UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2010

OR

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

Commission File Number 001-32563

Orchids Paper Products Company
(Exact name of Registrant as Specified in its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**23-2956944** (I.R.S. Employer Identification No.)

4826 Hunt Street
Pryor, Oklahoma 74361
(Address of Principal Executive Offices and Zip Code)

(918) 825-0616
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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

Large accelerated filer ☐	Accelerated filer ☒
Non-accelerated filer ☐	Smaller reporting company ☐

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

Number of shares outstanding of the issuer's Common Stock, par value $.001 per share, as of November 1, 2010: 7,486,725 shares

ORCHIDS PAPER PRODUCTS COMPANY
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QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

ORCHIDS PAPER PRODUCTS COMPANY
BALANCE SHEETS
(Dollars in thousands, except share data)

	September 30, 2010 (unaudited)	December 31, 2009
ASSETS		
Current assets:		
Cash	$ 6	$ 1,232
Accounts receivable, net of allowance of $254 in 2010 and $209 in 2009	7,468	6,750
Inventories, net	7,487	7,569
Income taxes receivable	2,653	—
Short term investments	9,516	18,509
Prepaid expenses	703	497
Deferred income taxes	693	547
Total current assets	28,526	35,104
Property, plant and equipment	110,864	87,535
Accumulated depreciation	(18,764)	(14,844)
Net property, plant and equipment	92,100	72,691
Deferred debt issuance costs, net of accumulated amortization of $669 in 2010 and $632 in 2009	92	104
Total assets	$ 120,718	$ 107,899
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,688	$ 4,049
Accrued liabilities	4,077	3,118
Current portion of long-term debt	8,839	3,742
Total current liabilities	18,604	10,909
Long-term debt, less current portion	17,105	19,533
Deferred income taxes	16,442	14,337
Stockholders' equity:		
Common stock, $.001 par value, 25,000,000 shares authorized 7,486,725, and 7,393,874 shares issued and outstanding in 2010 and 2009, respectively	7	7
Additional paid-in capital	38,827	38,354
Retained earnings	29,733	24,759
Total stockholders' equity	68,567	63,120
Total liabilities and stockholders' equity	$ 120,718	$ 107,899

See notes to unaudited interim financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010 (unaudited)	2009 (unaudited)	2010 (unaudited)	2009 (unaudited)
Net sales	$ 24,523	$ 24,557	$ 70,248	$ 72,328
Cost of sales	20,494	17,128	57,283	50,639
Gross profit	4,029	7,429	12,965	21,689
Selling, general and administrative expenses	1,649	1,772	5,225	5,689
Operating income	2,380	5,657	7,740	16,000
Interest expense	249	174	675	468
Other income	(24)	(5)	(51)	(9)
Income before income taxes	2,155	5,488	7,116	15,541
Provision (benefit) for income taxes:				
Current	(1,350)	748	182	1,554
Deferred	2,063	925	1,960	3,600
	713	1,673	2,142	5,154
Net income	$ 1,442	$ 3,815	$ 4,974	$ 10,387
Earnings per share of common stock:				
Basic	$ 0.20	$ 0.56	$ 0.67	$ 1.58
Diluted	$ 0.18	$ 0.52	$ 0.64	$ 1.49
Weighted average number of common shares outstanding:				
Basic	7,486,725	6,838,726	7,456,455	6,562,051
Diluted	7,762,210	7,304,226	7,757,773	6,955,133

See notes to unaudited interim financial statements.

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ORCHIDS PAPER PRODUCTS COMPANY
STATEMENTS OF CASH FLOWS
(Dollars in thousands)

	Nine Months Ended September 30, 2010 (unaudited)	Nine Months Ended September 30, 2009 (unaudited)
Cash Flows From Operating Activities		
Net income	$ 4,974	$ 10,387
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,011	2,661
Provision for doubtful accounts	45	46
Deferred income taxes	1,959	3,601
Stock option plan expense	473	518
Changes in cash due to changes in operating assets and liabilities:		
Accounts receivable	(763)	(2,462)
Inventories	82	(373)
Income taxes receivable	(2,653)	(430)
Prepaid expenses	(206)	(339)
Accounts payable	1,639	(1,004)
Accrued liabilities	959	1,455
Net cash provided (used in) by operating activities	10,520	14,060
Cash Flows From Investing Activities		
Purchases of property, plant and equipment	(23,383)	(6,554)
Purchase of investment securities	—	(22,502)
Proceeds from the sale of investment securities	8,993	—
Net cash provided by (used in) investing activities	(14,390)	(29,056)
Cash Flows From Financing Activities		
Proceeds from secondary issuance of common stock	—	14,848
Borrowings under construction loan	5,197	3,756
Principal payments on long-term debt	(2,820)	(2,284)
Net borrowings (repayments) on revolving credit line	292	(1,487)
Proceeds from the exercise of warrants attached to subordinated debentures	—	286
Proceeds from the exercise of stock options	—	226
Deferred issuance cost	(25)	(43)
Net cash provided by (used in) financing activities	2,644	15,302
Net increase (decrease) in cash	(1,226)	306
Cash, beginning	1,232	11
Cash, ending	$ 6	$ 317
Supplemental Disclosure:		
Interest paid	$ 675	$ 468
Income taxes paid	$ 2,675	$ 1,735

See notes to unaudited interim financial statements.

ORCHIDS PAPER PRODUCTS COMPANY
NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

Note 1 — Basis of Presentation

Orchids Paper Products Company ("Orchids" or the "Company") was formed in 1998 to acquire and operate the paper manufacturing facility, built in 1976, in Pryor, Oklahoma. Orchids Acquisition Group, Inc. ("Orchids Acquisition") was established in November 2003, for the purpose of acquiring the common stock of Orchids. The sale of equity and debt securities closed in March 2004 and Orchids Acquisition Group, Inc. acquired Orchids for a price of $21.6 million. Orchids Acquisition was subsequently merged into Orchids.

