GRAY TELEVISION INC
Form 10-K
March 05, 2013

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

x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2012 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 1-13796

GRAY TELEVISION, INC.
(Exact Name of Registrant as Specified in its Charter)

Georgia (State or Other Jurisdiction of Incorporation or Organization)	58-0285030 (I.R.S. Employer Identification No.)
4370 Peachtree Road, NE Atlanta, GA (Address of Principal Executive Offices)	30319 (Zip Code)

Registrant's telephone number, including area code: (404) 504-9828

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Class A Common Stock (no par value)	New York Stock Exchange
Common Stock (no par value)	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (do not check if a smaller reporting company)	Smaller Reporting Company o

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

The aggregate market value of the voting stock (based upon the closing sales prices quoted on the New York Stock Exchange) held by non-affiliates of the registrant (solely for purposes of this calculation, all directors, executive officers and 10% or greater stockholders of the registrant are considered to be "affiliates") as of June 29, 2012: Class A Common Stock and Common Stock; no par value –$73,701,960.

The number of shares outstanding of the registrant's classes of common stock as of February 25, 2013: Class A Common Stock; no par value –5,753,020 shares; Common Stock, no par value –51,768,945 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for the annual meeting of stockholders, to be filed within 120 days of the registrant's fiscal year end, pursuant to Regulation 14A are incorporated by reference into Part III hereof.

Gray Television Inc.

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PART 1

Item 1. Business.

In this annual report on Form 10-K (the “Annual Report”), unless otherwise indicated or the context otherwise requires, the words ”Gray,” “we,” “us,” and “our” refer to Gray Television, Inc. and its subsidiaries. Our discussion of the television (or “TV”) stations that we own and operate does not include our interest in the television and radio stations owned by Sarkes Tarzian, Inc.

Our common stock, no par value, and our Class A common stock, no par value, have been listed on The New York Stock Exchange (the “NYSE”) and traded under the symbols “GTN” and “GTN.A” since 1996 and 1995, respectively.

Unless otherwise indicated, all station rank, in-market share and television household data herein are derived from reports prepared by Nielsen Media Research Company (“Nielsen”), a national audience measuring service. While we believe this data to be accurate and reliable, we have not independently verified such data.

General

We are a television broadcast company headquartered in Atlanta, Georgia, that owns and operates television stations broadcasting 40 primary channels and 45 secondary channels in 30 television markets. Nineteen of our primary channels and one secondary channel are affiliated with the CBS Network owned by CBS Inc. (“CBS”), ten primary channels are affiliated with the NBC Network owned by National Broadcasting Company, Inc. (“NBC”), eight primary channels and one secondary channel are affiliated with the ABC Network owned by American Broadcasting Company (“ABC”), and three primary channels and two secondary channels are affiliated with the FOX Network owned by the FOX Broadcasting Company (“FOX”).

Within a market, our secondary broadcast channels are generally affiliated with networks different from those affiliated with our primary broadcast channels, and are operated by us to make better use of our broadcast spectrum by providing supplemental and/or alternative programming to our primary channels. Certain of our secondary channels are affiliated with more than one network simultaneously. In addition to ABC, CBS and FOX, our secondary channels are affiliated with the following networks: CW Network or the CW Plus Network, both owned by The CW Network, LLC (collectively, “CW”), Master Distribution Service, Inc. (an affiliate of Twentieth Television, Inc.) (“MyNetworkTV” or “MyNet.”), the MeTV Network owned by Weigel Broadcasting Co. (“MeTV”), This TV Network also owned by Weigel Broadcasting (“This TV”), Untamed Sports Network (“USN”), the Country Network (“TCN”) and Antenna TV (“Ant.”). We also broadcast nine local news/weather channels in certain of our existing markets. Our combined TV station group reaches approximately 6.2% of total United States households.

In addition, we have entered into agreements to acquire one full-power television station and two low power television stations in the Lincoln, Nebraska market, and one low power television station in Dothan, Alabama. We anticipate completing these acquisitions in the first and second quarters of 2013, respectively.

Our operating revenues are derived primarily from broadcast and internet advertising and from other sources such as production of commercials, tower rentals, retransmission consent fees and management fees. For the years ended December 31, 2012 and 2011, we generated revenue of $404.8 million and $307.1 million, respectively.

Television Industry Background

The Federal Communications Commission (the “FCC”) grants broadcast licenses to television stations. Historically, there have been a limited number of channels available for broadcasting in any one geographic area.

Television station revenue is derived primarily from local, regional and national advertising. Television station revenue is derived to a much lesser extent from retransmission consent fees; network compensation; studio and tower space rental fees; and commercial production activities. “Advertising” refers primarily to advertisements broadcast by television stations, but it also includes advertisements placed on a television station’s website and sponsorships of television programming and off-line content (such as email messages, mobile applications, and other electronic content distributed by stations). Advertising rates are based upon: (i) the size of a station’s market, (ii) a station’s overall ratings, (iii) a program’s popularity among targeted viewers, (iv) the number of advertisers competing for available time, (v) the demographic makeup of the station’s market, (vi) the availability of alternative advertising media in the market, (vii) the presence of effective sales forces and (viii) the development of projects, features and programs that tie advertiser messages to programming. Advertising rates can also be determined in part by a station’s overall ratings and in-market share, as well as the station’s ratings and market share among particular demographic groups that an advertiser may be targeting. Because broadcast stations rely on advertising revenues, they are sensitive to cyclical changes in the economy. The sizes of advertisers’ budgets, which can be affected by broad economic trends, can affect the broadcast industry in general and the revenues of individual broadcast television stations.

