

CTI INDUSTRIES CORP
Form 10-Q
November 15, 2010
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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

000-23115

CTI INDUSTRIES CORPORATION
(Exact name of Registrant as specified in its charter)

Illinois
(State or other jurisdiction of
incorporation or organization)

36-2848943
(I.R.S. Employer Identification Number)

22160 N. Pepper Road
Lake Barrington, Illinois
(Address of principal executive offices)

60010
(Zip Code)

(847) 382-1000
(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 requirements 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

Edgar Filing: CTI INDUSTRIES CORP - Form 10-Q

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

The number of shares outstanding of the Registrant’s common stock as of November 1, 2010 was 3,128,568.

INDEX

PART I – FINANCIAL INFORMATION

| | | |
|------------|---|----|
| Item No. 1 | Financial Statements | |
| | Condensed Consolidated Interim Balance Sheet at September 30, 2010 (unaudited) and December 31, 2009 | 3 |
| | Condensed Consolidated Interim Statements of Operations (unaudited) for the three and nine months ended September 30, 2010 and September 30, 2009 | 4 |
| | Condensed Consolidated Interim Statements of Cash Flows (unaudited) for the three and nine months ended September 30, 2010 and September 30, 2009 | 5 |
| | Condensed Consolidated Interim Earnings per Share (unaudited) for the three and nine months ended September 30, 2010 and September 30, 2009 | 6 |
| | Notes to Condensed Consolidated Financial Statements (unaudited) | 7 |
| Item No. 2 | Management’s Discussion and Analysis of Financial Condition and Results of Operations | 18 |
| Item No. 3 | Quantitative and Qualitative Disclosures Regarding Market Risk | 24 |
| Item No. 4 | Controls and Procedures | 24 |

PART II – OTHER INFORMATION

| | | |
|-------------|---|----|
| Item No. 1 | Legal Proceedings | 25 |
| Item No. 1A | Risk Factors | 25 |
| Item No. 2 | Unregistered Sales of Equity Securities and Use of Proceeds | 25 |
| Item No. 3 | Defaults Upon Senior Securities | 26 |
| Item No. 4 | Submission of Matters to a Vote of Security Holders | 26 |
| Item No. 5 | Other Information | 26 |
| Item No. 6 | Exhibits | 26 |
| | Signatures | 28 |
| | Exhibit 31.1 | |
| | Exhibit 31.2 | |
| | Exhibit 32 | |

PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements

CTI Industries Corporation and Subsidiaries
Condensed Consolidated Balance Sheets

| | September 30, 2010 (unaudited) | December 31, 2009 |
|--|--------------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 682,193 | \$ 870,446 |
| Accounts receivable, (less allowance for doubtful accounts of \$68,000 and \$57,000, respectively) | 7,567,111 | 7,320,181 |
| Inventories, net | 10,554,914 | 9,643,914 |
| Net deferred income tax asset | 724,972 | 706,754 |
| Prepaid expenses and other current assets | 769,159 | 607,127 |
| Total current assets | 20,298,349 | 19,148,422 |
| Property, plant and equipment: | | |
| Machinery and equipment | 22,716,187 | 22,390,891 |
| Building | 3,260,201 | 3,183,795 |
| Office furniture and equipment | 2,711,986 | 2,677,476 |
| Intellectual property | 345,092 | 345,092 |
| Land | 250,000 | 250,000 |
| Leasehold improvements | 441,377 | 428,864 |
| Fixtures and equipment at customer locations | 2,629,902 | 2,541,881 |
| Projects under construction | 612,800 | 270,131 |
| | 32,967,545 | 32,088,130 |
| Less : accumulated depreciation and amortization | (24,023,275) | (22,554,719) |
| Total property, plant and equipment, net | 8,944,270 | 9,533,411 |
| Other assets: | | |
| Deferred financing costs, net | 111,071 | 11,846 |
| Goodwill | 1,033,077 | 989,108 |
| Net deferred income tax asset | 416,293 | 361,457 |
| Other assets (due from related party \$196,000 and \$79,000, respectively) | 300,649 | 351,065 |
| Total other assets | 1,861,090 | 1,713,476 |
| TOTAL ASSETS | 31,103,709 | 30,395,309 |
| LIABILITIES AND EQUITY | | |
| Current liabilities: | | |
| Checks written in excess of bank balance | 290,719 | 735,257 |
| Trade payables | 3,464,584 | 3,236,607 |
| Line of credit | 7,542,736 | 7,598,671 |

Edgar Filing: CTI INDUSTRIES CORP - Form 10-Q

| | | |
|---|----------------------|----------------------|
| Notes payable - current portion | 385,001 | 811,996 |
| Notes payable - officers, current portion, net of debt discount of \$31,000 and \$89,000 | 1,386,632 | 1,368,964 |
| Capital lease - current portion | 46,784 | 299,311 |
| Notes Payable Affiliates - current portion | 6,499 | 5,793 |
| Accrued liabilities | 3,083,427 | 2,683,714 |
| Total current liabilities | 16,206,382 | 16,740,313 |
| Long-term liabilities: | | |
| Notes Payable - Affiliates | 156,985 | 774,294 |
| Notes payable, net of current portion | 2,200,700 | 2,375,435 |
| Capital Lease | 462,598 | 733,414 |
| Notes payable - officers, subordinated, net of debt discount of \$0 and \$7,000 | 372,058 | 992,632 |
| Total long-term liabilities | 3,192,341 | 4,875,775 |
| Equity: | | |
| CTI Industries Corporation 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, 3,191,225 and 2,808,720 shares issued and 3,120,568 and 2,808,720 outstanding, respectively | 14,124,068 | 12,457,966 |
| Warrants issued in connection with subordinated debt and bank debt | - | 443,313 |
| Dividends | (156,135) | - |
| Accumulated deficit | (757,790) | (2,206,728) |
| Accumulated other comprehensive loss | (1,410,365) | (1,803,442) |
| Less: Treasury stock, 70,657 shares and 70,657 shares | (128,446) | (128,446) |
| Total CTI Industries Corporation stockholders' equity | 11,671,332 | 8,762,663 |
| Noncontrolling interest | 33,654 | 16,558 |
| Total Equity | 11,704,986 | 8,779,221 |
| TOTAL LIABILITIES AND EQUITY | \$ 31,103,709 | \$ 30,395,309 |