In July, 2005, the Company completed its initial public offering of 2,156,250 shares of its common stock. Following the offering, 4,156,250 shares of common stock were outstanding. In July 2006, the Company effected a 3-for-2 stock split resulting in outstanding shares of 6,234,346. The Company's stock trades on the NYSE Amex under the ticker symbol "TIS."

On August 26, 2009, the Company closed a follow-on public offering of 750,000 shares of its common stock at an offering price of $18.50 per share. The Company received net proceeds of approximately $12.8 million from the offering, after deducting the underwriting discount and offering expenses. On September 2, 2009, the underwriter exercised its over-allotment option and purchased an additional 112,500 shares of common stock at a price of $18.50 per share. The Company received approximately $2.0 million in net proceeds from this exercised option. The Company is using the proceeds from the offering for the construction of a new warehouse, the purchase and installation of a new converting line, and general corporate purposes.

Common Stock Outstanding

March 2004 Orchids Acquisition Group, Inc. Shares	2,000,000
July 2005 Initial Public Common Stock Offering	2,156,250
July 2006 3-for-2 Stock Split	2,078,096
August 2009 Common Stock Offering	862,500
Stock Options and Warrants Exercised	389,879
	7,486,725

The accompanying financial statements have been prepared without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted ("GAAP") in the United States have been condensed or omitted pursuant to the rules and regulations. However, the Company believes that the disclosures made are adequate to make the information presented not misleading when read in conjunction with the audited financial statements and the notes in the Company's Annual Report on Form 10-K filed March 12, 2010. Management believes that the financial statements contain all adjustments necessary for a fair presentation of the results for the interim periods presented. All adjustments were of a normal, recurring nature. The results of operations for the interim period are not necessarily indicative of the results for the entire fiscal year.

Note 2— Fair Value Measurements

The Company has previously adopted the Financial Accounting Standards Board ("FASB") Accounting Standards Codification (FASB ASC) 820-10-50 Fair Value Measurements and Disclosures for assets and liabilities which are required to be measured at fair value. This standard establishes a framework for measuring fair value and related disclosures. The standard has the following key elements:

- Defines fair value as the exit price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date;
- Establishes a three-level hierarchy ("valuation hierarchy") for fair value measurements;
- Requires consideration of the Company's creditworthiness when valuing liabilities; and

- Expands disclosures about instruments measured at fair value.

The valuation hierarchy considers the transparency of inputs used to value assets and liabilities as of the measurement date. The less transparent or observable the inputs used to value assets and liabilities, the lower the classification of the assets and liabilities in the valuation hierarchy. A financial instrument's classification within the valuation hierarchy is based on the lowest level of input that is significant to its fair value measurement. The three levels of the valuation hierarchy and the classification of the Company's financial assets and liabilities within the hierarchy are as follows:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 - Observable inputs other than quoted prices included within Level 1 for the asset or liability, either directly or indirectly. If an asset or liability has a specified term, a Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Unobservable inputs for the asset or liability.

The Company considers the following to be financial instruments: cash, short term investments, accounts receivable, accounts payable and debt. The estimated fair value of such instruments at September 30, 2010 approximates their carrying value as reported on the Company's balance sheet.

The following table presents information about Orchids Paper Products Company's assets measured at fair value on a recurring basis as of September 30, 2010, and indicates the fair value hierarchy of the valuation techniques utilized to determine such values. Short term investments are valued as Level 1 in the fair value hierarchy from independent pricing services utilized by our investment custodians.

	Fair Value Measurements at September 30, 2010 Using Inputs Considered as		
	Level 1	Level 2 (in thousands)	Level 3
Assets			
US Government Guaranteed Certificate of Deposit	$ 5,000		
Commercial Deposit	3,016		
Certificate of Deposit	1,500		
Total Short Term Investments	$ 9,516	$ —	$ —

	Fair Value Measurements at December 31, 2009 Using Inputs Considered as		
	Level 1	Level 2 (in thousands)	Level 3
Assets			
US Government Guaranteed Certificate of Deposit	$ 13,000		
Commercial Deposit	3,009		
Certificate of Deposit	1,500		
Money Market	1,000		
Total Short Term Investments	$ 18,509	$ —	$ —

Note 3 — Fair Value Financial Instruments

The carrying value of the Company's long-term debt is estimated by management to approximate fair value based on the obligations' characteristics, including floating interest rate, credit ratings, maturity and collateral.

Note 4 — Commitments and Contingencies

The Company is involved from time to time in litigation arising from the normal course of business. In management's opinion, the result from such litigation is not expected to materially affect the Company's results of operations or financial condition.

In the fourth quarter of 2008, the Company entered into a contract to purchase 334,000 MMBTU per year of natural gas requirements at $7.50 per MMBTU plus a $0.07 per MMBTU management delivery fee for the period from April 2009 through March 2011. The amount represents approximately 60% of the Company's natural gas requirements based upon expected usage rates for 2009. In November 2009, the agreement was extended for one year to March 2012 for 334,000 MMBTU per year at a price of $6.50 per MMBTU plus a $0.07 per MMBTU management delivery fee. In August 2010, the Company extended the contract through March 2013 for 334,000 MMBTU per year at a price of $5.50 per MMBTU plus a $.07 per MMBTU management delivery fee.

If the Company is unable to purchase the contracted amounts and the market price at that time is less than the contracted price, the Company would be obligated under the terms of the agreement to reimburse an amount equal to the volume purchased that was less than the contracted amount multiplied by the difference between the contract price and current spot price. This fixed price natural gas contract meets the qualifications of the normal purchases and normal sales exception for derivatives and hedging.