Each commercial television station in the United States is assigned by Nielsen to one of 210 geographic television markets or designated market areas (“DMAs”). These markets are ranked in size according to their number of television households, with the market having the largest number of television households (New York City) ranked first. Each DMA is an exclusive geographic area consisting of all counties (and in some cases, portions of counties) in which the home-market commercial television stations receive the greatest percentage of total viewing hours. Nielsen periodically publishes data on estimated audiences for the television stations in each DMA.

Strategy

Our success is based on the following strategies for growing our revenues and operating cash flows:

Maintain and Grow our Market Leadership Position

We have the #1 ranking in overall audience in 22 of the 30 markets in which we operate. We are ranked #2 in seven of our other markets. We have the #1 ranking in local news audience in 23 of our markets and our news audience share significantly over indexes the national average of the networks’ audience share for both early evening and late night news.

We believe there are significant advantages in operating the #1 or #2 television broadcasting stations. Strong audience and market share allows us to enhance our advertising revenue through price discipline and leadership. We believe a top-rated news platform is critical to capturing incremental sponsorship and political advertising revenue. Our high-quality station group allows us to generate high operating margins, which allows us additional opportunities to reinvest in our business to further strengthen our network and news ratings. Furthermore, we believe operating the top ranked stations in our various markets allows us to attract and retain top talent.

We also believe that our leadership position in the markets in which we operate gives us additional leverage to negotiate retransmission contracts with multiple cable system operators, telephone video distributors, direct broadcast satellite (“DBS”) operators, and other multichannel video programming distributors (collectively, “MVPDs”). We believe it helps us in our negotiations with networks when negotiating our network affiliation agreements with them.

We intend to maintain our market leadership position through continued prudent investment in our news and syndicated programs, as well as continued technological advances and program improvements. We continue to convert our local studios in select markets to be able to provide high definition digital broadcasting (“HD”) to further enhance the visual quality of our local programs, which we believe will drive incremental viewership, and we expect to continue to invest in local HD conversion over the next few years.

Pursue New Media Opportunities

We currently operate web, mobile and desktop applications in all of our markets. We have focused on expanding relevant local content, such as news, weather and sports, on our websites to drive increased page views. We have experienced strong growth in internet page views in the past, with page views growing at approximately a 46.3% compound annual growth rate from 2003 to 2012, and we anticipate continued growth in the future. We believe increased page views will result in increased internet revenue.

Our aggregate internet revenue is derived from two sources. The first is advertising or sponsorship opportunities directly on our websites, referred to as “direct internet revenue.” The other source is television advertising time purchased by our clients to directly promote their involvement in our websites, referred to as “internet-related commercial time sales.”

We are a member of the Open Mobile Video Coalition, which aims to accelerate the development and rollout of mobile DTV products and services, maximizing the full potential of the digital television spectrum. As of January 1, 2013, we are testing mobile television services in three markets.

Monetize Digital Spectrum

We currently broadcast 45 secondary channels. We created our secondary channels to better utilize our excess broadcast spectrum. Our secondary channels are affiliated with networks different from those affiliated with our primary channels and are operated by us to make better use of our broadcast spectrum by providing supplemental and/or alternative programming to our primary channels. Certain of our secondary channels are affiliated with more than one network simultaneously.

Our strategy includes expanding upon our digital offerings, and we evaluate potential opportunities from time to time either on our own and/or in partnership with other companies, as such opportunities present themselves. We intend to aggressively pursue the use of our spectrum for additional opportunities such as local video on demand, music on demand and other digital downloads. We also evaluate opportunities to use spectrum for future delivery of television broadcasts to handheld and other mobile devices.

Prudent Cost Management

Historically, we have closely managed our costs to maintain our margins. We believe that our market leadership position gives us additional negotiating leverage to enable us to lower our syndicated programming costs. We have increased the efficiency of our stations by automating processes as a part of the conversion of local studios to digital. As of December 31, 2012, we had reduced our total number of

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employees by 367, or 15.0%, since December 31, 2007. We intend to continue to seek and implement additional cost saving opportunities in the future.

Cyclicality, Seasonality and Revenue Concentrations

Because broadcast stations like ours rely on advertising revenue, they are sensitive to cyclical changes in the economy. As a result, our non-political advertising revenue was significantly negatively affected during the economic recession in 2007 to 2009, but improved along with the general economic environment in 2010, 2011 and 2012. Our political advertising revenue was not as significantly affected by the recession as our non-political advertising revenue.

Broadcast advertising revenue is generally highest in the second and fourth quarters each year. This seasonality results partly from increases in consumer advertising in the spring and retail advertising in the period leading up to and including the Christmas holiday season. Broadcast advertising revenue is also typically higher in even-numbered years due to spending by political candidates, political parties and special interest groups. This political advertising spending typically is heaviest during the fourth quarter.

