MOD PAC CORP
Form 10-Q
August 05, 2010

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended: July 3, 2010

OR

o **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: 0-50063

MOD-PAC CORP.

(Exact Name of Registrant as Specified in its Charter)

New York	**16-0957153**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
1801 Elmwood Avenue, Buffalo, New York	**14207**
(Address of principal executive office)	*(Zip Code)*

(716) 873-0640

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 þ No o

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 o No o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o *(Do not check if a smaller reporting company)*	Smaller reporting company þ

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

The number of shares outstanding of each class of common stock as of April 3, 2010 was:

Common Stock, $0.01 par value	2,808,130 shares
Class B Common Stock, $0.01 par value	623,420 shares

MOD-PAC CORP.
QUARTERLY REPORT ON FORM 10-Q
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PART I FINANCIAL INFORMATION

Item 1. Financial Statements
MOD-PAC CORP.
CONSOLIDATED BALANCE SHEET

(dollars in thousands)	(Unaudited) **July 3, 2010**	**December 31, 2009**
Current assets:		
Cash and cash equivalents	$ 2,873	$ 3,780
Accounts receivable	5,122	4,975
Allowance for doubtful accounts	(106)	(155)
Net accounts receivable	5,016	4,820
Inventories	4,248	4,258
Prepaid expenses	618	297
Total current assets	12,755	13,155
Property, plant and equipment, at cost:		
Land	1,170	1,170
Buildings and equipment	12,406	12,389
Machinery and equipment	49,891	49,129
Construction in progress	902	990
	64,369	63,678
Less accumulated depreciation	(49,348)	(48,262)
Net property, plant and equipment	15,021	15,416
Assets held for sale	63	171
Other assets	477	459
Totals assets	**$ 28,316**	**$ 29,201**
Current liabilities:		
Current maturities of long-term debt	$ 109	$ 202
Accounts payable	1,929	2,567
Accrued expenses	591	803
Total current liabilities	2,629	3,572
Long-term debt	2,014	2,292
Other liabilities	26	38
Total liabilities	**4,669**	**5,902**

Shareholders equity:				
Common stock, $.01 par value, authorized 20,000,000 shares, issued 3,458,828 in 2010, 3,453,863 in 2009		35		35
Class B common stock, $.01 par value, authorized 5,000,000 shares, issued 623,420 in 2010, 628,385 in 2009		6		6
Additional paid-in capital		2,936		2,654
Retained earnings		26,885		26,819
		29,862		29,514
Less treasury stock at cost, 650,698 shares in 2010 and 2009		(6,215)		(6,215)
Total shareholders equity		**23,647**		**23,299**
Total liabilities and shareholders equity	**$**	**28,316**	**$**	**29,201**

See accompanying notes to financial statements

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MOD-PAC CORP.
CONSOLIDATED STATEMENT OF OPERATIONS

	(Unaudited)			
	Six Months Ended		**Three Months Ended**	
(in thousands, except per share data)	**July 3, 2010**	**July 4, 2009**	**July 3, 2010**	**July 4, 2009**
Revenue:				
Net sales	$ 23,268	$ 23,281	$ 11,384	$ 11,071
Rental income	269	258	137	142
Total revenue	23,537	23,539	11,521	11,213
Costs and expenses:				
Cost of products sold	19,768	21,663	9,547	10,756
Selling, general and administrative expenses	3,657	3,958	1,880	1,960
Write-down of impaired assets		2,175		2,175
Income (loss) from operations	112	(4,257)	94	(3,678)
Interest expense	(104)	(130)	(52)	(67)
Other income	72	11	8	22
Income (loss) before taxes	80	(4,376)	50	(3,723)
Income tax expense (benefit)	14	(120)	4	
Net income (loss)	**$ 66**	**$ (4,256)**	**$ 46**	**$ (3,723)**
Income (loss) per share:				
Basic	$ 0.02	$ (1.24)	$ 0.01	$ (1.09)
Diluted	$ 0.02	$ (1.24)	$ 0.01	$ (1.09)