Note 5 — Inventories

Inventories at September 30, 2010 and December 31, 2009 are as follows:

	September 30, 2010	December 31, 2009
	(in thousands)	
Raw materials	$ 1,978	$ 1,901
Bulk paper rolls	853	908
Converted finished goods	4,834	5,138
Inventory valuation reserve	(178)	(378)
	$ 7,487	$ 7,569

Note 6 — Earnings per Share

The computation of basic and diluted net income per share for the three-month and nine-month periods ended September 30, 2010 and 2009 is as follows:

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Net income - ($ thousands)	$ 1,442	$ 3,815	$ 4,974	$ 10,387
Weighted average shares outstanding	7,486,725	6,838,726	7,456,455	6,562,051
Effect of stock options	275,485	103,749	301,318	90,314
Effect of dilutive warrants	—	361,751	—	302,768
Weighted average shares outstanding - assuming dilution	7,762,210	7,304,226	7,757,773	6,955,133
Net income per share:				
Basic	$ 0.20	$ 0.56	$ 0.67	$ 1.58
Diluted	$ 0.18	$ 0.52	$ 0.64	$ 1.49
Anti-dilutive stock options not considered above	57,250	—	57,250	49,750

Note 7 — Stock Incentive Plan

In April 2005, the board of directors and the stockholders approved the 2005 Stock Incentive Plan (the "Plan"). The Plan provides for the granting of incentive stock options to employees selected by the board's compensation committee. The Plan authorized up to 697,500 shares to be issued. In May 2008, the shareholders approved increasing the number of authorized shares under the Plan from

697,500 to 897,500. Options for 20,000 shares were granted effective January 20, 2009, to an officer of the Company, at an exercise price of $10.205, the fair market value of the stock on the date of grant. The options vest 50% on the first anniversary date of the grant and 50% on the second anniversary date. The options have a 10 year life.

The following table details the options granted to certain members of the board of directors and management during the nine months ended September 30, 2010 and 2009:

Grant Date	Number of Shares	Exercise Price	Risk-Free Interest Rate	Estimated Volatility	Dividend Yield	Expected Life
January-09	60,000	$ 10.205	2.35%	46%	None	5-7 years
May-09	49,750	$ 17.480	3.30%	50%	None	5-7 years
January-10	10,000	$ 20.825	3.82%	49%	None	5-7 years
May-10	28,750	$ 13.840	3.36%	49%	None	5-7 years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, options valuation models require the input of highly subjective assumptions including the expected stock price volatility.

In connection with the approval of the Plan, the Company expenses the cost of options granted over the vesting period of the option based on the grant-date fair value of the award. The Company recognized expense of $90,000 and $84,000 for the three months ended September 30, 2010 and 2009, respectively, related to options granted under the Plan. The Company recognized expense of $473,000 and $518,000 for the nine months ended September 30, 2010 and 2009, respectively, related to options granted under the Plan.

Note 8 — Major Customers and Concentration of Credit Risk

The Company sells primarily all of its paper production in the form of converted products; however, following the start-up of a new paper machine in the summer of 2006, the Company’s paper production capacity exceeded its converting production requirements resulting in excess paper production which it began to sell in parent roll form. Revenues from converted product sales and parent roll sales in the three-month and nine-month periods ended September 30, 2010 and 2009 were:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)		(in thousands)	
Converted product net sales	$ 19,669	$ 22,160	$ 57,492	$ 65,750
Parent roll net sales	4,854	2,397	12,756	6,578
Net sales	$ 24,523	$ 24,557	$ 70,248	$ 72,328

The credit risk for the Company in the third quarter of 2010 is concentrated with four significant customers. Three are customers of the Company’s converted products, each of whom operates discount retail stores located throughout the United States and one is a customer who accounts for most of the Company’s third party sales of parent rolls. During the three months ended September 30, 2010, sales to these four significant customers accounted for approximately 71% of total sales, comprised of customers of 33%, 16%, 11% and 11%, respectively. During the three months ended September 30, 2009, sales to two of the significant converted product customers plus the purchaser of the majority of our parent rolls accounted for approximately 62% of total sales, comprised of customers of 34%, 18%, and 10%, respectively.

For the nine months ended September 30, 2010, sales to two significant converted product customers plus one parent roll customer accounted for approximately 57% of total sales, comprised of customers of 33%, 14%, and 10%, respectively. For the nine months ended September 30, 2009, sales to three significant converted product customers accounted for approximately 57% of total sales, comprised of customers of 30%, 16%, and 11%, respectively. At September 30, 2010 and 2009, approximately $5.1 million (68%) and $5.3 million (58%), respectively, of accounts receivable was due from the significant customers noted. No other customer of the Company accounted for more than 10% of sales during these periods. The Company generally does not require collateral from its customers and has not incurred any significant losses on uncollectible accounts receivable.

Note 9 — Income Tax Receivable

As of September 30, 2010, the company has classified $2.7 million as an income tax receivable. In September 2010, the eligibility period for Bonus depreciation was extended which resulted in a significant decrease in the Company's current tax liability. The extension of the eligibility period occurred after the Company made quarterly tax payments for the first, second, and third quarters of 2010.

Note 10 — New Accounting Standards

The Financial Accounting Standards Board ("FASB") periodically issues new accounting standards in a continuing effort to improve standards of financial accounting and reporting. We have reviewed the recently issued pronouncements and concluded that no new standards were issued this quarter that applied to the Company.

In January 2010, the Financial Accounting Standards Board ("FASB") issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs. The guidance became effective for us with the reporting period beginning January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for us with the reporting period beginning January 1, 2011. Other than requiring additional disclosures, adoption of this new guidance did not have a material impact on our financial statements.