We consider broadcast advertising revenue to be revenue earned from the sale of advertisements broadcast by our stations. Although no single customer represented more than 5% of our broadcast advertising revenue for the years ended December 31, 2012 or 2011, we derived a material portion of our non-political broadcast advertising revenue from advertisers in a limited number of industries, particularly the automotive industry. For the years ended December 31, 2012 and 2011, we derived approximately 18% and 21%, respectively, of our total broadcast advertising revenue from customers in the automotive industry. Our results of operations and financial condition could be materially adversely affected if broadcast advertising revenue from the automotive, or certain other industries, such as the medical, restaurant, communications, furniture and appliances, industries, declined.

Markets and Stations

Gray operates in DMAs ranked between 61 and 193 and primarily focuses its operations on university towns and state capitals. Our markets include 17 university towns, representing enrollment of approximately 474,000 students, and eight state capitals. We believe university towns and state capitals provide significant advantages as they generally offer more favorable advertising demographics, more stable economics and a stronger affinity between local stations and university sports teams.

We have a strong, market leading position in our markets. We believe a key driver for our strong market position is the strength of our local news and information programs. Our news audience share significantly over indexes the national average of the networks' audience share based on the Nielsen Station Index ("NSI") national average market share in November 2012 for both early evening and late night news. We believe that our market position and our strong local revenue streams have enabled us to maintain more stable revenues in recent challenging economic conditions compared to many of our peers.

We are diversified across our markets and network affiliations. Our largest market by Company revenue is Charleston/Huntington, WV, which contributed approximately 7% and 8% of our revenue for the years ended December 31, 2012 and 2011, respectively. Our top 10 markets by Company revenue contributed 50% and 51% of our revenue for the years ended December 31, 2012 and 2011, respectively. For the years ended December 31, 2012 and 2011, our CBS-affiliated channels accounted for 42% and 45%, respectively, of our revenue, our NBC-affiliated channels accounted for 39% and 36%, respectively, of our revenue, our ABC-affiliated channels accounted for 15% and 14%, respectively of our revenue and our FOX-affiliated channels accounted for approximately 1%, of our revenue.

All of our stations broadcast primary channels that are affiliated with major networks. In addition to the primary channels, the majority of our stations also broadcast secondary digital channels that are affiliated with various networks. The terms of our affiliations with these networks are governed by network affiliation agreements. Each network affiliation agreement provides the affiliated station with the right to broadcast all programs transmitted by the affiliated network. Our network affiliation agreements expire at various dates through December 31, 2016.

The following table provides information about all of our owned and operated television stations as of February 1, 2013.

DMA Rank			Primary Channels		Secondary Channels		Broadcast License	F C Sta Ra i
(a)	Market	Station	Affil.(b)	Exp. (c)	Affil.(b)	Exp. (c)	Expiration	DM (
61	Knoxville, TN	WVLT	CBS	12/31/14	MyNet.	10/04/14	08/01/13	2
64	Lexington, KY	WKYT	CBS	12/31/14	CW News	09/17/14 NA	08/01/13	
65	Charleston/Huntington, WV	WSAZ	NBC	12/31/15	MyNet.	10/04/14	10/01/12 (i)	
66	Wichita/Hutchinson, KS	KAKE	ABC	12/31/13	MeTV	9/6/2015	06/01/14	2
	(Colby, KS)	KLBY (f)	ABC	12/31/13	NA	NA	06/01/14	2
	(Garden City, KS)	KUPK (f)	ABC	12/31/13	NA	NA	06/01/14	2
75	Omaha, NE	WOWT	NBC	12/31/15	News	NA	06/01/14	2
85	Madison, WI	WMTV	NBC	12/31/15	News	NA	12/01/13	
88	Waco-Temple-Bryan, TX	KWTX	CBS	12/31/14	CW	08/31/14	08/01/14	
	(Bryan, TX)	KBTX (g)	CBS	12/31/14	CW	08/31/14	08/01/14	
89	Colorado Springs, CO	KKTV	CBS	12/31/14	MyNet.	10/04/14	04/01/14	
95	South Bend, IN	WNDU	NBC	12/31/15	NA	NA	08/01/13	2
100	Greenville/New Bern/ Washington, NC							

Other liabilities (related parties $1,082,000 and $1,070,000)	1,082,012	1,070,151
	4,436,998	4,351,743

Notes payable, net of current portion				
Notes payable - officers, subordinated, net of debt discount of $163,000 and $185,000		837,463		815,296
Total long-term liabilities		6,356,473		6,237,190
Minority interest		12,822		12,534
Stockholders' equity:				
Preferred Stock — no par value 2,000,000 shares authorized 0 shares issued and outstanding		-		-
Common stock - no par value, 5,000,000 shares authorized, 2,732,124 and 2,569,124 shares issued and 2,732,124 and 2,569,124 outstanding, respectively		3,764,020		3,764,020
Paid-in-capital		7,562,887		6,754,077
Warrants issued in connection with subordinated debt and bank debt		1,038,487		1,038,487
Accumulated deficit		(4,085,179)		(4,363,999)
Accumulated other comprehensive loss		(728,519)		(601,283)
Total stockholders' equity		7,551,696		6,591,302
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	30,624,050	$	29,324,135