See accompanying notes to financial statements

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MOD-PAC CORP.
CONSOLIDATED STATEMENT OF CASH FLOWS

	(Unaudited) Six Months Ended	
(in thousands)	**July 3, 2010**	**July 4, 2009**
Cash flows from operating activities:		
Net income (loss)	$ 66	$ (4,256)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,374	1,869
Provision for doubtful accounts	(34)	39
Stock option compensation expense	282	169
Deferred income taxes		(118)
Write-down of impaired assets		2,175
(Gain) loss on disposal of assets	(33)	24
Cash flows from changes in operating assets and liabilities:		
Accounts receivable	(162)	63
Inventories	10	120
Prepaid expenses	(321)	(164)
Other liabilities	(12)	15
Accounts payable	(638)	(417)
Accrued expenses	(212)	(1)
Net cash provided by (used in) operating activities	320	(482)
Cash flows from investing activities:		
Proceeds from the sale of assets	131	6
Change in other assets	(5)	(74)
Capital expenditures	(965)	(702)
Net cash used in investing activities	(839)	(770)
Cash flows from financing activities:		
Principal payments on long-term debt	(371)	(82)
Deferred financing fees	(17)	
Increase in line of credit		1,300
Net cash (used in) provided by financing activities	(388)	1,218
Net decrease in cash and cash equivalents	(907)	(34)

Cash and cash equivalents at beginning of year		3,780		200
Cash and cash equivalents at end of period	$	2,873	$	166

See accompanying notes to financial statements

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MOD-PAC CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
SIX MONTHS ENDED JULY 3, 2010
(unaudited)

1) Basis of Presentation

The Registrant, MOD-PAC CORP., is referred to in this Quarterly Report on Form 10-Q as MOD-PAC , the Company or in the nominative we or the possessive our.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature. The results of operations for any interim period are not necessarily indicative of results for the full year. Operating results for the six-month period ended July 3, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

The balance sheet at December 31, 2009 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted U.S. accounting principles for complete financial statements.

For further information, refer to the financial statements and footnotes thereto included in the Company s 2009 annual report on Form 10-K.

Revenue is recognized on the accrual basis, which is at the time of shipment of goods or acceptance at the United States Postal Service.

2) Recent Accounting Pronouncements

In February 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (Update) 2010-09, Subsequent Events (Topic 855) Amendments to Certain Recognition and Disclosure Requirements. Update 2010-09 removes the requirement for SEC filers to disclose the date through which an entity has evaluated subsequent events. However, the disclosure exemption does not relieve management of an SEC filer from its responsibility to evaluate subsequent events through the date on which financial statements are issued. Update 2010-09 became effective for the Company for the fourth quarter of 2009. The adoption of the provisions of the Update did not have a material impact on the Company s consolidated financial statements.

3) Product Line Net Sales

Product line net sales are as follows:

(in thousands)	**Six months ended July 3, 2010**	**Six months ended July 4, 2009**	**Three months ended July 3, 2010**	**Three months ended July 4, 2009**
Folding cartons:				
Custom folding catrons	$ 17,715	$ 16,480	$ 9,036	$ 7,989
Stock packaging	3,994	3,649	1,492	1,475
Folding cartons sub-total	21,709	20,129	10,528	9,464
Print services				
Personalized	1,559	1,633	856	860
Specialty print and direct mail		1,519		747
Print services sub-total	1,559	3,152	856	1,607

Total	$ 23,268	$ 23,281	$ 11,384	$ 11,071

In the second quarter of 2009, the Company rationalized its product lines and exited the specialty print and direct mail business.

