill, Massachusetts	48,772	2/28/08	Flame lamination for Component Products segment
Raritan, New Jersey	67,125	2/28/08	Fabrication, molding, test lab, clean-room, and engineering for Packaging segment
Clinton, Iowa	30,000	12/31/14	Molded fiber operations for Packaging segment
Clinton, Iowa	62,000	2/28/15	Molded fiber operations for Packaging segment
Addison, Illinois	45,000	07/31/08	Fabrication and engineering for Packaging segment
Ventura, California	48,300	month-to-month	Fabrication and engineering for Component Products segment
Atlanta, Georgia	47,000	04/30/11	Fabrication and engineering for Component Products segment
Macomb Township, Michigan	70,703	12/31/07	Fabrication and engineering for Component Products segment
El Paso, Texas	24,698	3/31/07	Warehousing and fabrication for Packaging segment

(1) United Development Company Limited, a Florida limited partnership and an affiliate of the Company and certain officers, directors and stock-holders of the Company, is the lessor of these properties. United Development Company Limited was consolidated into the Company's financial statements in 2003 (see Note 1 to the Consolidated Financial Statements).

(2) Subject to mortgage (see Note 8 to the Consolidated Financial Statements).

12

**ITEM 3. LEGAL PROCEEDINGS**

The Company is not a party to any material pending legal proceedings.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE TO SECURITY HOLDERS**

None.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Price**

From July 8, 1996 until April 18, 2001, the Company's Common Stock was listed on the Nasdaq National Market under the symbol UFPT. Since April 19, 2001, the Company's Common Stock has been listed on the Nasdaq Capital Market (formerly known as the Nasdaq Small Cap Market). The following table sets forth the range of high and low quotations for the Common Stock as reported by Nasdaq for the quarterly periods from January 1, 2005 to December 31, 2006:

	<b>High</b>	<b>Low</b>
<b>Fiscal Year Ended December 31, 2005</b>		
First Quarter	\$ 6.39	\$ 3.11
Second Quarter	5.88	2.94
Third Quarter	4.25	3.25
Fourth Quarter	3.65	2.17
<b>Fiscal Year Ended December 31, 2006</b>		
First Quarter	\$ 3.70	\$ 2.22
Second Quarter	7.69	3.08
Third Quarter	7.99	4.88
Fourth Quarter	5.76	4.15

**Number of Stockholders**

As of February 15, 2007, there were 104 holders of record of the Company's Common Stock.

Due to the fact that many of the shares are held by brokers and other institutions on behalf of stockholders, the Company is unable to estimate the total number of individual stockholders represented by these holders of record.

**Dividends**

The Company did not pay any dividends in 2006, although prior to becoming a public company in December 1993, the Company had from time to time paid cash dividends on its capital stock. The Company presently intends to retain all of its earnings to provide funds for the operation of



its business, although it would consider paying cash dividends in the future. The Company's ability to pay dividends is subject to approval by its principal lending institution.

**Stock Plans**

The Company maintains three stock option plans to provide long-term rewards and incentives to the Company's key employees, officers, employee directors, non-employee directors and advisors. The first plan (1993 Employee Stock Option Plan) provides for the issuance of up to 1,550,000 shares of the Company's common stock. The second plan (1993 Director Plan) provided for the issuance of 110,000 shares of the Company's common stock to non-employee directors; this plan was frozen with the inception of the 1998 Director Plan, which provides for the issuance of up to 725,000 shares of the Company's common stock to non-employee directors. Additional details of these plans are discussed in Note 13 to the Consolidated Financial Statements.

The Company also maintains an Employee Stock Purchase Plan, which is intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code of 1986.

The Company also maintains a Stock Plan (2003 Equity Incentive Plan) to provide the Company with the ability to offer equity-based incentives to present and future executives and other employees who are in a position to contribute to the long-term success and growth of the Company.

Each of these plans and their amendments have been approved by the Company's stockholders.

Summary plan information as of December 31, 2006 is as follows:

	Number of shares of UFPT common stock to be issued (1)	Weighted average exercise price of outstanding options	Number of shares of UFPT common stock remaining available for future issuance
1993 Employee Plan	731,875	\$ 2.18	315,043
1993 Director Plan	20,000	4.13	0
1998 Director Plan	404,184	2.71	168,652
Total Option Plans	1,156,059	\$ 2.40	483,695
1998 Employee Stock Purchase Plan	0	0	101,672
2003 Equity Incentive Plan	144,000	0	164,834
Total All Stock Plans	1,300,059	0	750,201

(1) Will be issued upon exercise of outstanding options or vesting of stock unit awards.

**ITEM 6. SELECTED FINANCIAL DATA**

The following selected financial data for the five years ended December 31, 2006, is derived from the audited consolidated financial statements of the Company. The consolidated financial statements for fiscal years 2004, 2003, and 2002 were audited by PricewaterhouseCoopers LLP. The data should be read in conjunction with the consolidated financial statements and the related notes included in this report, and in conjunction with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Selected Consolidated Financial Data**

Consolidated statement of operations data:(1)	Years Ended December 31				
	2006 (2)	2005 (2)	2004 (2)	2003 (3)(2)(4)	2002 (5)(4)
	(in thousands, except per share data)				
Net sales	\$ 93,749	83,962	68,624	60,902	61,189
Gross profit	19,237	14,601	13,971	10,724	12,105
Operating income (loss)	5,054	2,171	2,144	(1,508 )	466
Net income (loss)	2,515	659	871	(1,516 )	(234 )
Diluted earnings (loss) per share	\$ 0.45	0.14	0.17	(0.34 )	(0.05 )
Weighted average number of diluted shares outstanding	5,571	5,261	4,995	4,490	4,343
	Years Ended December 31				
Consolidated balance sheet data:(1)	2006(2)	2005(2)	2004(2)	2003(2)	2002
	(in thousands)				
Working capital	\$ 8,236	3,321	1,431	1,209	1,540
Total assets	39,037	44,000	39,632	36,749	35,383
Short-term debt and capital lease obligations	1,767	9,716	9,484	8,173	7,169
Long-term debt and capital lease obligations, excluding current portion	6,921	7,650	7,497	8,119	6,851
Total liabilities	20,412	29,239	25,846	24,058	21,332
Stockholders' equity	\$ 18,625	14,761	13,787	12,691	14,050

(1) See Note 18 to the Consolidated Financial Statements for segment information.

(2) Amounts include the consolidation of United Development Company Limited, a 26.32% owned real estate limited partnership. See Note 1 to the Consolidated Financial Statements.

(3) Amounts include restructuring charges of \$1.4 million

(4) In years where the Company reported a net loss, basic and diluted earnings per share and weighted average shares outstanding are the same.

(5) Amounts include results of operations of the business of Excel Acquisition Group (acquired in January 2002) for the periods subsequent to its acquisition.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This report contains certain statements that are forward-looking statements as that term is defined under the Act and releases issued by the Securities and Exchange Commission. The words believe, expect, anticipate, intend, plan, estimate and other expressions which are present or indicate future events and trends and which do not relate to historical matters identify forward-looking statements. The Company's plans, described below, to execute a program which launched in the fourth quarter of 2004 for an automotive supplier that could be as large as \$95 million 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.

The \$95 million revenue value of the automotive contract is an estimate, based on the automotive supplier's projected needs. The Company cannot guarantee that it will fully benefit from this contract, which is terminable by the automotive supplier for any reason, subject to a cancellation charge that includes, among others, a provision whereby the customer will reimburse the Company for its total capital investment less any depreciation taken. The Company's revenues from this contract are directly dependent on the ability of the automotive supplier to develop, market, and sell its products in a timely, cost-effective manner. If the automotive supplier's needs decrease over the course of the contract, the Company's estimated revenues from this contract may also decrease. Even if the Company generates revenue from the project, the Company cannot guarantee that the project will be profitable, particularly if revenues from the contract are less than expected. Other examples of these risks, uncertainties, and other factors include, without limitation, the following: (i) economic conditions that affect sales of the products of the Company's packaging customers, (ii) actions by the Company's competitors and the ability of the Company to respond to such actions, (iii) the ability of the Company to obtain new customers and (iv) the ability of the Company to execute and integrate favorable acquisitions. 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. 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.

**Investment in and Advances to Affiliated Partnership**

The Company has a 26.32% ownership interest in a realty limited partnership, United Development Company Limited (UDT). As a result of adopting the provisions of FIN 46(R), the Company has consolidated the financial statements of UDT as of December 31, 2003, because when including related party ownership the Company effectively owns greater than 50% of UDT. Prior to December 31, 2003, this investment was accounted for under the equity method at cost, plus the Company's proportionate share of the limited partnership's income, less any distributions received from the limited partnership.

## Results of Operations

The following table sets forth, for the years indicated, the percentage of revenues represented by the items as shown in the Company's consolidated statements of operations:

	2006	2005	2004
Net sales	100.0%	100.0%	100.0%
Cost of sales	79.5	82.6	79.6
Gross profit	20.5	17.4	20.4
Selling, general and administrative expenses	15.1	14.8	17.7
Restructuring charge	0	0	(0.4 )
Operating income (loss)	5.4	2.6	3.1
Total other expenses, net	1.1	1.6	1.1
Income (loss) before income taxes	4.3	1.0	2.0
Expense (benefit) for income taxes	1.6	0.2	0.7
Net income (loss)	2.7	0.8	1.3

## Overview

UFP Technologies is an innovative designer and custom converter of foams, plastics and fiber products. 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 2005 the Company absorbed costs associated with the launch of several new programs in its automotive operations in Michigan as well as in its large, estimated \$95 million program in the Southeast that caused significant losses in its automotive business unit. These costs were in the form of higher than anticipated scrap rates and additional direct labor requirements that, combined, caused significant losses in this business unit. In 2006, the Company enjoyed materially better results in its automotive business unit. However, the automotive market remains very challenging with orders often below customer forecasts and pressure from customers to reduce prices.