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

Forward-Looking Information

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

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

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

You should not place undue reliance on forward-looking statements because they involve known and unknown risks, uncertainties, and other factors that are, in some cases, beyond our control and that could materially affect actual results, levels of activity, performance or achievements. Factors that could materially affect our actual results, levels of activity, performance or achievements include, without limitation, those detailed under the caption "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, as filed with the SEC on March 12, 2010, and include the following items:

- intense competition in our market and aggressive pricing by our competitors could force us to decrease our prices and reduce our profitability;
- a substantial percentage of our converted product revenues are attributable to a small number of customers which may decrease or cease purchases at any time;
- disruption in our supply or increase in the cost of waste paper;
- increased competition in our region;
- changes in our retail trade customers' policies and increased dependence on key retailers in developed markets;
- indebtedness limits our free cash flow and subjects us to restrictive covenants relating to the operation of our business;
- the availability of and prices for energy;
- failure to purchase the contracted quantity of natural gas may result in financial exposure;
- our exposure to variable interest rates;

- the loss of key personnel;
- labor interruption;
- natural disaster or other disruption to our facility;
- ability to finance the capital requirements of our business;
- cost to comply with existing and new laws and regulations;
- failure to maintain an effective system of internal controls necessary to accurately report our financial results and prevent fraud;
- the parent roll market is a commodity market and subject to fluctuations in demand and pricing;
- excess supply in the market may reduce our prices;
- an inability to continue to implement our business strategies;
- inability to sell the capacity generated from our new converting line; and
- a significant decline in sales causing us to no longer need the new converting line.

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

Overview

We are an integrated manufacturer of private label tissue products, including paper towels, bathroom tissue and paper napkins for the consumer, or "at-home," market. We produce bulk tissue paper, known as parent rolls and convert parent rolls into finished products. Historically, we have tailored our operations to serve a core customer base of dollar stores and other discount retailers. We have focused on the dollar stores or value retailers and discount retail market because of their consistent order patterns and low number of stock keeping units or SKUs in this market. By dollar stores, we mean retailers that offer a limited selection across a broad range of products at everyday low prices in a smaller store format. In mid-2010, we completed the purchase and installation of a new converting line to increase our converted product capacity, increase our product offerings and provide higher quality products, which is discussed in more detail in the background section. The production from the new line provides the capability to supply converted products into the higher quality, mid-tier product category to both existing and new customers.

While we have customers located throughout the United States, most of our products are distributed within an approximate 900-mile radius of our Oklahoma facility. However, our sales efforts are focused on an area within approximately 500 miles of our facility in northeast Oklahoma, which includes Texas, Oklahoma, Kansas, Missouri, Arkansas, Nebraska and Iowa. Because we are one of the few tissue paper manufacturers in this area, we typically have lower freight costs to our customers' distribution centers located in our target region. At-home tissue market growth has historically been closely correlated to population growth and as such, performs well in a variety of economic conditions. Our target region has experienced strong population growth in the past five years relative to the national average and these trends are expected to continue.

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

Our profitability depends on several key factors, including:

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

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

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Background

Since June 2006, when we began operations of a new paper machine, our paper-making capacity of approximately 56,000 tons per year has exceeded the demand requirements of our converting operations. Any excess supply is sold into the market in the form of a parent roll. We adjust our paper making production based on our internal converting needs for parent rolls and the open market demand for parent rolls. Parent rolls are a commodity product and thus are subject to market pricing. We plan to continue to sell any excess parent roll capacity on the open market as long as market pricing is profitable.

Our parent rolls are processed into paper towels, bathroom tissue and napkins in our adjacent converting facility. Our strategy is to sell all of our parent roll capacity as converted products which generally carry higher margins than parent rolls. To help achieve that goal, we continue to focus considerable efforts to improve our converting efficiencies and have realized incremental improvements in production output over the last two years. In addition, we are placing significant focus on improving our sales efforts to sell this additional capacity.

Our strategy is to expand our position as a low cost provider of private label tissue products to the growing discount retail channel within our geographic area while leveraging our competitive advantages to increase our presence in other retail channels. This will be accomplished through our continued high service levels, increased total manufacturing capacity and expansion of our highly perceived value product offering.

We intend to implement this strategy through our key initiatives set forth below:

- maintain and strengthen our core customer relationships;
- increase our flexibility to meet a wider array of customer needs;
- further expand our customer base in other retail channels; and
- continue to improve operating efficiencies and reduce manufacturing costs.

Since our inception in 1998, we have strategically expanded capacity to meet demand. We have recently completed an expansion project which added an eleventh converting line to our converting capacity and a 245,000 square foot warehouse. The new line has a rated annual capacity of approximately four million cases of either kitchen towel or bathroom tissue products, bringing our total annual converting capacity to approximately twelve million cases from eleven lines. The new line provides higher quality products and broadens our product offerings to supply the higher-quality, mid-tier market segment through increased packaging configurations, enhanced graphics and improved embossing. We expect to sell the majority of the output from this new line to new customers, particularly in the grocery segment. Start-up of the new line began in July 2010. The completion of the new warehouse has allowed us to consolidate all warehousing and shipping in our Pryor location, thereby eliminating third-party warehouse charges beginning in September.

Although we have an annual converting capacity of approximately 12 million cases, our in house supply of parent rolls provides enough to convert only approximately 10 million cases. In order to convert at an annual capacity above approximately 10 million cases, we must supplement our supplies by purchasing parent rolls in the open market.