See accompanying notes to condensed consolidated unaudited financial statements

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

	For the Three Months Ended March 31, 2008	2007
Net Sales	$ 10,734,701	$ 8,278,874
Cost of Sales	8,403,022	6,376,187
Gross profit	2,331,679	1,902,687
Operating expenses:		
General and administrative	1,158,487	1,212,169
Selling	186,580	205,969
Advertising and marketing	346,907	290,790
Total operating expenses	1,691,974	1,708,928
Income from operations	639,705	193,759
Other income (expense):		
Interest expense	(270,577)	(336,584)
Interest income	316	2,000
Foreign currency gain	30,322	52,172
Total other expense, net	(239,939)	(282,412)
Income (loss) before income taxes and minority interest	399,766	(88,653)
Income tax expense (benefit)	120,657	(36,407)
Income (loss) before minority interest	279,109	(52,246)
Minority interest in loss (income) of subsidiary	288	(34)
Net income (loss)	$ 278,821	$ (52,212)
Other Comprehensive Income		
Unrealized loss on derivative instruments	$ (136,861)	$ -
Foreign currency adjustment	$ 9,626	$ -
Comprehensive income (loss)	$ 151,586	$ (52,212)
Basic income (loss) per common share	$ 0.10	$ (0.02)
Diluted income (loss) per common share	$ 0.10	$ (0.02)
Weighted average number of shares and equivalent shares of common stock outstanding:		
Basic	2,662,267	2,156,783

Diluted	2,797,374	2,156,783

See accompanying notes to condensed consolidated unaudited financial statements

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

	For the Three Months Ended March 31, 2008	2007
Cash flows from operating activities:		
Net income (loss)	$ 278,821	$ (52,212)
Adjustment to reconcile net income (loss) to cash (used in) provided by operating activities:		
Depreciation and amortization	365,869	359,399
Amortization of debt discount	22,167	23,888
Stock based compensation	15,000	0
Minority interest in loss (gain) of subsidiary	288	(34)
Provision for losses on accounts receivable	35,447	27,224
Provision for losses on inventories	(5,457)	16,759
Deferred income taxes	120,656	(46,407)
Change in assets and liabilities:		
Accounts receivable	(979,386)	372,405
Inventories	104,501	(289,933)
Prepaid expenses and other assets	(138,316)	84,229
Trade payables	(1,306)	132,774
Accrued liabilities	(70,532)	(99,297)
Net cash (used in) provided by operating activities	(252,248)	528,795
Cash used in investing activity - purchases of property, plant and equipment	(479,156)	(326,643)
Net cash used in investing activity	(479,156)	(326,643)
Cash flows from financing activities:		
Change in checks written in excess of bank balance	(40,173)	93,620
Net change in revolving line of credit	702,855	(96,457)
Proceeds from issuance of long-term debt and warrants	506,503	0
Repayment of long-term debt (related parties $103,000 and $15,000)	(232,567)	(268,343)
Proceeds from exercise of stock options	0	46,271
Proceeds from issuance of stock, net	0	104,933
Cash paid for deferred financing fees	0	(2,500)
Net cash provided by (used in) financing activities	936,618	(122,476)
Effect of exchange rate changes on cash	3,368	2,150
Net increase in cash and cash equivalents	208,582	81,826
Cash and cash equivalents at beginning of period	483,112	384,565
Cash and cash equivalents at end of period	$ 691,694	$ 466,391

Supplemental disclosure of cash flow information:				
Cash payments for interest	$	288,224	$	319,713
Cash payments for taxes	$	-	$	10,000
Supplemental Disclosure of non-cash investing and financing activity				
Stock subscription receivable (Other current assets)	$	-	$	110,251
Exercise of Warrants and payment of Subordinated Debt	$	793,810	$	-

See accompanying notes to condensed consolidated unaudited financial statements

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

	Three Months Ended March 31, 2008		2007	
Basic				
Average shares outstanding:				
Weighted average number of common shares outstanding		2,662,267		2,156,783
Net income (loss):				
Net income (loss)	$	278,821	$	(52,212)
Per share amount	$	0.10	$	(0.02)
Diluted				
Average shares outstanding:				
Weighted average number of common shares outstanding		2,662,267		2,156,783
Effect of dilutive shares		135,107		-
Weighted average number of shares and equivalent shares of common stock outstanding		2,797,374		2,156,783
Net income (loss):				
Net income (loss)	$	278,821	$	(52,212)
Per share amount	$	0.10	$	(0.02)

See accompanying notes to condensed consolidated unaudited financial statements

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

Note 1 - Basis of Presentation

The accompanying unaudited 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 months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2007.

Principles of consolidation and nature of operations:

The 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., and Flexo Universal, S.A. de C.V. (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.

