FORTUNE BRANDS INC
Form 10-Q
August 08, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 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 1-9076

FORTUNE BRANDS, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE	13-3295276
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
520 Lake Cook Road, Deerfield, Illinois	60015-5611
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (847) 484-4400

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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer x 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 x

The number of shares outstanding of the registrant s common stock, par value $3.125 per share, at July 31, 2006 was 150,827,931.

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

(in millions)

	June 30, 2006 (Unaudited)	December 31, 2005
Assets		
Current assets		
Cash and cash equivalents	$ 214.9	$ 93.6
Accounts receivable, net	1,379.8	1,115.6
Inventories		
Maturing spirits and wine	1,139.7	889.3
Other raw materials, supplies and work in process	484.6	301.5
Finished products	459.4	472.3
	2,083.7	1,663.1
Other current assets	418.0	320.4
Total current assets	4,096.4	3,192.7
Property, plant and equipment, net	1,897.3	1,679.6
Goodwill resulting from business acquisitions	4,339.2	3,633.5
Other intangible assets resulting from business acquisitions, net	3,699.4	3,247.0
Investments in unconsolidated subsidiaries	88.3	1,173.9
Other assets	367.8	274.8
Total assets	$ 14,488.4	$13,201.5

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

(in millions, except per share amounts)

	June 30, 2006 (Unaudited)	December 31, 2005
Liabilities and stockholders equity		
Current liabilities		
Notes payable to banks	$ 84.4	$ 20.5
Commercial paper	722.9	616.7
Current portion of long-term debt	297.6	296.9
Accounts payable	413.1	684.9
Accrued taxes	400.2	199.9
Accrued customer programs	127.0	164.9
Accrued salaries, wages and other compensation	141.4	160.2
Accrued expenses and other liabilities	620.2	673.9
Total current liabilities	2,806.8	2,817.9
Long-term debt	5,487.2	4,889.9
Deferred income	105.7	119.2
Deferred income taxes	913.9	877.2
Other liabilities	474.6	476.9
Total liabilities	9,788.2	9,181.1
Minority interest in consolidated subsidiaries	359.4	374.8
Stockholders equity		
$2.67 Convertible Preferred stock redeemable at Company s option	6.4	6.6
Common stock, par value $3.125 per share, 229.6 shares issued	733.7	717.4
Paid-in capital	570.7	182.8
Accumulated other comprehensive income (loss)	26.3	(22.2)
Retained earnings	6,205.6	5,890.2
Treasury stock, at cost	(3,201.9)	(3,129.2)
Total stockholders equity	4,340.8	3,645.6
Total liabilities and stockholders equity	$ 14,488.4	$13,201.5

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF INCOME

For the Six Months Ended June 30, 2006 and 2005

(in millions, except per share amounts)

(Unaudited)

	2006	2005
Net sales	$ 4,273.9	$ 3,300.6
Cost of products sold	2,269.0	1,796.5
Excise tax duties on spirits and wine	224.4	136.1
Advertising, selling, general and administrative expenses	1,016.9	787.5
Amortization of intangibles	19.1	16.4
Restructuring charges	4.0	
Operating income	740.5	564.1
Interest expense	162.3	39.2
Other (income) expense, net	(20.1)	13.8
Income from continuing operations before income taxes and minority interests	598.3	511.1
Income taxes	168.3	175.7
Minority interests	8.8	9.0
Income from continuing operations	421.2	326.4
Income from discontinued operations		26.6
Net income	$ 421.2	$ 353.0
Earnings per common share		
Basic		
Continuing operations	$ 2.86	$ 2.25
Discontinued operations		0.18
Net earnings	$ 2.86	$ 2.43
Diluted		
Continuing operations	$ 2.79	$ 2.18
Discontinued operations		0.17
Net earnings	$ 2.79	$ 2.35
Dividends paid per common share	$ 0.72	$ 0.66
Average number of common shares outstanding		
Basic	147.1	145.1
Diluted	151.0	150.0

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF INCOME

For the Three Months Ended June 30, 2006 and 2005

(in millions, except per share amounts)

(Unaudited)

	2006	2005
Net sales	$ 2,257.1	$ 1,782.8
Cost of products sold	1,184.4	960.0
Excise tax duties on spirits and wine	103.6	71.3
Advertising, selling, general and administrative expenses	526.5	410.8
Amortization of intangibles	9.1	8.2
Restructuring credit	(0.1)	
Operating income	433.6	332.5
Interest expense	83.2	20.1
Other (income) expense, net	(10.1)	26.8
Income from continuing operations before income taxes and minority interests	360.5	285.6
Income taxes	108.6	97.7
Minority interests	4.1	4.1
Income from continuing operations	247.8	183.8
Income from discontinued operations		16.5
Net income	$ 247.8	$ 200.3
Earnings per common share		
Basic		
Continuing operations	$ 1.68	$ 1.26
Discontinued operations		0.12
Net earnings	$ 1.68	$ 1.38
Diluted		
Continuing operations	$ 1.63	$ 1.22
Discontinued operations		0.11
Net earnings	$ 1.63	$ 1.33
Dividends paid per common share	$ 0.36	$ 0.33
Average number of common shares outstanding		
Basic	147.7	145.5
Diluted	151.6	150.3

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

For the Six Months Ended June 30, 2006 and 2005

(in millions)

(Unaudited)

	2006	2005
Operating activities		
Net income	$ 421.2	$ 353.0
Restructuring charges	4.1	
Depreciation and amortization	131.5	111.6
Stock-based compensation	18.7	
Deferred income taxes	(62.1)	(2.9)
Changes in assets and liabilities including effects subsequent to acquisitions:		
Decrease (increase) in accounts receivable	4.2	(123.0)
Increase in inventories	(108.9)	(29.1)
Decrease in accounts payable	(286.1)	(10.8)
(Increase) decrease in accrued expenses and other liabilities	67.6	(110.8)
Increase in accrued taxes	52.6	83.5
Tax benefit on exercise of stock options		18.2
Other operating activities, net	(31.1)	43.1
Net cash provided by operating activities	211.7	332.8
Investing activities		
Additions to property, plant and equipment	(91.6)	(104.8)
Proceeds from the disposition of property, plant and equipment	4.2	3.7
Acquisitions, net of cash acquired	(592.2)	(9.4)
Cash paid for acquisition-related call options		(35.7)
Other investing activities, net		(1.0)
Net cash used by investing activities	(679.6)	(147.2)
Financing activities		
(Decrease) increase in short-term debt and commercial paper, net	(2,132.8)	(148.7)
Issuance of long-term debt	2,939.9	
Repayment of long-term debt	(148.9)	(0.2)
Dividends paid to stockholders	(105.8)	(96.2)
Proceeds received from exercise of stock options	16.2	54.3
Tax benefit on exercise of stock options	3.3	
Other financing activities, net	4.0	(4.8)
Net cash provided (used) by financing activities	575.9	(195.6)
Effect of foreign exchange rate changes on cash	13.3	(2.8)
Net increase (decrease) in cash and cash equivalents	$ 121.3	$ (12.8)
Cash and cash equivalents at beginning of period	$ 93.6	$ 164.9
Cash and cash equivalents at end of period	$ 214.9	$ 152.1

We believe there are approximately five manufacturers of latex balloons whose products are sold in the United States and numerous others whose products are sold in other countries.

The market for films, packaging and custom products is fragmented, and competition in this area is difficult to gauge. However, there are numerous participants in this market and the Company can expect to experience intense quality and price competition.

Many of these companies offer products and services that are the same or similar to those offered by us and our ability to compete depends on many factors within and outside our control. There are a number of well-established competitors in each of our product lines, several of which possess substantially greater financial, marketing and technical resources and have established, extensive, direct and indirect channels of distribution for their products and services. As a result, such competitors may be able to respond more quickly to new developments and changes in customer requirements, or devote greater resources to the development, promotion and sale of their products and services than we can. Competitive pressures include, among other things, price competition, new designs and product development and copyright licensing.

Patents, Trademarks and Copyrights

We have developed or acquired a number of intellectual property rights which we believe are significant to our business.

Copyright Licenses. We maintain licenses on certain popular characters and designs for our balloon products. We presently maintain seven licenses and produce balloon designs utilizing the characters or designs covered by the licenses. Licenses are generally maintained for a one or two-year term, although the Company has maintained long term relationships with several of its licensors.

Trademarks. We own 12 registered trademarks in the United States relating to our balloon products. Many of these trademarks are registered in foreign countries, principally in the European Union.

Patent Rights. We own, or have license rights under, or have applied for, patents related to our balloon products, certain film products and certain flexible container products. These include (i) ownership of two patents, and a license under a third, relating to self-sealing valves for metalized balloons and methods of making balloons with such valves, (ii) several metalized balloon design patents, (iii) patents and applications related to the design and structure of, and method of, inserting and affixing, zipper-closure systems in a bag, (iv) patents related to one-way valves for pouches, (v) a patent related to methods of embossing film and utilizing such film to produce pouches with fitments, and (vi) patent applications related to vacuumable storage bags with fitments.

Research and Development

We maintain a product development and research department of five individuals for the development or identification of new products, product components and sources of supply. Research and development includes (i) creative product development, (ii) creative marketing, and (iii) engineering development. During each of the fiscal years ended December 31, 2007, 2006, 2005, respectively, we estimate that the total amount spent on research and development activities was approximately $350,000, $230,000 and $224,000 and, respectively.

Employees

As of December 31, 2007, the Company had 84 full-time employees in the United States, of whom 17 are executive or supervisory, 5 are in sales, 44 are in manufacturing or warehouse functions and 18 are clerical. As of that same date, we had 9 full-time employees in England, of whom 3 are executive or supervisory, 2 are in sales, 3 are in warehousing and one is clerical. At Flexo Universal, our Mexico subsidiary, as of December 31, 2007, we had 228 full-time employees, of whom 5 are executive or supervisory, 3 are in sales, 210 are in manufacturing and 10 are clerical. The Company is not a party to any collective bargaining agreement in the United States, has not experienced any work stoppages and believes that its relationship with its employees is satisfactory.

Regulatory Matters

Our manufacturing operations in the United States are subject to the U.S. Occupational Safety and Health Act ("OSHA"). We believe we are in material compliance with OSHA. The Company generates liquid, gaseous and solid waste materials in its operations in Barrington, Illinois and the generation, emission or disposal of such waste materials are, or may be, subject to various federal, state and local laws and regulations regarding the generation, emission or disposal of waste materials. We believe we are in material compliance with applicable environmental rules and regulations. Several states have enacted laws limiting or restricting the release of helium filled metalized balloons. We do not believe such legislation will have any material effect on our operations.

International Operations

We sell balloon products in a number of countries outside the United States. Sales of these products for the United Kingdom and Europe are handled by our facility and personnel in Rugby, England, and for Mexico and Latin America by our facility and personnel in Guadalajara, Mexico. In other countries, we sell balloon products through distributors located in those countries. We conduct production, packaging, warehousing and sales operations in Mexico and warehousing and sales operations in the United Kingdom. We rely and are dependent on our operations in Mexico for the supply of latex balloons in the United States, Mexico, Europe and other markets. Interruption of that supply would have a material adverse effect on the business of the Company.

Our domestic and international sales and assets by area over the period 2005-2007 have been as follows:

	United States	United Kingdom	Mexico	Eliminations	Consolidated
Year ended 12/31/07					
Revenues	$ 28,657,000	$ 2,913,000	$ 7,189,000	$ (2,249,000)	$ 36,510,000
Operating income	$ 810,000	$ 215,000	$ 345,000	$ (125,000)	$ 1,245,000
Net (loss) income	$ (128,000)	$ 167,000	$ 168,000	$ (125,000)	$ 82,000
Total Assets	$ 27,854,000	$ 2,948,000	$ 5,780,000	$ (7,258,000)	$ 29,324,000
Year ended 12/31/06					
Revenues	$ 28,808,000	$ 2,925,000	$ 6,564,000	$ (2,869,000)	$ 35,428,000
Operating income	$ 2,116,000	$ 64,000	$ 578,000	$ (25,000)	$ 2,733,000
Net income	$ 1,544,000	$ 93,000	$ 284,000	$ (26,000)	$ 1,895,000
Total Assets	$ 25,245,000	$ 2,627,000	$ 5,050,000	$ (6,288,000)	$ 26,634,000
Year ended 12/31/05					
Revenues	$ 23,564,000	$ 2,573,000	$ 4,536,000	$ (1,483,000)	$ 29,190,000
Operating income (loss)	$ 602,000	$ 290,000	$ (240,000)	$	$ 652,000
Net (loss) income	$ (342,000)	$ 220,000	$ (211,000)	$	$ (333,000)

Item No. 1A – Risk Factors

The following factors, as well as factors described elsewhere in this Annual Report, or in our other filings with the Securities and Exchange Commission, could adversely affect our consolidated financial position, results of operation or cash flows. Other factors not presently known to us, that we do not presently consider material, or that we have not predicted, may also harm our business operations or adversely affect us.

Industry Risks

We engage in businesses which are intensely competitive, involve strong price competition and relatively low margins.

The businesses in which we engage - supply of films for flexible packaging, supply of pouches for flexible packaging and supply of novelty balloon items - are highly competitive. We face intense competition from a number of competitors in each of these product categories, several of which have extensive production facilities, well-developed sales and marketing staffs and greater financial resources than we do. Some of these competitors maintain international production facilities enabling them to produce at low costs and to offer products at highly competitive prices. We compete on the basis of price, quality, service, delivery and differentiation of products. Most of our competitors seek to engage in product development and may develop products that have superior performance characteristics to our products. This intense competition can limit or reduce our sales or market share for the sale of our products as well as our margins. There can be no assurance that we will be able to compete successfully in the markets for our products or that we will be able to generate sufficient margins from the sale of our products to become or remain profitable.

Our business is dependent on the price and availability of raw materials.

The cost of the raw materials we purchase represents about 41.2% of our revenues. The principal raw materials we purchase are: nylon sheeting, polyester sheeting, polyethylene sheeting, polyethylene resin and latex. Much of these materials are derived from petroleum and natural gas. Prices for these materials fluctuate substantially as a result of the change in petroleum and natural gas prices, demand and the capacity of companies who produce these products to meet market needs. Instability in the world markets for petroleum and natural gas has, and may, adversely affect the prices of these raw materials and their general availability. The price of latex has also fluctuated significantly over the past three years. Our ability to achieve and maintain profitability is partially dependent upon our ability to pass through to our customers the amount of increases in raw materials cost. If prices of these materials increase and we are not able to fully pass on the increases to our customers, our results of operations and our financial condition will be adversely affected.

Changes or limitations in the price and availability of helium to our customers may adversely affect our sales of novelty products.

Many of our novelty products, including many styles of foil balloons and latex balloons, are intended to be, and are, when sold to or used by customers filled with helium for buoyancy. During recent months, the price of helium has increased. It has been reported that the supply of helium is decreasing, that demand for helium for industrial and scientific uses has been increasing and that exports of helium from the United States, which is the principal producer of helium, have increased. As a result, the increased price of helium and possible lack of availability may adversely affect sales of novelty balloon products, including sales by the Company.

The loss of a key supplier or suppliers could lead to increased costs and lower margins as well as other adverse results.

We rely on eight principal suppliers for our petroleum, natural gas and latex-based raw material suppliers. We do not maintain supply agreements with any of our suppliers for these materials. The loss of any of these suppliers would force us to purchase these materials from other suppliers or on the open market, which may require us to pay higher prices for raw materials than we do now, with the result that our margins on the sale of our products would be adversely affected. In addition, the loss of the supply of an important raw material from one of our present suppliers may not be replaceable through open market purchases or through a supply arrangement with another supplier. In the event that we were unable to obtain a raw material from another supplier, we would be unable to continue to manufacture certain of our products.

Company Risks

We have a history of both income and losses and have experienced fluctuations of operating income, which may cause our stock to fluctuate.

We have had a history of losses and of fluctuating income from operations over the past five years. We have reported net income from operations in three of the past five years and losses in two of those years Our income or loss from operations during that time has ranged from a profit of $2,622,000 to a loss of $223,000 and has been subject to significant quarterly and annual fluctuations. These fluctuations can be caused by:

- Economic conditions
- Competition
- Production efficiencies
- Variability in raw materials prices
- Seasonality

These fluctuations make it more difficult for investors to compare our operating results to corresponding prior year periods. These fluctuations also cause our stock price to fluctuate. You should not rely on our results of operations for any particular quarter or year as being indicative of our results for a full year or any other period.

We have limited financial resources that may adversely affect our ability to invest in productive assets, marketing, new products and new developments.

Our working capital is limited. As of December 31, 2007, our current assets exceeded our current liabilities by approximately $1,318,000. As a result of this limited amount of working capital, we may be unable to fund capital investments, working capital needs, marketing and sales programs, research and development, patent or copyright licenses or other items which we would like to acquire or pursue in accordance with our business strategies. The inability to pursue any of these items may adversely affect our competitive position, our business, financial condition or prospects.

A high percentage of our sales are to a limited number of customers and the loss of any one or more of those customers could adversely affect our results of operation, cash flow and financial condition.

For the year ended December 31, 2007, our sales to our top 10 customers represented 65.3% of our net sales and our sales to our top three customers represented 49.8% of our net sales. We do not have long term contracts with several of our principal customers. The loss of any of our principal customers, or a significant reduction in the amount of our sales to any of them, would have a material adverse effect on our business and financial condition.

In March 2006, we entered into a four-year agreement with ITW, one of our top three customers, to provide (i) all of their requirements for a certain kind of pouch and (ii) all of their requirements, subject to competitive pricing, for film for their use in the production of certain pouches. In April 2006, we entered into a license agreement with Rapak, one of our top three customers, granting Rapak a license under a patent related to textured film and pouches, and extending the term of an existing supply agreement with Rapak to October 31, 2008. On February 1, 2008, we entered into a Supply and License Agreement with S.C. Johnson & Son, Inc. to manufacture and sell to SC Johnson certain home food management products to be sold under the SC Johnson ZipLoc® brand. The agreement is for a term expiring on June 30, 2011 and provides for two renewal terms of two years each at the option of SC Johnson.