See accompanying notes to condensed consolidated unaudited financial statements

Edgar Filing: CTI INDUSTRIES CORP - Form 10-Q

CTI Industries Corporation and Subsidiaries
Condensed Consolidated Statements of Operations (Unaudited)

| | For the Three Months Ended September 30, 2010 | | For the Nine Months Ended September 30, 2009 | |
|--|---|---------------|--|---------------|
| | 2010 | 2009 | 2010 | 2009 |
| Net Sales | \$ 10,962,272 | \$ 10,175,245 | \$ 36,337,241 | \$ 30,557,569 |
| Cost of Sales | 8,713,084 | 7,997,292 | 28,170,431 | 23,712,414 |
| Gross profit | 2,249,188 | 2,177,953 | 8,166,810 | 6,845,155 |
| Operating expenses: | | | | |
| General and administrative | 1,239,070 | 1,046,826 | 3,807,519 | 3,387,495 |
| Selling | 112,509 | 221,029 | 671,329 | 601,819 |
| Advertising and marketing | 388,887 | 404,103 | 1,329,524 | 1,213,166 |
| Total operating expenses | 1,740,466 | 1,671,958 | 5,808,372 | 5,202,480 |
| Income from operations | 508,722 | 505,995 | 2,358,438 | 1,642,675 |
| Other (expense) income: | | | | |
| Interest expense | (163,835) | (261,201) | (712,896) | (837,830) |
| Interest income | 4,497 | 4,566 | 13,090 | 13,077 |
| Foreign currency (loss) gain | (2,660) | 12,549 | (37,348) | (6,449) |
| Total other expense, net | (161,998) | (244,086) | (737,154) | (831,202) |
| Net Income before taxes | 346,724 | 261,909 | 1,621,284 | 811,473 |
| Income tax expense | 112,939 | 55,666 | 208,262 | 101,787 |
| Net Income | 233,785 | 206,243 | 1,413,022 | 709,686 |
| Less: Net (loss) income attributable to noncontrolling interest | (9,543) | 1,526 | (35,916) | 3,023 |
| Net income attributable to CTI Industries Corporation | \$ 243,328 | \$ 204,717 | \$ 1,448,938 | \$ 706,663 |
| Other Comprehensive Income | | | | |
| Unrealized gain on derivative instruments; adjustment to accumulated balance on swap termination | \$ - | \$ 25,056 | \$ 188,615 | \$ 113,111 |
| Foreign currency adjustment | \$ 275,687 | \$ (23,638) | \$ 204,462 | \$ 159,918 |
| Comprehensive income | \$ 519,015 | \$ 206,135 | \$ 1,842,015 | \$ 979,692 |
| Basic income per common share | \$ 0.08 | \$ 0.07 | \$ 0.49 | \$ 0.25 |
| Diluted income per common share | \$ 0.08 | \$ 0.07 | \$ 0.49 | \$ 0.25 |

Edgar Filing: CTI INDUSTRIES CORP - Form 10-Q

| | | | | | | | | |
|---------------------|----|---|----|---|----|------|----|---|
| Dividends per share | \$ | - | \$ | - | \$ | 0.05 | \$ | - |
|---------------------|----|---|----|---|----|------|----|---|

Weighted average number of shares and
equivalent shares of common stock
outstanding:

| | | | | |
|---------|-----------|-----------|-----------|-----------|
| Basic | 3,120,568 | 2,739,481 | 2,930,748 | 2,774,447 |
| Diluted | 3,201,064 | 2,749,685 | 2,985,697 | 2,781,178 |

See accompanying notes to condensed consolidated unaudited financial statements

Edgar Filing: CTI INDUSTRIES CORP - Form 10-Q

CTI Industries Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)

| | For the Nine Months Ended September 30, | |
|---|---|--------------------|
| | 2010 | 2009 |
| Cash flows from operating activities: | | |
| Net income | \$ 1,413,022 | \$ 709,686 |
| Adjustment to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 1,561,263 | 1,434,681 |
| Amortization of debt discount | 82,909 | 66,501 |
| Stock based compensation | 116,142 | 66,088 |
| Provision for losses on accounts receivable | 14,354 | 90,437 |
| Provision for losses on inventories | 11,083 | 72,000 |
| Deferred income taxes | 178,262 | 92,840 |
| Change in assets and liabilities: | | |
| Accounts receivable | (137,177) | (435,312) |
| Inventories | (790,620) | 570,189 |
| Prepaid expenses and other assets | (79,153) | (198,671) |
| Trade payables | 255,532 | 304,626 |
| Accrued liabilities | 298,232 | 135,639 |
| Net cash provided by operating activities | 2,923,849 | 2,908,704 |
| Cash used in investing activities - purchases of property, plant and equipment | | |
| | (848,143) | (595,109) |
| Net cash used in investing activities | (848,143) | (595,109) |
| Cash flows from financing activities: | | |
| Change in checks written in excess of bank balance | (445,792) | (166,696) |
| Net change in revolving line of credit | (55,935) | (977,664) |
| Repayment of long-term debt (related parties \$413,000 and \$0) | (1,491,607) | (904,791) |
| Proceeds from exercise of stock options and warrants | 79,647 | - |
| Cash received from investment in subsidiary | 42,300 | - |
| Dividends paid | (156,135) | - |
| Cash paid for purchase of stock | - | (58,608) |
| Cash paid for deferred financing fees | (244,726) | (40,555) |
| Net cash used in financing activities | (2,272,248) | (2,148,314) |
| Effect of exchange rate changes on cash | 8,289 | 19,851 |
| Net (decrease) increase in cash and cash equivalents | (188,253) | 185,132 |
| Cash and cash equivalents at beginning of period | 870,446 | 180,578 |
| Cash and cash equivalents at end of period | \$ 682,193 | \$ 365,710 |

Supplemental disclosure of cash flow information:

| | | | | |
|----------------------------|----|---------|----|---------|
| Cash payments for interest | \$ | 605,785 | \$ | 685,400 |
|----------------------------|----|---------|----|---------|

| | | | | |
|-------------------------|----|--------|----|-------|
| Cash payments for taxes | \$ | 30,000 | \$ | 8,946 |
|-------------------------|----|--------|----|-------|

Supplemental Disclosure of non-cash investing and financing activity

| | | | | |
|---|----|---|----|--------|
| Stock issued under consulting agreement | \$ | - | \$ | 69,063 |
|---|----|---|----|--------|

| | | | | |
|--|----|-----------|----|---|
| Exercise of Warrants by Payment of Subordinated Debt | \$ | 1,027,000 | \$ | - |
|--|----|-----------|----|---|

| | | | | |
|---|----|---------|----|---|
| Exercise of Options and Warrants by Surrender of Shares | \$ | 227,736 | \$ | - |
|---|----|---------|----|---|

| | | | | |
|--|----|--------|----|--------|
| Property, Plant & Equipment acquisitions funded by liabilities | \$ | 43,296 | \$ | 77,015 |
|--|----|--------|----|--------|

See accompanying notes to condensed consolidated unaudited financial statements

CTI Industries Corporation and Subsidiaries
Condensed Consolidated Earnings per Share (unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|------------|---------------------------------|------------|
| | 2010 | 2009 | 2010 | 2009 |
| Basic | | | | |
| Average shares outstanding: | | | | |
| Weighted average number of common shares outstanding | 3,120,568 | 2,739,481 | 2,930,748 | 2,774,447 |
| Net income: | | | | |
| Net income attributable to CTI Industries Corporation | \$ 243,328 | \$ 204,717 | \$ 1,448,938 | \$ 706,663 |
| Per share amount | \$ 0.08 | \$ 0.07 | \$ 0.49 | \$ 0.25 |
| Diluted | | | | |
| Average shares outstanding: | | | | |
| Weighted average number of common shares outstanding | 3,120,568 | 2,739,481 | 2,930,748 | 2,774,447 |
| Effect of dilutive shares | 80,496 | 10,204 | 54,949 | 6,731 |
| Weighted average number of shares and equivalent shares of common stock outstanding | 3,201,064 | 2,749,685 | 2,985,697 | 2,781,178 |
| Net income: | | | | |
| Net income attributable to CTI Industries Corporation | \$ 243,328 | \$ 204,717 | \$ 1,448,938 | \$ 706,663 |
| Per share amount | \$ 0.08 | \$ 0.07 | \$ 0.49 | \$ 0.25 |

See accompanying notes to condensed consolidated unaudited financial statements

CTI Industries Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements

Note 1 - Basis of Presentation

The accompanying condensed consolidated financial statements are unaudited but in the opinion of management contain all the adjustments (consisting of those of a normal recurring nature) considered necessary to present fairly the consolidated financial position and the consolidated results of operations and consolidated cash flows for the periods presented in conformity with generally accepted accounting principles for interim consolidated financial information and the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Operating results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2010. It is suggested that these condensed financial statements be read in conjunction with the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2009.