Use of estimates:

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

Earnings per share:

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

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

As of March 31, 2008, shares to be issued upon the exercise of options and warrants aggregated 268,365 and 303,030, respectively. As of March 31, 2007 the shares to be issued upon the exercise of options and warrants were 315,767 and 466,030, respectively. However, none of theses shares were included in the computation of loss per share for March 31, 2007, as their effect was anti-dilutive.

New Accounting Pronouncements:

In September 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, or SFAS No. 157. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption permitted. Subsequently, the FASB provided for a one-year deferral of the provisions of SFAS No. 157 for non-financial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements on a non-recurring basis. We adopted with no impact on our financial statements all requirements of SFAS No. 157 on January 1, 2008, except as they relate to nonfinancial assets and liabilities, which will be adopted on January 1, 2009, as allowed under SFAS No. 157. We have not yet determined the impact, if any, on our financial statements for nonfinancial assets and liabilities.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, or SFAS No. 159, which permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS No. 159, an entity may elect the fair value option for eligible items that exist at the adoption date. Subsequent to the initial adoption, the election of the fair value option should only be made at the initial recognition of the asset or liability or upon a re-measurement event that gives rise to the new-basis of accounting. All subsequent changes in fair value for that instrument are reported in earnings. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be recorded at fair value nor does it eliminate disclosure requirements included in other accounting standards. SFAS No. 159 is effective as of the beginning of each reporting entity’s first fiscal year that begins after November 15, 2007. We adopted SFAS No. 159 on January 1, 2008 and there was no impact on our financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations, or SFAS No. 141(R). SFAS No. 141(R) changes the requirements for an acquirer's recognition and measurement of the assets acquired and the liabilities assumed in a business combination. SFAS No. 141(R) is effective for annual periods beginning after December 15, 2008 and should be applied prospectively for all business combinations entered into after the date of adoption.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, Non-controlling Interests in Consolidated Financial Statements — an amendment of ARB No. 51, or SFAS No. 160. SFAS No. 160 requires (i) that non-controlling (minority) interests be reported as a component of shareholders' equity, (ii) that net income attributable to the parent and to the non-controlling interest be separately identified in the consolidated statement of operations, (iii) that changes in a parent's ownership interest while the parent retains its controlling interest be accounted for as equity transactions, (iv) that any retained non-controlling equity investment upon the deconsolidation of a subsidiary be initially measured at fair value, and (v) that sufficient disclosures are provided that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS No. 160 is effective for annual periods beginning after December 15, 2008 and should be applied prospectively. The presentation and disclosure requirements of the statement shall be applied retrospectively for all periods presented. We will adopt SFAS No. 160 on January 1, 2009 and have not yet determined the impact, if any, on our financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133, or SFAS No. 161. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in hedged positions. The statement also requires enhanced disclosures regarding how and why entities use derivative instruments, how derivative instruments and related hedged items are accounted and how derivative instruments and related hedged items affect entities' financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. We will adopt SFAS No. 161 on January 1, 2009 and do not expect the adoption to have a material impact on our financial statements.

Note 2 - Stock-Based Compensation; Changes in Equity

We adopted Statement of Financial Accounting Standards No 123R, *Share-Based Payment*, effective January 1, 2006. This statement requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their grant-date fair values.

The Black-Scholes model incorporates assumptions to value stock-based awards. 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 and have no current plans to do so in the future. The expected volatility is based on historical volatility of the Company's common stock.

The Company's net income for the three months ended March 31, 2008 and 2007 includes approximately $15,000 and $0, respectively of compensation costs related to share based payments. As of March 31, 2008 there is $136,000 of unrecognized compensation expense related to non-vested stock option grants. We expect approximately $41,000 to be recognized over the remainder of 2008, approximately $54,000 and $41,000 to be recognized during the years ended 2009 and 2010, respectively.

As of March 31, 2008, the Company had five stock-based compensation plans pursuant to which stock options may be granted. The Plans provide for the award of options, which may either be incentive stock options ("ISOs") within the meaning of Section 422A of the Internal Revenue Code of 1986, as amended (the "Code") or non-qualified options ("NQOs") which are not subject to special tax treatment under the Code.

On April 30, 2007, the Board of Directors approved for adoption, effective October 1, 2007, the 2002 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 March 31, 2008, 74,000 options had been granted and remain outstanding

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

	Shares under Option	Weighted Avgerage Exercise Price	Weighted Average Contractual Life	Aggregate Intrinsic Value
Balance at December 31, 2007	268,365	$ 3.71		
Granted	-	-	-	-
Cancelled	-	-	-	-
Exercised	-	-	-	$ -
Outstanding at March 31, 2008	268,365	$ 3.71	3.86	$ 269,000
Exercisable at March 31, 2008	194,365	3.32	3.91	$ 269,000

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

	Shares under Option	Weighted Avgerage Exercise Price	Weighted Average Contractual Life	Aggregate Intrinsic Value
Balance at December 31, 2007	466,030	$ 3.85		
Granted	-	-	-	-
Cancelled	-	-	-	-
Exercised	(163,000)	4.87	-	-
Outstanding at March 31, 2008	303,030	3.30	2.90	$ 258,000
Exercisable at March 31, 2008	303,030	$ 3.30	2.90	$ 258,000

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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 first quarter of 2008 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all the option holders exercised their options on March 31, 2008. There was no intrinsic value to the warrants exercised during the three months ended March 31, 2008 as they were out of the money. No options were exercised in the three months ended March 31, 2008. There was no cash received from the warrants exercised as they were in exchange for a decrease in subordinated debt. See Note 11 regarding the issuance of common stock to Babe Winkelman Productions, Inc.