During 2005, the Company was faced with significant raw material price increases and, in some cases, shortages due to high oil and natural gas prices, Asian demand for the same raw materials and the impact of Hurricanes Katrina and Rita on petrochemical plants along the Gulf coast. The majority of raw materials used by the Company polyurethane and polyethylene foams utilize petroleum based resins in their production. In 2006, prices have stabilized and, in some cases, were lower.

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 division. 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 the large automotive contract, generated record sales for the Company in 2006.

## 2006 Compared to 2005

The Company's net sales increased 11.7% to \$93.7 million for the year ended December 31, 2006, from \$84 million in 2005. Component Product sales increased 15.8% to \$55.8 million in 2006 from \$48.2 million in 2005. The increase in sales is primarily due to increased sales from recently launched automotive programs as well as strong demand from customers in the medical and military markets. Packaging sales increased 6.4% to \$38.0 million in 2006 from \$35.7 million in 2005. The increase in sales is primarily due to stronger demand for electronics packaging products and fiber packaging.

Gross profit as a percentage of sales (Gross Margin) increased to 20.5% in 2006 from 17.4% in 2005. The improvement in gross margin is primarily attributable to the fixed portion of labor and overhead measured against higher sales in both the Component Product and Packaging segments and the reduction in labor from 2005 when the Company incurred excess labor associated with the launch of several automotive programs. The material portion of cost-of-sales was slightly higher as a percent of sales in 2006 due primarily to the new automotive programs comprising a higher portion of sales.

Selling, General and Administrative Expenses (SG&A) increased 14.1% to \$14.2 million for the year ended December 31, 2006 from \$12.4 million in 2005. As a percentage of sales, SG&A was 15.1% and 14.8% in the years ended December 31, 2006 and 2005, respectively. The increase in SG&A spending is primarily attributable to equity based compensation resulting from the implementation of SFAS 123 (R) (Component Product and Packaging segments), increased corporate governance and compliance costs (Component Product and Packaging segments) and incremental SG&A within the automotive business unit (Component Product segment).

Interest expense decreased to \$964,000 for the year ended December 31, 2006, from approximately \$1,041,000 in 2005. The decrease in interest expense is primarily attributable to lower average borrowings partially offset by the impact of higher interest rates.

The Company recorded income tax expense of 37% and 24% for the years ended December 31, 2006 and 2005, respectively. The low effective tax rate for 2005 reflects research and development tax credits taken on the Company's tax returns. The Company has deferred tax assets on its books associated with net operating losses generated in previous years. The Company has considered both positive and negative available evidence in its determination that the deferred tax assets will be realized, and has not recorded a tax valuation allowance at December 31, 2006. The Company expects to utilize a significant amount of its federal NOLs when it prepares its 2006 tax returns. The Company will continue to assess the realizability of deferred tax assets created by recording tax benefits on operating losses and, where appropriate, record a valuation allowance against these assets. The amount of the net deferred tax asset considered realizable, however, could be reduced in the near term, if estimates of future taxable income during the carryforward period are reduced.

## 2005 Compared to 2004

The Company's net sales increased 22.4% to \$84.0 million for the year ended December 31, 2005, from \$68.6 million in 2004. Component Product sales increased 33.4% to \$48.2 million in 2005 from \$36.1 million in 2004. The increase in sales is primarily due to sales from recently launched automotive programs as well as strong demand from customers in the medical and

military markets. Packaging sales increased 10% to \$35.7 million in 2005 from \$32.5 million in 2004. The increase in sales is primarily due to growth in sales at the Company's plant in El Paso, Texas, and stronger demand for case insert product. The Company continued to invest in the area of marketing and sales in 2005 and attributes a portion of the Company's sales growth in 2005 to these investments.

Gross profit as a percentage of sales ( Gross Margin ) decreased to 17.4% in 2005 from 20.4% in 2004. The decline in gross margin is primarily attributable to the impact of high material scrap rates and direct labor associated with new automotive contracts partially offset by improvements from the fixed portion of labor and overhead measured against higher sales in both the Component Product and Packaging segments.

Selling, General and Administrative Expenses ( SG&A ) increased 2.7% to \$12.4 million for the year ended December 31, 2005 from \$12.1 million in 2004. As a percentage of sales, SG&A was 14.8% and 17.6% in the years ended December 31, 2005 and 2004, respectively. The increase in SG&A dollars is primarily attributable to continued investments made in the areas of marketing and sales (Component Product and Packaging segments), increased corporate governance and compliance costs (Component Product and Packaging segments) and incremental SG&A within the automotive business unit (Component Product segment).

Interest expense increased to \$1,041,000 for the year ended December 31, 2005, from approximately \$714,000 in 2004. The increase in interest expense is primarily attributable to higher average interest rates as well as higher average debt balances in the Company's revolving credit facility due to sales growth.

The Company recorded income tax expense of 24% and 35.9% for the years ended December 31, 2005 and 2004, respectively. The low effective tax rate for 2005 reflects research and development tax credits taken on the Company's tax returns. The Company has deferred tax assets on its books associated with net operating losses generated in previous years. The Company has considered both positive and negative available evidence in its determination that the deferred tax assets will be realized, and has not recorded a tax valuation allowance at December 31, 2005. The Company will continue to assess the realizability of deferred tax assets created by recording tax benefits on operating losses and, where appropriate, record a valuation allowance against these assets. The amount of the net deferred tax asset considered realizable, however, could be reduced in the near term, if estimates of future taxable income during the carryforward period are reduced.

#### **Goodwill**

Amortization of Goodwill and certain indefinite lived intangible assets ceased with the adoption of SFAS No. 142, effective January 1, 2002.

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

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

As of December 31, 2006 and 2005, working capital was \$8,236,000 and \$3,321,000, respectively. The increase in working capital is primarily attributable to the lower amount

outstanding on the revolving credit facility of approximately \$8.0, lower accounts payable balances of approximately \$1.4 million and higher cash balances of approximately \$750,000 partially offset by lower accounts receivable of approximately \$3.7 million due to strong collection efforts and increased accrued expenses of approximately \$1.3 million. Cash provided from operations was \$12.1 million and \$1.0 million in 2006 and 2005, respectively. The primary reason for the increase in cash generated from operations in 2006 is stronger earnings and the large reduction in accounts receivables. Net cash used in investing activities in 2006 was approximately \$1.8 million and was used primarily for the acquisition of new manufacturing equipment. In 2006, the Company spent approximately \$300,000 for the acquisition of significantly all of the assets of Stephen Packaging.

On February 28, 2003, the Company obtained a credit facility, which has been 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 December 31, 2006, based upon no revolving credit facility borrowings outstanding and collateral levels, the Company had availability of \$12.3 million of 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 Company performance. All borrowings at December 31, 2006 had interest computed at Prime or LIBOR plus 1.0%. Under the amended credit facility, the Company is subject to certain financial covenants including maximum capital expenditures and minimum fixed charge coverage. As of December 31, 2006, 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 December 31, 2006, the interest rate on these facilities ranged from 6.4% to 8.25%.

As a result of the consolidation of United Development Company Limited, a mortgage note collateralized by the Alabama and Florida facilities, dated September 4, 2002, originally for \$470,313, is included within long-term debt in the consolidated financial statements. The note calls for fifty principal payments of \$3,406 and one payment of \$388,967 due on March 4, 2007. The note bears interest at LIBOR plus 2.75%, adjusted monthly. At December 31, 2006, the outstanding balance was \$395,779. At December 31, 2006, the interest rate was approximately 8.1%. Payments on this note are funded through rent payments that the Company makes on its Alabama and Florida facilities. The Company is not subject to any financial covenants under this mortgage note.

In addition to the above credit facilities, the Company has capital lease debt of \$3,006,063 as of December 31, 2006. These loans are secured by specific manufacturing equipment used by the Company and have remaining lives ranging from one to six years and bear interest at rates ranging from 6.4% to 10%.

The Company has no significant capital commitments in 2007, but plans on adding capacity to enhance operating efficiencies in its manufacturing plants. The Company may consider the acquisition of companies, technologies or products in 2007, which are complementary to its business. The Company believes that its existing resources, including its revolving credit facility, together with cash generated from operations and funds expected to be available to it through any necessary equipment financing and additional bank borrowings, will be sufficient to fund its cash flow requirements through at least the end of 2007. However, there can be no assurances that such financing will be available at favorable terms, if at all.

### Commitments, Contractual Obligations and Off-Balance Sheet Arrangements

The following table summarizes the Company's contractual obligations at December 31, 2006, and the effect such obligations are expected to have on its cash flow in future periods:

Payments due in:	Operating Leases	Capital Leases	Term Loans	Mortgage Loan	UDT Mortgage	Debt Interest	Supplemental Retirement	Total
2007	1,645,615	688,991	526,572	156,000	395,779	516,673	244,000	\$ 4,173,630
2008	684,816	704,408	526,572	156,000		421,661	108,000	\$ 2,601,457
2009	473,895	702,765	526,572	156,000		324,945	104,000	\$ 2,288,177
2010	405,915	671,839	526,572	156,000		230,564	101,000	\$ 2,091,890
2011 & thereafter	1,220,334	238,060	1,009,260	1,547,000		543,781	381,000	\$ 4,939,435
	\$ 4,430,575	\$ 3,006,063	\$ 3,115,548	\$ 2,171,000	\$ 395,779	\$ 2,037,624	\$ 938,000	\$ 16,094,589

Payments on the United Development Company Limited 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, it cannot guarantee that its operations will generate cash in future periods.

The Company does not believe that inflation has had a material impact on its results of operations in the last three years.

### Critical Accounting Policies

The preparation of consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to product returns, bad debts, inventories, intangible assets, income taxes, warranty obligations, restructuring and contingencies and litigation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, including current and anticipated worldwide economic conditions both in general and specifically in relation to the packaging industry, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements included in Item 8 of this Form 10-K. The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

The Company has reviewed these policies with its Audit Committee.

**Revenue Recognition**

The Company recognizes revenue at the time of shipment when title and risk of loss have passed to the customer, persuasive evidence of an arrangement exists, performance of its obligation is complete, its price to the buyer is fixed or determinable, and the Company is reasonably assured of collecting. If a loss is anticipated on any contract, a provision for the entire loss is made immediately. Determination of these criteria, in some cases, requires management's judgments. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue for any reporting period could be adversely affected.