Principles of consolidation and nature of operations:

The condensed consolidated financial statements include the accounts of CTI-US and its wholly-owned subsidiaries, CTI Balloons Limited, CTI Helium, Inc. and CTF International S.A. de C.V., as well as its majority-owned subsidiaries CTI Mexico S.A. de C.V., Flexo Universal, S.A. de C.V. and CTI Europe gmbH (the "Company"). All significant intercompany transactions and accounts have been eliminated in consolidation. The Company (i) designs, manufactures and distributes balloon products throughout the world and (ii) operates 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.

Reclassification:

As of June 30, 2010, the Company reclassified obligations under capital leases from notes payable to capital leases including both the long term and current portions. This reclassification is reflected in the balance sheets for September 30, 2010 and December 31, 2009.

As of June 30, 2010, the company reclassified its equity in common stock from paid-in-capital. This reclassification is reflected in the balance sheets for September 30, 2010 and December 31, 2009.

Use of estimates:

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

Earnings per share:

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during each period.

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

As of September 30, 2010, shares to be issued upon the exercise of options and warrants aggregated 158,905 and 0, respectively. As of September 30, 2009, shares to be issued upon the exercise of options and warrants were 232,644 and 343,030, respectively. The number of anti-dilutive shares (not included in the determination of earnings on a diluted basis) for the three and nine months ended September 30, 2010 were 0 and 14,000, respectively, all of which were represented by options. The number of anti-dilutive shares (not included in the determination of earnings on a diluted basis) for the three and nine months ended September 30, 2009 were 479,935 of which 136,905 were represented by options and 343,030 were represented by warrants.

New Accounting Pronouncements:

The Company's significant accounting policies are summarized in Note 2 of the Company's consolidated financial statements for the year ended December 31, 2009. There were no significant changes to these accounting policies during the three and nine months ended September 30, 2010 and the Company does not expect that the adoption of other recent accounting pronouncements will have a material impact in its consolidated financial statements.

Note 2 - Stock-Based Compensation; Changes in Equity

We have adopted Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718 which requires all share-based payments to employees, including grants of employee stock options, to be recognized in the condensed consolidated financial statements based on their grant-date fair values.

We have applied the Black-Scholes model to value stock-based awards. That model incorporates various assumptions in the valuation of stock-based awards relating to the risk-free rate of interest to be applied, the estimated dividend yield and expected volatility of our common stock. The risk-free rate of interest is the related U.S. Treasury yield curve for periods within the expected term of the option at the time of grant. The dividend yield on our common stock is assumed to be zero as we have historically not paid dividends. The expected volatility is based on historical volatility of the Company's common stock.

The Company's net income for the three months ended September 30, 2010 and 2009 includes approximately \$35,000 and \$21,000, respectively of compensation costs related to share based payments. The Company's net income for the nine months ended September 30, 2010 and 2009 includes approximately \$116,000 and \$66,000, respectively of compensation costs related to share based payments. As of September 30, 2010 there is \$46,000 of unrecognized compensation expense related to non-vested stock option grants and stock grants. We expect approximately \$21,000 to be recognized over the remainder of 2010, and approximately \$25,000 to be recognized during 2011.

As of September 30, 2010, the Company had four stock-based compensation plans pursuant to which stock options were, or 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.

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 September 30, 2010, 139,958 shares have been granted and were fully vested at the time of grant, 12,500 remain outstanding.

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 September 30, 2010, 123,430 shares have been granted and were fully vested at the time of grant, 28,500 remain outstanding.

On April 30, 2007, the Board of Directors approved for adoption, effective October 1, 2007, the 2007 Stock Option 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. As of September 30, 2010, 165,750 options had been granted and 106,000 remain outstanding.

On April 10, 2009, the Board of Directors approved for adoption, and on June 5, 2009, the shareholders of the Corporation approved, a 2009 Incentive Stock Plan (“Incentive Stock Plan”). The Incentive Stock Plan authorizes the issuance of up to 250,000 shares of stock or options to purchase stock of the Company. No stock or options have been granted under this Plan to date.

A summary of the Company’s stock option activity and related information is as follows:

| | Shares under Option | Weighted Average Exercise Price | Weighted Average Contractual Life | Aggregate Intrinsic Value |
|-----------------------------------|------------------------|---------------------------------------|--|---------------------------------|
| Balance at December 31, 2009 | 232,644 | \$ 3.04 | | |
| Granted | - | - | | |
| Cancelled | 15,000 | \$ 3.48 | | |
| Exercised | 58,739 | \$ 2.42 | | |
| Outstanding at September 30, 2010 | 158,905 | \$ 3.22 | 2.50 | \$ 590,793 |
| Exercisable at September 30, 2010 | 109,280 | \$ 3.36 | 2.90 | \$ 391,674 |

A summary of the Company's stock warrant activity and related information is as follows:

| | Shares under Warrant | Weighted Average Exercise Price | Weighted Average Contractual Life | Aggregate Intrinsic Value |
|---|-------------------------|---------------------------------------|--|------------------------------|
| Outstanding and Exercisable at December 31, 2009 | 343,030 | \$ 3.47 | | |
| Granted | - | - | | |
| Cancelled | - | - | | |
| Exercised | 343,030 | \$ 3.47 | | |
| Outstanding and Exercisable at September 30, 2010 | - | \$ - | - | \$ - |

A summary of the Company's stock option activity by grant date as of September 30, 2010 is as follows:

| Options by Grant Date | Shares | Options Outstanding | | | Options Vested | | | |
|--------------------------|---------|---------------------|--------------|---------------|----------------|---------|--------------|---------------|
| | | Wtd Avg | Remain. Life | Intrinsic Val | Shares | Wtd Avg | Remain. Life | Intrinsic Val |
| Dec 2001 | - | \$ - | - | \$ - | - | \$ - | - | \$ - |
| Apr 2002 | 11,905 | \$ 2.10 | 1.6 | \$ 57,620 | 11,905 | \$ 2.10 | 1.6 | \$ 57,620 |
| Dec 2005 | 41,000 | \$ 2.88 | 5.3 | \$ 166,460 | 41,000 | \$ 2.88 | 5.3 | \$ 166,460 |
| Oct 2007 | 49,000 | \$ 4.72 | 1.0 | \$ 108,662 | 34,125 | \$ 4.70 | 1.0 | \$ 76,413 |
| Aug 2008 | 6,000 | \$ 6.14 | 1.9 | \$ 4,800 | 4,500 | \$ 6.14 | 1.9 | \$ 3,600 |
| Oct 2008 | 2,500 | \$ 4.97 | 2.0 | \$ 4,925 | 1,250 | \$ 4.97 | 2.0 | \$ 2,463 |
| Nov 2008 | 48,500 | \$ 1.82 | 2.1 | \$ 248,326 | 16,500 | \$ 1.78 | 2.1 | \$ 85,118 |
| Jan 2010 | - | \$ - | - | \$ - | - | \$ - | - | \$ - |
| TOTAL | 158,905 | \$ 3.22 | 2.5 | \$ 590,793 | 109,280 | \$ 3.36 | 2.9 | \$ 391,674 |

The aggregate intrinsic value in the tables above represents the total pre-tax intrinsic value (the difference between the closing price of the Company's common stock on the last trading day of the quarter ended September 30, 2010 and the exercise price, multiplied by the number of in-the-money options and warrants) that would have been received by the option and warrant holders had all the holders exercised their options on September 30, 2010.

