Siena Market Line
4th week of March 2015

Orchids Paper Products Company

Amex: TIS

Analyst: Matthew Darcy
Sector: Consumer Staples

BUY

Price Target: $49.10

Key Statistics as of 3/12/2015

Market Price:	$26.57
Industry:	Household Products
Market Cap:	$232.7 M
52-Week Range:	$22.76-32.75
Beta:	.591

Thesis Points:

- Profit margins are projected to expand
- Historic multiple valuation suggests the stock is undervalued.
- The current price of this stock is unjustifiably low
- A Monte Carlo simulation shows no downside risk

Company Description:

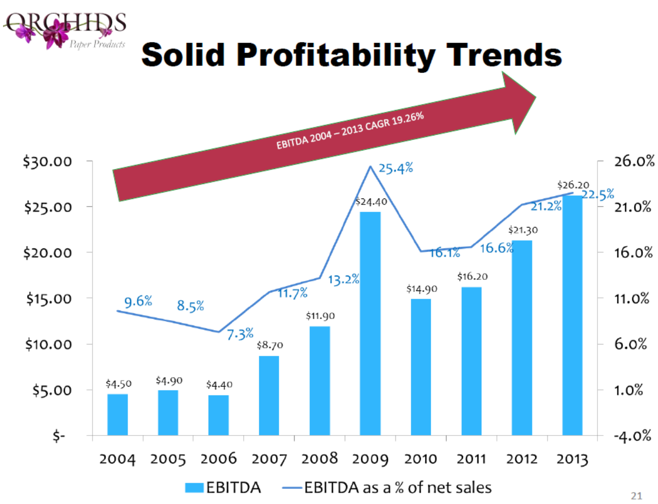
Orchids Paper Products Company manufactures and sells tissue products, in the United States. These products include paper towels, toilet paper, and paper napkins. The company offers its products under Colortex, My Size, Velvet, Big Mopper, Linen Soft, Soft & Fluffy, and Tackle brands. After a recent acquisition of Fabrica de Papel San Francisco, the company now uses the brand names Virtue, Truly Green, Golden Gate Paper, and Big Quality. The products are considered the bargain brand. It also sells parent rolls, which are essentially a work in progress inventory, to other companies that converter these rolls to a finished product. The company claims there are significant barriers to entry for this industry, especially due to capital expenditures. The company sells to discount retailers, grocery stores, grocery wholesalers and cooperatives, convenience stores, janitorial supply stores, and stores in the food service market. Orchids Paper Products Company was founded in 1976 and is headquartered in Pryor, Oklahoma. The company is funded with 13% debt, and the stock has a 5.26% dividend yield.

Thesis

This company may not be the most exciting company on the American Exchange. However, the company is projecting expansion of its margins. More importantly, its stock is worth way more than its current price. The comparison between this stock's past and current valuation multiples, as well as the fundamental valuation of the stock price, show that this company is significantly undervalued. Using a Monte Carlo simulation, this stock has a minimum target price greater than its current price, which suggests there is no downside risk. All of these methods point to a BUY for Orchid Paper Products Company.

Margin Expansion

Orchid has seen a significant amount of margin expansion through 2013, and has plans to continue this trend. Shown below, the company's EBITDA margins have increased from 16% in 2010, to 22.5% in 2013.



The company has Capital Expenditures of about $30 million in the past year, which has been invested in new machinery. Right now the company is in the process of switching their machines over. While the new machinery was being installed, the old equipment had to be demolished. These machines produce parent rolls, which are a form of work in progress inventory. This meant the company would have to purchase some of the parent rolls, to make up for its lack of production, which lead to a decrease in 2014 EBITDA margins, to 18.2%.

Once these machines are fully installed, however, the company's margins will be able to expand again.
In 2013, the company also had to purchase these parent rolls, in order to keep up with demand. The instalment of the new machinery will allow the company to produce for higher levels of demand.

Historical Relative Valuation

Historically, Orchid has been trading at a value that gives the company a P/E that is 2% higher than its competitors, and a P/BV that is 8% higher than competitors. These multiples are currently 11% and 8% lower than current competitor multiples, respectively. This suggests that the company is currently undervalued, because the company is trading at a discount to its competitors, when it usually trades at a premium. The same has happened with the companies implied enterprise value. The current multiples at which the company is trading, show that the company is trading at a discount compared to the past 2 years.