We rely on intellectual property in our business and the failure to develop, acquire or protect our intellectual property could adversely affect our business.

We consider patents, copyright licenses and to some degree trademarks, as being significant to our competitive position, our ability to obtain and retain customers and to achieve acceptable margin levels on the sale of our products. With respect to our film and flexible packaging/pouch business, we believe that developing, acquiring and maintaining patent rights are of significance to us for those reasons. Over the past 12 years, we have obtained nine patents related to films, pouches, zippers for pouches, the method of inserting zippers in pouches and certain valves for pouches. We have three patents pending with regard to such products With respect to our novelty balloon products, we believe that patent rights and trade secrets for product developments and copyright licenses for characters and designs are of significance to our ability to compete in the market and to obtain acceptable margins on the sale of our products. Our limited financial resources have made it more difficult for us to invest in product and patent developments and to obtain copyright licenses. If we are unable to develop, acquire, maintain or enforce some or all of our intellectual property rights, our business, financial conditions and prospects will be adversely affected.

We produce all of our products at two plants and damage to or destruction of one or both of the plants would have a serious adverse affect on our business.

We produce all of our film products and pouches at our plant in Barrington, Illinois and all of our latex balloon products at our plant in Guadalajara, Mexico. In the event of a fire, flood, or other natural disaster, or the termination of our lease in Mexico, we could lose access to one or both of our plants. Loss of, significant damage to, or destruction of, one or both of these plants would render us unable to produce our products presently produced in such plants, possibly for an extended period of time and our business, financial condition and prospects would be materially adversely affected. While we maintain business interruption insurance, the proceeds of such insurance may not be adequate to compensate us for all of our losses in such an event.

We are dependent on the management experience of our key personnel.

We are dependent on the management experience and continued services of our executive officers, including Howard W. Schwan, our President, John H. Schwan, our Chairman and Stephen M. Merrick, our Chief Financial Officer, as well as each of these other executive officers of the Company: Brent Anderson, Sam Komar, Steve Frank and Timothy Patterson. We have an existing employment agreement with Howard Schwan, dated January 1, 1997, which is automatically renewed each July 1 for another year unless terminated by either party. The agreement includes confidentiality, inventions, non-compete and other customary provisions. The loss of any of these executive officers would have an adverse effect on our business.

In addition, our continued growth depends on our ability to attract and retain experienced key employees. Competition for qualified employees is intense, and the loss of such persons, or an inability to attract, retain and motivate such skilled employees, could have a material adverse effect on our results of operations, financial condition and prospects. There can be no assurance that we will be able to retain our existing personnel or attract and retain additional qualified employees.

Our principal executive officers own a majority of our outstanding common stock, have warrants to purchase additional shares, and have significant influence and control over our business.

Howard W. Schwan (our President), John H. Schwan (our Chairman) and Stephen M. Merrick (our Chief Financial Officer) or persons affiliated to them, in combination, owned approximately 45.2% of the outstanding shares of common stock of the Company as of April 9, 2008 and then had options and warrants to purchase additional shares which, if exercised, together with the shares owned, would aggregate 48.2% of the shares then outstanding. As a result of such ownership, these executives have the ability to exert significant influence and control on the outcome of corporate transactions and other matters submitted to the Board of Directors or stockholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets, and also the power to prevent or cause a change in control of the Company.

Financial Risks

We have a high level of debt relative to our equity, which reduces cash available for our business and which may adversely affect our ability to obtain additional funds, and increases our vulnerability to economic or business turndowns.

We have a substantial amount of debt in relation to our shareholders' equity. As of December 31, 2007, we had $22,720,000 of debt outstanding and $6,591,000 in shareholders equity. These circumstances could have important adverse consequences for our Company. For example they could:

- Increase our vulnerability to general adverse economic and industry conditions
- Require us to dedicate a substantial portion of our cash flow from operations to payments on our debt, thereby limiting our ability to fund working capital, capital expenditures and other general corporate purposes;
- Limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- Place us at a competitive disadvantage compared to our competitors who may have less debt and greater financial resources; and
- Limit, among other things, our ability to borrow additional funds.

On February 1, 2006, we entered into a loan agreement with RBS Citizens, N.A., previously referred to as Charter One Bank, in which, as amended, RBS Citizens, N.A. provides to us a line of credit totaling $15,300,000, including a five year mortgage loan on our principal plant and offices in Barrington, Illinois for $2,800,000, a five year term loan secured by our physical assets in Barrington, Illinois for $3,500,000 and a three year revolving line of credit secured by inventory and receivables in the maximum amount of $9,000,000. In November, 2007 RBS Citizens, N.A. also provided to us a capital lease line of credit in the aggregate amount of $1,500,000 for the acquisition of production equipment. Also, on February 1, 2006, Messrs. John Schwan and Stephen Merrick, each loaned to the Company the sum of $500,000 in exchange for five year subordinated notes and warrants to purchase up to 151,515 shares of common stock of the Company, each.

We will require a significant amount of cash to service our debt, to develop new business and to make capital investments and our ability to generate cash depends on many factors beyond our control.

Our ability to service our debt and to fund our operations and planned capital expenditures will depend on our financial and operating performance and our ability to borrow money or raise capital. These matters are, in part, subject to prevailing economic conditions and to financial, business and other factors beyond our control. If our cash flow from operations is insufficient to fund our debt service obligations, we may be forced to reduce or delay funding capital or working capital, marketing or other commitments or to sell assets, obtain additional equity capital or indebtedness or refinance or restructure our debt. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations, or to fund operations, initiatives or capital requirements. In the absence of cash flow from operations, or the generation of cash from such other sources sufficient to meet our debt service obligations and our other cash requirements, we could face substantial cash problems.

In July 2006, we entered into a Standby Equity Distribution Agreement (SEDA) with Cornell Capital Partners, LP ("Cornell Capital") pursuant to which we may, at our discretion, periodically sell to Cornell Capital shares of common stock at a price equal to the volume weighted average price of our common stock on the NASDAQ Capital Market for the five days immediately following the date we notify Cornell Capital of our request. See pages 35-37 for a description of the agreement. On December 28, 2006, we filed a Registration Statement with the SEC for the registration of 403,500 shares to be sold by Cornell Capital and Newbridge Securities (our placement agent). On January 28, 2007, the Registration Statement was declared effective. Through December 31, 2007, in connection with the SEDA, we have requested and received aggregate advances from Cornell Capital under this agreement for $1,580,000 and Cornell Capital has purchased from us an aggregate of 323,625 shares of our common stock.

We are subject to a number of restrictive debt covenants that may restrict our business and financing activities.

Our credit facility contains restrictive debt covenants that, among other things, restrict our ability to:

- Borrow money;
- Pay dividends and make distributions;
- Issue stock
- Make certain investments;
- Use assets as security in other transactions;
- Create liens;
- Enter into affiliate transactions;
- Merge or consolidate; or
- Transfer and sell assets.

In addition, our credit facility also requires us to meet certain financial tests, including (i) maintaining tangible net worth in excess of $3,500,000, (ii) maintaining specified ratios of senior debt to EBITDA and (iii) maintaining a ratio of EBITDA to fixed charges. These restrictive covenants may limit our ability to expand or pursue our business strategies.

Our ability to comply with the restrictions contained in our credit facility may be affected by changes in our business condition or results of operation, adverse regulatory developments, or other events beyond our control. A failure to comply with these restrictions could result in a default under our credit facility which, in turn, could cause our debt to become immediately due and payable. If our debt were to be accelerated, we cannot assure that we would be able to repay it. In addition, a default would give our lender the right to terminate any commitment to provide us with additional funds.

Market Risks and Risks Related to the Offering Described in Our Registration Statement

Our common stock may be affected by limited trading volume and may fluctuate significantly, which may affect shareholders' ability to sell shares of our common stock.

There has been a limited public market for our common stock and a more active trading market for our common stock may not develop. An absence of an active trading market could adversely affect our shareholders' ability to sell our common stock in short time periods, or possibly at all. Our common stock has experienced, and is likely to experience in the future, significant price and volume fluctuations, which could adversely affect the market price of our common stock without regard to our operating performance. In addition, we believe that factors such as quarterly fluctuations in our financial results and changes in the overall economy or the condition of the financial markets could cause the price of our common stock to fluctuate substantially. These factors may negatively affect shareholders' ability to sell shares of our common stock.

Our common stock may be affected by sales of short sellers, which may affect shareholders' ability to sell shares of our common stock.

As stated, our common stock has experienced, and is likely to experience in the future, significant price and volume fluctuations. These fluctuations could cause short sellers to enter the market from time to time in the belief that we may have poor operating results in the future. The market for our common stock may not be stable or appreciate over time and the sale of our common stock may negatively impact shareholders' ability to sell shares of our common stock.

Future Sales of Stock By Our Shareholders May Negatively Affect Our Stock Price And Our Ability To Raise Funds In New Stock Offerings

Sales of our common stock in the public market by our existing substantial shareholders, could lower the market price of our common stock. Sales may also make it more difficult for us to sell equity securities or equity-related securities in the future at a time and price that our management deems acceptable or at all. Of the 2,732,124 shares of common stock outstanding as of April 9, 2008, 811,182 shares of common stock are, or will be, held by our "affiliates" and 1,296,066 shares of common stock, held by existing shareholders, including the officers and directors, are "restricted securities" and may be resold in the public market only if registered or pursuant to an exemption from registration. Some of these shares may be resold under Rule 144.

Item No. 1B – Unresolved Staff Comments

As of the filing of this Annual report on Form 10-K, we had no unresolved comments from the staff of the Securities and Exchange Commission that were received not less than 180 days before the end of our 2007 fiscal year.

Item No. 2 Properties

We own our principal plant and offices located in Barrington, Illinois, approximately 45 miles northwest of Chicago, Illinois. The facility includes approximately 75,000 square feet of office, manufacturing and warehouse space. This facility is subject to a mortgage loan in the principal amount of $2,800,000, having a term of 5 years, with payments amortized over 25 years.

In September 2005, the Company entered into a lease to rent 16,306 square feet of space in Cary, Illinois. This lease has a 2-year term. In September 2006, the Company signed an extension to this lease to run through September 2009. The facility includes warehouse and office space, which is utilized principally for the warehousing of balloon inventory. In addition, as of December 2007, we entered into a month-to-month agreement to rent additional warehouse space as required.

The Company also leases approximately 15,000 square feet of office and warehouse space in Rugby, England at an annual lease cost of $51,700, expiring in 2019. This facility is utilized to warehouse balloon products and to manage and service the Company's operations in England and Europe.

In February 2008, Flexo Universal entered into a 3-year lease agreement for the lease of approximately 43,000 square feet of manufacturing, warehouse and office space in Guadalajara, Mexico at the cost of $19,200 per month.

We believe that our properties have been adequately maintained, are in generally good condition and are suitable for our business as presently conducted. We believe our existing facilities provide sufficient production capacity for our present needs and for our presently anticipated needs in the foreseeable future. We also believe that, with respect to leased properties, upon the expiration of our current leases, we will be able to either secure renewal terms or to enter into leases for alternative locations at market terms.

Item No. 3 Legal Proceedings

On December 20, 2006, Pliant Corporation filed an action against the Company in the Circuit Court of Cook County, Illinois. In the action, Pliant claims that there is due from the Company to Pliant the sum of $245,000 for goods sold and delivered by Pliant to the Company as well as interest on such amount. On February 21, 2007, the Company filed an answer to the complaint and counterclaim denying liability and asserting certain claims against Pliant for damages for the sale by Pliant to the Company of defective products. Management intends to defend the claims of Pliant in this action and to pursue its counterclaims and believes that the Company has established adequate reserves regarding the claim.

In addition, the Company is also party to certain lawsuits or claims arising in the normal course of business. The ultimate outcome of these matters is unknown, but in the opinion of management, we do not believe any of these proceedings will have, individually or in the aggregate, a material adverse effect upon our financial condition, cash flows or future results of operation.

Item No. 4 Submission of Matters to a Vote of Security Holders

No matters were submitted to the shareholders of the Company during the Fourth Quarter 2007.

PART II

Item No. 5 Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information. The Company's Common Stock was admitted to trading on the NASDAQ SmallCap Market (now the NASDAQ Capital Market) under the symbol CTIB on November 5, 1997.

The high and low sales prices for the last nine fiscal quarters (retroactively adjusted to reflect post-reverse split share and stock dividend values), according to the NASDAQ Stock Market's Stock Price History Report, were:

	High	Low
January 1, 2006 to March 31, 2006	3.56	2.77
April 1, 2006 to June 30, 2006	3.90	2.60
July 1, 2006 to September 30, 2006	4.68	2.20
October 1, 2006 to December 31, 2006	8.23	3.50
January 1, 2007 to March 31, 2007	10.39	4.39
April 1, 2007 to June 30, 2007	8.10	3.68
July 1, 2007 to September 30, 2007	5.59	2.88
October 1, 2007 to December 31, 2007	5.44	2.76
January 1, 2008 to March 31, 2008	6.43	3.25

As of March 4, 2008 there were approximately 32 holders of record of the Company's Common Stock. The Company believes that its total number of actual shareholders is substantially greater than the number of record shareholders.

The Company has never paid any cash dividends on its Common Stock and does not currently intend to pay cash dividends on its Common Stock in the foreseeable future. The Company currently intends to retain all its earnings to finance the development and expansion of its business. Under the terms of its current loan agreement, the Company is restricted from declaring any cash dividends or other distributions on its shares.

Issuer Purchases of Equity Shares

The Company made no purchases of its shares during 2007.

Recent Sales of Unregistered Securities

During February 2003, John H. Schwan loaned $930,000 to the Company and Stephen M. Merrick loaned $700,000 to the Company, each in exchange for (i) two year promissory notes bearing interest at 9% per annum and (ii) five year warrants to purchase up to 163,000 shares of Common Stock of the Company at $4.87 per share, the market price of the Common Stock on the date of the Warrants. The proceeds of these loans were to (i) re-finance the bank loan of CTI Mexico in the amount of $880,000 and (ii) to provide financing for CTI Mexico and Flexo Universal. On February 8, 2008, Mr. Schwan and Mr. Merrick exercised these warrants utilizing $793,810 in principal amount of such promissory notes as payment of the exercise price for the shares purchased. The payment date of the remaining amount of the notes have been extended to December 31, 2008.

On September 23, 2005, the Company issued 50,229 shares of its common stock to three service providers as payment for services.

On February 1, 2006, John H. Schwan and Stephen M. Merrick each loaned the sum of $500,000 to the Company, each in exchange for (i) five year promissory notes bearing interest at 2% in excess of the prime rate and (ii) five year warrants to purchase up to 151,515 shares each of common stock of the Company at the price of $3.30 per share, an amount equal to 110% of the market price of the common stock on the day immediately preceding the date of the transaction.

On June 6, 2006, the Company entered into a Standby Equity Distribution Agreement with Cornell Capital pursuant to which Cornell Capital agreed, subject to certain conditions, to purchase up to $5,000,000 of the Company's common stock for its own account, for investment, during a commitment period of 24 months commencing on the date of an effective registration statement covering the shares to be sold. Under the agreement, shares are to be purchased at the lowest volume weighted average price of the shares as traded during the five trading days after an advanced request by the Company. The number of shares to be sold under the agreement is limited to 400,000 shares unless shareholder approval shall have been obtained for the sale of a greater amount of shares. The sale of the shares is subject to certain conditions including the filing by the Company, and the declaration of effectiveness by the SEC, of a Registration Statement covering the shares to be sold under the agreement. On December 28, 2006, the Company filed a Registration Statement with respect to 403,500 shares and on January 26, 2007, the Registration Statement was declared effective. Since the effective date to March 19, 2008, the Company has sold to Cornell Capital an aggregate of 323,625 shares of common stock at an average price of $4.88 per share.

Also on July 6, 2006, the Company entered into a Placement Agent Agreement with Newbridge Securities Corp. under which Newbridge agreed to act as the Company's exclusive placement agent in connection with the Standby Equity Distribution Agreement. Under this agreement, the Company agreed to issue 3,500 shares of its common stock to Newbridge.

On June 12, 2006, John Schwan exercised a warrant issued on July 1, 2001 to purchase 79,367 shares of common stock of the Company at the warrant exercise price of $1.50 per share. In payment for such shares, Mr. Schwan surrendered to the Company 38,404 shares of common stock at the then market price per share of $3.09. On June 12, 2006, Stephen M. Merrick exercised a warrant issued on July 1, 2001 to purchase 39,683 shares of common stock of the Company at the warrant exercise price of $1.50 per share.

On February 1, 2007, the Company issued to Capstone Advisory Group, L.L.C. 17,000 shares of common stock for consulting services to be performed over an 18-month period.

Each of the foregoing transactions involved the sale of securities of the Company to a limited number of sophisticated investors on a restricted basis, for investment, and an exemption from registration with respect to such sales is claimed pursuant to Section 4(2) of the Securities Act of 1933.

Stock Performance Graph

The following graph compares for the period December, 2002 to December, 2007, the cumulative total return (assuming reinvestment of dividends) on our common stock with (i) NASDAQ Composite Index (U.S.), (ii) S&P 500 Specialty Stores Index (U.S.) and (iii) a Peer Group. The Peer Group was created based on ten companies with similar Market-Capitalization (5 above and 5 below). The graph assumes an investment of $100 on December 31, 2002, in our common stock and each of the other investment categories.

The historical stock prices of our common stock shown on the graph below are not necessarily indicative of future stock performance. Per share value as of December 31, 2002 through December 31, 2007 is based on the common stock's closing price as of such date. All prices reflect any stock splits or dividends during the period.

The information under this heading shall not be deemed incorporated by reference by any general statement incorporating by reference information from this Annual Report into any filing under the Securities Act of 1933 or under the Securities Exchange Act of 1934 and shall not otherwise be deemed filed under such Acts.