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4) Income (Loss) Per Share
The following table sets forth the computation of income (loss) per share:

	Six months ended		Three months ended	
(in thousands, except per share data)	**July 3, 2010**	**July 4, 2009**	**July 3, 2010**	**July 4, 2009**
Net income (loss)	$ 66	$ (4,256)	$ 46	$ (3,723)
Basic income (loss) per share weighted average shares	3,432	3,430	3,432	3,430
Net effect of diluted stock options	143		143	
Diluted income (loss) per share weighted average shares	3,575	3,430	3,575	3,430
Basic income (loss) per share	$ 0.02	$ (1.24)	$ 0.01	$ (1.09)
Diluted income (loss) per share	$ 0.02	$ (1.24)	$ 0.01	$ (1.09)

5) Inventories
Inventories are stated at the lower of cost or market, cost being determined in accordance with the first-in, first-out method.
Inventories are as follows:

(in thousands)	**July 3, 2010**	**December 31, 2009**
Finished goods	$ 2,182	$ 2,788
Work in progress	272	327
Raw material	1,794	1,143
Total inventory	$ 4,248	$ 4,258

6) Income Taxes
The Company s effective tax rate for the second quarter and first six months of 2010 was 8.0% and 17.3%, respectively. Tax expense for the second quarter and first six months of 2010 related solely to federal and state minimum taxes as a result of utilization of available net operating loss carry-forwards for which a valuation allowance was recorded. The effective tax rate for the second quarter and first six months of 2009 was 0% and 2.8%, respectively. This benefit was less than the statutory income tax rate, primarily as a result of the Company recording a valuation allowance related to its net operating loss carry-forward. The valuation allowance was recorded due to the uncertainty with respect to utilizing this deferred tax asset in the future associated with the net operating loss carry-forward based on the trend of operating losses.
The Company s continuing practice is not to recognize interest and/or penalties related to income tax matters in income tax expense. As of July 3, 2010, the Company had no amounts accrued related to uncertain tax positions. The tax years 2007, 2008, and 2009 remain open to examination by the major taxing jurisdictions to which the Company is subject.
7) Stock-Based Compensation

MOD-PAC CORP. established a Stock Option Plan that authorized the issuance of 800,000 shares of Common Stock for the purpose of attracting and retaining executive officers and key employees, and to align management s interests with those of the shareholders of MOD-PAC CORP. The options must be exercised no more than ten years from the grant date and vest over up to a five-year period. The exercise price for the options is equal to the fair market value of the common stock at the date of grant.

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MOD-PAC CORP. established the Director s Stock Option Plan that authorized the issuance of 200,000 shares of Common Stock for the purpose of attracting and retaining the services of experienced and knowledgeable outside directors, and to align their interest with those of its shareholders. The options must be exercised no more than ten years from the grant date and vest after six months. The exercise price for the options is equal to the fair market value at the date of grant.

The Company uses a straight-line method of attributing the value of stock-based compensation expense, subject to minimum levels of expense, based on vesting. Stock compensation expense recognized during the period is based on the value of the portion of shared-based payment awards that is ultimately expected to vest during the period.

The fair value of stock options granted was estimated on the date of grant using the Black-Scholes option-pricing model. The weighted average fair value of the options was $4.12 and $1.08 for options granted during the six months ended July 3, 2010 and July 4, 2009, respectively. The following table provides the range of assumptions used to value stock options granted during the six months ended July 3, 2010 and July 4, 2009.

	Three Months Ended	
	July 3, 2010	July 4, 2009
Expected volatility	82%	75%
Risk-free rate	2.5%	2.0%
Expected dividends	0%	0%
Expected term (in years)	5.5	5.5

To determine expected volatility, the Company uses historical volatility based on weekly closing prices of its Common Stock since the Company s spin-off from Astronics Corporation in March 2003. The risk-free rate is based on the United States Treasury yield curve at the time of grant for the appropriate term of the options granted. Expected dividends are based on the Company s history and expectation of dividend payouts. The expected term of stock options is based on vesting schedules, expected exercise patterns and contractual terms.