Current vs 2Yr Average Historical Premium

Metric	Current	Hist Avg	Diff	# SD
Current Price				
1) NTM P/E	-11%	2%	-13%	-1.7
2) NTM EV/EBITDA	-27%	-22% *	-6%	-0.8
3) NTM EV/EBIT	N.A.	N.A.	N.A.	N.A.
4) NTM EV/Rev	-11%	7%	-18%	-1.5
5) LF P/BV	-8%	8%	-16%	-1.9

Proforma Valuation

Using extremely conservative valuation assumptions, this stock has an intrinsic value of $44.30, well above the current price of $26.57. Even though this company has some potential risks, there is no justifiable way to value this stock at the market price. More detail on the key assumptions used can be found in the proforma shown below.

A Monte Carlo Simulation shows that the value of this company was most sensitive to revenue. So the question is. 'What assumptions for revenue give this stock a value near $26.57?'

The value of the stock will not be reduced to its current market price, unless the company's revenue remains constant, through 2018. Alternatively, the revenue growth must be stunted, at only 2%, for the next seven years. This is a completely unjustifiable assumption, because there is no data to suggest the possibility of such a poor performance.

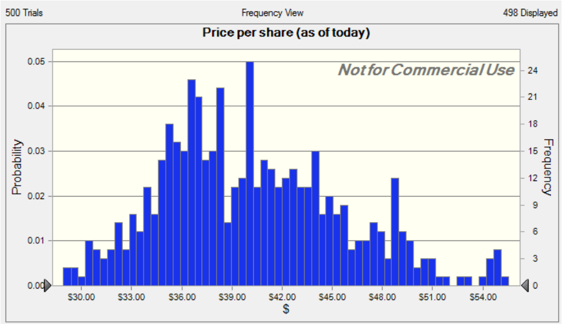
The assumption that causes the most variation in the value of this stock, second to revenue, is the assumption for operating margin. So the same question was raised for operating costs.

When the long term operating margin is reduced to a mere 10% from its current level of 18.2%, the stock becomes fairly valued. But this is another unjustifiable assumption. Remember that 2014 was a particularly bad year for Orchid, and the margins are actually projected to expand further, in future years. This means it is actually conservative, to value the company using its current margin. It is just too pessimistic to use a 10% margin; there is no way to justify such a large increase in operating costs to revenue.

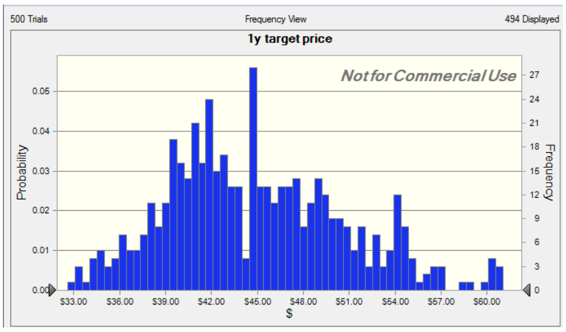
Limited Downside

When a Monte Carlo simulation is run on the valuation of this stock, the minimum intrinsic value is $28.93, and the minimum one year target is $32.65. This means, even with the most pessimistic concoction of inputs that excel could produce for this company (within a reasonable deviation from the key assumptions) Orchid still will produce a positive return of 28%. This is including the 5.26% dividend yield. The full output of this simulation can be seen in the column to the right.

This company's current price is so much lower than the stocks intrinsic value, that it has relatively no downside risk. That being said, the stock has been as low as $22.76 within the last 52 weeks. So this can also be viewed as the stock's downside. In this event, the loss would only be 9.08%.



Statistic	Forecast values
Trials	500
Base Case	$42.25
Mean	$40.23
Median	$39.68
Mode	---
Standard Deviation	$5.46
Variance	$29.80
Skewness	0.5371
Kurtosis	3.01
Coeff. of Variation	0.1357
Minimum	$28.93
Maximum	$59.79
Mean Std. Error	$0.24



Statistic	Forecast values
Trials	500
Base Case	$46.98
Mean	$44.97
Median	$44.50
Mode	---
Standard Deviation	$5.90
Variance	$34.81
Skewness	0.5240
Kurtosis	2.99
Coeff. of Variation	0.1312
Minimum	$32.65
Maximum	$65.78
Mean Std. Error	$0.26

Potential Threats

This stock had seen a major price dip in august through September last year. The reason for this dip was a potential merger between Dollar General and Family Dollar. These are 2 of Orchids largest customers. The newly created company would account for around 60% of Orchids revenue, giving the new company an extreme amount of bargaining power over Orchid. This merger however, did not materialize, and the price began to recover. With the acquisition of Fabrica de Papel, Orchid took on another new customer, HEB which now accounts for 12% of revenue. Walmart is also contributing the strong costumer bargaining power, supplying 9% of Orchids revenue.