Item No. 6 Selected Financial Data

The following selected financial data are derived from the consolidated financial statements of the Company. The data should be read in conjunction with the consolidated financial statements, related notes, and other financial information included herein.

	Year ended December 31, (000 omitted)				
	2007	2006	2005	2004	2003
Statement of Operations Data:					
Net Sales	$ 36,510	$ 35,428	$ 29,190	$ 37,193	$ 36,260
Costs of Sales	$ 27,826	$ 26,531	$ 22,726	$ 30,841	$ 29,627
Gross Profit	$ 8,684	$ 8,897	$ 6,464	$ 6,352	$ 6,633
Operating expenses	$ 7,439	$ 6,275	$ 5,812	$ 6,402	$ 6,856
Income (loss) from operations	$ 1,245	$ 2,622	$ 652	$ (50)	$ (223)
Interest expense	$ 1,286	$ 1,691	$ 1,231	$ 1,350	$ 1,103
Other (income) expense	$ (174)	$ (191)	$ (45)	$ (208)	$ 23
Income (loss) before taxes and minority interest	$ 133	$ 1,122	$ (534)	$ (1,192)	$ (1,349)
Income tax (benefit) expense	$ 51	$ (774)	$ (200)	$ 1,286	$ (782)
Minority interest	$ -	$ 1	$ -	$ 1	$ -
Net Income (loss)	$ 82	$ 1,895	$ (333)	$ (2,479)	$ (566)
Earnings (loss) per common share					
Basic	$ 0.03	$ 0.91	$ (0.17)	$ (1.28)	$ (0.30)
Diluted	$ 0.03	$ 0.85	$ (0.17)	$ (1.28)	$ (0.30)
Other Financial Data:					
Gross margin percentage	23.79%	25.11%	22.14%	17.08%	18.29%
Capital Expenses	$ 2,848	$ 553	$ 550	$ 306	$ 2,007
Depreciation & Amortization	$ 1,299	$ 1,205	$ 1,463	$ 1,651	$ 1,619
Balance Sheet Data:					
Working capital (Deficit)	$ 1,318	$ 1,848	$ (2,426)	$ (2,790)	$ (706)
Total assets	$ 29,256	$ 26,645	$ 23,536	$ 27,888	$ 30,270
Short-term obligations [(1)]	$ 9,767	$ 9,422	$ 8,618	$ 9,962	$ 6,692
Long-term obligations	$ 6,237	$ 6,887	$ 6,039	$ 6,491	$ 8,909
Stockholders' Equity	$ 6,523	$ 5,102	$ 2,726	$ 2,951	$ 5,212

(1) Short term obligations consist of primarily of borrowings under bank line of credit and current portion of long-term debt.

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The following table sets forth selected unaudited statements of operations for each quarter of fiscal 2007 and 2006:

	For the Year Ended December 31, 2007 (1)			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net sales	$ 8,279,000	$ 9,259,000	$ 8,673,000	$ 10,299,000
Gross profit	$ 1,903,000	$ 2,744,000	$ 1,617,000	$ 2,420,000
Net (loss) income	$ (52,000)	$ 423,000	$ (414,000)	$ 125,000
Earnings per common share				
Basic	$ (0.02)	$ 0.18	$ (0.18)	$ 0.05
Diluted	$ (0.02)	$ 0.17	$ (0.18)	$ 0.05

(1) Earnings per common share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly per common share information may not equal the annual earnings per common share

	For the Year Ended December 31, 2006 (1)			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter (2)
Net sales	$ 8,156,000	$ 8,997,000	$ 8,603,000	$ 9,672,000
Gross profit	$ 1,953,000	$ 2,197,000	$ 2,253,000	$ 2,494,000
Net income	$ 220,000	$ 206,000	$ 315,000	$ 1,154,000
Earnings per common share				
Basic	$ 0.11	$ 0.10	$ 0.15	$ 0.54
Diluted	$ 0.10	$ 0.10	$ 0.15	$ 0.49

(1) Earnings per common share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly per common share information may not equal the annual earnings per common share

(2) During the fourth quarter 2006, management of the Company conducted an analysis of the recoverability of the deferred tax asset based on results of operations during the fourth quarter of 2005 and for the full year of 2006, expected continued achievement of and continuing improvement in operating results for the forseeable future and anticipated repatriations of profits and services income to be generated from the Company's foreign subsidiaries. As a result of such analysis, management determined that the net recorded deferred tax asset in the amount of $1,127,000 is more likely than not to be realized.

Item No. 7 Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company produces film products for novelty, packaging and container applications. These products include metalized balloons, latex balloons and related latex toy products, films for packaging applications, and flexible containers for packaging and storage applications. We produce all of our film products for packaging and container applications at the facilities in Barrington, Illinois. We produce all of our latex balloons and latex products at our facility in Guadalajara, Mexico. Substantially all of our film products for packaging applications and flexible containers for packaging and storage are sold to customers in the United States. We market and sell our novelty items - principally metalized balloons and latex balloons - in the United States, Mexico, the United Kingdom and a number of additional countries.

Our revenues from each of our product categories in each of the past three years have been as follows:

	(000 Omitted)					
Product Category	**$ 2007**	**% of Net Sales**	**$ 2006**	**% of Net Sales**	**$ 2005**	**% of Net Sales**
Metalized Balloons	15,998	43.8%	17,050	48.1%	11,737	40.2%
Films	7,846	21.5%	8,412	23.7%	7,616	26.1%
Pouches	4,938	13.5%	3,081	8.7%	4,079	14.0%
Latex Balloons	6,853	18.8%	6,083	17.2%	4,855	16.6%
Helium/Other	875	2.4%	802	2.3%	903	3.1%
Total	**36,510**	**100.0%**	**35,428**	**100.0%**	**29,190**	**100.0%**

Our primary expenses include the cost of products sold and selling, general and administrative expenses.

Cost of products sold primarily consists of expenses related to raw materials, labor, quality control and overhead directly associated with production of our products, as well as shipping costs relating to the shipment of products to customers. Cost of products sold is impacted by the cost of the raw materials used in our products, the cost of shipping, along with our efficiency in managing the production of our products.

Selling, general and administrative expenses include the compensation and benefits paid to our employees, all other selling expenses, marketing, promotional expenses, travel and other corporate administrative expenses. These other corporate administrative expenses include professional fees, depreciation and amortization, occupancy costs, communication costs and other similar operating expenses. Selling, general and administrative expenses can be affected by a number of factors, including staffing levels and the cost of providing competitive salaries and benefits, the cost of regulatory compliance and other administrative costs.

Purchases by a limited number of customers represent a significant portion of our total revenues. In 2007, sales to our top 10 customers represented 65.3% of net revenues. During 2007, there were three customers to whom our sales represented more than 10% of net revenues. Our principle customers and 2007 sales to them were:

Customer	Product	2007 Sales	% of 2007 Revenues	2006 Sales	% of 2006 Revenues
Dollar Tree Stores	Balloons	$ 7,419,000	20.3%	$ 8,596,000	24.3%
Rapak L.L.C	Films	$ 6,982,000	19.1%	$ 7,110,000	20.1%
ITW Spacebag	Pouches	$ 3,771,000	10.3%	$ 2,526,000	7.1%

The loss of one or more of these principal customers, or a significant reduction in purchases by one or more of them, could have a material adverse effect on our business.

Results of Operations

The following table sets forth selected results of our operations expressed as a percentage of net sales for the years ended December 31, 2007, 2006 and 2005. Our results of operations for the periods described below are not necessarily indicative of results of operations for future periods.

	Year ended December 31,		
	2007	2006	2005
Net sales	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of products sold	76.2	74.9	77.9
Operating Expenses	20.4	17.7	19.9
Income from operations	3.4	7.4	2.2
Interest expense	(3.5)	(4.8)	(4.2)
Other income	0.5	0.5	0.2
Income (loss) before income taxes	0.4	3.1	(1.8)
Provision for income taxes	0.2	(2.2)	(0.7)
Net profit (loss)	0.2%	5.3%	(1.1)%

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Net Sales

For the fiscal year ended December 31, 2007, consolidated net sales from the sale of all products were $36,510,000 compared to consolidated net sales of $35,428,000 for the year ended December 31, 2006, an increase of 3.1%.

In 2007, sales of metalized balloons declined by 6.2% from $17,050,000 in 2006 to $15,998,000 in 2007. This decline is attributable to a decline in sales of metalized balloons to Dollar Tree Stores from $8,596,000 in 2006 to $7,419,000 in 2007. Sales of metalized balloons to customers other than Dollar Tree Stores increased from $8,454,000 in 2006 to $8,579,000 in 2007.

Sales of film products declined from $8,412,000 in 2006 to $7,846,000 in 2007. This decline is due principally to our decision to withdraw from the production and sale of certain product items we deemed not profitable. Sales to our principal films customer, Rapak LLC, decreased from $7,110,000 in 2006 to $6,982,000 in 2007.

Sales of pouch products increased by 60.3% from $3,081,000 in 2006 to $4,938,000 in 2007. This increase was due to (i) an increase in pouch sales to our principal pouch customer ITW Space Bag from $2,526,000 in 2006 to $3,771,000 in 2007 and (ii) the introduction of our ZipVac™ line of products. Total sales of the ZipVac™ line in 2007 were $465,000.

Sales of latex balloons increased by 12.7% from $6,083,000 in 2006 to $6,853,000 in 2007. Most of this increase is represented by increased sales of latex balloons in Mexico by Flexo Universal, our Mexican subsidiary.

Cost of Sales

Cost of sales increased from 74.9% of sales in 2006 to 76.2% of sales in 2007. This increase is the result of (i) changes in product mix (ii) increase in raw materials, (iii) increase labor rates and (iv) production cost related to the set-up, testing and initial production of pouch production lines.

General and Administrative Expenses

General and administrative expenses increased from $4,554,000 in 2006 or 12.9% of net sales to $5,211,000 or 14.3% of net sales. This increase is attributable principally to (i) increases in personnel and compensation, (ii) increases in accounting fees, (iii) increases in legal fees, (iii) increases in consulting fees relating to operational strategies and internal controls documentation and (iv) increases in travel related to vendor development in Southeast Asia.

Selling

Selling expenses decreased from $847,000 or 2.4% of sales in 2006 to $754,000 or 2.1% of sales in 2007. We anticipate that selling expenses will increase during 2008, due to new personnel and related sales expenses.

Advertising and Marketing

Advertising and Marketing expenses increased from $1,201,000 or 3.4% of sales in 2006 to $1,474,000 or 4% of sales in 2007. This increase is due to (i) an increase in marketing and promotion relating to the Company's new Zip-Vac product, (ii) artwork and films and (iii) an increase in the cost of in store servicing for new retail customers.

We anticipate further increases in marketing and advertising expenses during 2008 as we invest in the marketing and sale of our ZipVac™ line of zippered vacuum pouches.

Other Income or Expense

During 2007, we incurred net interest expense of $1,286,000 compared to net interest expense of $1,691,000 during 2006. The reduction in interest expense incurred in 2007 is the result of both lower applicable interest rates and reduced levels of borrowing.

During 2007, we realized foreign currency gain in the amount of $174,000 compared to foreign currency gain in 2006 of $191,000.

During 2007, we had no other items of operating income or expense. During 2006, we incurred a loss on the sale of certain assets in the amount of $145,000 and we realized income from the settlement of certain vendor claims in the amount of $472,000.

Net Income or Loss

During 2007, we had net income of $82,000 compared to net income of $1,895,000 in 2006. Net income for 2007 was affected by cost related to the set-up, testing and initial production of pouch production lines. During 2007, we incurred such costs in the total amount of approximately $2,330,000 of which $2,082,000 was capitalized. Our 2006 net income included a tax benefit of $774,000 and, absent that tax benefit, our net income for that year was $1,121,000.

Income Taxes

For 2007, the Company recognized an income tax expense, on a consolidated basis, of $51,000. This income tax expense is composed of income tax expense realized by CTI Balloons, our United Kingdom subsidiary, and Flexo Universal, our Mexico subsidiary, in the amounts of $90,000 and $98,000, respectively, and an income tax benefit of $137,000 recognized by the Company in the United States. In 2006, the Company recognized an income tax benefit of $774,000 by reason of the determination of management to reduce the amount of the valuation allowance previously taken with respect to the deferred tax asset.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Net Sales

For the fiscal year ended December 31, 2006, consolidated net sales from the sale of all products were $35,428,000 compared to consolidated net sales of $29,190,000 for the year ended December 31, 2005, an increase of 21.4%. The increase in net sales is attributable principally to an increase in (i) metalized balloon sales from $11,737,000 in 2005 to $17,050,000 in 2006 and (ii) latex balloon sales from $4,855,000 in 2005 to $6,083,000 in 2006.

The increase in metalized balloon sales reflects, principally, an increase in sales of these products to a principal customer, Dollar Tree Stores. Sales to this chain increased from $3,987,000 in 2005 to $8,596,000 in 2006.

Sales of commercial films increased by 10% from $7,616,000 in 2005 to $8,412,000 in 2006. Most of this increase is reflected in increased sales to Rapak, LLC.

Sales of pouches declined from $4,079,000 to $3,081,000. The decline is accounted for by reduced sales to ITW Spacebag. Sales of our vacuumable pouch line in 2006 were $319,000.

The increase in latex balloon sales occurred as the result of increased levels of production achieved by our Guadalajara facility and increases in sales to several customers in the United States and Mexico.

Cost of Sales

Cost of sales declined from 77.9% of net sales in 2005 to 74.9% of net sales in 2006. This improvement in gross margin has resulted from production efficiencies which include (i) the allocation of production overhead among a larger number of units produced and (ii) stabilization in the cost of raw materials.

General and Administrative Expenses

For 2006, general and administrative expenses were $4,554,000, or 12.9% of net sales compared to $3,847,000 or 13.2% of net sales in 2005. The increases in general and administrative expenses consisted principally of (i) salary increases to existing personnel, (ii) new personnel and (iii) increases in audit expenses.

Selling

Selling expenses declined from $928,000 or 3.2% of net sales in 2005 to $847,000 or 2.4% of net sales in 2006. This decline is attributable principally to (i) the change in position of one executive from sales to marketing during 2006 and the associated change in recording of salary and related expense from sales to marketing and (ii) the reclassification of customer service expenses to marketing expense.

Advertising and Marketing

Advertising and marketing expenses increased from $913,000 or 3.1% of net sales in 2005 to $1,201,000 or 3.4% of net sales in 2006. This increase is attributable principally to the change in position described with respect to selling expense and the reclassification of customer service expense to marketing.

Other Operating Expense (Income)

During 2006, we had income from the settlement of vendor claims totaling $472,000 and we incurred losses on the disposition of assets in the amount of $145,000. In 2005, we did not generate income from the settlement of vendor claims and did not have any gain or loss from the disposition of assets.

Other Expense

During 2006, the Company incurred $1,691,000 in net interest expense compared to net interest expense in 2005 of $1,231,000. The increase in net interest expense is attributable to the fact that debt levels during 2006 were higher than 2005.

Net Income or Loss

The company had net income for 2006 of $1,895,000 compared to a net loss of $333,000 for 2005. The 2006 net income included an income tax benefit of $774,000 and, absent the tax benefit was $1,121,000 as compared to loss of $534,000 in 2005.

Income Taxes

For 2006, the company recognized an income tax benefit of $774,000. On the basis of results of operations over the past five quarters, anticipated repatriation of income from foreign subsidiaries, charges to foreign subsidiaries and the expectation of continued achievement of, and improvement in, operating results for the foreseeable future, the management of the Company has determined that it is more likely than not that the Company will realize the value recorded of its deferred tax assets. In 2005, the Company recognized an income tax benefit of $200,000 arising from the deferred tax benefit of the loss incurred for the year. Management determined based upon the evaluation of certain transactions involving the repatriation of profits from its U.K. and Mexico subsidiaries that it is more likely than not that deferred tax assets will be realized in 2006. There can be no assurance that the Company will realize the benefit of its deferred tax assets.

Financial Condition, Liquidity and Capital Resources

Cash Flow Provided by Operating Activities During fiscal 2007, cash provided by operating activities amounted to $1,356,000, compared to cash flow used in operating activities during fiscal 2006 of $1,353,000. Significant changes in working capital items affecting cash flow provided by operating activities were:

- Depreciation and amortization of $1,466,000
- An increase in net inventory of $1,732,000
- An increase in trade payables of $823,000
- A decrease in accounts receivable of $338,000
- A decrease in prepaid expenses and other assets of $270,000

We anticipate the level of depreciation to increase in 2008 compared to 2007, reflecting investments in plant and equipment during 2007. The increase in inventory during 2007 reflects (i) an increase of $880,000 related to the Company's new ZipVac™ line, (ii) an increase of $250,000 in inflated balloons for a rollout to a new retail customer and (iii) increase of $400,000 at the Company's Mexican subsidiary to support an increased level of sales. We do not anticipate significant increases in inventory during 2008.

Cash Used in Investing Activities During fiscal 2007, cash used in investing activities amounted to $2,848,000 compared to cash used in investing activities during fiscal 2006 of $553,000. Cash used in investing activities was principally for the purchase of equipment and plant improvements. During 2008, we anticipate that our levels of investment in plant and equipment will be reduced from 2007 levels.

Cash Provided by Financing Activities During fiscal 2007, cash provided by financing activities amounted to $1,586,000, compared to cash provided by financing activities of $2,045,000 during fiscal 2006. During 2007, we received $1,355,000 from the sale of stock to Cornell Capital and $195,000 from the exercise of options and warrants, and we repaid long-term debt of $1,242,000. We received, net, $428,000 proceeds under our revolving line of credit.

On February 1, 2006, we entered into a Loan Agreement with RBS Citizens, N.A., Chicago, Illinois, under which, as amended, the Bank has agreed to provide a credit facility to our Company in the total amount of $15,300,000, which includes (i) a five year mortgage loan secured by our Barrington, Illinois property in the principal amount of $2,800,000, amortized over a 20 year period, (ii) a five year term-loan secured by our equipment at the Barrington, Illinois plant in the amount of $3,500,000 and (iii) a three-year revolving line of credit up to a maximum amount of $9,000,000, secured by inventory and receivables. The amount we can borrow on the revolving line of credit includes 85% of eligible accounts receivable and 60% of eligible inventory.