A summary of the Company s stock option activity and related information for the six months ended July 3, 2010 is as follows:

(aggregate intrinsic value in thousands)	Options	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding at January 1, 2010	630,829	$ 6.77	$ 398
Options granted	20,000	6.03	
Options forfeited	(1,114)	6.76	
Options expired	(17,049)	6.22	
Outstanding at July 3, 2010	632,666	$ 6.76	$ 382
Exercisable at July 3, 2010	509,566	$ 7.16	$ 299

The aggregate intrinsic value in the preceding table represents the total pretax option holder s intrinsic value, based on the Company s closing stock price of Common Stock of $4.33 as of July 3, 2010, which would have been received by the option holders had all option holders with an exercise price less than the market price been exercised as of that date. The intrinsic value of options exercised is based on the Company s closing stock price of common stock as of the date the option is exercised. There were no options exercised in the first six months of 2010. The Company s current policy is to issue additional new shares upon exercise of stock options.

The fair value of options vested since December 31, 2009 is $27 thousand. At July 3, 2010, total compensation costs related to non-vested awards not yet recognized was $239 thousand which will be recognized over a weighted average period of 2.5 years.

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The following is a summary of weighted average exercise prices and contractual lives for outstanding and exercisable stock options as of July 3, 2010:

Exercise Price Range	Outstanding Shares	Outstanding Weighted Average Remaining Life in Years	Weighted Average Exercise Price	Exercisable Shares	Exercisable Weighted Average Remaining Life in Years	Weighted Average Exercise Price
$1.68 to $5.62	292,045	8.0	$ 3.25	223,445	7.7	$ 3.28
$6.03 to $8.44	151,370	6.0	$ 7.66	109,470	5.0	$ 8.02
$10.00 to $11.73	132,474	5.6	$ 10.79	119,874	5.5	$ 10.82
$12.41 to $15.54	56,777	3.8	$ 13.01	56,777	3.8	$ 13.01
	632,666	6.6	$ 6.76	509,566	6.1	$ 7.16

8) Capital Structure

The Company s Class B stock is fully convertible into Common stock on a one-for-one basis at no cost. During the first six months of 2010, 4,965 shares of Class B stock were converted to Common stock.

9) Information Regarding Industry Segments

The Company operates as one reporting segment. The Company s customer base is comprised of companies and individuals throughout the United States and North America and is diverse in both geographic and demographic terms. The format of the information used by the Company s President and CEO is consistent with the reporting format used in the Company s 2009 Form 10-K and other external information.

10) Financial Instruments

The Company s financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable and long-term debt. The carrying value of the Company s accounts receivable and accounts payable approximate fair value due to the short-term nature of the instruments. The recorded amounts for long-term debt approximate fair value based on current market rates of similar instruments.

11) Long-Term Debt

Long-term debt includes the following:

(in thousands)	July 3, 2010	December 31, 2009
Capital lease obligations:		
Building due in 2023; bears interest at 10%; payable monthly	$ 1,800	$ 1,800
Equipment	71	90
	1,871	1,890
Less estimated current maturities	(29)	(35)
Capital lease obligations long-term	1,842	1,855
Loans:		
Equipment loans	171	513
Other	81	91
	252	604

Less estimated current maturities		(80)		(167)
Loans long-term		172		437
Total long-term debt	$	2,014	$	2,292

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12) Assets Under Capital Leases Included in Property, Plant and Equipment

Assets under capital leases included in property, plant and equipment are summarized as follows:

(in thousands)	July 3, 2010	December 31, 2009
Land	$ 400	$ 400
Building	4,148	4,148
Equipment	89	89
	4,637	4,637
Less accumulated depreciation	(998)	(894)
Net assets under capital leases	$ 3,639	$ 3,743

13) Long-Lived Assets

Long-lived assets, including acquired identifiable intangible assets, are tested for impairment whenever events or changes in circumstances indicate that the carrying amount of those assets may not be recoverable. An impairment loss is recognized if the carrying amount of a long-lived asset or asset group is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset or asset group is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group. That assessment is based on the carrying amount of the asset or asset group at the date tested. An impairment loss is measured as the amount by which the carrying amount of a long-lived asset or asset group exceeds its fair value which is based upon estimated future discounted cash flows.