It is very unlikely for this threat to materialize ever, because family dollar is now being acquired by dollar tree. The acquisition will be completed on April 30th. There are no other large customers of Orchid that will benefit from a merger. The new threat to consider is that family dollar will begin using dollar tree's suppliers, instead of Orchid.

This would result in a reduction of the growth in revenue for year 2015 by 11%. After making this adjustment to the proforma, the fair value of this stock is still $38.70, with a one year price target of $42.80. It is also important to remember that this is an unlikely event, because family dollar will most likely keep their same suppliers. It is also possible that dollar tree take on orchid as a supplier, for their stores.

It is possible that when potential investors see this threat, the immediately move on to look at another company. It is important to remember, though, that when buying a stock, that the stock has a value. If there are future cash flows, then there is a value. Yes, this company has risks, but the potential return on its stock is more than enough to compensate for that risk.

Summary

When an investor sits down to find a stock, they often do not look towards consumer staples as a big payoff. This is even more correct for company's selling toilet paper. Often times, it is the unexpected, overlooked companies that can be purchased at the deepest discounts. When deciding whether to a purchase a stock, the most important consideration is what the value of the future cash flows is today. The value of the stock of Orchid Paper Products Company is $49.10, and there is a chance to buy it today at $26.57. The fact of the matter is, this stock is simply too cheap to justify. The company has decent income prospects, and barely any claims against operating assets. There is truly no reason it should be trading at such a low price. That is why Orchid is a BUY.

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Orchids Paper Products Company	tis	Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield	Target Return	BULLISH
		Matthew Darcy	$26.68	$44.33	$49.14	5%	89.45%	

General Info

Sector	Consumer Staples
Industry	Household Products
Last Guidance	Oct-29-2014
Next earnings date	NM

Market Data

Enterprise value	$270.04
Market Capitalization	$232.99
Daily volume	0.01
Shares outstanding	8.76
Diluted shares outstanding	8.54
% shares held by institutions	38.90%
% shares held by insiders	6.50%
Short interest	3.58%
Days to cover short interest	10.99
52 week high	$32.75
52-week low	$22.76
5y Beta	0.42
6-month volatility	32.27%

Peers	Market Cap.
Wausau Paper Corp.	$463.52
Clearwater Paper Corporation	$1,234.66
Cascades, Inc.	$673.67
The Procter & Gamble Company	$224,169.34
Kimberly - Clark de Mexico S.A.B. de C.V.	$93,003.72

Current Capital Structure

Total debt/market cap	14.10%
Cost of Borrowing	1.97%
Interest Coverage	5860.89%
Altman Z	3.57
Debt Rating	A
Levered Beta	0.57
WACC (based on market value weights)	5.26%

Management

Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014
Schoen, Jeffrey	Chief Executive Officer, Presiden	$ 79,433.00	$ 240,227.00	$ 2,471,363.00
Schroeder, Keith	Chief Financial Officer and Secret	$ 390,056.00	$ 393,078.00	$ 468,728.00
Daniels, Dan	Vice President of Sales & Marketi	$ -	$ -	$ -
Keller, William	National Sales Director	$ -	$ -	$ -
Harper, Lonnie	Director of Engineering & Reliab	$ -	$ -	$ -

Historical Performance

	tis	Peers	Industry	All U.S. firms
Growth	14.0%	5.3%	4.7%	6.0%
Retention Ratio	27.8%	27.0%	32.0%	61.6%
ROIC	74.1%	4.5%	12.1%	11.8%
EBITA Margin	9.8%	19.8%	13.5%	13.7%
Revenues/Invested capital	122.0%	83.2%	147.4%	202.3%
Excess Cash/Revenue	0.7%	6.8%	9.3%	18.5%
Unlevered Beta	0.42	0.86	0.53	0.95
TEV/REV	1.5x	2.8x	1.9x	2.4x
TEV/EBITDA	9.4x	12.6x	10.2x	11.3x
TEV/EBITA	14.7x	14.9x	12.7x	15.4x
TEV/UFCF	14.2x	14.6x	21.1x	26.8x