Certain terms of the loan agreement include:

- *Restrictive Covenants*: The Loan Agreement includes several restrictive covenants under which we are prohibited from, or restricted in our ability to:
  - o Borrow money;
  - o Pay dividends and make distributions;
  - o Issue stock
  - o Make certain investments;
  - o Use assets as security in other transactions;
  - o Create liens;
  - o Enter into affiliate transactions;
  - o Merge or consolidate; or
  - o Transfer and sell assets.

- *Financial Covenants*: The loan agreement includes a series of financial covenants we are required to meet including:
  - o We are required to maintain a tangible net worth in excess of $3,500,000;
  - o We are required to maintain specified ratios of senior debt to EBITDA on an annual basis and determined quarterly commencing as of June 30, 2006; and,
  - o We are required to maintain a specified level of EBITDA to fixed charges for the six months ending June 30, 2006, the nine months ending September 30, 2006 and twelve months thereafter.

As of December 31, 2007, we were not in compliance with the senior debt to EBITDA or the EBITDA to fixed charge covenants. We have obtained a waiver from the Bank with respect to these covenant violations as of December 31, 2007. We believe that we will be in compliance with our debt covenants during 2008.

The loan agreement provides for interest at varying rates in excess of the Bank's prime rate, depending on the level of senior debt to EBITDA over time. The initial interest rate under the loan is prime plus 1.5% per annum. On a quarterly basis, this ratio will be measured and the interest rate changed in accordance to the table below.

When Senior Debt to Equity is:	The Premium to the Prime Rate is:
Greater or equal to 4.50 to 1.00	1.00%
Between 4.50 to 1.00 and 4.00 to 1.00	0.75%
Between 4.00 to 1.00 and 3.50 to 1.00	0.50%
Between 3.50 to 1.00 and 2.75 to 1.00	0.25%
Less than 2.75 to 1.00	0.00%

At December 31, 2007 the Company was paying a premium of 0.75% over Prime.

Also, under the loan agreement, we are required to purchase a swap agreement with respect to at least 60% of the mortgage and term loan portions of our loan. On April 5, 2006, we entered into a swap arrangement with RBS Citizens, N.A. with respect to 60% of the principle amounts of the mortgage loan and the term loan, which had the effect of fixing the interest rate for such portions of the loans at 8.49% for the balance of the loan terms. These swap arrangements are subject to some market variation due to market interest rate variability. Management believes that these variations will not materially affect the results of the company. As of December 31, 2007 the net effect of these market adjustments was $123,000.

Each of John H. Schwan and Stephen M. Merrick, officers, directors and principal shareholders of the Company have personally guaranteed the obligations of the company to RBS Citizens, N.A. up to $2,000,000.

On November 13, 2007 RBS Citizens, N.A. granted to the Company a capital lease line of credit of up to $1,500,000 to fund equipment acquisitions by the Company. During 2007, the Company received aggregate advances under this line of $272,000.

On February 1, 2006, two principal officers and shareholders of our Company each loaned to our Company the sum of $500,000 in exchange for (i) Promissory Notes due January 31, 2011 and bearing interest at the rate of 2% per annum in excess of the prime rate determined quarterly and (ii) five year Warrants to purchase up to 151,515 shares of common stock of the Company at the price of $3.30 per share (110% of the closing market price on the day preceding the date of the loans).

On June 6, 2006, we entered into a Standby Equity Distribution Agreement with Cornell Capital pursuant to which we may, at our discretion, periodically sell to Cornell Capital shares of common stock for a total purchase price of up to $5 million. For each share of common stock purchased under the Standby Equity Distribution Agreement, Cornell Capital will pay one hundred percent (100%) of the lowest volume weighted average price (as quoted by Bloomberg, LP) of our common stock on the NASDAQ Capital Market or other principal market on which our common stock is traded for the five (5) days immediately following the notice date. The number of shares purchased by Cornell Capital for each advance is determined by dividing the amount of each advance by the purchase price for the shares of common stock. Furthermore, Cornell Capital will receive five percent (5%) of each advance in cash under the Standby Equity Distribution Agreement as an underwriting discount. Cornell’s obligation to purchase shares of our common stock under the Agreement is subject to certain conditions, including: (i) we shall have obtained an effective registration statement for the shares of common stock sold to Cornell under the Agreement and (ii) the amount of each advance requested by us under the Agreement shall not be more than $100,000.

Cornell Capital is a private limited partnership whose business operations are conducted through its general partner, Yorkville Advisors, LLC. In addition, we engaged Newbridge Securities Corporation, a registered broker-dealer, as our placement agent in connection with the Standby Equity Distribution Agreement. For its services, Newbridge received 3,500 shares of our common stock on or about June 8, 2006, equal to approximately $11,200 based on our stock price of $3.20 when the shares were issued on June 26, 2006. The effectiveness of the sale of the shares under the Standby Equity Distribution Agreement was conditioned upon us registering the shares of common stock with the SEC and obtaining all necessary permits or qualifying for exemptions under applicable state law. Except as stated above, there are no other significant closing conditions to draw under the Standby Equity Distribution Agreement.

Pursuant to the Standby Equity Distribution Agreement, we may periodically sell shares of common stock to Cornell Capital to raise capital to fund our working capital needs. The periodic sale of shares is known as an advance. We may request an advance every five (5) trading days. A closing will be held the first trading day after the pricing period at which time we will deliver shares of common stock and Cornell Capital will pay the advance amount. There are no closing conditions imposed on CTI for any of the draws other than that CTI has filed its periodic and other reports with the SEC, has delivered the stock for an advance, and the trading of CTI's common stock has not been suspended. We may request advances under the Standby Equity Distribution Agreement until Cornell Capital has advanced $5 million or twenty-four (24) months after the effective date of this Registration Statement, whichever occurs first. It is unlikely that we will be able to draw the entire amount of $5 million before twenty-four (24) months after the effective date of this Registration Statement, given the limitations on the size and frequency with which we may request advances from Cornell Capital, unless our stock price increases significantly.

The amount of each advance is subject to a maximum amount of $100,000, and we may not submit an advance within five (5) trading days of a prior advance. The amount available under the Standby Equity Distribution Agreement is not dependent on the price or volume of our common stock. Our ability to request advances is conditioned upon us registering the shares of common stock with the SEC. In addition, we may not request advances if the shares to be issued in connection with such advances would result in Cornell Capital owning more than 9.9% of our outstanding common stock. Cornell Capital's beneficial ownership of CTI common stock was 0% before the initial advance. We would be permitted to make draws on the Standby Equity Distribution Agreement only so long as Cornell Capital's beneficial ownership of our common stock remains lower than 9.9% and, therefore, a possibility exists that Cornell Capital may own more than 9.9% of CTI's outstanding common stock at a time when we would otherwise plan to make an advance under the Standby Equity Distribution Agreement.

We do not have any agreements with Cornell Capital regarding the distribution of such stock, although Cornell Capital has indicated that it intends to promptly sell any stock received under the Standby Equity Distribution Agreement.

We cannot predict the actual number of shares of common stock that will be issued pursuant to the Standby Equity Distribution Agreement, in part, because the purchase price of the shares will fluctuate based on prevailing market conditions, and we have not determined the total amount of advances we intend to draw. Nonetheless, we can estimate the number of shares of our common stock that will be issued using certain assumptions. We have registered 400,000 shares of common stock for the sale under the Standby Equity Distribution Agreement. The Company and Cornell have agreed that the Company will not sell to Cornell Capital in excess of 400,000 shares unless and until the Company shall have obtained shareholder approval for such sales. In order to access all funds available to us under the Standby Equity Distribution Agreement with the 400,000 shares being registered in this offering, the average price of shares issued under the Standby Equity Distribution Agreement would need to be $12.50.

On December 28, 2006, we filed a Registration Statement for the registration of 403,500 shares of our common stock. On January 26, 2007, the Registration Statement was declared effective. Since that time, to December 31, 2007, we have sold an aggregate of 323,625 shares of common stock to Cornell under the SEDA and have received net proceeds from the sale of those shares in the amount of $1,492,000, excluding issuance costs.

Current Assets. As of December 31, 2007, the total current assets of the Company were $17,801,000, compared to total current assets of $16,491,000 at December 31, 2006. The change in current assets reflects, principally, (i) an increase in inventories of $1,727,000, and (ii) an increase in cash and equivalents of $99,000. The increase in inventory during 2007 reflects (i) an increase of $880,000 related to the Company's new ZipVac™ line, (ii) an increase of $250,000 in inflated balloons for a rollout to a new retail customer and (iii) an increase of $400,000 at the Company's Mexican subsidiary to support an increased level of sales. We do not anticipate significant increases in inventory during 2008.

Property, Plant and Equipment. During fiscal 2007, the Company invested $2,826,000 in capital items, principally in production equipment and plan improvements. We anticipate reduced levels of capital investment in 2008.

Current Liabilities. Total current liabilities increased from $14,643,000 as of December 31, 2006 to $16,483,000 as of December 31, 2007. Changes in current liabilities included: (i) an increase of $817,000 in trade payables, (ii) an increase in checks in excess of bank balance of $508,000 relating to deposits in transit from customers and (iii) an increase of the line of credit of $428,000.

Liquidity and Capital Resources. As of December 31, 2007, our current assets exceeded our current liabilities by $1,318,000. In addition, during 2008, we anticipate receiving advances under our capital lease line of credit in amounts up to $1,228,000. We believe that we have sufficient cash and financial resources to meet our operating requirements through December 31, 2008.

Shareholders' Equity. Shareholders' equity was $6,591,000 as of December 31, 2007 compared to $5,102,000 as of December 31, 2006.

The contractual commitments of the Company, determined as of December 31, 2007, over the next five years are as follows:

	Payments due by Period (000 omitted)				
	Total	**2008**	**2009-2010**	**2011-2012**	**2013 And Thereafter**
Revolving line of credit	$ 6,746	$ 6,746	$ -	$ -	$ -
Current maturities of long-term debt	$ 3,021	$ 3,021	$ -	$ -	$ -
Long-Term debt, net of current maturities	$ 5,167	$ -	$ 1,563	$ 3,604	$ -
Estimated interest payments	$ 1,457	$ 634	$ 715	$ 108	$ -
Lease Obligations	$ 2,021	$ 514	$ 900	$ 245	$ 362
License Commitments	$ 91	$ 91	$ -	$ -	$ -
Total contractual obligations	$ 18,503	$ 11,006	$ 3,178	$ 3,957	$ 362

The Company does not have any current material commitments for capital expenditures.

Seasonality

In the metalized product line, sales have historically been seasonal with approximately 45% occurring in the period from December through March of the succeeding year and 21% being generated in the period July through October in recent years. The sale of latex balloons, pouches and laminated film products have not historically been seasonal, and as sales in these products lines have increased as a percentage of total sales, the seasonality of the Company's total net sales has decreased.

Critical Accounting Policies

The financial statements of the Company are based on the selection and application of significant accounting policies which require management to make various estimates and assumptions. The following are some of the more critical judgment areas in the application of our accounting policies that currently affect our financial condition and results of operation.

Revenue Recognition. Substantially all of the Company's revenues are derived from the sale of products. With respect to the sale of products, revenue from a transaction is recognized when (i) a definitive arrangement exists for the sale of the product, (ii) delivery of the product has occurred, (iii) the price to the buyer has been fixed or is determinable and (iv) collectibility is reasonably assured. The Company generally recognizes revenue for the sale of products when the products have been shipped and invoiced. In some cases, product is provided on consignment to customers. In those cases, revenue is recognized when the customer reports a sale of the product.

Allowance for Doubtful Accounts. We estimate our allowance for doubtful accounts based on an analysis of specific accounts, an analysis of historical trends, payment and write-off histories. Our credit risks are continually reviewed and management believes that adequate provisions have been made for doubtful accounts. However, unexpected changes in the financial condition of customers or changes in the state of the economy could result in write-offs, which exceed estimates and negatively impact our financial results.

Inventory Valuation. Inventories are stated at the lower of cost or market. Cost is determined using standard costs which approximate costing determined on a first-in, first out basis. Standard costs are reviewed and adjusted at the time of introduction of a new product or design, periodically and at year-end based on actual direct and indirect production costs. On a periodic basis, the Company reviews its inventory levels for estimated obsolescence or unmarketable items, in reference to future demand requirements and shelf life of the products. As of December 31, 2007, the Company had established a reserve for obsolescence, marketability or excess quantities with respect to inventory in the aggregate amount of $383,000. As of December 31, 2006, the amount of the reserve was $276,000. In addition, on a periodic basis, the Company disposes of inventory deemed to be obsolete or unsaleable and, at such time, records an expense for the value of such inventory.

Valuation of Long-Lived Assets. We evaluate whether events or circumstances have occurred which indicate that the carrying amounts of long-lived assets (principally property and equipment and goodwill) may be impaired or not recoverable. Significant factors which may trigger an impairment review include: changes in business strategy, market conditions, the manner of use of an asset, underperformance relative to historical or expected future operating results, and negative industry or economic trends. FASB issued Statement No. 142, "Goodwill and Other Intangible Assets," which requires that goodwill be evaluated annually for impairment by applying a fair-value based test. We conduct a valuation analysis in consultation with valuation consulting firms of our goodwill in our Mexico subsidiary for the year ended December 31, 2007, 2006 and 2005. As of December 31, 2005, we determined in consultation with a valuation consulting firm, that the fair value of the Company’s interest in Flexo Universal was below its $1,113,000 carrying value. Then step two of the evaluation was done in which the value of the goodwill was determined to be $989,000. Accordingly, we recorded $124,000 as an expense and reduced the carrying value of the Company’s interest in Flexo Universal to $989,000. As of December 31, 2006 and December 31, 2007, we determined that the fair value of the Company’s interest in Flexo Universal was unchanged from December 31, 2005. Accordingly, we did not change the fair value of the Company’s interest in Flexo.

Foreign Currency Translation. All balance sheet accounts are translated using the exchange rates in effect at the balance sheet date. Statements of operations amounts are translated using the average exchange rates for the year-to-date periods. The gains and losses resulting from the changes in exchange rates during the period have been reported in other comprehensive income or loss. Foreign currency translation adjustments exclude income tax expense (benefit) given that our investments in non-U.S. subsidiaries are deemed to be reinvested for an indefinite period of time.

Stock-Based Compensation. On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123(R), “Share-Based Payments” (“SFAS No. 123(R)”). Prior to the adoption of SFAS No. 123(R), we had adopted the disclosure-only provisions of SFAS No. 123 and accounted for employee stock-based compensation under the intrinsic value method and no expense related to stock options was recognized. We adopted the provisions of SFAS 123(R) using the modified prospective transition method. Under this method, our consolidated financial statements as of and for the years ended December 31, 2007 reflect the impact of SFAS 123(R), while the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R).

We used the Black-Scholes option pricing model to determine the fair value of stock options which requires us to estimate certain key assumptions. As a result of adopting SFAS 123(R), we incurred employee stock-based compensation cost of $14,000 for the year ended December 31, 2007. At December 31, 2007, we had $154,000 of unrecognized compensation cost relating to stock options.

Income Taxes and Deferred Tax Assets. Income taxes are accounted for as prescribed in SFAS No. 109-Accounting for Income Taxes. Under the asset and liability method of Statement 109, the Company recognizes the amount of income taxes currently payable. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years these temporary differences are expected to be recovered or settled.

As of December 31, 2007, the Company had a net deferred tax asset of $1,080,000 (deferred tax assets of $2,307,000 less a valuation allowance of $1,227,000) representing the amount the Company may recover in future years from future taxable income. As of December 31, 2006, the amount of the net deferred tax asset was $1,127,000. Each quarter and year-end management makes a judgment to determine the extent to which the deferred tax asset will be recovered from future taxable income. At December 31, 2006, the Company reduced the valuation allowance against the deferred tax assets as management determined that the deferred tax asset is more likely than not to be realized. Management has made no change in the amount of the valuation allowance for 2007.

Accounting Pronouncements Not Yet Implemented

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement clarifies how to measure fair value as permitted under other accounting pronouncements but does not require any new fair value measurements. In February 2008, the FASB issued FASB Staff Position (FSP) 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" (FSP 157-1) and FSP 157-2, "Effective Date of FASB Statement No. 157" (FSP 157-2). FSP 157-1 amends SFAS No. 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of fiscal 2009. The measurement and disclosure requirements related to financial and non-financial assets and liabilities are not anticipated to have significant impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). SFAS 159 permits companies to choose to measure certain financial instruments and other items at fair value. The standard requires that unrealized gains and losses are reported in earnings for items measured using the fair value option. SFAS No. 159 is effective for us on January 1, 2008. The adoption of SFAS No. 159 is not expected to have a significant impact on our consolidated financial statements.

Item No. 7A - Qualitative And Quantitative Disclosures Regarding Market Risk

The Company is exposed to various market risks, primarily foreign currency risks and interest rate risks.

The Company's earnings are affected by changes in interest rates as a result of variable rate indebtedness. If market interest rates for our variable rate indebtedness averaged 1% more than the interest rate actually paid for the years ending December 31, 2007, 2006 and 2005, our interest rate expense would have increased, and income before income taxes would have decreased by $97,000, $96,000 and $72,000, for these years, respectively. These amounts are determined by considering the impact of the hypothetical interest rates on our borrowings. This analysis does not consider the effects of the reduced level of overall economic activity that could exist in such an environment. Further, in the event of a change of such magnitude, management would likely take actions to reduce our exposure to such change. However, due to the uncertainty of the specific actions we would take and their possible effects, the sensitivity analysis assumes no change in our financial structure.