Comparative Three-Month Periods Ended September 30, 2010 and 2009

Net Sales

	Three Months Ended September 30,	
	2010	2009
	(in thousands, except average price per ton and tons)	
Converted product net sales	$ 19,669	$ 22,160
Parent roll net sales	4,854	2,397
Total net sales	$ 24,523	$ 24,557
Total tons shipped	14,720	13,755
Average price per ton	$ 1,666	$ 1,785

Net sales in the quarter ended September 30, 2010 were $24.5 million which remained fairly flat from the prior year quarter net sales of $24.6 million. Net sales figures represent the gross selling price, including freight, less discounts and pricing allowances. Net sales of converted product decreased in the quarter ended September 30, 2010 by $2.5 million, or 11.2% to $19.7 million compared to $22.2

million in the same period last year. Net sales of parent rolls increased $2.5 million or 102.5% to $4.9 million in the quarter ended September 30, 2010 compared to $2.4 million in the same period last year. The decrease in net sales of converted product primarily resulted from a 10.8% decrease in tonnage shipped. The net selling price per ton was essentially flat in the year over year quarterly comparison. The lower converted product shipment tonnage resulted from a promotional program by a major customer in the third quarter of last year which did not recur this year and continued aggressive promotional pricing by branded producers. Net sales of parent rolls increased as a result of a 66.6% increase in parent roll tonnage shipped, as well as a 21.6% increase in the net selling price. Parent roll sales benefited from the lower requirements of our converting operation which resulted in more excess parent roll tons being available for sale. A stronger away-from-home market and higher waste paper prices were the principal reasons for the increase in parent roll pricing.

Total tons shipped in the third quarter of 2010 increased by 7.0% compared to the same period of 2009. The increase in total tonnage shipped was the result of a stronger parent roll market which allowed us to run all of our paper machines on a full-time basis in the third quarter of 2010 compared to the prior year quarter when we incurred intermittent downtime on some of our older paper machines due to the soft parent roll market in order to balance our parent roll production with market demand. As a result, the lower tonnage shipment of converted product in the third quarter of 2010 was more than offset by the higher tonnage shipments of excess parent rolls.

Cost of Sales

	Three Months Ended September 30, 2010	2009
	(in thousands, except gross profit margin % and paper cost per ton)	
Cost of paper	$ 11,324	$ 9,329
Non-paper materials, labor, supplies, etc.	7,474	6,796
Sub-total	18,798	16,125
Depreciation	1,696	1,003
Cost of sales	$ 20,494	$ 17,128
Gross Profit	$ 4,029	$ 7,429
Gross Profit Margin %	16.4%	30.3%
Total paper cost per ton consumed	$ 773	$ 678

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

Cost of sales increased approximately $3.4 million, or 19.7%, to $20.5 million for the quarter ended September 30, 2010, compared to $17.1 million in the same period of 2009. This increase in cost of sales was primarily attributable to higher cost of paper, higher converting production costs due to lower production levels, and higher depreciation expense, which was partially offset by decreased external warehouse expenses. As a percentage of net sales, cost of sales increased to 83.6% of net sales in the 2010 quarter from 69.7% of net sales in the 2009 quarter. Cost of sales as a percentage of net sales for the third quarter of 2010 was unfavorable to the prior year quarter primarily due to higher paper production costs.

Our overall cost of paper in the third quarter of 2010 was $773 per ton, an increase of $95 per ton compared to the same period in 2009. The primary reason for the increased cost of paper production is higher waste paper prices. Our cost of waste paper in the third quarter of 2010 was 38% higher than the same quarter in 2009, resulting in an increase in cost of sales of approximately $1.5 million. Following a sharp decrease in waste paper prices in the first half of 2009, waste paper prices began to rise in the third quarter of last year. However, compared to the second quarter of 2010, our cost of waste paper was relatively flat in the third quarter of 2010.

Depreciation expense increased primarily because the new converting line assets were placed in service in the third quarter of 2010. Largely due to lower converting production requirements and, to a lesser extent, additional staffing for our new converting line, converting production costs increased 24% in the third quarter of 2010 compared to the prior year quarter. External warehousing costs decreased by $325,000 due to the phasing out of a third-party warehouse during the current year quarter. Usage of a third-party warehouse was ceased in September and we are now warehousing and shipping all converted product from our Pryor, Oklahoma location.

Gross Profit

Gross profit in the quarter ended September 30, 2010, decreased $3.4 million, or 45.8%, to $4.0 million compared to $7.4 million in the same period last year. Gross profit as a percentage of net sales in the 2010 quarter was 16.4% compared to 30.3% in the 2009 quarter. The gross profit decrease as a percent of net sales was primarily the result of higher waste paper prices, lower converted product shipments, which also caused an increase in per case converting production costs, a higher percentage of lower margin parent roll sales, and higher depreciation expense.

Selling, General and Administrative Expenses

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009
	(in thousands, except SG&A as a % of net sales)	
Commission expense	$ 310	$ 329
Other SG&A expenses	1,339	1,443
Selling, General & Adm exp	$ 1,649	$ 1,772
SG&A as a % of net sales	6.7%	7.2%

Selling, general and administrative expenses include salaries, commissions to brokers and other miscellaneous expenses. Selling, general and administrative expenses decreased $123,000, or 6.9%, to $1.6 million in the quarter ended September 30, 2010 compared to $1.8 million in the comparable 2009 period. The decrease was primarily due to decreased accruals under our incentive bonus plan, which was partially offset by higher artwork and packaging related costs.

Operating Income

As a result of the foregoing factors, operating income for the quarter ended September 30, 2010 decreased $3.3 million to $2.4 million, compared to $5.7 million in the same period in 2009.

Interest Expense and Other Income

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009
	(in thousands)	
Interest expense	$ 249	$ 174
Other income, net	$ (24)	$ (5)
Income before income taxes	$ 2,155	$ 5,488

Interest expense includes interest on all debt and amortization of deferred debt issuance costs. Interest expense increased $75,000 to $249,000 in the quarter ended September 30, 2010, compared to $174,000 in the quarter ended September 30, 2009. The primary reason for the increase in interest expense was our higher total debt as a result of the full quarter inclusion of the waste water treatment and warehouse construction loans.

Income Before Income Taxes

As a result of the foregoing factors, income before income taxes decreased $3.3 million to $2.2 million in the quarter ended September 30, 2010, compared to $5.5 million in the same period in 2009.