**Long-Lived Assets and Intangible Assets**

The Company reviews long-lived assets and all intangible assets for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. Goodwill is reviewed at least annually for impairment. Beginning in 2005, the Company changed its annual goodwill impairment testing date from the second quarter to the fourth quarter of its fiscal year. The Company believes this new accounting method is preferable, since more complete and accurate information to assess goodwill for impairment is available in the fourth quarter, including actual financial performance to date and information relative to the carrying value of assets. There is no financial impact as of the year ended December 31, 2006, or on any prior periods, as a result of this change in accounting method. Recoverability of long-lived assets and definite lived intangible assets is determined by comparing the forecasted undiscounted net cash flows of the operation to which the assets relate, to the carrying amount. If the operation is determined to be unable to recover the carrying amount of its assets, then long-lived assets are written down to fair value. Fair value is determined based on discounted cash flows or appraised values, depending upon the nature of the assets. Recoverability of goodwill is determined under a two-step process as described in SFAS 142. The fair value of reporting units determined under step one is also based on a discounted cash flow model. At December 31, 2006, no impairment has been identified. Forecasted cash flows are based upon numerous assumptions used by management, such as revenue growth, margins and asset management. For purposes of this analysis, the Company reviews its internal forecasts and external data. The external data consist of data available from customer and competitor commentary, and industry forecasts of future revenue growth.

The estimates of expected cash flows require the Company to make significant judgments regarding future periods that are subject to some factors outside of the Company's control. Changes in these estimates can result in significant revisions to the carrying value of these assets and may result in material charges to the results of operations.

Accounts Receivable

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. These allowances for doubtful accounts are determined by reviewing specific accounts that the Company has deemed are at risk of being uncollectible and other credit risks associated with groups of customers. If the financial condition of the Company's customers were to deteriorate or economic conditions were to deteriorate resulting in an impairment of their ability to make payments, additional allowances may be required with a resulting charge to results of operations.

Inventory

The Company provides reserves for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. The Company fully reserves for inventories deemed obsolete. The Company performs periodic reviews of all inventory items to identify excess inventories on-hand by comparing on-hand balances to anticipated usage using recent historical activity as well as anticipated or forecasted demand, based upon sales and marketing inputs through its planning systems. If estimates of demand diminish or actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required with a resulting charge to operations.

Deferred Income Taxes

The Company evaluates the need for a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. The Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. Should the Company determine that it would not be able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

**ITEM 7A. QUANTITATIVE & 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 December 31, 2006, 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 four debt instruments where interest is based upon the prime rate (and/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 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The consolidated Financial Statements and Supplementary Data of the Company are listed under Part IV, Item 15, in this Report.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND**

### **FINANCIAL DISCLOSURE**

As previously disclosed on a Form 8-K filed by the Company on July 8, 2005, the Audit Committee of the Board of Directors of the Company, effective on July 5, 2005, dismissed PricewaterhouseCoopers, L.L.P. ( PwC ) as the Company's independent registered public accounting firm. The reports issued by PwC on the Company's financial statements as of December 31, 2003 and December 31, 2004, and for the years ended December 31, 2003 and December 31, 2004, did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principle. During the years ended December 31, 2003 and December 31, 2004, and through July 5, 2005: (i) there were no disagreements with PwC on any matter of accounting principle or practice, financial statement disclosure, or auditing scope or procedure which, if not resolved to PwC's satisfaction, would have caused them to make reference thereto in their report of the Company's financial statements for such years; and (ii) there were no reportable events as defined in Item 304(a)(1)(v) of Regulation S-K.

Effective as of July 5, 2005 the Company engaged Carlin, Charron & Rosen LLP ( CCR ) to serve as the Company's independent public accountants for the fiscal year ended December 31, 2005. During the years ended December 31, 2003 and December 31, 2004, and through July 5, 2005, the Company did not consult with CCR with respect to the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's consolidated financial statements, or any other matters, including disagreements or reportable events as set forth in Items 304(a)(2)(i) and (ii) of Regulation S-K.

## **ITEM 9A. CONTROLS AND PROCEDURES**

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), which have been designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and are operating in an effective manner. Based upon that evaluation, they concluded that the disclosure controls and procedures were effective.

## **ITEM 9B. OTHER INFORMATION**

None.

24

---

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, and corporate governance**

The information required by this Item 10 is hereby incorporated by reference to the Company's definitive proxy statement to be filed by the Company within 120 days after the close of its fiscal year.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item 11 is hereby incorporated by reference to the Company's definitive proxy statement to be filed by the Company within 120 days after the close of its fiscal year.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this Item 12 is hereby incorporated by reference to the Company's definitive proxy statement to be filed by the Company within 120 days after the close of its fiscal year.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this Item 13 is hereby incorporated by reference to the Company's definitive proxy statement to be filed by the Company within 120 days after the close of its fiscal year.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this Item 14 is hereby incorporated by reference to the Company's definitive proxy statement to be filed by the Company within 120 days after the close of its fiscal year.

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) (1) Financial Statements

Index to Consolidated Financial Statements and Financial Statement Schedules

Report of Independent Registered Public Accounting Firm, Carlin, Charron & Rosen, LLP, 2006 and 2005



Report of Independent Registered Public Accounting Firm,  
PricewaterhouseCoopers, LLP, 2004

Consolidated Balance Sheets as of December 31, 2006 and 2005

Consolidated Statements of Operations for the years ended December 31, 2006, 2005, and 2004

Consolidated Statements of Stockholders' Equity for the years ended December 31, 2006, 2005, and 2004

Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005, and 2004

Notes to Consolidated Financial Statements

(a) (2) Financial Statement Schedules  
Schedule II Valuation and Qualifying Accounts

(a)  
(3)

**Exhibits**

**Number**

**Reference**

2.01	Agreement and Plan of Reorganization among the Company, Moulded Fibre Technology, Inc. and UFP Acquisition, Inc.	A-2.01**
2.02	Agreement of Merger between Moulded Fibre Technology, Inc. and UFP Acquisition, Inc.	B-2.02**
2.03	Merger Agreement relating to the reincorporation of the Company in Delaware.	A-2.02**
2.04	Asset Purchase Agreement relating to the purchase of Foam Cutting Engineers, Inc.	C-2**
2.05	Asset Purchase Agreement relating to the purchase of the assets of Pacific Foam Technologies, Inc.	D-2.05**
2.06	Stock Purchase Agreement dated January 14, 2000, relating to the acquisition of the stock of Simco Industries, Inc.	E-2.01**
3.01	Certificate of Incorporation of the Company, as amended.	F-3.01** G-3.01**
3.02	Bylaws of the Company.	A-3.02**
4.01	Specimen Certificate for shares of the Company's Common Stock.	A-4.01**
4.02	Description of Capital Stock (contained in the Certificate of Incorporation of the Company, filed as Exhibit 3.01).	F-3.01**
4.03	Rights Agreement (including the Certificate of Designation and form of Rights Certificate attached as Exhibits A and B, respectively, thereto) between the Registrant and American Stock Transfer & Trust Company, as Rights Agent, dated as of January 13, 1999.	H-4**
10.01	Agreement between the Company and William H. Shaw.	A-10.08*, **



## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-K

10.02	Agreement and Severance Agreement between the Company and Richard L. Bailly.	A-10.09*, **
10.03	Employee Stock Purchase Plan.	A-10.18**
10.04	1993 Combined Stock Option Plan, as amended.	I-10.19*, **
10.05	1993 Non-employee Director Stock Option Plan.	J-4.5**
10.06	Facility Lease between the Company and Raritan Associates.	A-10.22**
10.07	Facility Lease between the Company and Dana Evans d/b/a Evans Enterprises.	A-10.27**
10.08	Form of Indemnification Agreement for directors and officers of the Company.	A-10.30**
10.09	Facility Lease between the Company and Clinton Area Development Corporation.	K-10.37**
10.10	Employment Agreement with R. Jeffrey Bailly dated April 4, 1995.	L-10.37*, **
10.11	Amended 1998 Employee Stock Purchase Plan.	M**
10.12	Facility Lease between the Company and Quadrate Development, LLC	N-10.43**
10.13	Amended 1998 Director Stock Option Incentive Plan	M*, **
10.14	Amended Facility Lease between the Company and United Development Company Limited.	O-10.27**
10.15	Amended Facility Lease between the Company and United Development Company Limited.	O-10.28**
10.16	Amended Facility Lease between the Company and Ward Hill Realty Associates, LLC, successors in interest to Evans Enterprises of South Beach	P-10.30**
10.17	Credit and Security Agreement between the Company and Fleet Capital Corporation	Q-10.31**
10.18	Facility Lease between Simco Automotive Trim, Inc. and Insite Atlanta, LLC	R-10.31**
10.19	Amended Credit and Security Agreement between the Company and Fleet Capital Corporation.	S-10.33**
10.20	Facility lease between the Company and Clinton Base Company LLC	G-10.34**
10.21	Second Amendment to the Credit Agreement between the Company and Fleet Capital Corporation	T-10.35**
10.22	Third Amendment to the Credit and Security Agreement between the Company and Bank of America	U-10.37
10.23	1998 Employee Stock Purchase Plan as amended	V-10.38
10.24	Form of Stock Unit Award Agreement under 2003 Equity Incentive Plan	W-10.40

Edgar Filing: UFP TECHNOLOGIES INC - Form 10-K

10.25	Executive Non-qualified Excess Plan	X-10.41
14.00	Code of Ethics	S-14.0**
21.01	Subsidiaries of the Company.	B-21.01**
23.01	Consent of Carlin, Charron & Rosen, LLP	Filed herewith
23.02	Consent of PricewaterhouseCoopers LLP	Filed herewith
31.01	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
31.02	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
32.01	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed herewith

- A. Incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 33-70912). The number set forth herein is the number of the Exhibit in said Registration Statement.
- B. Incorporated by reference to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 1993. The number set forth herein is the number of the Exhibit in said Annual Report.
- C. Incorporated by reference to the Company's report on 8-K dated February 3, 1997. The number set forth herein is the number of the Exhibit in said report.
- D. Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998. The number set forth herein is the number of the Exhibit in said Annual Report.
- E. Incorporated by reference to the Company's Report on Form 8-K dated January 31, 2000. The number set forth herein is the number of the Exhibit in said Report.
- F. Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the three months ended June 30, 1996. The number set forth herein is the number of the Exhibit in said Quarterly Report.
- G. Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2004. The number set forth herein is the number of the exhibit in said Quarterly Report.
- H. Incorporated by reference to the Company's report on Form 8-K dated January 13, 1999. The number set forth herein is the number of the Exhibit in said Report.
- I. Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the three months ended June 30, 1998. The number set forth herein is the number of the Exhibit in said Quarterly Report.
- J. Incorporated by reference to the Company's Registration Statement on Form S-8 (Registration No. 33-76440). The number set forth herein is the number of the Exhibit in said Registration Statement.