The Company's earnings and cash flows are subject to fluctuations due to changes in foreign currency rates, particularly the Mexican peso and the British pound, as the Company produces and sells products in Mexico for sale in the United States and other countries and the Company's U.K. subsidiary purchases balloon products from the Company in U.S. Dollars. Also, the Mexican subsidiary purchases goods from external sources in U.S. Dollars and is affected by currency fluctuations in those transactions. Substantially all of the Company's purchases and sales of goods for its operations in the United States are done in U.S. Dollars. However, the Company's level of sales in other countries may be affected by currency fluctuations. As a result, exchange rate fluctuations may have an effect on sales and gross margins. Accounting practices require that the Company's results from operations be converted to U.S. dollars for reporting purposes. Consequently, the reported earnings of the Company in future periods may be affected by fluctuations in currency exchange rates, generally increasing with a weaker U.S. dollar and decreasing with a strengthening U.S. dollar. To date, we have not entered into any transactions to hedge against currency fluctuation effects.

We have performed a sensitivity analysis as of December 31, 2007 that measures the change in the results of our foreign operations arising from a hypothetical 10% adverse movement in the exchange rate of all of the currencies the Company presently has operations in. Using the results of operations for 2007, 2006 and 2005 for the Company's foreign operations as a basis for comparison, an adverse movement of 10% would create a potential reduction in the Company's net income, or increase its net loss, before taxes, in the amount of, for each of those years, $187,000, $248,000 and $140,000, respectively.

The Company is also exposed to market risk in changes in commodity prices in some of the raw materials it purchases for its manufacturing needs. However, in the past, we have been able to adjust the sales price of our products so as to minimize the effect of changes in raw materials pricing and, as a result, we do not believe this market risk presents a risk that would have a material effect on the Company's results of operations or financial condition.

Item No. 8 Financial Statements and Supplementary Data

Reference is made to the Consolidated Financial Statements contained in Part IV hereof.

Item No. 9 Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item No. 9A - Controls and Procedures

Disclosure Controls and Procedures

As required by Rule 13a-15(b) under the Exchange Act, we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer (together the "Certifying Officers"), of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2007, the end of the period covered by this report. Based upon that evaluation, the Certifying Officers concluded that our disclosure controls and procedures were effective as of December 31, 2007 to provide reasonable assurance that the information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Certifying Officers, as appropriate, to allow for timely decisions regarding required disclosure.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of the management and the Board; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Company assets that could have a material effect on the financial statements.

Our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee Sponsoring Organizations of the Treadway Commission. This evaluation included review of the documentation of controls, evaluation of the design effectiveness of controls, testing of the operation effectiveness of controls and a conclusion on this evaluation. Although there are inherent limitations in the effectiveness of any system of internal controls over financial reporting, based on our evaluation, management has concluded our internal controls over financial reporting were effective as of December 31, 2007.

Management personnel, including the Certifying Officers, recognize that our internal control over financial reporting cannot prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Changes in Internal Control over Financial Reporting

There has been no change during the Company's fiscal quarter ended December 31, 2007 in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

Item 9B – Other Information

None

PART III

Item No. 10 – Directors and Executive Officers of the Registrant

Information called for by Item 10 of Part III is incorporated by reference to the definitive Proxy Statement for the 2008 Annual Meeting of Shareholders which is expected to be filed with the Commission within 120 days after December 31, 2007.

Item No. 11 – Executive Compensation

Information called for by Item 11 of Part III is incorporated by reference to the definitive Proxy Statement for the 2008 Annual Meeting of Shareholders which is expected to be filed with the Commission within 120 days after December 31, 2007.

Item No. 12 – Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information called for by Item 12 of Part III is incorporated by reference to the definitive Proxy Statement for the 2008 Annual Meeting of Shareholders which is expected to be filed with the Commission within 120 days after December 31, 2007.

Item No. 13 – Certain Relationships and Related Transactions

Information called for by Item 13 of Part III is incorporated by reference to the definitive Proxy Statement for the 2008 Annual Meeting of Shareholders which is expected to be filed with the Commission within 120 days after December 31, 2007.

Item No. 14 – Principal Accountant Fees and Services

Information called for by Item 14 of Part III is incorporated by reference to the definitive Proxy Statement for the 2008 Annual Meeting of Shareholders which is expected to be filed with the Commission within 120 days after December 31, 2007.

PART IV

Item No. 15 Exhibits and Financial Statement Schedules

1. The Consolidated Financial Statements filed as part of this report on Form 10-K are listed on the accompanying Index to Consolidated Financial Statements and Consolidated Financial Statement Schedules.

2. Financial schedules required to be filed by Item 8 of this form, and by Item 15(d) below:

Schedule II Valuation and qualifying accounts

All other financial schedules are not required under the related instructions or are inapplicable and therefore have been omitted.

3. Exhibits:

Exhibit Number	Document
3.1	Third Restated Certificate of Incorporation of CTI Industries Corporation (Incorporated by reference to Exhibit A contained in Registrant's Schedule 14A Definitive Proxy Statement for solicitation of written consent of shareholders, as filed with the Commission on October 25, 1999)
3.2	By-Laws of CTI Industries Corporation (Incorporated by reference to Exhibits, contained in Registrant's Form SB-2 Registration Statement (File No. 333-31969) effective November 5, 1997)
4.1	Form of CTI Industries Corporation's common stock certificate (Incorporated by reference to Exhibits, contained in Registrant's Form SB-2 Registration Statement (File No. 333-31969) effective November 5, 1997)
10.1	CTI Industries Corporation 1999 Stock Option Plan (Incorporated by reference to Exhibit contained in Registrant's Schedule 14A Definitive Proxy Statement, as filed with the Commission on March 26, 1999)
10.2	CTI Industries Corporation 2001 Stock Option Plan (Incorporated by reference to Exhibit contained in Registrant's Schedule 14A Definitive Proxy Statement, as filed with the Commission on May 21, 2001)
10.3	CTI Industries Corporation 2002 Stock Option Plan (Incorporated by reference to Exhibit contained in Registrant's Schedule 14A Definitive Proxy Statement, as filed with the Commission on May 15, 2002)
10.4	CTI Industries Corporation 2007 Stock Incentive Plan (Incorporated by reference to Exhibit contained in Registrant's Schedule 14A Definitive Proxy Statement, as filed with the Commission on April 30, 2007)
10.5	Employment Agreement dated June 30, 1997, between CTI Industries Corporation and Howard W. Schwan (Incorporated by reference to Exhibits, contained in Registrant's Form SB-2 Registration Statement (File No. 333-31969) effective November 5, 1997.)
10.6	Warrant dated July 17, 2001 to purchase 79,364 shares of Common Stock John H. Schwan (Incorporated by reference to Exhibits contained in the Registrant's 2002 10-KSB, as filed with the Commission on May 1, 2003)
10.7	Warrant dated July 17, 2001 to purchase 39,683 shares of Common Stock Stephen M. Merrick (Incorporated by reference to Exhibits contained in the Registrant's 2002 10-KSB, as filed with the Commission on May 1, 2003)
10.8	Note dated January 28, 2003, CTI Industries Corporation to Stephen M. Merrick in the sum of $500,000 (Incorporated by reference to Exhibits contained in the Registrant's 2002 10-KSB, as filed with the Commission on May 1, 2003)
10.9	Note dated February 28, 2003, CTI Industries Corporation to Stephen M. Merrick in the sum of $200,000 (Incorporated by reference to Exhibits contained in the Registrant's 2002 10-KSB, as filed with the Commission on May 1, 2003)
10.10	Note dated February 10, 2003, CTI Industries Corporation to John H. Schwan in the sum of $150,000 (Incorporated by reference to Exhibits contained in the Registrant's 2002 10-KSB, as filed with the Commission on May 1, 2003)
10.11	Note dated February 15, 2003, CTI Industries Corporation to John Schwan in the sum of $680,000 (Incorporated by reference to Exhibits contained in the Registrant's 2002 10-KSB, as filed with the Commission on May 1, 2003)
10.12	Note dated March 3, 2003, CTI Industries Corporation to John H. Schwan in the sum of $100,000 (Incorporated by reference to Exhibits contained in the Registrant's 2002 10-KSB, as filed with the Commission on May 1, 2003)
10.13	Warrant dated March 20, 2003, to purchase 70,000 shares of Common Stock - Stephen M. Merrick (Incorporated by reference to Exhibits contained in the Registrant's 2002 10-KSB, as filed with the Commission on May 1, 2003)
10.14	Warrant dated March 20, 2003, to purchase 93,000 shares of Common Stock - John H. Schwan (Incorporated by reference to Exhibits contained in the Registrant's 2002 10-KSB, as filed with the

	Commission on May 1, 2003)
10.15	Loan and Security Agreement between RBS Citizens, N.A. and the Company dated February 1, 2006 (Incorporated by reference to Exhibits contained in Registrant's Report on Form 8-K dated February 3, 2006)
10.16	Warrant dated February 1, 2006, to purchase 151,515 shares of Common Stock - John H. Schwan (Incorporated by reference to Exhibits contained in Registrant's Report on Form 8-K dated February 3, 2006)

10.17	Warrant dated February 1, 2006, to purchase 151,515 shares of Common Stock - Stephen M. Merrick (Incorporated by reference to Exhibits contained in Registrant's Report on Form 8-K dated February 3, 2006)
10.18	Note dated February 1, 2006, CTI Industries Corporation to John Schwan in the sum of $500,000 (Incorporated by reference to Exhibits contained in Registrant's Report on Form 8-K dated February 3, 2006)
10.19	Note dated February 1, 2006, CTI Industries Corporation to Stephen M. Merrick in the sum of $500,000 (Incorporated by reference to Exhibits contained in Registrant's Report on Form 8-K dated February 3, 2006)
10.20	Production and Supply Agreement between ITW Spacebag and the Company dated March 17, 2006 (Incorporated by reference to Exhibits contained in Registrant's Report on Form 8-K dated March 17, 2006)
10.21	License Agreement between Rapak, LLC and the Company dated April 28, 2006 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 8-K dated May 3, 2006)
10.22	Standby Equity Distribution Agreement between Cornell Capital Partners and the Company dated December 28, 2006
10.23	Second Amendment to Loan Agreement between RBS Citizens, N.A. and the Company dated December 18, 2006 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 8-K dated December 21, 2006.)
10.24	Third Amendment to Loan Agreement between RBS Citizens, N.A. and the Company dated November 13, 2007 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 10-Q dated November 13, 2007)
10.25	CTI Industries Corporation Incentive Compensation Plan (Incorporated by reference to Exhibit contained in Registrant's Report on Form 8-K dated October 2, 2007)
10.26	Supply and License Agreement among Registrant and S.C. Johnson & Son, Inc. dated February 1, 2008 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 8-K/A dated March 19, 2008)
14	Code of Ethics (Incorporated by reference to Exhibit contained in the Registrant's Form 10-K/A Amendment No. 2, as filed with the Commission on October 8, 2004)
21	Subsidiaries (description incorporated in Form 10-K under Item No. 1)
23.1	Consent of Independent Auditors, Blackman Kallick, LLP
23.2	Consent of Independent Auditors, Weiser LLP
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended (filed herewith)
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended (filed herewith)
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)

(a) The Exhibits listed in subparagraph (a)(3) of this Item 15 are attached hereto unless incorporated by reference to a previous filing.

(b) The Schedule listed in subparagraph (a)(2) of this Item 15 is attached hereto.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act the Registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized on April 15, 2008.

CTI INDUSTRIES CORPORATION
By: /s/ Howard W. Schwan
Howard W. Schwan, President

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

Signatures	Title	Date
/s/ Howard W. Schwan Howard W. Schwan	President and Director	April 15, 2008
/s/ John H. Schwan John H. Schwan	Chairman and Director	April 15, 2008
/s/ Stephen M. Merrick Stephen M. Merrick	Executive Vice President, Secretary, Chief Financial Officer and Director	April 15, 2008
/s/ Stanley M. Brown Stanley M. Brown	Director	April 15, 2008
/s/ Bret Tayne Bret Tayne	Director	April 15, 2008
/s/ John I. Collins John I. Collins	Director	April 15, 2008

CTI Industries Corporation
and Subsidiaries

Consolidated Financial Statements

Years ended December 31, 2007, 2006 and 2005

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All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and, therefore, have been omitted.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
CTI Industries Corporation

We have audited the accompanying consolidated balance sheet of CTI Industries Corporation and Subsidiaries (the "Company") as of December 31, 2007 and the related consolidated statements of operations, stockholders' equity and comprehensive loss and cash flows for the year then ended. Our audit also included the financial statement schedule listed in the Index at item 15(a). These consolidated financial statements and consolidated schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and consolidated schedule based on our audit.

We conducted our audit 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 consolidated financial statements are free of material misstatement. The Company has determined that it 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 consolidated 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CTI Industries Corporation and Subsidiaries as of December 31, 2007, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Blackman
Kallick, LLP
Chicago, Illinois
April 15, 2008

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
CTI Industries Corporation

We have audited the accompanying consolidated balance sheet of CTI Industries Corporation and Subsidiaries (the "Company") as of December 31, 2006 and the related consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows for each of the two years in the period ended December 31, 2006 and 2005. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These consolidated financial statements and consolidated schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and consolidated 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 audits 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. An audit also includes 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 CTI Industries Corporation and Subsidiaries as of December 31, 2006, and the consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2006 and 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all respects, the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), "Share-Based Payment", applying the modified prospective method at the beginning of the year ended December 31, 2006.

/s/ Weiser LLP

New York, New
York
April 9, 2007

CTI Industries Corporation and Subsidiaries
Consolidated Balance Sheets

	December 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 483,112	$ 384,565
Accounts receivable, (less allowance for doubtful accounts of $312,000 and $210,000, respectively)	5,950,551	6,442,765
Inventories, net	9,700,618	7,974,113
Net deferred income tax asset	1,014,451	1,025,782
Prepaid expenses and other current assets	651,969	664,020
Total current assets	17,800,701	16,491,245
Property, plant and equipment:		
Machinery and equipment	19,520,741	18,763,007
Building	3,035,250	2,689,956
Office furniture and equipment	1,900,219	1,782,691
Intellectual Property	305,017	305,017
Land	250,000	250,000
Leasehold improvements	465,838	459,502
Fixtures and equipment at customer locations	2,381,921	2,330,483
Projects under construction	1,836,877	289,229
	29,695,863	26,869,885
Less : accumulated depreciation and amortization	(19,599,708)	(18,277,611)
Total property,plant and equipment, net	10,096,155	8,592,274
Other assets:		
Deferred financing costs, net	113,209	207,049
Goodwill	989,108	989,108
Net deferred income tax asset	133,756	101,102
Other assets (due from related party $66,000 and $30,000, respectively)	191,206	264,161
Total other assets	1,427,279	1,561,420
TOTAL ASSETS	29,324,135	26,644,939
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Checks written in excess of bank balance	616,583	108,704
Trade payables	4,227,954	3,410,869
Line of credit	6,746,213	6,317,860
Notes payable - current portion	863,513	948,724
Notes payable - officers, current portion, (net of debt discount of $89,000 and $90,000)	2,157,065	2,155,284
Accrued liabilities	1,871,781	1,701,933
Total current liabilities	16,483,109	14,643,374

Long-term liabilities:				
Other liabilities (related parties $1,070,000 and $1,274,000)		1,070,151		1,294,272
Notes payable, net of current portion		4,351,743		4,866,008
Notes payable - officers, subordinated, (net of debt discount of $185,000 and $273,000)		815,296		726,688
Total long-term liabilities		6,237,190		6,886,968
Minority interest		12,534		12,672
Stockholders' equity:				
Preferred Stock — no par value 2,000,000 shares authorized 0 shares issued and outstanding		-		-
Common stock - no par value, 5,000,000 shares authorized, 2,569,124 and 2,412,297 shares issued and 2,569,124 and 2,142,097 outstanding, respectively		3,764,020		3,764,020
Paid-in-capital		6,754,077		6,100,587
Warrants issued in connection with subordinated debt and bank debt		1,038,487		1,038,487
Accumulated deficit		(4,363,999)		(4,445,897)
Accumulated other comprehensive loss		(601,283)		(297,490)
Less: Treasury stock - 270,200 shares at December 31, 2006		-		(1,057,782)
Total stockholders' equity		6,591,302		5,101,925
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	29,324,135	$	26,644,939

See accompanying notes to consolidated financial statements

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CTI Industries Corporation and Subsidiaries
Consolidated Statements of Operations

	For the Year Ended December 31, 2007	2006	2005
Net Sales	$ 36,509,710	$ 35,428,155	$ 29,189,974
Cost of Sales	27,825,493	26,531,045	22,725,825
Gross profit	8,684,217	8,897,110	6,464,149
Operating expenses:			
General and administrative	5,211,470	4,554,324	3,846,538
Selling	753,571	847,244	928,444
Advertising and marketing	1,474,289	1,200,782	913,071
Loss on sale of asset	-	144,936	-
Other income	-	(471,802)	-
Asset impairment loss	-	-	124,000
Total operating expenses	7,439,330	6,275,484	5,812,053
Income from operations	1,244,887	2,621,626	652,096
Other income (expense):			
Interest expense	(1,294,726)	(1,713,801)	(1,230,964)
Interest income	8,762	22,976	-
Foreign currency gain	173,510	191,270	45,128
Total other expense	(1,112,454)	(1,499,555)	(1,185,836)
Income (loss) before income taxes and minority interest	132,433	1,122,071	(533,740)
Income tax expense (benefit)	50,673	(774,195)	(200,392)
Income (loss) before minority interest	81,760	1,896,266	(333,348)
Minority interest in (income) loss of subsidiary	(138)	1,517	(139)
Net income (loss)	$ 81,898	$ 1,894,749	$ (333,209)
Other Comprehensive (Loss) Income:			
Unrealized loss on derivative instruments	$ (99,636)	-	-
Foreign currency adjustment	$ (204,157)	$ (74,070)	$ (146,536)
Comprehensive (loss) income	$ (303,793)	$ 1,820,679	$ (479,745)
Basic income (loss) per common share	$ 0.03	$ 0.91	$ (0.17)
Diluted income (loss) per common share	$ 0.03	$ 0.85	$ (0.17)