Based on this testing, no asset impairment charges were recognized in the first six months of 2010. The Company recognized asset impairment charges in the second quarter of 2009 of $2.2 million.

14) Rationalization of Product Lines

In the second quarter of 2009, the Company rationalized its product lines in order to capitalize on its growing position in the custom folding cartons product line. The Company recorded charges of approximately $2.1 million related to this rationalization in the consolidated statements of operations in June 2009.

The Company has not incurred any additional costs associated with this rationalization in the first six months of 2010 and does not expect to incur additional costs in the future. As of July 3, 2010, no accrued liabilities associated with this rationalization are recorded on the consolidated balance sheet.

15) Assets Held for Sale

As a result of the Company s rationalization of its product lines in the second quarter of 2009, the Company has presented $63 thousand in specialty print and direct mail equipment as assets as held for sale as of July 3, 2010. The presentation of assets held for sale is based on management s committed plan and related actions to sell these assets. The reported fair value of these assets held for sale is considered to be level three within the fair value hierarchy as established by ASC 820 *Fair Value Measurements* . Level three is defined as inputs for which significant valuation assumptions are unobservable in a market and therefore value is based on the best available data, some of which is internally developed and considers risk premiums that a market participant would require.

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16) Write-down of Impaired Assets

As a result of the Company s rationalization of its product lines and management s change of plans regarding the use of its Blasdell, NY facility, the Company recognized a write-down of impaired assets during the second quarter of 2009 which was included in operating income as follows:

(in thousands)

Specialty print and direct mail assets/equipment	$	1,933
Blasdell, NY facility		242
Total write-down of impaired assets	$	2,175

There were no write-downs of impaired assets included in operating income in the first six months of 2010.

17) Line of Credit

The Company has access to a $3.0 million line of credit with a commercial bank which expires June 9, 2013. Interest on the line of credit is based on LIBOR plus 2.75%, with an interest floor of 3.35%. At July 3, 2010, $0.2 million was in use through a standby letter of credit and there was no balance drawn on the line. The amount of the line of credit that was unused and available to the Company at July 3, 2010 was $2.8 million.

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

FORWARD-LOOKING STATEMENTS

Certain statements contained in this report are forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. All forward-looking statements involve risks and uncertainties. All statements contained herein that are not clearly historical in nature are forward-looking, and the word anticipate, believe, expect, estimate, project, and similar expressions are generally intended to identify forward-looking statements. Any forward looking statement contained herein, in press releases, written statements or other documents filed with the Securities and Exchange Commission, or in MOD-PAC s communications and discussions with investors and analysts in the normal course of business through meetings, webcasts, phone calls and conference calls, regarding expectations with respect to sales, earnings, cash flows, operating efficiencies, product and market channel expansions, capacity utilization and expansion, and repurchase of capital stock, are subject to known and unknown risks, uncertainties and contingencies. Many of these risks, uncertainties, and contingencies are beyond our control, and may cause actual results, performance or achievements to differ materially from anticipated results, performance or achievements. Factors that might affect such forward-looking statements include, among other things:

- Overall economic and business conditions;
- The demand for MOD-PAC s goods and services;
- Customer acceptance of the products and services MOD-PAC provides;
- Competitive factors in print and print services and folding cartons industries;
- Changes in tax requirements (including tax rate changes, new tax laws and revised tax law interpretations);
- Fluctuation in costs of natural gas supplies in Western New York State;
- The internal and external costs of compliance with laws and regulations such as Section 404 of the Sarbanes-Oxley Act of 2002; and
- Litigation against the Company.