Note 3 - Legal Proceedings

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

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

Note 4 – Comprehensive (Loss) Income

In the three months ended March 31, 2008 the Company incurred a comprehensive loss of $127,000, made up of an unrealized loss on a derivative instrument of $137,000 and a gain of $10,000 from foreign currency translation adjustments. All of these transactions are components of accumulated other comprehensive loss within stockholders' equity.

Note 5 – Inventories, net

	March 31, 2008	December 31, 2007
Raw materials	$ 1,722,000	$ 1,452,000
Work in process	767,000	1,423,000
Finished goods	7,455,000	7,208,000
Allowance, excess quantities	(313,000)	(382,000)
Inventories, net	$ 9,631,000	$ 9,701,000

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Note 6 - 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 For the Three Months Ended March 31, 2008	Net Sales For the Three Months Ended March 31, 2007	Total Assets at March 31, 2008	Total Assets at December 31, 2007
United States	$ 8,618,000	$ 6,344,000	$ 28,957,000	$ 27,854,000
Mexico	1,808,000	1,596,000	6,060,000	5,780,000
United Kingdom	812,000	870,000	3,227,000	2,948,000
Eliminations	(503,000)	(531,000)	(7,620,000)	(7,258,000)
	$ 10,735,000	$ 8,279,000	$ 30,624,000	$ 29,324,000

Note 7 – Cash and Cash Equivalents Concentration

As of March 31, 2008, the Company had cash and cash equivalents deposits at one financial institution that exceeded FDIC limits by $53,000.

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 months ended March 31, 2008, 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 months ended March 31, 2008 were $1,870,000 or 17.4%, $1,762,000 or 16.4%, and $1,097,000 or 10.2% of consolidated net sales respectively. Sales to these customers in the same period of 2007 were $1,347,000 or 16.3%, and $1,625,000 or 19.6% of consolidated net sales, respectively. The third customer is new to the Company in 2008. For the quarter ended March 31, 2008, the total amount owed by these customers was $1,313,000 or 18.9%, $1,412,000 or 20.4% and $749,000, or 10.8%, of the Company’s consolidated accounts receivable. The amounts owed at March 31, 2007 were $1,144,000, or 19.1% and $1,344,000, or 22.4% of the Company’s consolidated net accounts receivable, 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 first quarter of 2008 and 2007, respectively, were $50,000 and $39,000.

John H. Schwan, Chairman of the Company, is a principal of Shamrock Packaging and affiliated companies. The Company made purchases of approximately $247,000 during the three months ended March 31, 2008 and $105,000 during the three months ended March 31, 2007.

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 made purchases to Schwan Incorporated of approximately $43,000 during the three months ended March 31, 2008 and $2,000 during the three months ended March 31, 2007.

In February 2003, the Company received $1,630,000, in the aggregate, from John H. Schwan and Stephen M. Merrick in exchange for (a) two year 9% subordinated notes and (b) five year warrants to purchase an aggregate of 163,000 shares of common stock of the Company at the price of $4.87 per share. On February 8, 2008, those individuals exercised the warrants in exchange for the shares, based upon the principal amount of $794,000 of the subordinated notes.

On February 1, 2006, Mr. Schwan and Mr. Merrick advanced $500,000 each to the Company in exchange for (a) five year promissory notes bearing interest at 2% over the prime rate determined quarterly and (b) five year warrants to purchase an aggregate of 303,030 shares of common stock of the Company at the price of $3.30 per share. The fair value of each warrant was estimated as of the date of the grant using the Black-Scholes pricing model.

Interest payments have been made to John H. Schwan and Stephen M. Merrick for loans made to the Company. These interest payments for the three months ending March 31, 2008 totaled $41,000 and $18,000, respectively. In 2007, for the three months ending March 31, 2007, the amounts were $49,000 and $25,000, respectively.

Note 10 – Standby Equity Distribution Agreement (SEDA)

In July 2006, we entered into a Standby Equity Distribution Agreement (SEDA) with Cornell Capital Partners, LP (“Cornell Capital”) pursuant to which we may, at our discretion, periodically sell to Cornell Capital shares of common stock at a price equal to the volume weighted average price of our common stock on the NASDAQ Capital Market for the five days immediately following the date we notify Cornell Capital of our request. On December 28, 2006, we filed a Registration Statement with the SEC for the registration of 403,500 shares to be sold to Cornell Capital and Newbridge Securities (our placement agent). On January 28, 2007, the registration statement was declared effective. As of March 31, 2008, in connection with the SEDA, we have received $1,355,000 in net proceeds from Cornell Capital. Cornell Capital has purchased from us an aggregate of 323,625 shares of our common stock.