Weighted average number of shares and equivalent shares of common stock outstanding:			
Basic	2,346,126	2,087,145	1,977,235
Diluted	2,589,960	2,234,901	1,977,235

See accompanying notes to consolidated financial statements

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CTI Industries Corporation and Subsidiaries
Consolidated Statements of Stockholders' Equity and Comprehensive Loss

	Common Stock		Paid-in	Value of warrants issued in connection with	Accumulated	Accumulated Other Comprehensive	Less Treasury Stock		
	Shares	Amount	Capital	subordinated debt	Deficit	Loss	Shares	Amount	TOTA
Balance, December 31, 2004	2,185,897	$ 3,764,020	$ 5,615,411	$ 595,174	$ (6,007,437)	$ (76,884)	$ 231,796	$ (939,114)	$ 2,951,
Options Exercised	32,144		$ 53,501						$ 53
Stock issued in settlement of vendor obligations	50,229		$ 200,916						$ 200
Net Loss					$ (333,209)				$ (333
Other comprehensive loss Foreign currency translation						$ (146,536)			$ (146
Total comprehensive loss									$ (479
Balance, December 31, 2005	2,268,270	$ 3,764,020	$ 5,869,828	$ 595,174	$ (6,340,646)	$ (223,420)	231,796	$ (939,114)	$ 2,725,8
Options Exercised	21,477		$ 41,577						$ 41,:
Warrants Exercised	119,050		$ 178,192						$ 178,
Shares Surrendered to Exercise Warrants							38,404	$ (118,668)	$ (118,6
Issue of warrants related to				$ 443,313					$ 443,:

subordinated debt									
Stock issued in advance for services relating to the SEDA agreement	3,500		$ 10,990						$ 10,9
Net Income					$ 1,894,749				$ 1,894,7
Other comprehensive income Foreign currency translation						$ (74,070)			$ (74,0
Total comprehensive income									$ 1,820,0
Balance, December 31, 2006	2,412,297	$ 3,764,020	$ 6,100,587	$ 1,038,487	$ (4,445,897)	$ (297,490)	270,200	$ (1,057,782)	$ 5,101,9
Options Exercised	93,576	$ -	$ 228,467						$ 195,4
Shares issued under SEDA agreement (net of issuance costs)	323,625	$ -	$ 1,354,824						$ 1,354,8
Shares issued under consulting agreement	17,000		$ 79,050						$ 79,0
Cancellation of Treasury Shares	(270,200)		$ (1,057,782)				(270,200)	$ 1,057,782	$
Compensation relating to Option Issuance			$ 14,000						$ 14,0
Excess tax benefit -			$ 67,932						$ 67,9

Options									
Shares Surrendered to Exercise Options	(7,174)		$ (33,001)						$
Net Income					$ 81,898				$ 81,8
Other comprehensive income									
Unrealized loss on derivative instruments						$ (99,636)			$ (99,6
Foreign currency translation						$ (204,157)			$ (204,
Total comprehensive income						$ (303,793)			$ (221,8
Balance, December 31, 2007	2,569,124	$ 3,764,020	$ 6,754,077	$ 1,038,487	$ (4,363,999)	$ (601,283)	-	$ -	$ 6,591,3

See accompanying notes to consolidated financial statements

CTI Industries Corporation and Subsidiaries
Consolidated Statements of Cash Flows

	For the Year Ended December 31, 2007	2006	2005
Cash flows from operating activities:			
Net income (loss)	$ 81,898	$ 1,894,749	(333,209)
Adjustment to reconcile net income (loss) to cash provided by (used in) operating activities:			
Depreciation and amortization	1,466,419	1,424,385	1,479,916
Amortization of debt discount	90,389	102,939	35,967
Stock Based Compensation	14,000	-	-
Excess tax benefits from stock-based compensation	(35,373)	-	-
Minority interest in loss of subsidiary	138	1,517	65
Loss on sale of asset	-	144,936	-
Loss on impairment of goodwill	-	-	124,000
Gain on cancellation of vendor claim	-	(471,802)	-
Provision for losses on accounts receivable	105,153	202,571	145,000
Provision for losses on inventories	141,305	218,730	205,000
Stock issued for services and vendor settlements	43,917	-	200,916
Deferred income taxes	(21,323)	(774,195)	(200,392)
Change in assets and liabilities:			
Accounts receivable	338,142	(2,440,174)	1,680,617
Inventories	(1,872,903)	(1,063,203)	1,129,594
Prepaid expenses and other assets	270,117	106,112	167,332
Trade payables	823,185	(1,351,823)	(825,275)
Accrued liabilities	(88,874)	651,861	(1,151,032)
Net cash provided by (used in) operating activities	1,356,190	(1,353,397)	2,658,499
Cash flows from investing activities:			
Proceeds from sale of property, plant and equipment	-	-	151,206
Purchases of property, plant and equipment	(2,848,003)	(552,798)	(551,256)
Net cash used in investing activities	(2,848,003)	(552,798)	(400,050)
Cash flows from financing activities:			
Change in checks written in excess of bank balance	507,932	(390,748)	(14,225)
Net change in revolving line of credit	428,353	1,267,107	(1,350,472)
Proceeds from issuance of long-term debt and warrants (received from related party $1,000,000 in 2006)	325,913	2,647,879	231,392
Repayment of long-term debt (related parties $224,000, $15,000 and $45,000)	(1,241,757)	(959,647)	(850,986)
Repayment of short-term debt	-	(363,358)	(402,324)
Excess tax benefits from stock-based compensation	35,373		
Proceeds from exercise of stock options and warrants	195,467	101,101	53,501
Proceeds from issuance of stock, net	1,354,821	-	-

Cash paid for deferred financing fees		(20,213)		(256,884)		(141,316)
Net cash provided by (used in) financing activities		1,585,889		2,045,450		(2,474,430)
Effect of exchange rate changes on cash		4,472		(16,672)		(48,506)
Net increase (decrease) in cash and cash equivalents		98,548		122,583		(264,487)
Cash and cash equivalents at beginning of period		384,565		261,982		526,469
Cash and cash equivalents at end of period	$	483,113	$	384,565	$	261,982
Supplemental disclosure of cash flow information:						
Cash payments for interest	$	1,201,228	$	1,215,596		950,280
Cash payments for taxes	$	81,900	$	80,508		88,151
Accounts payable converted to notes payable	$	-		-	$	453,503
Issue of Warrants related to Subordinated Debt	$	-	$	443,313		-
Stock Issued to Placement Agent	$	-	$	10,990		-

See accompanying notes to consolidated financial statements

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December 31, 2007

1. Nature of Business

Nature of Operations

CTI Industries Corporation, its United Kingdom subsidiary (CTI Balloons Limited), its Mexican subsidiaries (Flexo Universal, S.A. de C.V., CTI Mexico Corporation, S.A. de C.V. and CTF International S.A. de C.V.), and CTI Helium, Inc. (the “Company”) (i) design, manufacture and distribute metalized and latex balloon products throughout the world and (ii) operate systems for the production, lamination, coating and printing of films used for food packaging and other commercial uses and for conversion of films to flexible packaging containers and other products.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of CTI Industries Corporation, its wholly owned subsidiaries CTI Balloons Limited, CTF International S.A. de C.V., and CTI Helium, Inc. and its majority owned subsidiaries, Flexo Universal and CTI Mexico Corporation. All significant intercompany accounts and transactions have been eliminated upon consolidation.

Foreign Currency Translation

The financial statements of foreign subsidiaries are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities, the historical exchange rate for stockholders’ equity, and a weighted average exchange rate for each period for revenues and expenses. Translation adjustments are recorded in accumulated other comprehensive income (loss) as the local currencies of the subsidiaries are the functional currencies. Foreign currency transaction gains and losses are recognized in the period incurred and are included in the Consolidated Statements of Operations.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions that affect the amounts reported of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period in the financial statements and accompanying notes. Actual results may differ from those estimates. The Company’s significant estimates include valuation allowances for doubtful accounts, lower of cost or market of inventory and deferred tax assets, and recovery value of goodwill.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, demand deposits and short term investments with original maturities of three months or less. At December 31, 2006, cash balances exceeded FDIC insured amounts by approximately $141,000.

Accounts Receivable

Trade receivables are carried at original invoice amount less an estimate for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by identifying troubled accounts, evaluating the individual customer receivables through consideration of the customer's financial condition, credit history and current economic conditions and use of historical experience applied to an aging of accounts. A trade receivable is considered to be past due if any portion of the receivable balance is outstanding for a period over the customer's normal terms. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using standard costs which approximates costing determined on a first-in, first-out basis, to reflect the actual cost of production of inventories.

Production costs of work in process and finished goods include material labor and overhead. Work in process and finished goods are not recorded in excess of net realizable value.

In 2006, the Company adopted SFAS No. 151, "Inventory Costs" which clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) should be recognized as period charges, rather than as an inventory value. This standard also requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The Company's pre-existing accounting policy for inventory valuation was generally consistent with this guidance, and therefore, the adoption of SFAS No. 151 did not have a significant impact on 2006 financial results.

Property, Plant and Equipment

Property and equipment are stated at cost. Expenditures for maintenance and repairs are charged to operations as incurred. Depreciation is computed using the straight-line and declining-balance methods over estimated useful lives of the related assets. Leasehold improvements are amortized on a straight-line method over the lesser of the estimated useful life or the lease term. The estimated useful lives range as follows:

Building	25 - 30 years
Machinery and equipment	3 - 15 years
Office furniture and equipment	5 - 8 years
Leasehold improvements	5 - 8 years
Furniture and equipment at customer locations	1 - 3 years

Projects in process represent those costs capitalized in connection with construction of new assets and/or improvements to existing assets including a factor for interest on funds committed to projects in process of $83,000. Upon completion, these costs are reclassified to the appropriate asset class.

Goodwill

The Company applies the provisions of SFAS 142, "Goodwill and Other Intangible Assets", under which goodwill is tested at least annually for impairment. Goodwill on the accompanying balance sheets relates to the Company's acquisition of Flexo Universal in a prior year. It is the Company's policy to perform impairment testing for Flexo Universal annually as of December 31, or as circumstances change. An annual impairment review was completed and no impairment was noted for the year ended December 31, 2007 and 2006 (see note 14). While the Company believes that its estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect these evaluations.

Valuation of Long Lived Assets

The Company evaluates whether events or circumstances have occurred which indicate that the carrying amounts of long-lived assets (principally property, plant and equipment) may be impaired or not recoverable. The significant factors that are considered that could trigger an impairment review include: changes in business strategy, market conditions, or the manner of use of an asset; underperformance relative to historical or expected future operating results; and negative industry or economic trends. In evaluating an asset for possible impairment, management estimates that asset's future undiscounted cash flows and appraised values to measure whether the asset is recoverable, the Company measures the impairment based on the projected discounted cash flows of the asset over its remaining life.

Deferred Financing Costs

Deferred financing costs are amortized on a straight line basis over the term of the loan. Upon a refinancing, existing unamortized deferred financing costs are expensed.

Income Taxes

The Company accounts for income taxes using the liability method. As such, deferred income taxes reflect the net tax effects of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Deferred tax assets and liabilities are measured using enacted tax rates expected to be in effect when the anticipated reversal of these differences is scheduled to occur. Deferred tax assets are reduced by a valuation allowance when, management cannot determine, in its opinion, that it is more likely than not that the Company will recover that recorded value of the deferred tax asset.. The Company is subject to U.S. Federal, state and local taxes as well as foreign taxes in the United Kingdom and Mexico.

In July 2006, the FASB issued Interpretation ("FIN") No. 48, Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109 ("FIN 48"). FIN 48 provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements in accordance with SFAS 109. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. We adopted FIN 48 effective January 1, 2007, and the provisions of FIN 48 have been applied to all income tax positions commencing from that date. There was no material impact from this adoption.

Fair Value of Financial Instruments

The fair value of the Company's financial instruments relating to accounts receivable, trade payables and accrued expenses approximates fair value due to their short-term nature. The fair value of debt approximates its carrying value as the interest rates applicable to these debt instruments are comparable to current market rates for similar maturities.

Other Comprehensive Income (Loss)

For the year ended December 31, 2007 the Company began recording the changes in the valuation of the company's swap agreements in other comprehensive income (loss). For the years ended December 31, 2007, 2006 and 2005 comprehensive income (loss) also reflected foreign currency translation adjustments. Both are components of accumulated other comprehensive loss within stockholder's equity.

Revenue Recognition

The Company recognizes revenue when title transfers upon shipment. Revenue from a transaction is not recognized until (i) a definitive arrangement exists, (ii) delivery of the product has occurred or the services have been performed and legal title and risk are transferred to the customer, (iii) the price to the buyer has been fixed or is determinable and (iv) collectibility is reasonably assured. In some cases, product is provided on consignment to customers. For these cases, revenue is recognized when the customer reports a sale of the product.

Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123, "Share-Based Payments" ("SFAS No. 123(R)") using the modified prospective transition method. Under this method, the Company's consolidated financial statements for prior periods have not been restated and do not include the impact of SFAS No. 123(R). Accordingly, no compensation expense related to stock option awards was recognized in the year ended December 31, 2005 because all stock options granted had an exercise price equal to the fair market value of the underlying common stock on the date of grant. The following table shows the effect on net income and earnings per share as if the fair-value-based method of accounting had been applied to all outstanding and unvested stock options prior to adoption of SFAS No. 123(R). For purposes of this pro forma disclosure, the estimated fair value of the stock option award is assumed to be expensed over the award's vesting periods (immediate) using the Black-Scholes model.

At December 31, 2005, the Company had 4 stock-based compensation plans, which are described more fully in Note 16. The Company accounted for those plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. The Company recognized compensation cost for stock-based compensation awards equal to the difference between the quoted market price of the stock at the date of grant or award and the price to be paid by the employee upon exercise in accordance with the provisions of APB No. 25. Based upon the terms of Company's current stock option plans, the stock price on the date of grant and price paid upon exercise are the same. Accordingly, no stock-based employee compensation cost had been recognized in 2005, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

		Year Ended December 31, 2005
Net Profit (loss):		
Reported	$	(333,000)
Deduct total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	$	(124,000)
Pro forma net income (loss)	$	(457,000)
Net income (loss) per share:		
Basic - As reported	$	(0.17)
Basic - Proforma	$	(0.23)
Diluted - As reported	$	(0.17)
Diluted - Proforma	$	(0.23)

The fair value of each option was estimated as of the date of the grant using the Black-Scholes option pricing model based on the following assumptions:

	2005
Expected life (years)	5
Volatility	138.86%
Risk-free interest rate	3.89%
Dividend yield	-

Research and Development

The Company conducts product development and research activities which includes (i) creative product development and (ii) engineering. During the years ended December 31, 2007, 2006 and 2005, research and development activities totaled $350,000, $230,000 and $224,000, respectively.

Advertising Costs

The Company expenses advertising costs as incurred. Advertising expenses amounted to $194,000, $116,000 and $50,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

Reclassifications

A reclassification of personnel from sales to marketing was made to the year end 2005 statement of operations to conform to the 2006 and 2007 presentation.

A reclassification of Intellectual property from office furniture and equipment to a new line item was made to the 2006 balance sheet to conform to the 2007 presentation.

Derivative Instruments and Hedging Activities

SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities," SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of SFAS No. 133," SFAS No. 138,"Accounting for Certain Derivative Instruments and Certain Hedging Activities" and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities, (Collectively "SFAS 133") require an entity to recognize all derivatives as either assets for liabilities in the consolidated balance sheet and to measure those instruments at fair value. Under certain conditions, a derivative may be specifically designated as a fair value hedge or a cash flow hedge. For the period from February 2006 to June 30, 2007, the Company accounted for changes in the valuation of the swap agreement as items of income or expense. The net effect of such changes on income for the year through June 30, 2007 was $31,000. Subsequent to June 30, 2007, the Company designated the swap agreements as cash flow hedges and began recording the changes in fair value in other comprehensive income.

3. New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement clarifies how to measure fair value as permitted under other accounting pronouncements but does not require any new fair value measurements. In February 2008, the FASB issued FASB Staff Position (FSP) 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" (FSP 157-1) and FSP 157-2, "Effective Date of FASB Statement No. 157" (FSP 157-2). FSP 157-1 amends SFAS No. 157 to remove certain leasing transactions from its scope. FSP 157-2 delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of fiscal 2009. The measurement and disclosure requirements related to financial and non-financial assets and liabilities are not anticipated to have significant impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). SFAS 159 permits companies to choose to measure certain financial instruments and other items at fair value. The standard requires that unrealized gains and losses are reported in earnings for items measured using the fair value option. SFAS No. 159 is effective for us on January 1, 2008. The adoption of SFAS No. 159 is not expected to have a significant impact on our consolidated financial statements.

4. Major Customers

For the year ended December 31, 2007, the Company had 3 customers that accounted for approximately 20.3%, 19.1% and 10.3%, respectively, of consolidated net sales. In 2006, the company had 2 customers that accounted for approximately 24.3%, and 20.1% respectively. See note 13 for disclosure of related parties major customer in 2006 and 2005. Corresponding percentages of consolidated net sales generated by these customers for the year ended December 31, 2005, were approximately 13.6%, 23.5% and 13.3% respectively. At December 31, 2007, the outstanding accounts receivable balances due from these three customers were $2,905,000, $519,000 and $113,000, respectively. At December 31, 2006, the outstanding accounts receivable balances due from these three customers were $2,641,000 and $598,000, respectively.

5. Inventories

Inventories are stated at the lower of cost or market. Cost is determined using standard costs which approximate costing determined on a first-in, first out basis. Standard costs are reviewed and adjusted periodically and at year end based on actual direct and indirect production costs. On a periodic basis, the Company reviews its inventory levels for estimated obsolescence or unmarketable items, in reference to future demand requirements and shelf life of the product.