OVERVIEW

In the first six months of 2010, we continue to focus our resources on our growing custom folding carton line. We expect that we can be more effective in sales and marketing in this product line with a more concentrated approach. Our custom folding carton customers are generally in the healthcare, confectionary, food and food service, and automotive industries, including private label manufacturers. Our expertise in this market is our ability to run, on-demand, the specific quantities required by our customers as opposed to doing long runs and creating inventory and obsolescence challenges either for our customers or ourselves. As a result, we do not require minimum print orders and are more flexible than most printers in addressing our customers needs. This capability has served extremely well for our private label customers who may have several of the same carton requirements with varying print requirements for their customers. In the second quarter of 2009, we made a strategic decision to rationalize our product lines and exit the commercial print market. As a result of the rationalization, we have begun to and expect to continue to realize significant improvement in operating performance as we had not realized the results that we had anticipated in the commercial print market.

We also plan to continue developing our stock packaging and personalized print product lines. Our stock packaging line serves primarily private confectionaries and, therefore is seasonal in nature and driven by the economy. Nonetheless, we believe that we are a leader in this market with over 4,000 customers that we serve around the world. Our personalized print product line is focused on its store, catalog and web sales. Because we provide products such as personalized dinner and cocktail napkins, small boxes for sundries at events, and other celebration type items both for the retail and corporate markets, this product line is heavily impacted by economic downturns. In personalized print where we compete with much larger companies, we have developed a strong brand as *Krepe-Kraft* among event planners and wedding coordinators. Our website, *www.partybasics.com*, has had some success, and we also provide our products to third-party webstores as well.

REVENUE

For the second quarter of 2010, total revenue was $11.5 million compared with $11.2 million in 2009, an increase of 2.7%. The custom folding carton product line sales were $9.0 million compared with $8.0 million in the second quarter of 2009. The 13.1% increase was mainly due to substantial new business with a large existing customer, and increased waste sales due to improved market conditions, offset partially by decreased business with several existing customers. Sales of the Company s stock packaging product line were $1.5 million in second quarter of 2010, up slightly from the second quarter of 2009. Personalized print sales for the second quarter of 2010 were $0.9 million, relatively unchanged from the same period in 2009. There were no specialty print and direct mail sales in the second quarter of 2010 due to the product line rationalization that took place at the end of the second quarter of 2009. Specialty print and direct mail sales were $0.7 million in the second quarter of 2009.

For the first six months of 2010, total revenue was $23.5 million, virtually unchanged from the first six months of 2009. The custom folding cartons product line sales were $17.7 million compared with $16.5 million in 2009. The increase of 7.5% was mainly due to substantial new business with a large existing customer and increased waste sales due to improved market conditions. Sales of the Company s stock packaging product line were $4.0 million, compared with $3.6 million in the prior year, an increase of 9.5% mainly due to improved general business conditions. Personalized print sales for the first six months of 2010 were $1.6 million, a decrease of 4.5% compared to the in the same period of 2009, primarily due to continued soft market conditions. There were no specialty print and direct mail sales in the first six months of 2010 due to the product line rationalization that took place at the end of the second quarter of 2009. Specialty print and direct mail sales were $1.5 million in the first six months of 2009.

EXPENSES AND MARGINS

Gross margin was 17.1% for the second quarter of 2010, an improvement from 4.1% in the second quarter of 2009. The second quarter 2010 gross margin was positively affected by decreases in material costs, labor costs, repairs and maintenance costs, utilities costs, and depreciation expense as well as higher waste sales due to an improvement in the recycled paper board market. Included in the second quarter of 2009 cost of sales, was $134 thousand in expenses related to the Company s rationalization of the specialty print and direct mail product lines in the second quarter of 2009.