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS
Last Quarter	-1.1%	-24.6%	-24.4%
Last Quarter-1	16.5%	11.4%	8.9%
Last Quarter -2	-7.3%	-30.6%	-53.8%
Last Quarter -3	-5.7%	-11.4%	-22.0%
Last Quarter -4	3.0%	-2.7%	6.7%

Non GAAP Adjustments

Operating Leases Capitalization	100%	Straightline	10 years
R&D Exp. Capitalization	100%	Straightline	10 years
Expl./Drilling Exp. Capitalization	0%	N/A	N/A
SG&A Capitalization	0%	N/A	N/A

Proforma Assumptions

Operating. Cash/Cash	0.0%
Unlevered Beta	0.50
Rev/Invested Capital	93.0%
Continuing Period Revenue Growth	3.0%
Long Term ROIC	20.4%
Invested Capital Growth	Equals to Maintenance
Justified TEV/REV	1.5x
Justified TEV/EBITDA	9.4x
Justified TEV/EBITA	14.1x
Justified TEV/UFCF	14.2x

Forecasted Profitability

Period	Rev. Growth	Adj. Op. Cost/Rev	Revenue	NOPLAT	Invested capital	UFCF
LTM	23%	81%	$142.72	$7.56	$152.86	$7.56
LTM+1Y	18%	79%	$168.58	$12.68	$161.22	$4.31
LTM+2Y	7%	79%	$180.94	$15.46	$163.33	$13.35
LTM+3Y	5%	78%	$190.20	$17.01	$165.15	$15.19
LTM+4Y	7%	78%	$203.85	$18.75	$167.16	$16.74
LTM+5Y	6%	78%	$216.82	$20.21	$169.03	$18.33
LTM+6Y	6%	78%	$229.19	$21.35	$174.96	$15.42
LTM+7Y	5%	79%	$240.92	$22.41	$176.85	$20.53
LTM+8Y	5%	79%	$251.93	$23.37	$178.35	$21.86
LTM+9Y	4%	79%	$262.75	$24.30	$179.55	$23.10

Valuation

	ROIC	WACC	EVA	Enterprise Value	Total Debt	Other claims	Equity	Adjusted Price
LTM	4.9%	5.3%	-$0.48	$437.26	$38.07	$14.28	$384.92	$45.05
LTM+1Y	8.3%	5.4%	$4.69	$461.68	$38.07	-$2.71	$426.33	$49.92
LTM+2Y	9.6%	5.5%	$6.70	$475.24	$38.07	-$31.06	$468.24	$54.62
LTM+3Y	10.4%	5.6%	$7.97	$487.26	$38.07	-$63.29	$512.47	$59.72
LTM+4Y	11.4%	5.7%	$9.47	$498.96	$38.07	-$97.72	$558.61	$65.06
LTM+5Y	12.1%	5.8%	$10.65	$509.71	$38.07	-$135.76	$607.40	$70.89
LTM+6Y	12.6%	5.9%	$11.83	$524.16	$38.07	-$172.93	$659.02	$76.64
LTM+7Y	12.8%	6.0%	$12.10	$533.98	$38.07	-$216.89	$712.81	$82.87
LTM+8Y	13.2%	6.1%	$12.74	$543.93	$38.07	-$264.20	$770.06	$89.48
LTM+9Y	13.6%	6.2%	$13.39	$553.43	$38.07	-$314.79	$830.15	$94.78

Monte Carlo Simulation Assumptions

	Base	Stdev	Min	Max	Distribution
Revenue Variation	**0**	**10%**	**N/A**	**N/A**	**Normal**
Op. Costs Variation	**0**	**10%**	**N/A**	**N/A**	**Normal**
Market Risk Premium	**6%**	**N/A**	**5%**	**7%**	**Triangular**
Long term Growth	**3%**	**N/A**	**3%**	**14%**	**Triangular**
Terminal Value	**0**	**0.1**	**N/A**	**N/A**	**Normal**

Monte Carlo Simulation Results

	Intrinsic Value	1y-Target
Mean est.	$45.05	$49.92
σ(ε)	$0.24	$0.26
3 σ(ε) adjusted price	$44.33	$49.14
Current Price	$26.68	
Analysts' median est.		$34.33