On June 9, 2010, the Board of Directors of the Company declared a dividend of \$0.05 per share to be paid to all shareholders of record as of June 18, 2010. The dividend was paid on or about June 28, 2010.

Note 3 - Legal Proceedings

The Company is party to certain claims or actions 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 or results of operations of the Company.

Note 4 – Other Comprehensive Gain

In the three months ended September 30, 2010 the company incurred a comprehensive gain of \$276,000, principally from foreign currency translation adjustments. In the nine months ended September 30, 2010 the company realized a comprehensive gain of \$393,000, principally from an unrealized gain on a derivative instrument of \$189,000 and a gain of \$204,000 from foreign currency translation adjustments. The gain on derivative instruments in the periods ended September 30, 2010 reflects the adjustment to the accumulated balance of the loss on derivatives arising from the termination of the swap agreements.

The following table sets forth the accumulated balance of other comprehensive loss and each component.

| | Foreign Currency Items | Unrealized Gains (Loss) on Derivatives | Accumulated Other Comprehensive (Loss) |
|---|------------------------------|--|--|
| Beginning balance as of January 1, 2010 | \$ (1,614,000) | \$ (189,000) | \$ (1,803,000) |
| Current period change, net of tax | 204,000 | 189,000 | 393,000 |
| Ending Balance as of September 30, 2010 | \$ (1,410,000) | \$ - | \$ (1,410,000) |

For the three and nine months ended September 30, 2010 no tax benefit for foreign currency translation adjustments has been recorded as such amounts would result in a deferred tax asset. For the three and nine months ended September 30, 2010 no income tax benefit was recorded for the unrealized losses on the derivative instruments by reason of the fact that the tax benefit was offset by a valuation allowance with respect to the related deferred tax asset.

Note 5 - Fair Value Disclosures; Derivative Instruments

Effective January 1, 2008, the Company adopted the provisions of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 820 “Fair Value Measurements and Disclosures,” which defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure requirements for fair value measurements. FASB ASC Topic 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. FASB ASC Topic 820 also requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based upon the best information available. In February 2008, the FASB issued guidance now codified in FASB ASC Topic 820 which provides for delayed application of certain guidance related to 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).

FASB ASC Topic 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy categorizes assets and liabilities at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. The three levels are defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of the input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. The following table presents information about the Company's liabilities measured at fair value on a recurring basis as of September 30, 2009 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

| Description | Amount as of | | | |
|---------------------------|--------------|---------|-----------|---------|
| | 9/30/2009 | Level 1 | Level 2 | Level 3 |
| Interest Rate Swap 2006-1 | \$ (23,000) | \$ | (23,000) | |
| Interest Rate Swap 2006-2 | (97,000) | | (97,000) | |
| Interest Rate Swap 2008 | (108,000) | | (108,000) | |
| | \$ (228,000) | \$ | (228,000) | |

The Company's interest rate swap agreements have been valued using the counterparty's mark-to-market statement, which can be validated using modeling techniques that include market inputs such as publically available interest rate yield curves, and have been designated as Level 2 within the valuation hierarchy.

FASB ASC Topic 815 requires an entity to recognize all derivatives as either assets or 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.

On April 5, 2006, the Company entered into two swap agreements with RBS Citizens N.A. (“RBS”) in connection with portions (original notional amount totaling \$3,780,000) of the principal amounts of a mortgage loan and term loan to the Company fixing the interest rate on such floating rate loans from prime plus 0.75% to 8.49%. On January 28, 2008, the Company entered into an additional swap agreement with RBS with respect to a \$3,000,000 notional amount of a floating rate revolving loan, fixing the interest rate on such amount from prime plus 0.75% to 6.17%. These swap agreements were designated as cash flow hedges to hedge the Company’s exposure to interest rate fluctuations on the portions of the principal amount of loans with RBS that were covered by the swap agreements. These swap agreements were derivative financial instruments and the Company determined the fair market value of these agreements on a quarterly basis, based on RBS’s mark-to-market statement, recording the fair market value of these contracts on the balance sheet with the offset to other comprehensive loss. In connection with the entry into a new credit agreement with Harris N.A. and the pay off of its loan balances with RBS, on April 30, 2010, the Company terminated these swap agreements and paid to RBS the sum of \$146,000, representing the then fair value of the swap agreements, which was or will be, recorded as additional interest expense in the condensed consolidated statement of operations.

As of September 30, 2010 and December 31, 2009, the Company recorded the fair value of these swap agreements on the balance sheet as a liability of \$0 and \$189,000, respectively. For the three and nine months ended September 30, 2010, the Company recorded an unrealized gain of \$0 and \$189,000, compared to an unrealized gain of \$25,000 and \$113,000 for the same period in 2009, with respect to these swap agreements in other comprehensive income, which represents the change in value of these swap agreements for the quarters ended.

Since May 1, 2010, the Company has not entered into or maintained any swap agreements with respect to its outstanding indebtedness.

Note 6 – Inventories, Net

| | September 30, 2010 | December 31, 2009 |
|---------------------------------|-----------------------|----------------------|
| Raw materials | \$ 3,003,000 | \$ 1,520,000 |
| Work in process | 881,000 | 442,000 |
| Finished goods | 7,024,000 | 8,024,000 |
| Allowance for excess quantities | (353,000) | (342,000) |
| Total inventories | \$ 10,555,000 | \$ 9,644,000 |

Note 7 - Geographic Segment Data

The Company has determined that it operates primarily in one business segment which designs, manufactures and distributes film products for use in packaging and novelty balloon products. The Company operates in foreign and domestic regions. Information about the Company's operations by geographic areas is as follows:

| | Net Sales to Outside Customers | | Net Sales to Outside Customers | |
|-----------------------|--------------------------------|---------------|--------------------------------|---------------|
| | For the Three Months Ended | | For the Nine Months Ended | |
| | September 30, | | September 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| United States | \$ 7,859,000 | \$ 7,424,000 | \$ 27,558,000 | \$ 23,315,000 |
| Europe (Excluding UK) | 31,000 | - | 61,000 | - |
| Mexico | 2,394,000 | 2,267,000 | 6,457,000 | 5,508,000 |
| United Kingdom (UK) | 678,000 | 484,000 | 2,261,000 | 1,735,000 |
| | \$ 10,962,000 | \$ 10,175,000 | \$ 36,337,000 | \$ 30,558,000 |

| | Total Assets at | |
|-----------------------|-----------------------|----------------------|
| | September 30, 2010 | December 31, 2009 |
| United States | \$ 24,078,000 | \$ 23,801,000 |
| Europe (Excluding UK) | 189,000 | - |
| Mexico | 5,704,000 | 5,861,000 |
| United Kingdom (UK) | 1,133,000 | 733,000 |
| | \$ 31,104,000 | \$ 30,395,000 |