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Selling, general, and administrative (SG&A) costs decreased 4.1% to $1.9 million in the second quarter of 2010 from $2.0 million during the same period in the prior year. This improvement was driven primarily by lower labor costs, offset partially by increased professional service costs and stock option expense. Included in the second quarter of 2009 SG&A, was $65 thousand in workforce reduction costs that were the result of the Company s rationalization of the specialty print and direct mail product lines in the second quarter of 2009. Also included in prior year operating expense was $2.2 million that was associated with the write-down of impaired assets in the second quarter of 2009. This impairment resulted from the Company s rationalization of the specialty print and direct mail product line in the second quarter of 2009 and the write-down of its Blasdell, NY facility to fair market value based on expected selling prices net of costs to sell.

Gross margin was 16.0% for the first six months of 2010, compared to 8.0% for the same period of 2009. The improvement from the prior year is mainly due to decreases in material costs, labor costs, repairs and maintenance costs, utilities costs and depreciation expense. Included in the second quarter of 2009 cost of sales, was $134 thousand in expenses related to the Company s rationalization of the specialty print and direct mail product lines in the second quarter of 2009.

SG&A costs decreased 7.6% to $3.7 million in the first six months of 2010 from $4.0 million during the same period in the prior year. This decrease was driven primarily by lower labor costs, slightly offset by higher stock option expense. Included in the first six months of 2009 SG&A, was $65 thousand in workforce reduction costs that were the result of the Company s rationalization of the specialty print and direct mail product lines in the second quarter of 2009. Also included in prior year operating expense was $2.2 million that was associated with the write-down of impaired assets in the second quarter of 2009. This impairment resulted from the Company s rationalization of the specialty print and direct mail product line in the second quarter of 2009 and the write-down of its Blasdell, NY facility to fair market value based on expected selling prices net of costs to sell.

TAXES

The Company s effective tax rate for the second quarter and first six months of 2010 was 8.0% and 17.3%, respectively. Tax expense for the second quarter and first six months of 2010 related solely to federal and state minimum taxes as a result of utilization of available net operating loss carry-forwards for which a valuation allowance was recorded. The effective tax rate for the second quarter and first six months of 2009 was 0% and 2.8%, respectively. This benefit was less than the statutory income tax rate, primarily as a result of the Company recording a valuation allowance related to its net operating loss carry-forward. The valuation allowance was recorded due to the uncertainty with respect to utilizing this deferred tax asset in the future associated with the net operating loss carry-forward based on the trend of operating losses.

NET INCOME/LOSS AND INCOME/LOSS PER SHARE

The net income for the second quarter of 2010 was $46 thousand, compared with a net loss of $3.7 million in the second quarter of 2009. The net income/loss was due to the fluctuations discussed above. Diluted income per share was $0.01 in the second quarter of 2010 and a loss of $1.09 in the second quarter of 2009.

The net income for the first six months of 2010 was $66 thousand or $0.02 per diluted share, compared with a net loss of $4.3 million, or $1.24 per diluted share, in the first six months of 2009. This net income/loss was due to the fluctuations discussed above.

LIQUIDITY

Cash and cash equivalents at July 3, 2010 decreased to $2.9 million from the $3.8 million balance at December 31, 2009.

The decrease in cash and cash equivalents during the first six months of 2010 was primarily the result of capital expenditures, pay-down of two equipment loans and working capital requirements, partially offset by proceeds from the sale of equipment and cash generated from operations.

Accounts payable declined $0.6 million during the first six months of 2010 primarily due to the timing of payments. Prepaid expenses increased $0.3 million during the first six months of 2010 primarily due to the timing of payments. Capital expenditures, driven primarily by productivity improvements and system related investments, for the first six months of 2010 were $1.0 million compared with $0.7 million in the first six months of 2009. Depreciation and amortization for the first six months of 2010 was $1.4 million compared with $1.9 million in the same period last year.

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There were no shares repurchased by the Company during the first six months of 2010. The Company has authorization to repurchase 75,885 shares at July 3, 2010. The closing price of the Company s stock at July 3, 2010 was $4.33. At this price, the repurchase of 75,885 shares would require $329 thousand.