Inventories are comprised of the following:

	December 31, 2007	December 31, 2006
Raw materials	$ 1,452,000	$ 1,449,000
Work in process	1,423,000	945,000
Finished goods	7,208,000	5,855,000
Allowance for excess quantities	(382,000)	(275,000)
Total inventories	$ 9,701,000	$ 7,974,000

6. Notes Payable

Long term debt consists of:

	Dec. 31, 2007	Dec. 31, 2006
Term Loan with bank, payable in monthly installments of $58,333 plus interest at prime (7.25% and 8.25% at December 31, 2007 and 2006, respectively) plus 0.75% (8.00%) and 0.25% (8.50%) at December 31, 2007 and 2006, respectively (amortized over 60 months) balance due January 31, 2011	$ 2,256,636	$ 2,936,242
Mortgage Loan with bank, payable in monthly installments of $9,333 plus interest at prime (7.25% and 8.25% at December 31, 2007 and 2006, respectively) plus 0.75% (8.00%) and 0.25% (8.50%) at December 31, 2007 and 2006, respectively (amortized over 25 years) balloon balance of $2,249,000 due January 31, 2011	$ 2,677,851	$ 2,741,763
(2006) Vendor Notes, at various rates of interest (weighted average of 6%) maturing through December 2007	$ -	$ 136,725
Subordinated Notes (Officers) due 2008, interest at 9% net of debt discount of $0 and $1,781 at December 31, 2007 and 2006, respectively (See Notes 7,13)	$ $ 1,431,500	$ 1,429,781
Subordinated Notes (Officers) due 2008, interest at 8% (See Notes 7,13)	$ 814,233	$ 814,233
Subordinated Notes (Officers) due 2011, interest at prime (7.25% and 8.25% at December 31, 2007 and 2006, respectively) + 2%, 9.25% and 10.25% as of December 31, 2007 and 2006, respectively, net of debt discount of $273,372 and $362,040 at December 31, 2007 and 2006, respectively.	$ 726,628	$ 637,960
(2007) Asset Financing Loans: Forklift, payable in monthly installments of $426 (amortized over 5 years) annual interest rate of 10.5%; Pouch Machine #6; payable in monthly installments of $5,626 (amortized over 5 years) annual interest rate of 8.78%	$ 280,768	$ -
Total long-term debt	$ 8,187,616	$ 8,696,704
Less current portion	$ (3,020,578)	$ (3,104,008)
Total Long-term debt, net of current portion	$ 5,167,038	$ 5,592,696

On February 1, 2006, the Company entered into a Loan Agreement with RBS Citizens, N.A., Chicago, Illinois, previously referred to as Charter One Bank, under which, as amended, the Bank has agreed to provide a credit facility to the Company in the total amount of $15,300,000, which includes (i) a five year mortgage loan secured by the Barrington, Illinois property in the principal amount of $2,800,000, amortized over a 25 year period, (ii) a five year term loan secured by the equipment at the Barrington, Illinois plant in the amount of $3,500,000 and (iii) a three-year revolving line of credit up to a maximum amount of $9,000,000, secured by inventory and receivables. The amount the Company can borrow on the revolving line of credit includes 85% of eligible receivables and 60% of eligible inventory. The Loan Agreement includes a number of covenants including financial covenants relating to Tangible Net Worth, Senior Debt to EBITDA, and Fixed Charge coverage. As of December 31, 2007, we were not in compliance with the senior debt to EBITDA or the EBITDA to fixed charge covenants. We have obtained a waiver from the Bank with respect to these covenant violations as of December 31, 2007. We believe that we will be in compliance with our debt covenants during 2008. On February 1, 2006, proceeds of these loans totaling $10,349,653 were utilized to pay the entire outstanding principal amount of the Company's then outstanding debt obligations to Cole Taylor Bank and Banco Popular.

The Company used interest rate swaps as a cash flow hedge to manage interest costs and the risk associated with changing interest rates of long-term debt. During the second quarter ended June 30, 2006, the Company entered into two separate forward-starting interest rate swap agreements as a means of managing its interest rate exposure on its variable rate $2.8 million mortgage and $3.5 million term loan. These agreements were effective beginning on May 1, 2006 and were designated to swap a variable rate of prime plus varying rates for a fixed rate ranging of 8.49%. The aggregate notional amount of the swaps was $6.2 million. The swap agreements expire on January 1, 2011. The net effect of such changes on for the six month ended June 30, 2007 was $31,000. For the third quarter 2007 and thereafter, the Company will record changes in the valuation of the swap agreement as items of other comprehensive income or loss.

Each of John H. Schwan and Stephen M. Merrick, officers, directors and principal shareholders of the Company have personally guaranteed the obligations of the Company to RBS Citizens, N.A. up to $2,000,000.

As of December 31, 2007 the balance outstanding on the revolving line of credit with RBS Citizens, N.A. was $6,746,000 with an interest rate of 8%.

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Future minimum principal payments, exclusive of debt discount, for amounts outstanding under these long-term debt agreements for each of the years ended December 31:

2008	$ 3,021,000
2009	779,000
2010	784,000
2011	3,556,000
2012	48,000
Thereafter	-
	$ 8,188,000

7. Subordinated Debt

In February 2003, the Company received $1,630,000 from certain shareholders in exchange for (a) two year 9% subordinated notes, and (b) five year warrants to purchase 163,000 common shares at $4.87 per share. The proceeds were to (i) re-finance the bank loan of CTI Mexico in the amount of $880,000 and (ii) to provide financing for CTI Mexico and Flexo Universal. The value of the warrants was $460,000 calculated using Black-Scholes option pricing formula. The Company applied the discount against the subordinated debt. The discount is being amortized using the effective interest method to interest expense over the term of the debt. These loans are subordinated to the Bank debt of the Company. On February 8, 2008 those shareholders exercised these warrants in exchange for a reduction on these notes of $794,000.

In February 2006, the Company received $1,000,000 from certain shareholders in exchange for (a) five year subordinated notes bearing interest at 2% over the prime rate determined on a quarterly basis, and (b) five year warrants to purchase an aggregate of 303,030 shares of common stock of the Company at the price of $3.30 per share. The proceeds were to fund capital improvements and give additional liquidity to the Company. The value of the warrants was $443,000 using the Black-Scholes option pricing formula. The Company applied the discount against the subordinated debt. The discount is amortized using the effective interest method to interest expense over the term of the debt. These loans are subordinated to the Bank debt of the Company.

At various times during 2003, John H. Schwan loaned an aggregate of $795,204 to the Company in exchange for notes bearing interest at various annual rates (5%-8%). These notes are subordinated to the bank loan of the Company. Mr. Merrick also advanced $19,209 to the Company in December 2005.

8. Income Taxes

The income tax provisions are comprised of the following:

	Dec. 31 2007	Dec. 31 2006	Dec. 31 2005
Current:			
Federal	$ -	$ -	$ -
State	-	-	-
Foreign	162,218	-	-
	$ 162,218	$ -	$
Deferred			
Federal	$ (94,934)	$ (806,683)	$ (180,134)
State	(16,611)	32,488	(24,797)
Foreign	-	-	4,539
	(111,545)	(774,195)	(200,392)
Total Income Tax Provision	$ 50,673	$ (774,195)	$ (200,392)

The components of the net deferred tax asset at December 31 are as follows:

	2007	2006
Deferred tax assets:		
Allowance for doubtful accounts	$ 113,265	$ 73,047
Inventory allowances	110,156	47,166
Accrued liabilities	71,576	64,859
Unicap 263A adjustment	114,774	109,111
Net operating loss carryforwards	2,972,715	3,036,424
Alternative minimum tax credit carryforwards	342,673	338,612
State investment tax credit carryforward	30,512	30,512
Other foreign tax items	55,556	55,556
Foreign asset tax credit carryforward	38,872	136,744
Total deferred tax assets	3,850,099	3,892,031
Deferred tax liabilities:		
Book over tax basis of capital assets	(1,193,457)	(1,346,794)
Other foreign tax items	(281,434)	(191,352)
	2,375,208	2,353,885
Less: Valuation allowance	(1,227,001)	(1,227,001)
Net deferred tax asset	$ 1,148,207	$ 1,126,884

The Company maintains a valuation allowance with respect to deferred tax assets as a result of the uncertainty of ultimate realization. At December 31, 2007, the Company has net operating loss carryforwards of approximately $7,474,000 expiring in various years through 2025. In addition, the Company has approximately $339,000 of alternative minimum tax credits as of December 31, 2007, which have no expiration date.

For 2007 the Company determined that it is more likely than not it will not realize the value recorded of its deferred tax assets. In 2006, the Company recognized an income tax benefit of $774,000. On the basis of results of operations over the past five quarters, anticipated repatriation of income from foreign subsidiaries, charges to foreign subsidiaries and the expectation of continued achievement of, and improvement in, operating results for the foreseeable future.

Income tax provisions differed from the taxes calculated at the statutory federal tax rate as follows:

	Years Ended December 31,		
	2007	**2006**	**2005**
Taxes at statutory rate	$ 46,352	$ 392,725	$ (186,809)
State income taxes	6,381	54,061	(25,716)
Nondeductible expenses	18,317	20,530	12,757
Decrease in deferred tax valuation allowance	-	(1,227,001)	-
Foreign taxes and other	(20,377)	(14,510)	(624)
Income tax provision	$ 50,673	$ (774,195)	$ (200,392)

The Company files tax returns in the U.S. federal and U.K. and Mexico foreign tax jurisdictions and various state jurisdictions. The tax years 2004 through 2006 remain open to examination. Our policy is to recognize interest and penalties related to uncertain tax positions in income tax expense. During the twelve months ended December 31, 2007, the Company did not recognize expense for interest or penalties, and do not have any amounts accrued at December 31, 2007, as the Company does not believe it has taken any uncertain tax positions.

9. Other Income/Expense

Other income/expense set forth on the Company's Consolidated Statement of Income for the fiscal year ended December 31, 2007 included gains of $174,000 from currency variability. In 2006 and 2005, the Company had a gain of $191,000 and $45,000, respectively, related to currency variability items.

10. Other Operating Expense (Income)

Other income/expense set forth on the Company's Consolidated Statement of Income for the fiscal year ended December 31, 2006 included gains of $472,000 related to the settlement of certain vendor claims in consideration for the payment of an amount less than the amount accrued.

11. Other Liabilities

Items identified as Other Liabilities in the Company's Consolidated Balance Sheet as of December 31, 2007 include (i) loans by officers/shareholders to Flexo Universal totaling $1,056,000, and (ii) $14,000 owed to others. Items identified as Other Liabilities in the Company's Consolidated Balance Sheet as of December 31, 2006 include (i) loans by officers/shareholders to Flexo Universal totaling $1,090,000, (ii) loans by officers/shareholders to CTI Balloons Limited of $184,000 and (iii) $20,000 owed to others..

12. Employee Benefit Plan

The Company has a defined contribution plan for substantially all employees. Profit sharing contributions may be made at the discretion of the Board of Directors. Effective January 1, 2006, the Company amended its defined contribution plan. Under the amended plan, the maximum contribution for the Company is 5% of gross wages. Employer contributions to the plan totaled $105,000, $91,000 and $52,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

13. Related Party Transactions

Stephen M. Merrick is of counsel to a law firm from which we received legal services during the year. Mr. Merrick is both a director and a shareholder of the Company. Legal fees incurred with this firm or predecessor, were $106,000, $120,000 and $117,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

John H. Schwan, Chariman of the Company, is principal of Shamrock Packaging and affiliated companies. The Company made purchases of packaging materials from Shamrock of approximately $622,000, $368,000 and $165,000 during the years ended December 31, 2007, 2006 and 2005, respectively.

John H. Schwan was an officer of an affiliate of Rapak, LLC. Mr. Schwan ended his affiliation with Rapak in 2006. Rapak's purchases of products from the Company totaled $7,110,000 and $6,860,000 in each of the years ended December 31, 2006 and 2005, respectively. (see note 4)

John H. Schwan, Chairman of the Company, is one of the owners of White Horse Production, Inc. The Company made purchases from White Horse of approximately $16,500 during the year ended December 31, 2007. The Company did not make any purchase from White Horse prior to 2007.

John. H. Schwan, Chairman of the Company, is the brother of Gary Schwan, one of the owners of Schwan Incorporated, which provides building maintenance and remodeling services to the Company. The Company made purchases from Schwan Incorporated of approximately $111,000 during the year ended December 31, 2007. The Company made purchases from Schwan Incorporated of approximately $13,000 during the year ended December 31, 2006.

In January 2006, an officer of Flexo Universal acquired the loan of Flexo Universal payable to a Mexican financial institution. During 2006, Flexo Universal made payments of $24,000 and $8,400 for the years ending December 31, 2007 and 2006 respectively, in principal and interest on this loan to the officer.

Messrs. Schwan and Merrick made advances to the Company's Mexican affiliate, Flexo Universal in the amount of $113,000 and $142,000, respectively in 2005. These advances are reflected in demand notes bearing interest at the rate of 7%. Additionally, Messrs. Schwan and Merrick advanced $130,000 and $155,000, in 2005 respectively to the Company's UK affiliate, CTI Balloons Ltd. The advances made to CTI Balloons Ltd. were paid back in full in 2007.

On February 1, 2006, Mr. Schwan and Mr. Merrick advanced $500,000 each to the Company in exchange for (a) five year promissory notes bearing interest at 2% over the prime rate determined quarterly and (b) five year warrants to purchase an aggregate of 303,030 shares of common stock of the Company at the price of $3.30 per share (110% of the market price on the day proceeding the day of the loan).

Interest paid to related parties during 2007, 2006 and 2005, was 299,000, $277,000 and $147,000, respectively.

14. Goodwill and Intangible Assets

Under the provisions of SFAS 142, goodwill is subject to at least annual assessments for impairment by applying a fair-value based test. SFAS 142 also requires that an acquired intangible asset should be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the asset can be sold, licensed, rented or exchanged, regardless of the acquirer's intent to do so. The Company has no acquired intangible assets other than goodwill.

As of December 31, 2005, we determined in consultation with a valuation consultant that the fair value of the Company's interest in Flexo Universal was below its $1,113,000 carrying value. Then step two of the evaluation was done in which the value of the goodwill was determined to be $989,000. Accordingly, in fiscal 2005, we recorded $124,000 as an expense and have reduced the carrying value of the Company's interest in Flexo Universal to $989,000. As of December 31, 2006 and 2007 we determined, in consultation with a valuation consultant, that the fair value of the Company's interest in goodwill related to Flexo Universal was not impaired.

The carrying amount of goodwill as of December 31, 2007, 2006 and 2005 was $989,000.

15. Commitments and Contingencies

Operating Leases

In September of 2005, the Company signed a lease to rent 16,306 square feet of space from Trinity Assets. This lease has a 2-year term. In September of 2006, the Company signed an extension to this lease to run through September of 2009. The Company's United Kingdom subsidiary also maintains a lease for office and warehouse space, which expires in 2019. The Company's Mexico subsidiary signed a five-year lease in January of 2003 to rent 43,000 square feet of warehouse and office space at a cost of approximately $18,000 per month. In February 2008, Flexo Universal entered into a new 3-year lease at the cost of $19,200 per month. The Company leases office and warehouse equipment under operating leases, which expire on various dates through December 2011.

The net lease expense was $430,000, $312,000 and $598,000 for the years ended December 31, 2007, 2006, and 2005 respectively.

The future aggregate minimum net lease payments under existing agreements as of December 31, are as follows:

	Trinity Assets	Other	Total Lease Payments
2008	$ 104.000	$ 410,000	$ 514,000
2009 – 2010	79,000	820,000	899,000
2011 – 2012		245,000	245,000
2013 and thereafter		362,000	362,000
Total	$ 183,000	$ 1,837,000	$ 2,020,000

Licenses

The Company has certain merchandising license agreements, which are of a one to two year duration that require royalty payments based upon the Company's net sales of the respective products. The agreements call for guaranteed minimum commitments that are determined on a calendar year basis. Future guaranteed commitments due, as computed on a pro rata basis, as of December 31, are as follows:

2008	$ 92,000

16. Stockholders' Equity

Stock Options

On January 1, 2006, the Company adopted SFAS 123(R). Prior to the adoption of SFAS 123(R), the Company had adopted the disclosure-only provisions of SFAS 123 and accounted for employee stock-based compensation under the intrinsic value method, and no expense related to stock options was recognized. The Company adopted the provisions of SFAS 123(R) using the modified prospective transition method. Under this method, stock based compensation expense for 2007 and 2006 includes the requisite service period portion of the grant date fair value of: (a) all awards of equity instruments granted prior to, but not yet vested as of, January 1, 2006; and (b) all awards of equity instruments granted subsequent to January 1, 2006.

As of December 31, 2007, the Company had five stock-based compensation plans pursuant to which stock options may be granted. The Plans provide for the award of options, which may either be incentive stock options ("ISOs") within the meaning of Section 422A of the Internal Revenue Code of 1986, as amended (the "Code") or non-qualified options ("NQOs") which are not subject to special tax treatment under the Code. When a new stock option plan is adopted no further options will be issued under any previous stock option plan.

Under the Company's 1997 Stock Option Plan (effective July 1, 1997), a total of 119,050 shares of Common Stock were reserved for issuance under the Stock Option Plan. As of December 31, 2007, 98,415 shares of Common Stock have been granted and were fully vested at the time of grant, 49,606 remain outstanding. During 2007, 4,762 options were exercised and proceeds of $30,001 were received from this plan.

On March 19, 1999, the Board of Directors approved for adoption, effective May 6, 1999, the 1999 Stock Option Plan ("Plan"). The Plan authorizes the grant of options to purchase up to an aggregate of 158,733 shares of the Company's Common Stock. As of December 31, 2007, 148,217 shares have been granted under the 1999 Stock Option Plan and were fully vested at the time of grant, 29,762 remain outstanding. During 2007, 23,812 options were exercised and proceeds of $45,005 were received from this plan.