- K. Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1995. The number set forth herein is the number of the Exhibit in said Annual Report.
- L. Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the three months ended June 30, 1995. The number set forth herein is the number of the Exhibit in said Quarterly Report.
- M. Incorporated by reference to the Company's Proxy Statement relating to the Company's Annual Meeting of Stockholders on June 5, 2002.
- N. Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000. The number set forth herein is the number of the Exhibit in said Annual Report.
- O. Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001. The number set forth herein is the number of the Exhibit in said Annual Report.
- P. Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the three months ended September 30, 2002. The number set forth herein is the number of the Exhibit in said Quarterly Report.
- Q. Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002. The number set forth is the number of the exhibit in said Annual Report.
- R. Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the three months ended June 30, 2003. The number set forth herein is the number of the Exhibit in said Annual Report.
- S. Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003. The number set forth is the number of the exhibit in said Annual Report.
- T. Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the three months ended June 30, 2004. The number set forth herein is the number of the exhibit in said Quarterly Report.
- U. Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005. The number set forth herein is the number of the exhibit in said annual report.
- V. Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2006. The number set forth herein is the number of the exhibit in said quarterly report.
- W. Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the three months ended June 30, 2006. The number set forth herein is the number of the exhibit in said quarterly report.
- X. Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the three months ended September 30, 2006. The number set forth herein is the number of the exhibit in said quarterly report.

---

\* Management contract or compensatory plan or arrangement.

\*\* In accordance with Rule 12b-32 under the Securities Exchange Act of 1934, as amended, reference is made to the documents previously filed with the Securities and Exchange Commission, which documents are hereby incorporated by reference.



## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-K

The SEC allows the Company to incorporate by reference certain information into this annual report on Form 10-K. This means that the Company can disclose important information by reference to other documents the Company has filed separately with the SEC. These documents contain important information about the Company and its financial condition. The Company has incorporated by reference into this annual report the information indicated above. This information is considered to be a part of this annual report, except for any information that is superseded by information that is filed at a later date.

You may read and copy any of the documents incorporated by reference in this annual report at the following locations of the SEC by using the Company's file number, 001-12648:

### Public Reference Room

450 Fifth Street, NW  
Room 1024  
Washington, DC 20549

### Midwest Regional Office

Citicorp Center  
500 West Madison Street, # 1400  
Chicago, IL 60661

### Northeast Regional Office

233 Broadway  
New York, NY 10279

You may also obtain copies of this information by mail from the Public Reference Room of the SEC, 450 Fifth Street, NW, Room 1024, Washington, DC 20549, at prescribed rates. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. The SEC also maintains a World Wide Web site that contains reports, proxy statements and other information about issuers, including the Company, that file electronically with the SEC. The address of that site is <http://www.sec.gov>.

Documents incorporated by reference are also available from the Company without charge, excluding any exhibits to those documents unless the exhibit is specifically incorporated by reference in this annual report. You can obtain these documents by requesting them by telephone or in writing from the Company at 172 East Main Street, Georgetown, MA 01833, (978) 352-2200.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: March 27, 2007

By: /s/R. Jeffrey Bailly  
R. Jeffrey Bailly, President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

SIGNATURE	TITLE	DATE
/s/ R. Jeffrey Bailly R. Jeffrey Bailly	Chairman, Chief Executive Officer, President, and Director	March 27, 2007
/s/ Ronald J. Lataille Ronald J. Lataille	Chief Financial Officer, Vice President, Principal Financial and Accounting Officer	March 27, 2007
/s/ Richard L. Bailly Richard L. Bailly	Director	March 27, 2007
/s/ Michael J. Ross Michael J. Ross	Director	March 27, 2007
/s/ Kenneth L. Gestal Kenneth L. Gestal	Director	March 27, 2007
/s/ David B. Gould David B. Gould	Director	March 27, 2007
/s/ Thomas W. Oberdorf Thomas W. Oberdorf	Director	March 27, 2007
/s/ Marc Kozin Marc Kozin	Director	March 27, 2007

**UFP TECHNOLOGIES, INC.**

Consolidated Financial Statements and Schedule

December 31, 2006 and 2005

With Reports of Independent Registered Public Accounting Firms

F-1

---

UFP TECHNOLOGIES, INC.

**Index to Consolidated Financial Statements and Financial Statement Schedule**

Report of Independent Registered Public Accounting Firm, Carlin, Charron & Rosen, LLP, 2006 and 2005

Report of Independent Registered Public Accounting Firm, PricewaterhouseCoopers LLP, 2004

Consolidated Balance Sheets as of December 31, 2006 and 2005

Consolidated Statements of Operations for the years ended December 31, 2006, 2005, and 2004

Consolidated Statements of Stockholders' Equity for the years ended December 31, 2006, 2005, and 2004

Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005, and 2004

Notes to Consolidated Financial Statements

Schedule

Schedule II - Valuation and Qualifying Accounts

F-2

---

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

**UFP Technologies, Inc.**

Georgetown, MA

We have audited the accompanying consolidated balance sheets of **UFP Technologies, Inc.** as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. Our audit also included the financial statement schedule for the years ended December 31, 2006 and 2005 as listed in the index at Item 15(a)(2). These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of **UFP Technologies, Inc.** as of December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

*/s/ Carlin, Charron & Rosen, LLP*

Westborough, Massachusetts

**March 22, 2007**

F-3

---

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of UFP Technologies, Inc.:

In our opinion, the consolidated statement of operations, of stockholders' equity, and of cash flows for the year ended December 31, 2004 listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the results of operations and cash flows of UFP Technologies, Inc., and its subsidiaries for the year then ended, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule for the year ended December 31, 2004 listed in the index appearing under Item 15(a)(2), present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Boston, Massachusetts

**March 14, 2005**

F-4

---

## UFP TECHNOLOGIES, INC.

CONSOLIDATED BALANCE SHEETS

Assets	December 31	
	2006	2005
Current assets:		
Cash	\$ 1,017,122	\$ 265,352
Receivables, net	11,628,639	15,299,748
Inventories	5,929,677	6,441,592
Prepaid expenses	766,467	791,677
Deferred income taxes	1,032,281	781,988
Total current assets	20,374,186	23,580,357
Property, plant and equipment	37,212,463	36,723,341
Less accumulated depreciation and amortization	(27,075,279 )	(25,750,620 )
Net property, plant and equipment	10,137,184	10,972,721
Cash surrender value of officers life insurance	157,835	140,135
Deferred income taxes	1,387,353	2,494,251
Goodwill	6,481,037	6,481,037
Other assets	499,417	331,515
Total assets	\$ 39,037,012	\$ 44,000,016
	<b>Liabilities and Stockholders Equity</b>	
Current liabilities:		
Notes payable	\$	\$ 7,990,521
Current installments of long-term debt	1,078,350	1,087,030
Current installments of capital lease obligations	688,991	638,875
Accounts payable	4,620,399	6,062,841
Accrued taxes and other expenses	5,749,949	4,480,239
Total current liabilities	12,137,689	20,259,506
Long-term debt, excluding current installments	4,603,977	5,286,548
Capital lease obligations, excluding current installments	2,317,072	2,363,163
Minority interest (Note 7)	616,157	633,853
Retirement and other liabilities	737,581	695,780
Total liabilities	20,412,476	29,238,850
Commitments and contingencies (Note 15)		
Stockholders equity:		
Preferred stock, \$.01 par value. Authorized 1,000,000 shares; no shares issued or outstanding		
Common stock, \$.01 par value. Authorized 20,000,000 shares; issued and outstanding 5,156,764 shares in 2006 and 4,828,079 shares in 2005	51,568	48,281
Additional paid-in capital	10,311,682	8,966,472
Retained earnings	8,261,286	5,746,413
Total stockholders equity	18,624,536	14,761,166
Total liabilities and stockholders equity	\$ 39,037,012	\$ 44,000,016

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

## UFP TECHNOLOGIES, INC.

**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Years ended December 31		
	2006	2005	2004
Net sales	\$ 93,749,239	\$ 83,962,457	\$ 68,624,098
Cost of sales	74,511,940	69,361,157	54,652,677
Gross profit	19,237,299	14,601,300	13,971,421
Selling, general and administrative expenses	14,183,117	12,430,515	12,107,012
Restructuring charge			(280,000 )
Operating income	5,054,182	2,170,785	2,144,409
Other income (expense):			
Interest expense	(963,982 )	(1,041,714 )	(713,651 )
Equity in net income of unconsolidated partnership	15,037	12,531	12,532
Minority interest earnings	(87,298 )	(305,037 )	(83,358 )
Other, net	(9,705 )	30,734	
Total other expense	(1,045,948 )	(1,303,486 )	(784,477 )
Income before income tax provision	4,008,234	867,299	1,359,932
Income tax expense	1,493,361	208,208	488,671
Net income	\$ 2,514,873	\$ 659,091	\$ 871,261
Net income per share:			
Basic	\$ 0.50	\$ 0.14	\$ 0.19
Diluted	\$ 0.45	\$ 0.13	\$ 0.17
Weighted average common shares:			
Basic	5,022,532	4,798,008	4,616,983
Diluted	5,571,068	5,260,569	4,994,611