Note 8 - Concentration of Credit Risk

Concentration of credit risk with respect to trade accounts receivable is generally limited due to the number of entities comprising the Company's customer base. The Company performs ongoing credit evaluations and provides an allowance for potential credit losses against the portion of accounts receivable which is estimated to be uncollectible. Such losses have historically been within management's expectations. During the three and nine months ended September 30, 2010, there were two and three customers, respectively whose purchases represented more than 10% of the Company's consolidated net sales. During the three and nine months ended September 30, 2009, there were three customers whose purchases represented more than 10% of the Company's consolidated net sales. The sales to each of these customers for the three and nine months ended September 30, 2010 and 2009 are as follows:

| Customer | Three Months Ended September 30, 2010 | | Three Months Ended September 30, 2009 | |
|------------|--|-------------------|--|-------------------|
| | Net Sales | % of Net Sales | Net Sales | % of Net Sales |
| Customer A | \$ 2,347,000 | 21.4% | \$ 1,792,000 | 17.6% |
| Customer B | \$ 2,250,000 | 20.5% | \$ 1,533,000 | 15.1% |
| Customer C | \$ 721,227 | 6.6% | \$ 1,676,000 | 16.5% |

| Customer | Nine Months Ended September 30, 2010 | | Nine Months Ended September 30, 2009 | |
|------------|---|-------------------|---|-------------------|
| | Net Sales | % of Net Sales | Net Sales | % of Net Sales |
| Customer A | \$ 9,573,000 | 26.3% | \$ 7,941,000 | 26.0% |
| Customer B | \$ 5,305,000 | 14.6% | \$ 5,042,000 | 16.5% |
| Customer C | \$ 4,575,000 | 12.6% | \$ 3,117,000 | 10.2% |

As of September 30, 2010, the total amount owed to the Company by these customers was \$1,750,000 or 23.1%, \$1,256,000 or 16.6%, and \$288,000 or 3.8% of the Company's consolidated accounts receivables. The amounts owed at September 30, 2009 were \$935,000, or 14.8%, \$1,046,000, or 16.5%, and \$906,000 or 14.3% of the Company's consolidated net accounts receivables, respectively.

Note 9 – Related Party Transactions

Stephen M. Merrick, Executive Vice President, Secretary and a Director of the Company, is of counsel to the law firm of Vanasco Genelly and Miller PC which provides legal services to the Company. Legal fees incurred by the Company with this firm for the three months ended September 30, 2010 and 2009, respectively, were \$28,000 and \$22,000. Legal fees incurred by the Company with this firm for the nine months ended September 30, 2010 and 2009, respectively, were \$112,000 and \$69,000.

John H. Schwan, Chairman of the Company, is a principal of Shamrock Specialty Packaging and affiliated companies. The Company made purchases of approximately \$598,000 from Shamrock Specialty Packaging during the three months ended September 30, 2010 and \$357,000 during the three months ended September 30, 2009. The Company made purchases of approximately \$1,586,000 from Shamrock Specialty Packaging during the nine months ended September 30, 2010 and \$1,322,000 during the nine months ended September 30, 2009. At September 30, 2010 and 2009, outstanding accounts payable balances were \$301,000 and \$234,000, respectively.

John H. Schwan, Chairman of the Company, and Howard W. Schwan, President of the Company, are the brothers of Gary Schwan, one of the owners of Schwan Incorporated, which provides building maintenance and remodeling services to the Company. The Company received services from Schwan Incorporated of approximately \$11,000 during the three months ended September 30, 2010 and \$3,000 during the three months ended September 30, 2009. The Company received services from Schwan Incorporated of approximately \$36,000 during the nine months ended September 30, 2010 and \$21,000 during the nine months ended September 30, 2009.

On February 1, 2006, John H. Schwan and Stephen M. 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. On May 28, 2010, John H. Schwan (with respect to 101,515 shares of common stock of the Company at the price of \$3.30 per share) and Stephen M. Merrick (with respect to 151,515 shares of common stock of the Company at the price of \$3.30 per share) exercised such warrants in consideration of the cancellation of indebtedness to them of the Company in the amount of such exercise price.

On April 3, 2007, John H. Schwan assigned and transferred warrants to purchase up to 50,000 shares of common stock to Howard W. Schwan, an officer and director of the Company. On June 25, 2010, Howard W. Schwan exercised warrants to purchase 50,000 shares of common stock of the Company at the price of \$3.30 per share in consideration of the transfer to the Company and cancellation of 22,971 shares of common stock of the Company having a market value in the amount of such purchase price.

On October 1, 2008, the Company issued warrants to purchase 20,000 shares of common stock of the Company to both John H. Schwan and Stephen M. Merrick exercisable at the price of \$4.80 per share (the market price of the stock on the date of the warrants) in consideration for the personal guarantees by each of up to \$2 million in principal amount of the bank debt of the Company. On May 28, 2010, John H. Schwan and Stephen M. Merrick exercised these warrants in consideration of the cancellation of indebtedness of the Company to them in the amount of the exercise price.

Interest payments have been made to John H. Schwan and Stephen M. Merrick for loans made to the Company. During the three months ended September 30, 2010 these interest payments totaled \$33,000 and \$9,000, respectively. For the three months ended September 30, 2009 these interest payments totaled \$44,000 and \$19,000, respectively. During the nine months ended September 30, 2010 these interest payments totaled \$113,000 and \$41,000, respectively. For the nine months ended September 30, 2009 these interest payments totaled \$119,000 and \$49,000, respectively.

Note 10 – Changes in Contracts; Indebtedness

On April 29, 2010, the Company entered into a Credit Agreement with Harris N.A. (“Harris”) replacing and paying off the Company’s credit line with RBS Citizens N.A. (formerly Charter One Bank). Under the Credit Agreement, Harris agreed to provide loans and credits to the Company in the aggregate maximum amount of \$14,417,000. The arrangement includes:

- A revolving credit up to a maximum amount of \$9,000,000 based upon a borrowing base of 85% of eligible
- i. receivables and 60% of eligible inventory (up to a maximum of \$5,000,000);
 - ii. A mortgage loan in the principal amount of \$2,333,350, amortized over 25 years, the principal balance due on April 29, 2013;
 - iii. A term loan in the principal amount of \$583,333 maturing in monthly principal installments of \$58,333; and
An equipment loan commitment in the amount of up to \$2,500,000 providing for loan advances from time to time
 - iv. until April 29, 2011 based upon 100% of the purchase price of equipment purchased, the loans to be amortized on a five year basis commencing April 29, 2011, the balance due on April 29, 2013.

The Credit Agreement includes various representations, warranties and covenants of the Company.

In connection with the Credit Agreement, the Company executed and delivered to Harris, a Term Loan Note, a Mortgage Loan Note, an Equipment Note and a Revolving Note, as well as a form of Mortgage, Security Agreement, Pledge Agreement (pursuant to which shares of capital stock of the Registrant's Mexico subsidiary were pledged as security for the loans), Patent Security Agreement and Trademark Security Agreement. Two officers and principal shareholders of the Company, John H. Schwan and Stephen M. Merrick each executed Limited Guaranties of the loans and also executed Subordination Agreements with respect to obligations of the Company to them.

On April 29, 2010, Harris advanced a total of \$11,963,518 under these loans on behalf of the Company for the pay-off of all outstanding loan and lease financing balances of the Company to RBS Citizens N.A. and RBS Asset Finance.