On April 12, 2001, the Board of Directors approved for adoption, effective December 27, 2001, the 2001 Stock Option Plan (the "Plan"). The Plan authorizes the grant of options to purchase up to an aggregate of 119,050 shares of the Company's Common Stock. As of December 31, 2007, 137,955 shares have been granted and were fully vested at the time of grant, 41,692 remain outstanding. During 2007, 5,953 options were exercised and $8,751 in proceeds were received from this plan.

On April 24, 2002, the Board of Directors approved for adoption, effective October 12, 2002, the 2002 Stock Option Plan ("Plan"). The Plan authorizes the grant of options to purchase up to an aggregate of 142,860 shares of the Company's Common Stock.As of December 31, 2007, 123,430 shares have been granted and were fully vested at the time of grant, 49,500 remain outstanding. In 2007, 59,049 options were exercised and proceeds of $144,711 were received from this plan. 7,174 shares were surrendered to exercise 14,826 of these options.

In December 2005, certain members of company management were issued incentive-based options to purchase 79,000 shares of the Company's Common Stock at an exercise price of $2.88 per share. These options have a term of 10 years.

The fair value of the options granted in 2005 were estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rate of 3.9%; dividend yield of 0%; volatility factor of the expected price of the Company's stock was 138.9%; and a weighted average expected life of 5 years. The weighted average fair value of the options granted during 2005 was $2.56 per share. The fair value of these options was $202,000, which were fully vested at the time of grant.

	2007	2006	2005
Options granted	74,000	-	79,000
Options vested	-	-	79,000

The following is a summary of options exercised during the years ended December 31:

	2007			2006			2005		
	Shares		Intrinsic Value	Shares		Intrinsic Value	Shares		Intrinsic Value
1997 Plan	4,762	$	17,000	-	$	-	-	$	-
1999 Plan	23,813	$	166,000	3,572	$	6,000	17,263	$	57,000
2001 Plan	5,953	$	34,000	17,905	$	42,000	14,881	$	84,000
2002 Plan	59,049	$	119,000	-	$	-	-	$	-

On June 22, 2007, the Board of Directors approved for adoption, effective October 1, 2007, the 2007 Incentive Stock Plan ("Plan"). The Plan authorizes the grant of options to purchase up to an aggregate of 150,000 shares of the Company's Common Stock**.** On October 1, 2007, the company issued 74,000 shares under the 2007 Plan. The fair value of these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rate of 3.89%; dividend yield of 0%; volatility factor of the expected price of the Company's stock was 60.67%; and a weighted average expected life of 2.8 years. The weighted average fair value of the options granted during 2007 was $1.854 per share. Through December 31, 2007 the Company has recorded $14,000 in share based compensation expense relating to this option program. The Company has $152,000 of unrecognized compensation cost as of December 31, 2007, which relates to non vested shares. This expense will be recognized over the next 11 quarters.

Vesting of 2007 Options

%	Date
25	April 1, 2008
50	October 1, 2008
75	October 1, 2009
100	October 1, 2010

The Compensation Committee administers the Plan. The exercise price for ISOs cannot be less than the fair market value of the stock subject to the option on the grant date (110% of such fair market value in the case of ISOs granted to a stockholder who owns more than 10% of the Company's Common Stock). The exercise price of a NQO shall be fixed by the Compensation Committee at whatever price the Committee may determine in good faith. Unless the Committee determines otherwise, options generally have a 10-year term (or five years in the case of ISOs granted to a participant owning more than 10% of the total voting power of the Company's capital stock). Unless the Committee provides otherwise, options terminate upon the termination of a participant's employment, except that the participant may exercise an option to the extent it was exercisable on the date of termination for a period of time after termination. Officers, directors, and employees of, and consultants to, the Company or any parent or subsidiary corporation selected by the Committee are eligible to receive options under the Plan. Subject to certain restrictions, the Committee is authorized to designate the number of shares to be covered by each award, the terms of the award, the date on which and the rates at which options or other awards may be exercised, the method of payment, vesting and other terms.

The valuation assumptions were determined as follows:

Historical stock price volatility: The Company used the monthly closing price to calculate historical annual volatility.

Risk-free interest rate: The Company bases the risk-free interest rate on the rate payable on US treasury securities in effect at the time of the grant.

Expected life: The expected life of the option represents the period of time options are expected to be outstanding. The Company uses one half of the life of the option.

Dividend yield: The estimate for dividend yield is 0.0%, because the Company has not historically paid, and does not intend for the foreseeable future to pay, a dividend.

The following is a summary of the activity in the Company's stock option plans and other options for the years ended December 31, 2007, 2006 and 2005, respectively.

	Dec. 31, 2007		Weighted Avg. Exercise Price	Dec. 31, 2006		Weighted Avg. Exercise Price	Dec. 31, 2005		Weighted Avg. Exercise Price
Exercisable, beginning of period	337,941	$	3.42	361,402	$	3.36	405,422	$	3.25
Granted	-		4.75	-		3.30	79,000		2.88
Exercised	(93,576)		2.44	(21,477)		1.88	(32,144)		1.70
Cancelled	(50,000)		5.75	(1,984)		6.30	(90,876)		1.77
Exercisable at the end of period	194,365	$	3.32	337,941	$	3.42	361,402	$	3.36

	Dec. 31, 2007		Weighted Avg. Exercise Price	Dec. 31, 2006		Weighted Avg. Exercise Price	Dec. 31, 2005		Weighted Avg. Exercise Price
Outstanding, beginning of period	337,941	$	3.42	361,402	$	3.36	405,422	$	3.25
Granted	74,000		4.75	-		3.30	79,000		2.88
Exercised	(93,576)		2.44	(21,477)		1.88	(32,144)		1.70
Cancelled	(50,000)		5.75	(1,984)		6.30	(90,876)		1.77
Outstanding at the end of period	268,365	$	3.71	337,941	$	3.42	361,402	$	3.36

At December 31, 2007, available options to grant were 76,000.

Significant option groups outstanding at December 31, 2007 and related weighted average price and remaining life information are as follows:

Grant Date	Outstanding	Exercisable		Exercise Price	Remaining Life (Years)
September 1998	49,604	49,604	$	6.30	0.9
September 1998	11,905	11,905	$	2.10	0.9
March 2000	29,759	29,759	$	1.89	2.3
December 2001	26,192	26,192	$	1.47	4.0
April 2002	11,905	11,905	$	2.10	4.4
December 2005	65,000	65,000	$	2.88	8.0
October 2007	74,000	-	$	4.75	3.9
	268,365	194,365			

The aggregate intrinsic value of options were $220,000 as of December 31, 2007 for all options in the money, outstanding and exercisable.

Warrants

In July 2001, certain members of company management were issued warrants to purchase 119,050 shares of the Company's Common Stock at an exercise price of $1.50 per share in consideration of their facilitating and guaranteeing and securing bank loans to the Company in the amount of $1.4 million and for advancing additional monies to the company that were repaid in 2001. On June 12, 2006 one member of the company management paid $59,524 to exercise warrants for 39,683 shares and another member of the company management turned in 38,404 shares with a market value of $3.09 per share on the day of the transaction, or $118,666, to pay for the shares issued under the warrant

In February 2003, certain members of company management were issued warrants to purchase 163,000 shares of the Company's Common Stock at an exercise price of $4.87 per share in consideration of their loaning the company $1,630,000. On February 8, 2008 those shareholders exercised these options in exchange for a reduction on these notes of $794,000.

In February 2006, certain members of company management were issued warrants, which fully vested immediately, to purchase 303,030 shares of the Company's Common Stock at an exercise price of $3.30 per share in consideration of their loaning the company $1,000,000. The fair value of the warrants granted on February 1, 2006, was $443,000 which was estimated at the date of grant using a Black-Scholes pricing model with the following weighted average assumptions: risk-free interest rate of 3.9%; dividend yield of 0%; volatility factor of the expected price of the Company's stock was 138.9%; and a weighted average expected life of 5 years. The weighted average fair value of the warrants granted during 2006 was $2.56 per share.

	Dec. 31, 2007	Weighted Avg. Exercise Price	Dec. 31, 2006	Weighted Avg. Exercise Price	Dec. 31, 2005	Weighted Avg. Exercise Price
Outstanding and exercisable, beginning of period	466,030	$ 3.85	282,050	$ 3.45	282,050	$ 3.45
Granted	-	-	303,030	3.30	-	-
Exercised	-	-	(119,050)	1.50	-	-
Cancelled	-	-	-		-	-
Outstanding and exercisable at the end of period	466,030	$ 3.85	466,030	$ 3.85	282,050	$ 3.45

The aggregate intrinsic value of warrants were $155,000 as of December 31, 2007 for all warrants in the money, outstanding and exercisable.

	Intrinsic value of Warrants Exercised					
	2007		2006		2005	
	Shares	Intrinsic Value	Shares	Intrinsic Value	Shares	Intrinsic Value
2001 Warrants	-	$ -	119,050	$ 146,000	-	$ -

17. Earnings Per Share

Basic earnings per share is computed by dividing the income available to common shareholders, net earnings, less redeemable preferred stock dividends and redeemable common stock accretion, by the weighted average number of shares of common stock outstanding during each period.

Diluted earnings per share is computed by dividing the net earnings by the weighted average number of shares of common stock and common stock equivalents (redeemable common stock, stock options and warrants), unless anti-dilutive, during each period.

CTI Industries Corporation and Subsidiaries
Consolidated Earnings per Share

	Year Ended December 31,		
	2007	2006	2005
Basic			
Average shares outstanding:			
Weighted average number of shares outstanding during the period	2,346,126	2,087,145	1,977,235
Earnings:			
Net income (loss):	$ 81,898	$ 1,894,749	$ (333,209)
Amount for per share Computation	$ 81,898	$ 1,894,749	$ (333,209)
Net earnings (loss) applicable to Common Shares	$ 0.03	$ 0.91	$ (0.17)
Diluted			
Average shares outstanding:	2,346,126	2,087,145	1,977,235
Weighted average shares Outstanding Common stock equivalents (options, warrants)	243,834	147,756	0
Weighted average number of shares outstanding during the period	2,589,960	2,234,901	1,977,235
Earnings:			
Net income (loss)	$ 81,898	$ 1,894,749	$ (333,209)
Amount for per share computation	$ 81,898	$ 1,894,749	$ (333,209)
Net income (loss) applicable to Common Shares	$ 0.03	$ 0.85	$ (0.17)

18. Geographic Segment Data

The Company's operations consist of a business segment which designs, manufactures, and distributes film products. Transfers between geographic areas were primarily at cost. The Company's subsidiaries have assets consisting primarily of trade accounts receivable, inventory and machinery and equipment. Sales and selected financial information by geographic area for the years ended December 31, 2007, 2006 and 2005, respectively:

	United States	United Kingdom	Mexico	Eliminations	Consolidated
Year ended 12/31/07					
Revenues	$ 28,657,000	$ 2,913,000	$ 7,189,000	$ (2,249,000)	$ 36,510,000
Operating income	$ 810,000	$ 215,000	$ 345,000	$ (125,000)	$ 1,245,000
Net (loss) income	$ (128,000)	$ 167,000	$ 168,000	$ (125,000)	$ 82,000
Total Assets	$ 27,854,000	$ 2,948,000	$ 5,780,000	$ (7,258,000)	$ 29,324,000
Year ended 12/31/06					
Revenues	$ 28,808,000	$ 2,925,000	$ 6,564,000	$ (2,869,000)	$ 35,428,000
Operating income	$ 2,116,000	$ 64,000	$ 578,000	$ (25,000)	$ 2,733,000
Net income	$ 1,544,000	$ 93,000	$ 284,000	$ (26,000)	$ 1,895,000
Total Assets	$ 25,245,000	$ 2,627,000	$ 5,050,000	$ (6,288,000)	$ 26,634,000
Year ended 12/31/05					
Revenues	$ 23,564,000	$ 2,573,000	$ 4,536,000	$ (1,483,000)	$ 29,190,000
Operating income (loss)	$ 602,000	$ 290,000	$ (240,000)		$ 652,000
Net (loss) income	$ (342,000)	$ 220,000	$ (211,000)		$ (333,000)

19. Litigation

On December 20, 2006, Pliant Corporation filed an action against the Company in the Circuit Court of Cook County, Illinois. In the action, Pliant claims that there is due from the Company to Pliant the sum of $245,000 for goods sold and delivered by Pliant to the Company as well as interest on such amount. On February 21, 2007, the Company filed and answer to the complaint and counterclaim denying liability and asserting certain claims against Pliant for damages for the sale by Pliant to the Company of defective products. Management intends to defend the claims of Pliant in this action and to pursue its counterclaims and believes that the Company has established adequate reserves regarding the claim.

In addition, the Company is also party to certain lawsuits arising in the normal course of business. The ultimate outcome of these matters is unknown, but in the opinion of management, the settlement of these matters is not expected to have a significant effect on the future financial position, cash flows or results of operations of the Company.

20. Quarterly Financial Data (Unaudited):

The following table sets forth selected unaudited statements of income for each quarter of fiscal 2007, 2006 and 2005:

	For the Year Ended December 31, 2007 (1)			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net sales	$ 8,279,000	$ 9,259,000	$ 8,673,000	$ 10,299,000
Gross profit	$ 1,903,000	$ 2,744,000	$ 1,617,000	$ 2,420,000
Net (loss) income	$ (52,000)	$ 423,000	$ (414,000)	$ 125,000
Earnings per common share				
Basic	$ (0.02)	$ 0.18	$ (0.18)	$ 0.05
Diluted	$ (0.02)	$ 0.17	$ (0.18)	$ 0.05

(1) Earnings per common share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly per common share information may not equal the annual earnings per common share

	For the Year Ended December 31, 2006 (1)			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter (2)
Net sales	$ 8,156,000	$ 8,997,000	$ 8,603,000	$ 9,672,000
Gross profit	$ 1,953,000	$ 2,197,000	$ 2,253,000	$ 2,494,000
Net income	$ 220,000	$ 206,000	$ 315,000	$ 1,154,000
Earnings per common share				
Basic	$ 0.11	$ 0.10	$ 0.15	$ 0.54
Diluted	$ 0.10	$ 0.10	$ 0.15	$ 0.49

(1) Earnings per common share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly per common share information may not equal the annual earnings per common share

(2) During the fourth quarter 2006, management of the Company conducted an analysis of the recoverability of the deferred tax asset based on results of operations during the fourth quarter of 2005 and for the full year of 2006, expected continued achievement of and continuing improvement in operating results for the forseeable future and anticipated repatriations of profits and services income to be generated from the Company's foreign subsidiaries. As a result of such analysis, management determined that the net recorded deferred tax asset in the amount of $1,127,000 is more likely than not to be realized.

	For the Year Ended December 31, 2005 (1)			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net sales	$ 9,103,000	$ 7,573,000	$ 6,034,000	$ 6,480,000
Gross profit	$ 1,874,000	$ 1,583,000	$ 1,242,000	$ 1,765,000
Net income (loss)	$ 84,000	$ (54,000)	$ (416,000)	$ 52,000
Earnings per common share				

Basic	$ 0.04	$ (0.03)	$ (0.21)	$ 0.03
Diluted	$ 0.04	$ (0.03)	$ (0.21)	$ 0.02

(1) Earnings per common share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly per common share information may not equal the annual earnings per common share

21. Subsequent Events

On January 28, 2008 the Company employed an interest rate swap as a cash flow hedge to manage interest costs and the risk associated with changing interest rates of our revolving debt. This first payment under this agreement is due on May 1, 2008 and was designated to swap a variable rate of prime plus varying rates for a fixed rate ranging of 6.17%. The aggregate notional amount of the swap was $3.0 million. The swap agreements expire on January 1, 2011. The Company will record changes in the valuation of the swap agreement as items of other comprehensive income or loss.

In February 2003, the Company received $1,630,000 from certain shareholders in exchange for (a) two year 9% subordinated notes, and (b) five year warrants to purchase 163,000 common shares at $4.87 per share. The proceeds were to (i) re-finance the bank loan of CTI Mexico in the amount of $880,000 and (ii) to provide financing for CTI Mexico and Flexo Universal. The value of the warrants was $460,000 calculated using Black-Scholes option pricing formula. The Company applied the discount against the subordinated debt. The discount is being amortized using the effective interest method in interest expense over the term of the debt. These loans are subordinated to the Bank debt of the Company. On February 8, 2008 those shareholders exercised these options in exchange for a reduction on these notes of $794,000.

Schedule II - Valuation and Qualifying Accounts:

The following is a summary of the allowance for doubtful accounts related to accounts receivable for the years ended December 31:

		2007		2006		2005
Balance at beginning of year	$	210,000	$	80,000	$	404,000
Charged to expenses	$	105,000	$	203,000	$	145,000
Uncollectible accounts written off	$	(3,000)	$	(73,000)	$	(469,000)
Balance at end of year	$	312,000	$	210,000	$	80,000

The following is a summary of the allowance for excess inventory for the years ended December 31:

		2007		2006		2005
Balance at beginning of year	$	276,000	$	255,000	$	187,000
Charged to expenses	$	231,000	$	219,000	$	205,000
Obsolete inventory written off	$	(124,000)	$	(198,000)	$	(137,000)
Balance at end of year	$	383,000	$	276,000	$	255,000

The following is a summary of property and equipment and the related accounts of accumulated depreciation for the years ended December 31:

		2007		2006		2005
Cost Basis						
Balance at beginning of year	$	26,869,885	$	26,704,366	$	26,224,962
Additions	$	2,825,978	$	604,028	$	549,547
Disposals	$	-	$	(438,509)	$	(70,143)
Balance at end of year	$	29,695,863	$	26,869,885	$	26,704,366
Accumulated depreciation						
Balance at beginning of year	$	18,277,611	$	17,087,622	$	15,636,451
Depreciation	$	1,322,097	$	1,189,989	$	1,463,369
Disposals	$	-	$	-	$	(12,198)
Balance at end of year	$	19,599,708	$	18,277,611	$	17,087,622
Property and equipment, net	$	10,096,155	$	8,592,274	$	9,616,744