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

F-6

## UFP TECHNOLOGIES, INC.

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

Years ended December 31, 2006, 2005, and 2004

	Common Stock		Additional		Retained	Total
	Shares	Amount	Paid-in		Earnings	Stockholders
			Capital			Equity
Balance at December 31, 2003	4,519,666	\$ 45,197	\$ 8,429,937		\$ 4,216,061	\$ 12,691,195
Employee Stock Purchase Plan	38,229	382	46,733			47,115
Stock issued in lieu of compensation	71,283	713	136,037			136,750
Exercise of stock options, net of shares presented for exercise	49,388	494	2,122			2,616
Tax benefit relating to non-qualified stock option exercise			37,659			37,659
Net income					871,261	871,261
Balance at December 31, 2004	4,678,566	\$ 46,786	\$ 8,652,488		\$ 5,087,322	\$ 13,786,596
Employee Stock Purchase Plan	16,931	169	48,416			48,585
Stock issued in lieu of compensation	65,472	655	239,795			240,450
Exercise of stock options, net of shares presented for exercise	67,110	671	25,773			26,444
Net income					659,091	659,091
Balance at December 31, 2005	4,828,079	48,281	8,966,472		5,746,413	14,761,166
Employee Stock Purchase Plan	21,148	211	47,111			47,322
Stock issued in lieu of compensation	54,411	544	143,703			144,247
Share-based compensation			459,340			459,340
Exercise of stock options, net of shares presented for exercise	253,126	2,532	518,189			520,721
Tax benefit relating to non-qualified stock option exercise			176,867			176,867
Net income					2,514,873	2,514,873
Balance at December 31, 2006	5,156,764	\$ 51,568	\$ 10,311,682		\$ 8,261,286	\$ 18,624,536

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

F-7

## UFP TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31		
	2006	2005	2004
Cash flows from operating activities:			
Net income	\$ 2,514,873	\$ 659,091	\$ 871,261
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	3,059,702	2,936,691	2,493,300
Equity in net income of unconsolidated affiliate and partnership	(15,038 )	(12,531 )	(12,532 )
Minority interest	87,298	305,037	83,358
Loss on disposal of property, plant, and equipment	9,705		
Restructuring charges			(280,000 )
Share-based compensation	459,340		
Stock issued in lieu of compensation	144,247	240,450	136,750
Deferred income taxes	856,605	(97,899 )	266,438
Changes in operating assets and liabilities, net of effects from acquisition:			
Receivables, net	3,767,676	(3,480,842 )	(2,679,592 )
Inventories	598,132	(1,205,360 )	(823,626 )
Prepaid expenses	25,210	(80,983 )	(216,944 )
Refundable income tax			419,658
Accounts payable	(647,048 )	1,335,525	733,176
Accrued taxes and other expenses	1,269,710	495,352	444,181
Retirement and other liabilities	41,801	(84,724 )	(76,188 )
Cash surrender value of officers' life insurance	(17,700 )	(14,209 )	(8,056 )
Other assets	(61,105 )	12,801	44,744
Net cash provided by operating activities	12,093,408	1,008,399	1,395,928
Cash flows from investing activities:			
Additions to property, plant and equipment	(1,515,533 )	(1,109,995 )	(2,141,700 )
Payments received on affiliated partnership	15,038	12,531	12,532
Proceeds from sale of property, plant, and equipment	30,000		
Acquisition of assets of Stephen Packaging, Corp.	(309,229 )		
Net cash used in investing activities	(1,779,724 )	(1,097,464 )	(2,129,168 )
Cash flows from financing activities:			
Net borrowings (payments) under notes payable	(7,990,521 )	67,051	1,185,758
Change in book overdrafts	(832,378 )	1,061,594	300,049
Proceeds from long-term borrowings		731,388	768,612
Distribution to United Development Company Partners	(104,994 )	(104,993 )	(104,982 )
Tax benefit from exercise of non-qualified stock options	176,867		37,659
Proceeds from sale of common stock	568,043	75,029	49,731
Principal repayment of long-term debt	(691,251 )	(1,366,834 )	(1,030,682 )
Principal repayment of obligations under capital leases	(2,046,680 )	(426,769 )	(465,091 )
Proceeds from refinancing capital leases	1,359,000		
Net cash provided by financing activities	(9,561,914 )	36,466	741,054
Net change in cash	751,770	(52,599 )	7,814
Cash at beginning of year	265,352	317,951	310,137
Cash at end of year	\$ 1,017,122	\$ 265,352	\$ 317,951

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

**UFP TECHNOLOGIES, INC.**

**Notes to Consolidated Financial Statements**

December 31, 2006 and 2005

**(1) Summary of Significant Accounting Policies**

UFP Technologies, Inc. (the Company) is an innovative designer and custom converter of foams, plastics, and natural fiber products principally serving the automotive, computer and electronics, medical, aerospace and defense, consumer, and industrial markets. The Company was incorporated in the State of Delaware in 1993.

**(a) Principles of Consolidation**

The consolidated financial statements include the accounts and results of operations of UFP Technologies, Inc., its wholly owned subsidiaries, Moulded Fibre Technology, Inc. (MFT), Simco Automotive Trim, and Simco Automotive Technology. The Company also consolidates United Development Company Limited of which the Company owns 26.32% (see Note 7). All significant inter-company balances and transactions have been eliminated in consolidation.

**(b) Accounts Receivable**

The Company periodically reviews the collectibility of its accounts receivable. Provisions are established for accounts that are potentially uncollectible. Determining adequate reserves for accounts receivable requires management's judgment. Conditions impacting the realizability of the Company's receivables could cause actual asset write-offs to be materially different than the reserved balances as of December 31, 2006.

**(c) Inventories**

Inventories which include material, labor, and manufacturing overhead are valued at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method.

The Company periodically reviews the realizability of its inventory. Provisions are established for potential obsolescence. Determining adequate reserves for inventory obsolescence requires management's judgment. Conditions impacting the realizability of the Company's inventory could cause actual asset write-offs to be materially different than the reserve balances as of December 31, 2006.

**(d) Property, Plant and Equipment**

Property, plant and equipment are stated at cost and depreciated and amortized using the straight-line method over the estimated useful lives of the assets for financial statement purposes and accelerated methods for income tax purposes. Certain manufacturing machines that are dedicated to a specific program where total units to be produced over the life of the program are estimable are depreciated using the modified units of production method for financial statement purposes.

F-9

Estimated useful lives of property, plant and equipment are as follows:

Leasehold improvements	Estimated useful life or remaining lease term, whichever is shorter
Buildings and improvements	31.5 years
Equipment	8-10 years
Furniture and fixtures	5 - 7 years

**(e) Income Taxes**

The Company's income taxes are accounted for under the asset and liability method of accounting. Under the asset and liability method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carry-forwards. Deferred tax expense (benefit) results from the net change during the year in deferred tax assets and liabilities. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

**(f) Revenue Recognition**

The Company recognizes revenue at the time of shipment when title and risk of loss have passed to the customer, persuasive evidence of an arrangement exists, performance of its obligation is complete, its price to the buyer is fixed or determinable, and the Company is reasonably assured of collecting. If a loss is anticipated on any contract, a provision for the entire loss is made immediately. Determination of these criteria, in some cases, require management's judgments. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue for any reporting period could be adversely affected.

**(g) Investments in Realty Partnership**

The Company has invested in Lakeshore Estates Associates, a realty limited partnership. The Lakeshore Estates investment is stated at cost, plus or minus the Company's proportionate share of the limited partnerships' income or losses, less any distributions received from the limited partnership. The Company has recognized its share of Lakeshore Estates Associates' losses only to the extent of its original investment in, and advances to, this partnership. The Company's book value in this investment is zero at December 31, 2006 and 2005, respectively.

**(h) Impairment of Long-Lived Assets**

The Company reviews long-lived assets and all intangible assets for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. Goodwill is reviewed at least annually for impairment. Recoverability of long-lived assets and definite lived intangible assets is determined by comparing the forecasted undiscounted net cash flows of the operation to which the assets relate, to the carrying amount. If the operation is determined to be unable to recover the carrying amount of its assets, then long-lived assets are written

F-10

---

down to fair value. Fair value is determined based on discounted cash flows or appraised values, depending upon the nature of the assets. Recoverability of goodwill is determined under a two-step process as described in SFAS 142. The fair value of reporting units determined under step one is also based on a discounted cash flow model. At December 31, 2006, no impairment has been identified. Forecasted cash flows are based upon numerous assumptions used by management, such as revenue growth, margins and asset management. For purposes of this analysis, the Company reviews its internal forecasts and external data. The external data consist of data available from customer and competitor commentary, and industry forecasts of future revenue growth.

The estimates of expected cash flows require the Company to make significant judgments regarding future periods that are subject to some factors outside of the Company's control. Changes in these estimates can result in significant revisions to the carrying value of these assets and may result in material charges to the results of operations.

*(i)* Goodwill and Other Intangible Assets

Goodwill and indefinite-lived intangible assets are assessed for impairment on at least an annual basis. Beginning in 2005, the Company changed its annual goodwill impairment testing date from the second quarter to the fourth quarter of its fiscal year. The Company believes this new accounting method is preferable, since more complete and accurate information to assess goodwill for impairment is available in the fourth quarter, including actual financial performance to date and information relative to the carrying value of assets. There is no financial impact as of the year ended December 31, 2006, or on any prior periods, as a result of this change in accounting method. Goodwill of a reporting unit will also be tested for impairment between annual tests if a triggering event occurs, as defined by SFAS No. 142, that could potentially reduce the fair value of the reporting unit below its carrying value.

Definite-lived intangible assets, such as patents, are amortized over their estimated useful lives, generally periods ranging from eight to fourteen years. The Company continually evaluates the reasonableness of the useful lives of these assets.

*(j)* Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company utilizes zero balance disbursement accounts to manage its funds. These accounts reflect negative cash balances as checks clear the banking system. In accordance with accounting principles generally accepted in the United States of America, the negative cash book balances at the end of a period are reclassified to accounts payable. At December 31, 2006 and 2005, the amounts reclassified were approximately \$1.7 million and \$2.5 million, respectively,

*(k)* Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect assets and liabilities and disclosure of

F-11

---

contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*(l)*            Segments and Related Information

The Company has adopted the provisions of SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, which established standards for the way that public business enterprises report information and operating segments in annual financial statements and requires reporting of selected information in interim financial reports (see Note 18).