Under the terms of the Credit Agreement, in order to obtain advances under the revolving line of credit and the equipment loan, the Company is required to meet various financial covenants including a senior leverage ratio, fixed charge coverage ratio and tangible net worth. As of September 30, 2010, we were in compliance with these covenants.

The Credit Agreement provides that the outstanding balance of all loans under the agreement will bear interest with reference to a base rate or, at the option of the Company, with reference to an adjusted LIBOR. At September 30, 2010, the effective rate on the outstanding loan balances was 4.0%.

FORWARD-LOOKING STATEMENTS

This quarterly report includes both historical and “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current expectations and projections about future results. Words such as “may,” “should,” “could,” “would,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” “continue,” or similar words are intended to identify forward-looking statements, although not all forward-looking statements contain these words. Although we believe that our opinions and expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements, and our actual results may differ substantially from the views and expectations set forth in this quarterly report on Form 10-Q. We disclaim any intent or obligation to update any forward-looking statements after the date of this quarterly report to conform such statements to actual results or to changes in our opinions or expectations.

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

Overview. We produce film products for novelty, packaging and container applications. These products include metalized balloons, latex balloons and related latex toy products, films for packaging and custom product applications, and flexible containers for packaging and consumer storage applications. We produce all of our film products for packaging and container applications at our plant in Lake 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 and custom product applications are sold to customers in the United States. We market and sell our novelty items and flexible containers for consumer use in the United States, Mexico, Latin America, and Europe.

Results of Operations

Net Sales. For the three months ended September 30, 2010, net sales were \$10,962,000 compared to net sales of \$10,175,000 for the same period of 2009, an increase of 7.7%. For the quarters ended September 30, 2010 and 2009, net sales by product category were as follows:

| Product Category | Three Months Ended | | | |
|--------------------|--------------------|-------------|--------------------|-------------|
| | September 30, 2010 | | September 30, 2009 | |
| | \$ | % of | \$ | % of |
| | (000) Omitted | Net Sales | (000) Omitted | Net Sales |
| Metalized Balloons | 4,204 | 38% | 3,573 | 35% |
| Film Products | 2,538 | 23% | 1,945 | 19% |
| Pouches | 1,431 | 13% | 2,337 | 23% |
| Latex Balloons | 2,523 | 23% | 2,150 | 21% |
| Helium/Other | 266 | 3% | 170 | 2% |
| Total | 10,962 | 100% | 10,175 | 100% |

Net Sales. For the nine months ended September 30, 2010, net sales were \$36,337,000 compared to net sales of \$30,558,000 for the same period of 2009, an increase of 18.9%. For the nine months ended September 30, 2010 and 2009, net sales by product category were as follows:

| Product Category | Nine Months Ended | | | |
|--------------------|--------------------|-------------|--------------------|-------------|
| | September 30, 2010 | | September 30, 2009 | |
| | \$ | % of | \$ | % of |
| | (000) Omitted | Net Sales | (000) Omitted | Net Sales |
| Metalized Balloons | 16,370 | 45% | 14,359 | 47% |
| Film Products | 5,811 | 16% | 5,464 | 18% |
| Pouches | 6,697 | 19% | 4,899 | 16% |
| Latex Balloons | 6,668 | 18% | 5,346 | 17% |
| Helium/Other | 791 | 2% | 490 | 2% |
| Total | 36,337 | 100% | 30,558 | 100% |

Metalized Balloons. During the three months ended September 30, 2010 revenues from the sale of metalized balloons increased by 17.7% compared to the prior year period from \$3,573,000 to \$4,204,000. During the nine months ended September 30, 2010 revenues from the sale of metalized balloons increased by 14.0% compared to the prior year period from \$14,359,000 to \$16,370,000. These increases are attributable to increased sales to a principal balloon customer, as well as to other customers in the United States and in international markets.

Films. During the three months ended September 30, 2010 revenues from the sale of laminated film products increased by 30.5% compared to the prior year period from \$1,945,000 to \$2,538,000. During the second quarter, we began deliveries of a new film product to a medical device supplier. During the nine months ended September 30, 2010 revenues from the sale of laminated film products increased by 6.4% compared to the prior year period from \$5,464,000 to \$5,811,000. The increase was the result principally, of increased sales to a principal film customer.

Pouches. During the three months ended September 30, 2010 revenues from the sale of pouches decreased by 38.8% compared to the prior year period, from \$2,337,000 to \$1,431,000. The decrease during the three months ended September 30, 2010 is attributable to decreased sales to a principal customer during the quarter. During the nine months ended September 30, 2010 revenues from the sale of pouches increased by 36.7% compared to the prior year period, from \$4,899,000 to \$6,697,000. The increase is attributable to (i) increase sales to a principal pouch customer, (ii) increases in international sales of our ZipVac product line and (iii) sales of our Universal bag to a new customer.

Latex Balloons. During the three months ended September 30, 2010 revenues from the sale of latex balloons increased by 17.3% compared to the prior year period from \$2,150,000 to \$2,523,000. During the nine months ended September 30, 2010 revenues from the sale of latex balloons increased by 24.7% compared to the prior year period from \$5,346,000 to \$6,668,000. The increase is attributable to increased sales in Mexico by Flexo Universal, our subsidiary there, as well as increased sales to various customers in the United States.

Sales to a limited number of customers continue to represent a large percentage of our net sales. The table below illustrates the impact on sales of our top three and ten customers for the three and nine months ended September 30, 2010 and 2009.

| | Three Months Ended % of Net Sales | | Nine Months Ended % of Net Sales | |
|------------------|--------------------------------------|-----------------------|-------------------------------------|-----------------------|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Top 3 Customers | 48.5% | 49.2% | 53.5% | 52.7% |
| Top 10 Customers | 67.7% | 65.6% | 70.1% | 68.6% |

During the three months ended September 30, 2010, there were two customers whose purchases represented more than 10% of the Company's consolidated net sales. The sales to each of these customers for the three months ended September 30, 2010 were \$2,347,000 or 21.4% and \$2,250,000 or 20.5% of consolidated net sales, respectively. Sales to the top three customers in the same period of 2009 were \$1,792,000 or 17.6%, \$1,533,000 or 15.1% and \$1,676,000 or 16.5% of consolidated net sales, respectively. During the nine months ended September 30, 2010, there were three customers whose purchases represented more than 10% of the Company's consolidated net sales. The sales to each of these customers for the nine months ended September 30, 2010 were \$9,573,000 or 26.3%, \$5,305,000 or 14.6%, and \$4,575,000 or 12.6% of consolidated net sales, respectively. Sales to these customers in the same period of 2009 were \$7,941,000 or 26.0%, \$5,042,000 or 16.5%, and \$3,117,000 or 10.2% of consolidated net sales, respectively. As of September 30, 2010, the total amount owed to the Company by these customers was \$1,750,000 or 23.1%, \$1,256,000 or 16.6%, and \$288,000 or 3.8% of the Company's consolidated accounts receivables. The amounts owed at September 30, 2009 were \$935,000, or 14.8%, \$1,046,000, or 16.5%, and \$906,000 or 14.3% of the Company's consolidated net accounts receivables, respectively.