Income Tax Provision

As of September 30, 2010, we estimate our full-year effective income tax rate to be 30.1%. The effective rate includes the effects of the recently passed extension of the bonus depreciation rule, which has lowered the current tax portion of our tax liability to 2.6 %. Our full-year estimated rate is lower than the statutory rate because of the Oklahoma Investment Tax Credits associated with capital equipment investments and the Section 199 manufacturing deduction. The Oklahoma Investment Tax Credits offset our Oklahoma state tax liability. Our effective rate does not reflect the Federal Indian Employment Credits (“IEC”) as this tax regulation expired as of December 31, 2009 and has not been reauthorized for 2010. As of September 30, 2009, our annual effective income tax rate was 33.2%.

Comparative Nine-Month Periods Ended September 30, 2010 and 2009

Net Sales

	Nine Months Ended September 30,	
	2010	2009
	(in thousands, except average price per ton and tons)	
Converted product net sales	$ 57,492	$ 65,750
Parent roll net sales	12,756	6,578
Net sales	$ 70,248	$ 72,328
Total tons shipped	42,513	38,481
Net selling price per ton	$ 1,652	$ 1,880

Net sales decreased 2.9% to $70.2 million in the nine months ended September 30, 2010, compared to $72.3 million in the same period of 2009. Net sales figures represent gross selling price, including freight, less discounts and pricing allowances. Net sales of converted product decreased for the nine months ended September 30, 2010, by $8.3 million, or 12.6%, to $57.5 million compared to $65.8 million in the same period last year. Net sales of parent rolls increased $6.2 million, or 93.9%, to $12.8 million in the nine months ended September 30, 2010 compared to $6.6 million in the same period last year. Net sales of converted product were negatively affected by an 8% decrease in tonnage shipped and a 5% decrease in net selling prices. The reduction in tonnage shipments was due to the factors cited in the quarterly discussion. The reduction in selling prices was primarily product mix related. Net sales of parent rolls benefited from the lower requirements from our converting operation and from a 6% increase in net selling prices.

Total shipments in the nine-month period of 2010 increased by 4,032 tons, or 10.5%, to 42,513 tons compared to 38,481 tons in the same period of 2009. The overall increase in tonnage shipped is due to the factors cited in the quarterly discussion.

Cost of Sales

	Nine Months Ended September 30,	
	2010	2009
	(in thousands, except gross profit margin % and paper cost per ton)	
Cost of paper	$ 32,415	$ 25,763
Non-paper materials, labor, supplies, etc.	20,894	22,235
Sub-total	$ 53,309	$ 47,998
Depreciation	3,974	2,641
Cost of sales	$ 57,283	$ 50,639
Gross profit	$ 12,965	$ 21,689
Gross profit margin %	18.5%	30.0%
Total paper cost per ton consumed	$ 783	$ 669

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

Cost of sales increased approximately $6.6 million, or 13.1%, to $57.3 million for the nine months ended September 30, 2010, compared to $50.6 million in the same period of 2009. As a percentage of net sales, cost of sales increased to 81.5% of net sales in the nine-month period ended September 30, 2010 from 70.0% of net sales in the nine-month period ended September 30, 2009. The increase in cost of sales as a percentage of net sales in the nine months ended September 30, 2010 was primarily attributed to higher waste paper prices, higher converting production costs due to lower production levels, a higher percentage of parent roll sales, and higher depreciation expense.

In the nine months ended September 30, 2010, our overall cost of paper was $783 per ton, an increase of $114 per ton compared to the same period in 2009. Our increased production cost per ton was primarily associated with a 48% increase in our cost of waste paper, which accounted for $4.9 million in increased cost of sales. Converting production costs increased for the first nine months of 2010 compared to the same period in 2009 by approximately 14% on a per unit basis for the same reasons cited in the quarterly discussion. The previously discussed increase in the percentage of parent roll production being sold as a parent roll negatively affected our gross margin percentage. Depreciation expense increased $1.3 million in the first nine months of 2010 compared to the same period last year due to the new converting line assets being placed in service in the third quarter as well as other major capital projects. External warehousing costs decreased by approximately $520,000 in the nine months ended September 30, 2010 compared to the same period in 2009 due to the previously discussed phasing out of the use of a third party warehouse.

Gross Profit

Gross profit in the nine months ended September 30, 2010, decreased $8.7 million, or 40.2 %, to $13.0 million compared to $21.7 million in the same period last year. Gross profit as a percentage of net sales in the nine-month period ended September 30, 2010, was 18.5% compared to 30.0% in the same period in 2009. The effect of higher waste paper prices, lower converted product shipments, and a higher percentage of lower margin parent roll sales and higher depreciation expense all contributed to the decrease in gross profit as a percentage of net sales.

Selling, General and Administrative Expenses

	Nine Months Ended September 30, 2010	2009
	(in thousands, except SG&A as a % of net sales)	
Commission expense	$ 940	$ 1,007
Other SG&A expenses	4,285	4,682
Selling, General & Adm exp	$ 5,225	$ 5,689
SG&A as a % of net sales	7.4%	7.9%

Selling, general and administrative expenses include salaries, commissions to brokers and other miscellaneous expenses. Selling, general and administrative expenses decreased $464,000, or 8.2%, to $5.2 million in the nine months ended September 30, 2010, compared to $5.7 million in the comparable 2009 period. The decrease is mainly attributable to lower accruals under our incentive bonus plans due to lower earnings, and decreased stock option expense primarily due to a decrease in the price of our stock, which was partially offset by an increase in artwork and packaging related design cost. As a percentage of net sales, selling, general and administrative expenses decreased to 7.4% in the nine months ended September 30, 2010, compared to 7.9% in the same period of 2009.

Operating Income

As a result of the foregoing factors, operating income for the nine months ended September 30, 2010 was $7.7 million compared to operating income of $16.0 million for the same period of 2009.