*(m)*            Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes which is an interpretation of FASB Statement 109, Accounting for Income Taxes. FIN 48 requires managements to perform a two-step evaluation of all tax positions, ensuring that these tax return positions meet the more-likely than not recognition threshold and can be measured with sufficient precision to determine the benefit recognized in the financial statements. These evaluations provide management with a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements certain tax positions that the Company has taken or expects to take on income tax returns. The Company does not believe this pronouncement will have a material impact on its financial position or results of operations. FIN 48 is effective for the Company's interim period beginning January 1, 2007.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108). SAB 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB 108 requires companies to quantify misstatements using a balance sheet and income statement approach and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. When the effect of initial adoption is material, companies will record the effect as a cumulative effect adjustment to beginning of year retained earnings. The Company adopted SAB 108 during the fourth quarter of 2006. The adoption did not have a material impact on the Company's financial position, cash flows or 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 February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159) which permits entities to

F-12

---

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 on its financial position, cash flows, and results of operations.

**(n) Share-Based Compensation**

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R, ( 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). Prior to January 1, 2006, the Company accounted for share-based compensation to employees in accordance with Accounting Principles Board Opinion ( APB ) No. 25, Accounting for Stock Issued to Employees, and related interpretations. The Company also followed the disclosure requirements of SFAS 123, Accounting for Stock-Based Compensation, as amended by SFAS 148, Accounting for Stock-Based Compensation Transition and Disclosure. The Company elected to adopt the modified prospective transition method as provided by SFAS 123R and, accordingly, financial statement amounts for the periods prior to January 1, 2006 presented in this Form 10-K have not been restated to reflect the fair value method of expensing share-based compensation. Under this application, the Company is required to record compensation cost for all share-based payments granted after the date of adoption based on the grant date fair value estimated in accordance with the provisions of SFAS 123R and for the unvested portion of all share-based payments previously granted that remain outstanding which were based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. The Company expenses its share-based compensation on a straight line basis over the requisite service period for each award.

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:

	<b>Year Ended 31-Dec-06</b>
Cost of sales	\$
Selling, general & administrative expense	459,340
<b>Total share-based compensation expense</b>	<b>\$ 459,340</b>

The Company has recorded compensation expense of \$116,991 for the year ended December 31, 2006 for options granted during the period. The compensation expense was determined as the intrinsic fair market value of the options, using a lattice-based option valuation model with the assumptions noted as follows:

Edgar Filing: UFP TECHNOLOGIES INC - Form 10-K

Expected volatility: 92.7% to 96.7%

Expected dividends: None

Risk-free interest rate: 4.7% to 5.1%

Exercise price: Closing price on date of grant

Imputed life: 4.0 to 8.0 years (output in lattice-based model)

The Company did not recognize compensation expense for employee stock options for the years ended December 31, 2005 and 2004, when the exercise price of the employee stock option equaled the market price of the underlying stock on the grant date.

The total income tax benefit recognized in the income statement for share-based compensation arrangements was approximately \$175,000 for the year ended December 31, 2006:

The following table illustrates the effects on net income and earnings per share for the years ended December 31, 2005 and 2004, respectively, as if the Company had applied the fair value recognition provisions of SFAS 123 to share-based employee awards:

	Years Ended December 31	
	2005	2004
Net income as reported	\$ 659,091	\$ 871,261
Total stock based compensation expense		
deter-mined under fair value based method for all		
awards net of tax related effects	(553,109 )	(519,084 )
Pro forma net income	\$ 105,982	\$ 352,177
Basic net income per share as reported	0.14	0.19
Pro forma basic net income per share	0.02	0.08
Diluted net income per share as reported	0.13	0.17
Pro forma diluted net income per share	\$ 0.02	\$ 0.07

The fair value of each option grant for options granted prior to January 1, 2006 is estimated on the date of grant, using the Black Scholes option pricing model with the following assumptions:

	Years Ended	
	December 31, 2005	December 31, 2004
Expected term	6.8 years	5.7 years
Volatility	84.4 %	102.8 %
Risk free interest rate	4.08 %	3.72 %
Dividend yield	0 %	0 %

The weighted average fair value of options granted during 2005 and 2004 was \$2.39 and \$2.34, respectively.

F-14

(o) Deferred Rent

The Company accounts for escalating rental payments on the straight line basis over the term of the lease.

(p) Shipping and Handling Costs

Costs incurred related to shipping and handling are included in cost of sales. Amounts charged to customers pertaining to these costs are included as revenue.

(2) Supplemental Cash Flow Information

Cash paid for interest and income taxes is as follows:

	Years ended December 31		
	2006	2005	2004
Interest	\$ 1,001,382	\$ 1,022,314	\$ 697,651
Income taxes (refunds) net	\$ 368,975	\$ 81,019	\$ (340,599 )
Significant non-cash transactions:			

	Years ended December 31		
	2006	2005	2004
Property and equipment acquired under capital lease	\$ 691,705	\$ 1,380,615	\$ 229,540
Tax benefit resulting from the exercise of non-qualified stock options	176,867		37,659
Shares presented for stock option exercises	(15,500 )	(104,750 )	(239,747 )
Total non-cash transactions	\$ 853,072	\$ 1,275,865	\$ 27,452

(3) Receivables

Receivables consist of the following:

	December 31	
	2006	2005
Accounts receivable - trade	\$ 11,969,616	\$ 15,864,919
Less allowance for doubtful receivables	(340,977 )	(565,171 )
	\$ 11,628,639	\$ 15,299,748

(4) Goodwill and Other Intangible Assets

The Company completed its annual impairment test of goodwill in the fourth quarter of 2006, and determined that no goodwill was impaired.

F-15

## Edgar Filing: UFP TECHNOLOGIES INC - Form 10-K

At December 31, 2006 and December 31, 2005, the carrying value of the Company's patents was \$157,603 and \$192,055, respectively, net of accumulated amortization. Future patent amortizations for years ended December 31 will be approximately:

2007	\$ 34,000
2008	34,000
2009	34,000
2010	34,000
2011	21,603
Thereafter	
<b>Total:</b>	<b>\$ 157,603</b>

### (5) Inventories

Inventories consist of the following:

	<b>December 31</b>	
	<b>2006</b>	<b>2005</b>
Raw materials	\$ 3,796,380	\$ 4,487,659
Work in process	293,580	370,106
Finished goods	2,080,537	1,845,981
Reserve for obsolescence	(240,820 )	(262,154 )
	<b>\$ 5,929,677</b>	<b>\$ 6,441,592</b>

### (6) Property, Plant and Equipment

Property, plant and equipment consist of the following:

	<b>December 31</b>	
	<b>2006</b>	<b>2005</b>
Land	\$ 409,119	\$ 409,119
Buildings and improvements	4,537,484	4,079,714
Leasehold improvements	1,821,944	1,946,122
Equipment	28,121,833	27,389,836
Furniture and fixtures	2,026,102	2,447,820
Construction in progress - equipment/buildings	295,981	450,630
	<b>\$ 37,212,463</b>	<b>\$ 36,723,241</b>

Depreciation expense for the years ended December 31, 2006, 2005, and 2004 was \$3,003,070, \$2,902,329, and \$2,460,048, respectively.

### (7) Investment in and Advances to Affiliated Partnership

The Company has a 26.32% ownership interest in a realty limited partnership, United Development Company Limited ( UDT ). In compliance with FIN 46(R), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, the Company has consolidated the financial statements of UDT as of December 31, 2003. Prior to

F-16

December 31, 2003, this investment was accounted for under the equity method at cost, plus the Company's proportionate share of the limited partnership's income, less any distributions received from the limited partnership. As a result of consolidating UDT, both total assets and total liabilities of the Company increased by \$1,061,000 at December 31, 2006. There was no impact on net income.

**(8) Indebtedness**

As a component of consolidating UDT's assets, the Company included \$196,465 in cash at December 31, 2006. 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 has been 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 December 31, 2006, based upon no revolving credit facility borrowings outstanding and collateral levels, the Company had availability of \$12.3 million of 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 Company operating performance. All borrowings at December 31, 2006 had interest computed at Prime or LIBOR plus 1.0%. Under the amended credit facility, the Company is subject to certain financial covenants including maximum capital expenditures and minimum fixed charge coverage. As of December 31, 2006, 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 December 31, 2006, the interest rate on these facilities ranged from 6.4% to 8.25%.

As a result of the consolidation of United Development Company Limited, a mortgage note collateralized by the Alabama and Florida facilities, dated September 4, 2002, originally for \$470,313 is included within long-term debt in the Consolidated Financial Statements. The note calls for fifty principal payments of \$3,406 and one payment of \$388,967 due on March 4, 2007. The note bears interest at LIBOR plus 2.75%, adjusted monthly. At December 31, 2006, the outstanding balance was \$395,779. At December 31, 2006, the interest rate was approximately 8.1%. Payments on this note are funded through rent payments that the Company makes on its Alabama and Florida facilities. The Company is not subject to any financial covenants under this mortgage note.