Note 11 – Changes in Contractual Commitments

On February 1, 2008, we entered into a License and Supply Agreement with S.C. Johnson & Son, Inc ("SC Johnson"). The agreement provides for the Company to manufacture and sell to SC Johnson certain home food management products to be sold under the SC Johnson ZipLoc® brand. The agreement is for a term expiring on June 30, 2011 and provides for two renewal terms of two years each at the option of SC Johnson.

On April 10, 2008, we entered into an agreement with Babe Winkelman Productions, Inc. (BWP). The agreement provides for BWP to provide marketing and advertising services to us in connection with our ZipVac™ brand portable food storage system. BWP will produce commercials featuring the ZipVac™ product line which are to be aired at the time of Babe Winkelman syndicated programs, will produce a Kris Winkelman segment of the Babe Winkelman shows which will feature uses of the ZipVac™ product line, and will provide other advertising and marketing services. We will receive a license to use the name, image, likeness and testimonies of Babe and Kris Winkelman in connection with the ZipVac™ product line. We will pay a royalty to BWP of 3% of net revenues from the sale of the ZipVac™ product and will issue to BWP 50,000 shares of our common stock which will be earned by BWP over a two year period. The agreement is for a term commencing on April 1, 2008 and expiring on March 31, 2011.

On May 6, 2008, we entered into an Amendment to License Agreement with Rapak, L.L.C. which amends a License Agreement among the Company and Rapak dated April 28, 2006. Under the License Agreement, we granted to Rapak a worldwide, royalty-free license under Patent No. 6,984,278 relating to a method for texturing film and the production of a pouch utilizing such film and incorporating an evacuation tube. The license was granted for the full term of the patent and was made exclusive to Rapak for a period at least through October 31, 2008. The License Agreement also amended a Supply Agreement between the Company and Rapak for the supply of textured film extending the term of the Supply Agreement until at least October 31, 2008 and providing for Rapak to purchase from the Company at least 65% of Rapak's requirements for the patented film through that date.

Under the Amendment to License Agreement, the License Agreement was amended to: (i) extend the period of exclusivity of the patent license to October 31, 2011, (ii) extend the term of the Supply Agreement to October 31, 2011, (iii) provide, under the Supply Agreement, for Rapak to commit to purchase not less than 75% of its requirements for textured film from the Company during the term of the Supply Agreement, (iv) adjust pricing under the Supply Agreement and (v) change the definition of the field of use for the patent license.

Rapak has been one of the top three customers of the Company for the past five years and is expected to continue to be a principal customer of the Company.

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

Recent Developments. On February 1, 2008, we entered into a License and Supply Agreement with S.C. Johnson & Son, Inc ("SC Johnson"). The agreement provides for the Company to manufacture and sell to SC Johnson certain home food management products to be sold under the SC Johnson ZipLoc® brand. The agreement is for a term expiring on June 30, 2011 and provides for two renewal terms of two years each at the option of SC Johnson.

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Under the Amendment to License Agreement, the License Agreement was amended to: (i) extend the period of exclusivity of the patent license to October 31, 2011, (ii) extend the term of the Supply Agreement to October 31, 2011, (iii) provide, under the Supply Agreement, for Rapak to commit to purchase not less than 75% of its requirements for textured film from the Company during the term of the Supply Agreement, (iv) adjust pricing under the Supply Agreement and (v) change the definition of the field of use for the patent license.

Rapak has been one of the top three customers of the Company for the past five years and is expected to continue to be a principal customer of the Company.

Results of Operations

Net Sales. For the three months ended March 31, 2008, net sales were $10,735,000 compared to net sales of $8,279,000 for the same period of 2007, an increase of 29.7%. For the quarters ended March 31, 2008 and 2007, net sales by product category were as follows:

	Three Months Ended			
	March 31, 2008		March 31, 2007	
Product Category	$ (000) Omitted	% of Net Sales	$ (000) Omitted	% of Net Sales
Metalized Balloons	4,599	43%	3,999	48%
Films	1,943	18%	1,826	22%
Pouches	2,447	23%	665	8%
Latex Balloons	1,502	14%	1,516	19%
Helium/Other	244	2%	273	3%

Revenues from the sale of pouches increased by 268%, from $665,000 in the first quarter of 2007 to $2,447,000 in the first quarter of 2008. This significant increase was the result of (i) initial sales of product under a new supply arrangement and (ii) increased sales levels to an existing customer.

Sales of metalized balloons in the first quarter of 2008 increased by 15% over the first quarter of 2007, from $3,999,000 to $4,599,000. Most of this increase was the result of an increase in sales to a principal balloon customer.

Revenues from the sale of commercial films increased by 6.4% over the first quarter of 2007. The increase was the result of increased sales to a principal customer.

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 months ended March 31, 2008 and 2007.