Interest Expense and Other Income

	Nine Months Ended September 30, 2010	2009
	(in thousands)	
Interest expense	$ 675	$ 468
Other income, net	$ (51)	$ (9)
Income before income taxes	$ 7,116	$ 15,541

Interest expense increased by $207,000 from $468,000 in the nine months ended September 30, 2009, to $675,000 in the same period in 2010. The increase was primarily attributable to higher interest rates and higher levels of debt as a result of the construction loans.

Income Before Income Taxes

As a result of the foregoing factors, income before income taxes decreased $8.4 million to $7.1 million in the nine months ended September 30, 2010, compared to $15.5 million in the same period in 2009.

Income Tax Provision

As of September 30, 2010, we estimate our full-year effective income tax rate to be 30.1%. It is lower than the statutory rate because of Oklahoma Investment Tax Credits associated with our investment in 2006 in a paper machine as well as continued capital investment in our mill and converting production facilities, and the Section 199 manufacturing credits. For the nine months ended September 30, 2009, our effective income tax rate was 33.1%.

Liquidity and Capital Resources

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

On April 12, 2010, the board of directors approved an expansion of our waste water treatment facility costing approximately $2.6 million. The expansion, which includes an additional water clarifying tank, an aeration basin and new diffused air system, increases the capacity of our facility by approximately 50% and will provide us with an ability to independently meet our water discharge permit limits. We began this expansion project early in the third quarter and expect completion by the end of the fourth quarter of 2010. Subsequently, we amended our credit agreement in June 2010, which among other things, increased our capital expenditures limit for the current year. Cash outlays to date for this project have been approximately $1.1 million.

During the nine months ended September 30, 2010, cash decreased $1.2 million. In addition, we utilized $9.0 million of short term investments in the period. The primary driver of this use of cash and short term investments was capital projects for which we spent $23.2 million in the first nine months of 2010, including $14.1 million for the new converting line, $4.3 million for the new warehouse and $1.1 million for the waste water treatment plant expansion. Additional funding for the warehouse project was provided from borrowings of $5.2 million under a construction loan which provides funding for 80% of the construction cost of the warehouse. Capital expenditures for the fourth quarter of 2010 are expected to be approximately $3.3 million. The capital expenditures estimate for the fourth quarter includes $500,000 for the new converting line, $1.4 million on the waste water treatment expansion project and $1.4 million for normal, recurring projects.

As of September 30, 2010, total debt outstanding was $25.9 million. Cash and short-term investments as of September 30, 2010, totaled $9.5 million, resulting in a net debt level of $16.4 million. The revolving credit facility and Term Loan B have termination dates of April 2011, and accordingly the outstanding balances of these two loans of $292,000 and $7.9 million, respectively, have been classified as current obligations in the accompanying balance sheet. It is our intention to refinance the entire credit facility by early 2011.

As of September 30, 2010, approximately $2.7 million was recorded as a Federal income tax receivable. The receivable resulted from the extension of the eligibility period for Bonus depreciation, which significantly decreased our current federal income tax liability. The extension occurred after deposits were made for the first three quarters of 2010. A refund of this receivable is expected after the filing of the 2010 federal tax return in mid-2011.

The following table summarizes key cash flow information for the nine-month periods ended September 30, 2010 and 2009:

	Nine Months Ended September 30,	
	2010	2009
	(in thousands)	
Cash flow provided by (used in):		
Operating activities	$ 10,520	$ 14,060
Investing activities	$ (14,390)	$ (29,056)
Financing activities	$ 2,644	$ 15,302

Cash flows provided by operating activities was $10.5 million in the nine-month period ended September 30, 2010, which primarily resulted from earnings before non-cash charges and an increase in accounts payable which was partially offset by an increase in accounts receivable. The increase in both accounts receivable and accounts payable are primarily related to timing.

Cash flows used in investing activities was $14.4 million in the first nine months of 2010 largely due to $23.4 million in expenditures on capital projects, primarily for our converting expansion project. We used $9.0 million of short-term investments to help finance this project.

Cash flows provided by financing activities was $2.6 million in the nine-month period ended September 30, 2010, which consisted primarily of $5.2 million of borrowings on a construction loan for our finished goods warehouse. This inflow was partially offset by $2.8 million of principal payments on term loans.

Cash flows provided by operating activities was $14.1 million in the nine-month period ended September 30, 2009, which primarily resulted from earnings before non-cash charges which was partially offset by an increase in accounts receivable.

Cash flows used in investing activities was $29.1 million in the first nine months of 2009 due to the purchase of $22.5 million in short-term investments from the proceeds from our common stock offering as well as from cash provided from operations. Additionally, we had $6.6 million in expenditures on capital projects, primarily for the construction of the waste water treatment facility, which was completed in August.

Cash flows provided by financing activities was $15.3 million in the nine-month period ended September 30, 2009, which was primarily attributable to $14.8 million in net proceeds from our common stock offering and $3.8 million of borrowings under a construction loan related to the waste water treatment plant project. These inflows were partially offset by principal payments of $2.3 million on our term loans and a $1.5 million repayment on our revolving line of credit.

Critical Accounting Policies and Estimates

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

Accounts Receivable. Accounts receivable consist of amounts due to us from normal business activities. Our management must make estimates of accounts receivable that will not be collected. We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's creditworthiness as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain an allowance for estimated losses based on historical experience and specific customer collection issues that we have identified. Trade receivables are written-off when all reasonable collection efforts have been exhausted, including, but not limited to, external third party collection efforts and litigation. While such credit losses have historically been within management's expectations and the allowance provided, there can be no assurance that we will continue to experience the same credit loss rates as in the past. During the nine-month periods ended September 30, 2010 and 2009, provisions for doubtful accounts were recognized in the amount of $45,000 and $46,000 respectively. In the first nine months of 2010, no recoveries of previously written off accounts were received. In the first nine months of 2009, $3,000 of recoveries were received. No accounts receivable balances were written off in nine-month period of 2010 and $39,000 were written off in the same period ended September 30, 2009.