F-17

---

Edgar Filing: UFP TECHNOLOGIES INC - Form 10-K

Long-term debt consists of the following:

	<b>December 31</b>	
	<b>2006</b>	<b>2005</b>
Mortgage note	\$ 2,171,000	\$ 2,327,000
Notes payable - term loans	3,115,548	3,642,119
United Development Company mortgage	395,779	404,459
<b>Total long-term debt</b>	<b>5,682,327</b>	<b>6,373,578</b>
Less current installments	1,078,350	1,087,030
<b>Long-term debt, excluding current installments</b>	<b>\$ 4,603,977</b>	<b>\$ 5,286,548</b>

Aggregate maturities of long-term debt are as follows:

Year ending December 31:

2007	\$ 1,078,350
2008	682,571
2009	682,571
2010	682,571
2011 and thereafter	2,556,264
	<b>\$ 5,682,327</b>

**(9) Accrued Taxes and Other Expenses**

Accrued taxes and other expenses consist of the following:

	<b>December 31</b>	
	<b>2006</b>	<b>2005</b>
Compensation	\$ 1,666,949	\$ 1,179,024
Benefits	1,464,198	846,091
Paid time off	486,680	466,946
Other	2,132,122	1,988,178
	<b>\$ 5,749,949</b>	<b>\$ 4,480,239</b>

**(10) Income Taxes**

The Company's income tax (benefit) provision for the years ended December 31, 2006, 2005, and 2004 consists of approximately:

F-18

	Years ended December 31		
	2006	2005	2004
<b>Current:</b>			
Federal	\$ 160,000	\$	\$ 76,000
State	300,000	122,000	108,000
	460,000	122,000	184,000
<b>Deferred:</b>			
Federal	1,061,000	131,000	174,000
State	(28,000 )	(45,000 )	131,000
	1,033,000	86,000	305,000
<b>Total income tax provision</b>	<b>\$ 1,493,000</b>	<b>\$ 208,000</b>	<b>\$ 489,000</b>

At December 31, 2006, the Company has net operating loss carry-forwards for federal income tax purposes of approximately \$4,172,000 and for state income tax purposes of approximately \$2,045,000, which are available to offset future taxable income and expire during the federal tax years ending December 31, 2019 through 2024.

The future benefit of the net operating loss carry-forwards acquired from Simco will be limited to approximately \$300,000 per year in accordance with Section 382 of the Internal Revenue Code. As of December 31, 2006, net operating loss carry-forwards acquired from Simco for federal income tax purposes totaled \$3,365,000.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are approximately as follows:

	December 31	
	2006	2005
<b>Deferred tax assets related to:</b>		
Reserves	\$	\$ 27,000
Research and development credits	650,000	544,000
Compensation programs	195,000	124,000
Retirement liability	263,000	263,000
Net operating loss carryforwards	1,758,000	3,265,000
AMT tax	123,000	
Other	62,000	73,000
<b>Total deferred tax assets</b>	<b>3,051,000</b>	<b>4,296,000</b>
<b>Deferred tax liabilities related to:</b>		
Excess of book over tax basis of fixed assets	617,000	925,000
Investee tax loss in excess of book losses	7,000	89,000
Capital leases		6,000
Reserves	7,000	
<b>Total deferred tax liabilities</b>	<b>631,000</b>	<b>1,020,000</b>
<b>Net deferred tax assets</b>	<b>\$ 2,420,000</b>	<b>\$ 3,276,000</b>

The amount recorded as net deferred tax assets as of December 31, 2006 and 2005 represents the amount of tax benefits of existing deductible temporary differences or carry-

forwards that are more likely than not to be realized through the generation of sufficient future taxable income within the carry-forward period. The Company believes that the net deferred tax asset of \$2,420,000 at December 31, 2006 is more likely than not to be realized in the carry-forward period. Management reviews the recoverability of deferred tax assets during each reporting period.

The actual tax provision for the years presented differs from the expected tax provision for those years, computed by applying the U.S. federal corporate rate of 34% to income before income tax expense as follows:

	Years ended December 31					
	2006		2005		2004	
Computed expected tax rate	34.0	%	34.0	%	34.0	%
Increase (decrease) in income taxes resulting from:						
State taxes, net of federal tax benefit	4.6		5.9		10.4	
Officers life insurance	0.1		1.4		0.4	
Meals and entertainment	0.3		3.0		2.2	
R&D credits	(2.7	)	(20.3	)	(9.9	)
Non-deductible ISO stock option expense	1.0		0.0		0.0	
Other	0.0		0.0		(1.2	)
Effective tax rate	37.3	%	24.0	%	35.9	%

The impact on the Company's 2005 effective tax rate from research and development credits is higher than usual due to true-up adjustments.

**(11) Net Income Per Share**

Basic income per share is based upon the weighted average common shares outstanding during each year. Diluted income per share is based upon the weighted average of common shares and dilutive common stock equivalent shares outstanding during each year. The weighted average number of shares used to compute both basic and diluted income per share consisted of the following:

	Years ended December 31		
	2006	2005	2004
Basic weighted average common shares outstanding			
during the year	5,022,532	4,798,008	4,616,983
Weighted average common equivalent shares due to			
stock options	548,536	462,561	377,628
Diluted weighted average common shares outstanding			
during the year	5,571,068	5,260,569	4,994,611

**(12) Stock Option and Employee Stock Purchase Plans**

The Company maintains a stock option plan to provide long-term rewards and incentives to the Company's key employees, officers, employee directors, consultants and advisors. The

plan provides for either nonqualified 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 nonqualified stock options shall be determined by the Stock Option 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 option. At December 31, 2006, there were 731,875 options outstanding under the plan. These options are not transferable except by will or domestic relations order.

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 ( 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 six months after the date of 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 December 31, 2006, there were 20,000 options outstanding under the 1993 Director Plan.

Effective July 15, 1998, the Company adopted the 1998 Director Stock Option Incentive 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 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 discontinued; however, the options outstanding under the 1993 Director Plan were not affected by the adoption of the new plan. At December 31, 2006, there were 404,184 options outstanding under the 1998 Director Plan.

On April 18, 1998, the Company adopted the 1998 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 1998 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 withheld up to 10% of their base salaries during the six month offering periods ending June 30 and December 31 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 1998 Stock Purchase Plan provides for the issuance of up to 400,000 shares of common stock. To date 298,328 shares have been issued.

In June 2003, the Company formally adopted the 2003 Equity Incentive Plan (the 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.

F-21

Two types of awards may be granted to participants under the 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, without limitation, unrestricted 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 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 is 500,000 shares. As of December 31, 2006, 191,166 shares have been issued.

On June 8, 2006, the Company's Board of Directors, upon the recommendation of the Compensation Committee, approved a grant, effective as of July 1, 2006, of restricted stock awards to certain executive officers. The grants of restricted stock awards were made under and pursuant to the Company's 2003 Equity Incentive Plan.

A	Number of shares of restricted stock granted (not subject to performance criteria)	48,000
B	Number of shares of restricted stock granted (subject to performance criteria)	48,000
C	Number of shares of restricted stock granted (subject to performance criteria)	48,000
	Total:	144,000

The awards of restricted stock listed under A above are subject to a time-based vesting requirement. One third of these awards vest on July 1, 2007, one third of these awards vest on July 1, 2008, and one third of these awards vest on July 1, 2009, so long as the recipient remains continuously employed by the Company through each such vesting date.

The shares of restricted stock listed under B and C above are subject to a different time-based vesting requirement and to the Company meeting certain financial performance requirements, described below. One third of these awards vest on July 1, 2008, one third of these awards vest on July 1, 2009, and one third of these awards vest on July 1, 2010, so long as the recipient remains continuously employed by the Company through each such vesting date.

The financial performance requirement for the shares listed under B and C above is based on the Company's earnings before interest and taxes (EBIT) for calendar year 2006 relative to an EBIT target established by the Compensation Committee. If the Company achieves the EBIT target, then all of the restricted shares listed under B above will be eligible to become vested, subject to the time-based vesting and continuous employment requirements described above. To the extent the Company achieves in excess of the EBIT target, restricted shares listed under C above (in addition to the restricted shares listed under B above) will be eligible to become vested, subject to the time-based vesting and continuous employment requirements described above, based on a straight-line interpolation of the EBIT target established by the Compensation Committee in increments of 20% of such shares, up to the maximum amount listed under C. All of the

F-22

performance requirements for B and C have been met for the year ended December 31, 2006.

Any unvested shares of restricted stock shall terminate upon the cessation of a recipient's employment with the company. In the event of a change in control of the Company (as defined in the restricted stock agreement evidencing the award): (i) the shares of restricted stock listed under A above shall become fully vested immediately prior to the effective date of such change in control; (ii) on or prior to December 31, 2006, all shares of restricted stock listed under B and C above shall terminate; and (iii) on or after January 1, 2007, to the extent the EBIT target has been achieved or exceeded, the applicable number of shares of restricted stock listed under B and C above, to the extent not already vested, shall become fully vested immediately prior to the effective date of such change in control.

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

	Shares Under Options	Weighted Average Exercise Price
Outstanding December 31, 2003	1,136,170	\$ 1.88
Granted	214,167	2.74
Exercised	(118,800 )	2.04
Cancelled or expired	(56,000 )	3.08
Outstanding December 31, 2004	1,175,537	\$ 1.97
Granted	305,759	3.08
Exercised	(86,875 )	1.51
Cancelled or expired	(18,875 )	3.20
Outstanding December 31, 2005	1,375,546	\$ 2.23
Granted	64,877	5.86
Exercised	(255,614 )	2.10
Cancelled or expired	(28,750 )	4.45
Outstanding December 31, 2006	1,156,059	\$ 2.40

There were 1,061,809 exercisable options as of December 31, 2006.

During the twelve months ended December 31, 2006, 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 \$883,417, and the total amount of consideration received from the exercise of these options was \$537,065.

F-23

Edgar Filing: UFP TECHNOLOGIES INC - Form 10-K

The following is a summary of information relating to stock options outstanding and exercisable by price range as of December 31, 2006:

Range of exercise prices	Options Outstanding			Options Exercisable	
	Outstanding as of 12/31/06	Weighted average remaining contractual life	Weighted average exercise price	Exercisable as of 12/31/06	Weighted average exercise price
\$0.00 - \$0.99	50,000	5.1 years	\$ 0.81	50,000	\$ 0.81
\$1.00 - \$1.99	401,892	4.8 years	1.25	391,892	1.25
\$2.00 - \$2.99	349,684	6.0 years	2.50	349,684	2.50
\$3.00 - \$3.99	272,106	5.6 years	3.33	202,856	3.32
\$4.00 - \$4.99	22,500	1.8 years	4.35	17,500	4.18
\$5.00 - \$5.99	10,000	4.7 years	5.31		
\$6.00 - \$6.99	49,877	9.5 years	6.07	49,877	6.07
	1,156,059	5.5 years	\$ 2.40	1,061,809	\$ 2.31

The total grant date fair value of stock options that vested during the twelve months ended December 31, 2006 was approximately \$702,000 with a weighted average remaining contractual term of approximately 6 years.