Cost of Sales. During the three months ended September 30, 2010, the cost of sales represented 79.5% of net sales compared to 78.6% for the three months ended September 30, 2009. During the nine months ended September 30, 2010, the cost of sales represented 77.5% of net sales compared to 77.6% for the nine months ended September 30, 2009. During the three and nine months ended September 30, 2010, cost of sales were affected by (i) a reduction in the unit cost of production overhead arising from increased unit production, (ii) shifts in the mix of products sold and (iii) increases in raw materials cost including film, resin and latex.

General and Administrative. During the three months ended September 30, 2010, general and administrative expenses were \$1,239,000 or 11.3% of net sales, compared to \$1,047,000 or 10.3% of net sales for the same period in 2009. During the nine months ended September 30, 2010, general and administrative expenses were \$3,808,000 or 10.5% of net sales, compared to \$3,387,000 or 11.1% of net sales for the same period in 2009. The increase in general and administrative expenses compared to the corresponding period of 2009, is attributable to (i) an increase in administrative salaries of \$214,000 (ii) an increase in corporate legal expense of \$132,000 and (iii) administrative expenses of \$112,000 incurred at our Europe subsidiary.

Selling. During the three months ended September 30, 2010, selling expenses were \$113,000 or 1.0% of net sales, compared to \$221,000 or 2.2% of net sales for the same period in 2009. During the nine months ended September 30, 2010, selling expenses were \$671,000 or 1.8% of net sales, compared to \$602,000 or 2.0% of net sales for the same period in 2009. The increase in selling expenses compared to the corresponding period of 2009, is attributable to (i) an increase in royalties expense of \$38,000, and (ii) selling expenses of \$30,000 incurred in our Europe subsidiary.

Advertising and Marketing. During the three months ended September 30, 2010, advertising and marketing expenses were \$389,000 or 3.5% of net sales for the period, compared to \$404,000 or 4.0% of net sales for the same period of 2009. During the nine months ended September 30, 2010, advertising and marketing expenses were \$1,330,000 or 3.7% of net sales for the period, compared to \$1,213,000 or 4.0% of net sales for the same period of 2009. The increase in advertising and marketing expense is attributable to (i) increased compensation expense of \$57,000 and (ii) servicing fees for in-store servicing of balloon inventories in two retail accounts.

Other Income (Expense). During the three months ended September 30, 2010, the Company incurred net interest expense of \$159,000, compared to net interest expense during the same period of 2009 in the amount of \$257,000. During the nine months ended September 30, 2010, the Company incurred net interest expense of \$700,000, compared to net interest expense during the same period of 2009 in the amount of \$825,000. The decline in interest expense is attributable to lower applicable interest rates and reduced loan balance.

For the three months ended September 30, 2010, the Company had a foreign currency transaction loss of \$3,000 compared to a foreign currency transaction gain of \$13,000 during the same period of 2009. For the nine months ended September 30, 2010, the Company had a foreign currency transaction loss of \$37,000 compared to a foreign currency transaction loss of \$6,000 during the same period of 2009.

Income Taxes. For the three months ended September 30, 2010, the Company reported a consolidated income tax expense of \$113,000, compared to a consolidated income tax expense of \$56,000 for the same period of 2009. For the nine months ended September 30, 2010, the Company reported a consolidated income tax expense of \$208,000, compared to a consolidated income tax expense of \$102,000 for the same period of 2009. For the three and nine months ended September 30, 2010, this income tax provision was composed of provisions for income tax on the income of Flexo Universal, our Mexican subsidiary, CTI Europe gmbH, our German subsidiary, and CTI Balloons Limited, our United Kingdom subsidiary. The Company did not recognize any income tax expense in the United States for the three and nine months ended September 30, 2010, or for the same period of 2009 by reason of its net operating loss carryforward and reversals to the Company's valuation reserve against its deferred tax asset account.

As of September 30, 2010, the amount of the Company's valuation allowance with respect to its deferred tax asset has been reduced to \$72,000. During the past four years, the amount of book income tax expense which would have been realized by reason of net income of the Company in quarterly and annual periods has been offset by reductions in the valuation allowance against the Company's deferred tax assets, primarily operating loss carryforwards. By reason of the reduction of valuation allowance, in future periods in which the Company realizes net income, the book tax expense realized by the Company will not be fully offset by a reduction in the valuation allowance and the Company will be required to record book tax expense, which will affect net income of the Company. As of September 30, 2010, the net operating loss carryforward balance of the Company is \$3,210,000 so the Company will not be subject to income tax on income to such amount, but the Company will be required to record income tax expense in its statement of operations.

Net Income. For the three months ended September 30, 2010, the Company had net income of \$243,000 or \$0.08 per share (basic and diluted), compared to net income of \$205,000 for the same period of 2009 or \$0.07 per share (basic and diluted). For the nine months ended September 30, 2010, the Company had net income of \$1,449,000 or \$0.49 per share (basic and diluted), compared to net income of \$707,000 for the same period of 2009 or \$0.25 per share (basic and diluted).

Financial Condition, Liquidity and Capital Resources

Cash Flow Items.

Operating Activities. During the nine months ended September 30, 2010, net cash provided by operations was \$2,924,000, compared to net cash used in operations during the nine months ended September 30, 2009 of \$2,909,000.

Significant changes in working capital items during the nine months ended September 30, 2010 consisted of (i) an increase in accounts receivable of \$137,000, (ii) an increase in inventories of \$791,000, (iii) depreciation and amortization in the amount of \$1,561,000, (iv) an increase in trade payables of \$256,000, (v) an increase in accrued liabilities of \$298,000, and (vi) an increase of \$79,000 in prepaid expenses and other assets.

Investing Activity. During the nine months ended September 30, 2010, cash used in investing activity for the purchase or improvement of equipment was \$848,000, compared to \$595,000 in the same period of 2009.

Financing Activities. During the nine months ended September 30, 2010, cash used in financing activities was \$2,272,000 compared to cash provided by financing activities for the same period of 2009 in the amount of \$2,148,000. During the nine months ended September 30, 2010, financing activities included payment of \$1,492,000 on long-term debt obligations.

Also, on a non-cash basis, subordinated indebtedness in the aggregate amount of \$1,027,000 was paid through the exercise of warrants to purchase an aggregate of 293,030 shares of common stock of the Company.

Liquidity and Capital Resources. At September 30, 2010, the Company had cash balances of \$682,000 compared to cash balances of \$366,000 for the same period in 2009.

At September 30, 2010, the Company had a working capital balance of \$4,092,000 compared to a working capital balance of \$2,408,000 at December 31, 2009.

The Company's liquidity is dependent significantly on its bank financing and the Company relies on its revolving line of credit to maintain liquidity. On April 29, 2010, the Company entered into a Credit Agreement with Harris N.A. ("Harris") replacing and paying off the Company's credit line with RBS Citizens N.A. (formerly Charter One Bank). Under the Credit Agreement, Harris agreed to provide loans and credits to the Company in the aggregate maximum amount of \$14,417,000. The arrangement includes:

- i. A revolving credit up to a maximum amount of \$9,000,000 based upon a borrowing base of 85% of eligible receivables and 60% of eligible inventory (up to a maximum of \$5,000,000);
- ii. A mortgage loan in the principal amount of \$2,333,350, amortized over 25 years, the principal balance due on April 29, 2013;
- iii. A term loan in the principal amount of \$583,333 maturing in monthly principal installments of \$58,333; and
- iv. An equipment loan commitment in the amount of up to \$2,500,000 providing for loan advances from time to time until April 29, 2011 based upon 100% of the purchase price of equipment purchased, the loans to be amortized on a five year basis commencing April 29, 2011, the balance due on April 29, 2013.