The Company has access to a $3.0 million line of credit with a commercial bank which expires June 9, 2013. Interest on the line of credit is based on LIBOR plus 2.75%, with an interest floor of 3.35%. At July 3, 2010, $0.2 million was in use through a standby letter of credit and there was no balance drawn on the line. The Company was in compliance with all applicable covenants at the end of the second quarter of 2010. The amount of the line of credit that was unused and available to the Company at July 3, 2010 was $2.8 million.

The Company believes that cash and cash equivalents, which totaled $2.9 million at July 3, 2010, in combination with cash expected to be generated from operations and the line of credit, will be adequate for the Company to meet its obligations, working capital requirements and capital expenditure needs for the balance of 2010.

COMMITMENTS

The Company has commitments for items that it purchases in the normal on-going affairs of the business. The Company is not aware of any obligations in excess of normal market conditions, or of any long-term commitments that would have a material adverse affect on its financial condition.

MARKET RISK

There has been no significant change in market risks since December 31, 2009.

As a result of short cycle times, the Company does not have any long-term commitments to purchase production raw materials or sell products that would present significant risks due to price fluctuations. Raw paper stock is available to us from multiple domestic sources; as a result, we believe the risk of supply interruptions due to such things as strikes at the source of supply or to failures in logistics systems are limited.

Risks due to fluctuation in interest rates are not material to the Company at July 3, 2010 because of our limited exposure to floating rate debt.

Since May of 2003, over 90% of the Company s power needs are met through natural gas. The Company has investigated supply contracts of various lengths and currently it has supply arrangements for fixed prices on approximately 60% of its estimated usage through October 2010 and 50% of its estimated usage from November 2010 through October 2011. Historically, the price of natural gas has fluctuated widely. The Company monitors the availability of natural gas, considering such factors as amount in storage, gas production data and transportation data, so that it can take appropriate action if concerns about availability occur. The Company has investigated and tested a back-up power source in the form of a rented transportable diesel-powered generator.

We have no foreign operations, nor do we transact any business in foreign currencies. Accordingly, we have no foreign currency market risks.

The market risk that the Company was exposed to at December 31, 2009 was generally the same as described above.

CRITICAL ACCOUNTING POLICIES

There have been no changes in critical accounting policies in the current year from those disclosed in our 2009 Form 10-K.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Market Risk in Item 2, above.

Item 4. Controls and Procedures

(a.) Evaluation of Disclosure Controls and Procedures:

The Company s management, with the participation of the Company s President and Chief Executive Officer, and Chief Operating Officer and Chief Financial Officer, has evaluated the effectiveness of the Company s disclosure controls and procedures as defined in Rules 13a - 15(e) and 15(d) 15(e) of the Securities Exchange Act of 1934, as of July 3, 2010. Based on that evaluation, the Company s President and Chief Executive Officer, and Chief Operating Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective as of July 3, 2010.

(b.) Changes in Internal Control over Financial Reporting:

There were no changes in the Company s internal control over financial reporting during the first six months of 2010 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

There are no material pending legal proceedings to which the Registrant or any of its subsidiaries is a party or of which any of their property is the subject.

Item 1A. Risk Factors

There has been no significant change to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

Period	(a) Total Number of Shares (or Units) Purchased	b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
April 4 May 1, 2010		N/A		75,885
May 2 May 29, 2010		N/A		75,885
May 30 July 3, 2010		N/A		75,885
Total		**N/A**		**75,885**

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. (Removed and Reserved)

Item 5. Other Information

Not applicable.

Item 6. Exhibits

Exhibit 31.1	Section 302 Certification	President and Chief Executive Officer
Exhibit 31.2	Section 302 Certification	Chief Operating Officer and Chief Financial Officer
Exhibit 32.1	Certification of President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.	
Exhibit 32.2	Certification of Chief Operating Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.	

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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.

MOD-PAC CORP.

(Registrant)

Date: August 5, 2010

/s/ David B. Lupp

David B. Lupp
Chief Operating Officer and Chief Financial Officer
(Principal Financial Officer)