Inventory. Our inventory consists of finished goods and raw materials and is stated at the lower of cost or market. Our management regularly reviews inventory quantities on hand and records a provision for excess and obsolete inventory based on the age of the inventory and forecasts of product demand. A significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand. During the first nine months of 2010, $90,000 was provided and there were charges totaling $124,000 against the valuation reserve. During the first nine months of 2009, $45,000 was provided and there were charges totaling $233,000 against the valuation reserve.

New Accounting Pronouncements

Refer to the discussion of recently adopted/issued accounting pronouncements under Part I, Notes to Unaudited Interim Financial Statements Note 10 — New Accounting Standards.

Non-GAAP Discussion

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

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

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

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

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

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

The following table reconciles EBITDA to net income for the three months ended September 30, 2010 and 2009:

	Three Months Ended September 30,	
	2010	2009
	(In thousands, except % of net sales)	
Net income	$ 1,442	$ 3,815
Plus: Interest expense	249	174
Plus: Income tax expense	713	1,673
Plus: Depreciation	1,696	1,003
EBITDA	$ 4,100	$ 6,665
% of net sales	16.7%	27.1%

EBITDA decreased $2.6 million to $4.1 million in the quarter ended September 30, 2010, compared to $6.7 million in the same period in 2009. EBITDA as a percent of net sales decreased to 16.7% in the third quarter of 2010 from 27.1% in the same quarter of 2009. The foregoing factors discussed in the net sales, cost of sales and selling, general and administrative expenses sections are the reasons for the decrease in EBITDA for the third quarter of 2010.

The following table reconciles EBITDA to net income for the nine months ended September 30, 2010 and 2009:

	Nine Months Ended September 30, 2010	2009
	(In thousands, except % of net sales)	
Net income	$ 4,974	$ 10,387
Plus: Interest expense	675	468
Plus: Income tax expense	2,142	5,154
Plus: Depreciation	3,974	2,641
EBITDA	$ 11,765	$ 18,650
% of net sales	16.7%	25.8%

EBITDA decreased $6.9 million to $11.8 million in the nine months ended September 30, 2010, compared to $18.7 million in the same period of 2009. EBITDA as a percent of net sales decreased to 16.7% in the current nine-month period from 25.8% in the prior year nine-month period. The foregoing factors discussed in the net sales, cost of sales and selling, general and administrative sections are the reasons for these changes.

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

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

Net Debt has increased from $3.5 million on December 31, 2009, to $16.4 million on September 30, 2010 as a result of a $10.2 million decrease in cash and short term investments as the proceeds from our secondary offering have been used to purchase our new converting line and 20% of our finished goods warehouse. Our total debt has increased $2.7 million as we funded 80% of our warehouse in our credit facility which was partially offset by $2.8 million in principal payments.

The following table presents Net Debt as of September 30, 2010 and December 31, 2009:

	As of September 30, 2010	December 31, 2009
	(in thousands)	
Current portion long term debt	$ 8,839	$ 3,742
Long-term debt	17,105	19,533
Total debt	25,944	23,275
Less cash	(6)	(1,232)
Less short term investments	(9,516)	(18,509)
Net debt	$ 16,422	$ 3,534

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

There has been no material change in the information provided in response to Item 7A of the Company’s Form 10-K for the year ended December 31, 2009.

ITEM 4. Controls and Procedures

Our management, under the supervision and with the participation of our chief executive officer and our chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities

Exchange Act of 1934, as amended), as of the end of the period covered by this Quarterly Report on Form 10-Q. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Based on such evaluation, our chief executive officer and our chief financial officer have concluded that our disclosure controls and procedures were effective as of September 30, 2010.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended September 30, 2010, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

None

ITEM 1A. Risk Factors

As of the date of this filing, there have been no material changes from the risk factors disclosed in the Company's Annual Report on Form 10-K filed for the year ended December 31, 2009. We operate in a changing environment that involves numerous known and unknown risks and uncertainties that could materially affect our operations. The risks, uncertainties and other factors set forth in our Annual Report on Form 10-K may cause our actual results, performances and achievements to be materially different from those expressed or implied by our forward-looking statements. If any of these risks or events occur, our business, financial condition or results of operations may be adversely affected.

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

(a) Unregistered Sales of Equity Securities

None

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

None

(c) Repurchases of Equity Securities

We do not have any programs to repurchase shares of our common stock and no such repurchases were made during the three months ended September 30, 2010.

ITEM 3. Defaults Upon Senior Securities

None

ITEM 4. RESERVED

ITEM 5. Other Information

None

ITEM 6. Exhibits

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

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ORCHIDS PAPER PRODUCTS COMPANY

Date: November 3, 2010

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

Exhibit Index

Exhibit	Description
3.1	Amended and Restated Certificate of Incorporation of the Registrant incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement on Form S-1 (File No. 333-124173) filed with the Securities and Exchange Commission on April 19, 2005.
3.1.1	Amendment to the Amended and Restated Certificate of Incorporation of the Registrant incorporated by reference to the Form 10-Q filed with the Securities and Exchange Commission on August 14, 2007.
3.2	Amended and Restated Bylaws of the Registrant incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-1 (File No. 333-124173) filed with the Securities and Exchange Commission on April 19, 2005.
10.1	Amendment Five to Second Amended and Restated Agented Credit Agreement dated June 1, 2010, incorporated by reference to Orchids Paper Products Company Form 8-K (File No. 001-32563) filed with the Securities and Exchange Commission on June 2, 2010.
31.1	Certification of Chief Executive Officer Pursuant to Section 302.
31.2	Certification of Chief Financial Officer Pursuant to Section 302.
32.1	Certification of Chief Executive Officer Pursuant to Section 906.
32.2	Certification of Chief Financial Officer Pursuant to Section 906.