The following summarizes the future share-based compensation expense the Company will record as the equity securities granted through December 31, 2006 vest:

	Options	Common Stock	Restricted Stock Units	Total
2007	\$ 104,432	0	\$ 240,328	\$ 344,760
2008	\$ 87,932	0	\$ 240,328	\$ 328,260
2009	\$ 29,643	0	\$ 192,458	\$ 222,101
2010	\$ 9,922		\$ 72,294	\$ 82,216
	\$ 231,929	0	\$ 745,408	\$ 977,337

**(13) Preferred Stock**

On January 13, 1999, the Company declared a dividend of one preferred share purchase right ( a Right ) for each outstanding share of common stock, par value \$0.01 per share on February 5, 1999 to the stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company one one-thousandth of a share of Series A Junior Participating Preferred Stock, par value \$0.01 per share (the Preferred Share ), of the Company, at a price of \$30.00 per one one-thousandth of a Preferred Share subject to adjustment and the terms of the Rights Agreement.

**(14) Supplemental Retirement Plan**

The Company has a supplemental retirement plan for certain retired officers, which will provide an annual benefit to these individuals for various terms following separation from employment. The Company recorded an expense of approximately \$111,000, \$42,000, and \$58,000 for the years ended December 31, 2006, 2005, and 2004, respectively, in

accordance with this plan, which includes both current costs and prior service costs for these individuals. The present value of the supplemental retirement obligation has been calculated using an 8.5% discount rate. Total projected future cash payments for the years ending December 31, 2007 through 2010 are approximately \$244,000, \$108,000, \$104,000, and \$101,000, respectively, and approximately \$381,000 thereafter.

**(15) Commitments and Contingencies**

(a) **Leases** The Company has non-cancelable operating leases for certain facilities that expire through 2011. Certain of the leases contain escalation clauses which require payments of additional rent, as well as increases in related operating costs. The Company also leases various equipment under capital leases which expire through 2011.

Included in property, plant, and equipment are the following amounts held under capital lease:

	<b>December 31</b>	
	<b>2006</b>	<b>2005</b>
Equipment	\$ 4,539,977	\$ 2,765,061
Less accumulated depreciation	(1,695,186 )	(680,831 )
	\$ 2,844,791	\$ 2,084,230

Future minimum lease payments under noncancelable operating leases and the present value of future minimum lease payments under capital leases as of December 31, 2006, are as follows:

<b>Years ending December 31:</b>	<b>Capital Leases</b>	<b>Operating Leases</b>
2007	891,704	1,645,615
2008	852,894	684,816
2009	798,979	473,895
2010	717,916	405,915
Thereafter	244,250	1,220,334
Total minimum lease payments	\$ 3,505,743	\$ 4,430,575
Less amount representing interest	499,680	
Present value of future minimum lease payments	3,006,063	
Less current installments of obligations under capital leases	688,991	
Obligations under capital lease, excluding current installments	\$ 2,317,072	

Rent expense amounted to approximately \$2,375,000, \$2,230,000, and \$2,153,000 in 2006, 2005, and 2004, respectively. Approximately \$244,000, \$244,000, and \$244,000 in 2006, 2005 and 2004, respectively, was paid to United Development Company Limited ( UDT ), a real estate company of which the Company owns

F-25

26.32%, that owns the Decatur, Alabama, and Kissimmee, Florida, facilities. The 2006 and 2005 rent expense incurred from UDT has been eliminated in consolidation.

In connection with the eight-year automotive program, the Company has purchased a new forming line for approximately \$1.7 million in 2003, and a second similar forming line for approximately \$1.9 million in 2004.

(b) **Legal** The Company is a defendant in various administrative proceedings that are being handled in the ordinary course of business. In the opinion of management of the Company, these suits and claims should not result in final judgments or settlements that, in the aggregate, would have a material adverse effect on the Company's financial condition or results of operations.

**(16) Employee Benefit Plans**

The Company maintains a profit-sharing plan for eligible employees. Contributions to the Plan are made in the form of matching contributions to employee 401k deferrals as well as discretionary amounts determined by the Board of Directors, and amounted to approximately \$432,000, \$451,000, and \$459,000 in 2006, 2005, and 2004, respectively.

The Company has a partially self-insured health insurance program that covers all eligible participating employees. The maximum liability is limited by a stop loss of \$75,000 per insured person, along with an aggregate stop loss determined by the number of participants.

During 2006, the Company established an Executive, Non-qualified Excess Plan (the Plan), which is a deferred compensation plan available to certain executives. The Plan permits participants to defer receipt of part of their current compensation to a later date as part of their personal retirement or financial planning. Participants have an unsecured contractual commitment by the Company to pay amounts due under the Plan. There is currently no security mechanism to ensure that these obligations will be paid in the future by the Company.

The compensation withheld from Plan participants, together with investment income on the Plan, is reflected as a deferred compensation obligation to participants and is classified within accrued liabilities in the accompanying balance sheet. At December 31, 2006, the balance of the deferred compensation liability totaled approximately \$35,000. The related assets, which are held in the form of a company-owned, variable life insurance policy that names the Company as the beneficiary, are classified within other assets in the accompanying balance sheet and are reported at cash surrender value, which was approximately \$34,000 as of December 31, 2006.

**(17) Fair Value of Financial Instruments**

Statement of Financial Accounting Standards No. 107, *Disclosures About Fair Value of Financial Instruments*, defines the fair value of financial instruments as the amount at which the instrument could be exchanged in a transaction between willing parties.

Cash and cash equivalents, accounts receivable, inventories, prepaid expenses, notes payable to bank, accounts payable, and accrued expenses and payroll withholdings are

F-26

---

stated at carrying amounts that approximate fair value because of the short maturity of those instruments.

Long-term debt and capital lease obligations are subject to interest rates currently offered to the Company; therefore, the historical carrying amount approximates fair value.

**(18) Segment Data**

The Company has adopted SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

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; Packaging and Component Products. Within the 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 applications 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. Income taxes and interest expense have been allocated based on operating results and total assets employed in each segment.

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, net profits and assets agree with the Company's comparable amount contained in the audited financial statements. Revenues from customers outside of the United States are not material.

The top customer in the Company's Component Products segment comprises 30% of that segment's total sales and 18% of the Company's total sales for the year ended December 31, 2006. No one customer accounted for more than 10% of the Packaging segment sales for the year ended December 31, 2006.

The results for the Packaging segment include the results of United Development Company Limited.

F-27

---

Edgar Filing: UFP TECHNOLOGIES INC - Form 10-K

Financial statement information by reportable segment is as follows:

<b>2006</b>	<b>Component</b>		<b>Total</b>
	<b>Products</b>	<b>Packaging</b>	
Sales	\$ 55,757,985	37,991,254	\$ 93,749,239
Operating income (loss)	2,833,743	2,220,439	5,054,182
Total assets	21,131,060	17,905,952	39,037,012
Depreciation / amortization	1,933,949	1,125,753	3,059,702
Capital expenditures	911,032	604,501	1,515,533
Interest expense	493,534	470,448	963,982
Goodwill	4,463,246	2,017,791	6,481,037

<b>2005</b>	<b>Component</b>		<b>Total</b>
	<b>Products</b>	<b>Packaging</b>	
Sales	\$ 48,218,839	35,743,618	\$ 83,962,457
Operating income (loss)	(601,839 )	2,772,624	2,170,785
Total assets	25,460,467	18,539,549	44,000,016
Depreciation / amortization	1,645,010	1,291,681	2,936,691
Capital expenditures	35,485	1,074,510	1,109,995
Interest expense	582,266	459,448	1,041,714
Goodwill	4,463,246	2,017,791	6,481,037

<b>2004</b>	<b>Component</b>		<b>Total</b>
	<b>Products</b>	<b>Packaging</b>	
Sales	\$ 36,135,175	32,488,923	\$ 68,624,098
Operating income	967,616	1,176,793	2,144,409
Total assets	21,921,263	17,710,941	39,632,204
Depreciation / amortization	1,111,537	1,381,763	2,493,300
Capital expenditures	1,343,254	828,446	2,171,700
Interest expense	375,822	337,829	713,651
Goodwill	4,463,246	2,017,791	6,481,037

F-28

**(19) Quarterly Financial Information (unaudited)**

	Q1	Q2	Q3	Q4
Year ended 12/31/2006				
Net sales	\$ 24,140,718	\$ 24,533,970	\$ 21,737,107	\$ 23,337,444
Gross profit	4,878,826	5,289,301	4,176,799	4,892,373
Net income	573,594	700,544	395,515	845,220
Basic net income per share	0.12	0.14	0.08	0.16
Diluted net income per share	0.11	0.13	0.07	0.15
Year ended 12/31/2005				
Net sales	\$ 18,191,891	\$ 20,917,802	\$ 21,649,267	\$ 23,203,497
Gross profit	3,622,964	4,126,323	3,087,184	3,764,829
Net income	85,402	314,189	(148,531)	) 408,031
Basic net income per share	0.02	0.07	(0.03)	) 0.08
Diluted net income per share	0.02	0.06	(0.03)	) 0.08

F-29

## UFP TECHNOLOGIES, INC.

## Consolidated Financial Statement Schedule

## Valuation and Qualifying Accounts

Years ended December 31, 2006, 2005, and 2004

Accounts receivable, allowance for doubtful accounts:

	2006	2005	2004
Balance at beginning of year	\$ 565,171	\$ 543,317	\$ 475,625
Provision / Recoveries charged to expense	(36,292 )	85,140	165,284
Write-offs and recoveries	(187,902 )	(63,286 )	(97,592 )
Balance at end of year	\$ 340,977	\$ 565,171	\$ 543,317

Inventory allowance for obsolescence:

	2006	2005	2004
Balance at beginning of year	\$ 262,154	\$ 304,273	\$ 270,289
Provision	300,673	177,440	175,929
Write-offs and recoveries	(322,007 )	(219,559 )	(141,945 )
Balance at end of year	\$ 240,820	\$ 262,154	\$ 304,273

\* \* \*

F-30