The Credit Agreement includes various representations, warranties and covenants of the Company, including various financial covenants.

In connection with the Credit Agreement, the Company executed and delivered to Harris, a Term Loan Note, a Mortgage Loan Note, an Equipment Note and a Revolving Note, as well as a form of Mortgage, Security Agreement, Pledge Agreement (pursuant to which shares of capital stock of the Registrant's Mexico subsidiary were pledged as security for the loans), Patent Security Agreement and Trademark Security Agreement. Two officers and principal shareholders of the Company, John H. Schwan and Stephen M. Merrick each executed Limited Guaranties of the loans and also executed Subordination Agreements with respect to obligations of the Company to them.

On April 29, 2010, Harris advanced a total of \$11,963,518 under these loans on behalf of the Company for the pay-off of all outstanding loan and lease financing balances of the Company to RBS Citizens N.A. and RBS Asset Finance.

Under the terms of the Credit Agreement, in order to obtain advances under the revolving line of credit and the equipment loan, the Company is required to meet various financial covenants including a senior leverage ratio, fixed charge coverage ratio and tangible net worth. As of September 30, 2010, we were in compliance with these covenants.

The Credit Agreement provides that the outstanding balance of all loans under the agreement will bear interest with reference to a base rate or, at the option of the Company, with reference to an adjusted LIBOR. At September 30, 2010, the effective rate on the outstanding loan balances was 4.0%.

Under the prior loan agreement with RBS Citizens N.A., we maintained swap agreements with respect to \$6,780,000 of our loan balances with RBS Citizens. These swap agreements were designated as a cash flow hedge to hedge the Company's exposure to interest rate fluctuations on the Company's floating rate loans. These swap arrangements were derivative financial instruments with respect to which we determined and recorded the fair market value each quarter. We recorded the fair market value of these contracts in the balance sheet, with an offset to other comprehensive loss. On April 29, 2010, at the time of the closing of the Credit Agreement with Harris, these swap agreements were terminated, and we paid to the counterparty under the agreements the then fair market value of the swap agreements which was \$146,000. As of September 30, 2010, the Company does not maintain any swap agreements with respect to its outstanding loans.

Seasonality

In recent years, sales in the metalized balloon product line have historically been seasonal with approximately 45% occurring in the period from December through March and 21% being generated in the period from July through October. The sale of latex balloons and laminated film products have not historically been seasonal.

Critical Accounting Policies

Please see pages 22-24 of our Annual Report on Form 10-K for the year ended December 31, 2009 for a description of policies that are critical to our business operations and the understanding of our results of operations. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. No material changes to such information have occurred during the three and nine months ended September 30, 2010.

New Accounting Pronouncements

See "New Accounting Pronouncements" in Note 1 to the Notes to Unaudited Condensed Consolidated Financial Statements which is here incorporated by reference.

Item 3. Quantitative and Qualitative Disclosures Regarding Market Risk

Not applicable.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures:

Our Principal Executive Officer and Principal Financial Officer have reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures as of September 30, 2010. Based on such review and evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were adequate and effective to ensure that the information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 (a) is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms and (b) is accumulated and communicated to the Company's management, including the officers, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls Over Financial Reporting

There have been no changes in our internal controls over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the most recent fiscal quarter covered by the report, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 1A. Risk Factors

Not applicable.

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

On February 1, 2006, John H. Schwan and Stephen M. Merrick, directors and officers of the Company, each loaned the sum of \$500,000 to the Company 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 of the Company on the day immediately preceding the date of the transaction.

On April 3, 2007, John H. Schwan assigned and transferred warrants to purchase up to 50,000 shares of common stock to Howard W. Schwan, an officer and director of the Company.

On October 1, 2008, the Company issued warrants to purchase 20,000 shares of common stock of the Company to both John H. Schwan and Stephen M. Merrick exercisable at the price of \$4.80 per share in consideration of the personal guarantees by each of them of up to \$2 million in principal amount of the bank debt of the Company.

On May 28, 2010, John H. Schwan (with respect to 101,515 shares of common stock of the Company at the price of \$3.30 per share and 20,000 shares of common stock of the Company at the price of \$4.80 per share) and Stephen M. Merrick (with respect to 151,515 shares of common stock of the Company at the price of \$3.30 per share and 20,000 shares of common stock of the Company at the price of \$4.80 per share) exercised such warrants in consideration of the cancellation of indebtedness to them of the Company in the amount of such exercise price.

On June 25, 2010, Howard W. Schwan exercised warrants to purchase 50,000 shares of common stock of the Company at the price of \$3.30 per share in consideration of the transfer to the Company and cancellation of 22,971 shares of common stock of the Company having a market value in the amount of such purchase price.

Each of the foregoing transactions involved the sale of securities by 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.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

Reference made to the Company's Report on Form 8-K dated June 8, 2010.

Item 5. Other Information

The Certifications of the Chief Executive Officer and the Chief Financial Officer of Registrant Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 are attached as Exhibits to this Report on Form 10-Q.

Item 6. Exhibits

The following are being filed as exhibits to this report: *

26

| Exhibit Number | Description |
|----------------|--|
| 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 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) |
| 10.1 | Credit Agreement between Harris N.A. and CTI Industries Corporation dated April 29, 2010 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 10-Q dated May 14, 2010) |
| 10.2 | Mortgage and Security Agreement between Harris N.A. and the Company dated April 29, 2010 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 10-Q dated May 14, 2010) |
| 10.3 | Security Agreement between Harris N.A. and the Company dated April 29, 2010 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 10-Q dated May 14, 2010) |
| 10.4 | Pledge Agreement between Harris N.A. and the Company dated April 29, 2010 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 10-Q dated May 14, 2010) |
| 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). |

* Also incorporated by reference the Exhibits filed as part of the SB-2 Registration Statement of the Registrant, effective November 5, 1997, and subsequent periodic filings.

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.

Dated: November 15, 2010

CTI INDUSTRIES CORPORATION

By: /s/ Howard W. Schwan
Howard W. Schwan, President and
Chief Executive Officer

By: /s/ Stephen M. Merrick
Stephen M. Merrick
Executive Vice President and
Chief Financial Officer

Exhibit Index

| Exhibit Number | Description |
|----------------|--|
| 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 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) |
| 10.1 | Credit Agreement between Harris N.A. and CTI Industries Corporation dated April 29, 2010 (Incorporated by reference to Exhibit contained in Registrant’s Report on Form 10-Q dated May 14, 2010) |
| 10.2 | Mortgage and Security Agreement between Harris N.A. and the Company dated April 29, 2010 (Incorporated by reference to Exhibit contained in Registrant’s Report on Form 10-Q dated May 14, 2010) |
| 10.3 | Security Agreement between Harris N.A. and the Company dated April 29, 2010 (Incorporated by reference to Exhibit contained in Registrant’s Report on Form 10-Q dated May 14, 2010) |
| 10.4 | Pledge Agreement between Harris N.A. and the Company dated April 29, 2010 (Incorporated by reference to Exhibit contained in Registrant’s Report on Form 10-Q dated May 14, 2010) |
| 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). |