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	Three Months Ended	
	% of Net Sales	
	March 31, 2008	March 31,2007
Top 3 customers	44.1%	35.9%
Top 10 Customers	73.0%	64.1%

During the three months ended March 31, 2008, 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 months ended March 31, 2008 were $1,870,000 or 17.4%, $1,762,000 or 16.4%, and $1,097,000 or 10.2% of consolidated net sales respectively. Sales to these customers in the same period of 2007 were $1,347,000 or 16.3%, and $1,625,000 or 19.6% of consolidated net sales, respectively. The third customer is new to the Company in 2008. For the quarter ended March 31, 2008, the total amount owed by these customers was $1,313,000 or 18.9%, $1,412,000 or 20.4% and $749,000, or 10.8%, of the Company’s consolidated accounts receivable. The amounts owed at March 31, 2007 were $1,144,000, or 19.1% and $1,344,000, or 22.4% of the Company’s consolidated net accounts receivable, respectively.

Cost of Sales. Cost of sales in the first quarter of 2008 were $8,403,000 or 78.3% compared to cost of sales of $6,376,000 or 77% in the first quarter of 2007. The increase in cost of sales as a percentage of net sales is attributable to (i) increased levels of raw materials costs and (ii) revenue adjustments on certain sales which will affect principally the first quarter.

General and Administrative. For the three months ended March 31, 2008, general and administrative expenses were $1,158,000 or 10.8% of net sales, compared to $1,212,000 or 14.6% of net sales for the same period in 2007. The decline in general and administrative expenses consisted of principally from a reduction of administrative expense in our U. K. affiliate.

Selling. For the three months ended March 31, 2008, selling expenses were $187,000 or 1.7% of net sales for the quarter, compared to $206,000 or 2.5% of net sales for the same three months of 2007. There were no material changes in selling expenses in the first quarter of 2008 compared to the same period of 2007.

Advertising and Marketing. For the three months ended March 31, 2008, advertising and marketing expenses were $347,000 or 3.2% of net sales for the period, compared to $291,000 or 3.5% of net sales for the same period of 2007. The increase in advertising and marketing expense in the first quarter of 2008 is attributable to additional commissions related to our Zip-Vac product.

Other Income (Expense). During the three months ended March 31, 2008, the Company incurred net interest expense of $271,000, compared to net interest expense during the same period of 2007 in the amount of $337,000. The decrease is due to lower interest rates.

During the three months ended March 31, 2008, the Company had other income of $31,000 compared to other income of $54,000 during the first quarter of 2007. Both amounts consisted principally of foreign currency transaction gains.

Income Taxes. For the three months ended March 31, 2008, the income tax expense constituted provisions for income taxes in the United Kingdom for CTI Balloons, Ltd., the Company’s subsidiary in the United Kingdom and in Mexico for Flexo Universal S.A. de C.V. the Company’s subsidiary in Mexico. For the same period of 2007, the Company recorded an income tax benefit of $36,000, by reason of the loss incurred by the Company in the United States.

Net Income (Loss). For the three months ended March 31, 2008, the Company had net income of $279,000 or $0.10 per share (basic and diluted), compared to a loss for the same period of 2007 of $(52,000) or $(0.02) per share (basic and diluted). For the three months ended March 31, 2008, the Company had net income from operations (before interest, taxes and non-operating items) of $400,000, compared to net loss from operations of $(89,000) during the same period of 2007. The difference in net income between the first quarter of 2008 and 2007 is attributable principally to (i) increased sales and gross profits and (ii) reduced interest expense.

Financial Condition, Liquidity and Capital Resources

Cash Flow Items.

Operating Activities. During the quarter ended March 31, 2008, net cash used in operations was $252,000, compared to net cash provided by operations during the three months ended March 31, 2007 of $529,000.

Significant changes in working capital items during the three months ended March 31, 2008 consisted of (i) an increase in accounts receivable of $979,000, (ii) depreciation and amortization in the amount of $366,000, (iii) an increase of $138,000 in prepaid expenses and other assets and (iv) a decrease in accrued liabilities of $207,000.

Investing Activity. During the three months ended March 31, 2008, cash used in investing activity was $479,000, compared to $327,000 in same period of 2007. We do anticipate incurring additional capital expenditures during the balance of 2008 for improvements and for the acquisition or upgrade of production equipment.

Financing Activities. For the three months ended March 31, 2008, cash provided by financing activities was $937,000 compared to cash used in financing activities for the same period of 2007 in the amount of $122,000. In the first quarter of 2008 financing activities included the receipt of $703,000 from the increase in the balances on our revolving line of credit, the receipt of $507,000 from the issuance of additional long term debt, and payment of long term debt obligations in the amount of $233,000.

Liquidity and Capital Resources. At March 31, 2008, the Company had cash balances of $692,000. At March 31, 2008, the Company had a working capital balance of $2,360,000 compared to a working capital balance of $1,318,000 at December 31, 2007.

The Company's current cash management strategy includes utilizing the Company's revolving line of credit for liquidity. Under our line of credit with RBS Citizens N.A. (formerly Charter One Bank), we are entitled to borrow an amount equal to 85% of eligible receivables and 60% of eligible inventory, up to a maximum of $9,000,000. Foreign receivables and inventory held by our foreign subsidiaries are not eligible. In addition, in order to be permitted to make advances under the line of credit, we are required to meet various financial covenants. As of March 31, 2008, we had complied with all applicable financial covenants in the loan agreement. Based on our results to date for the year and our projected results of operations for the balance of this year, we believe we will be in compliance with all applicable financial covenants of the loan agreement for the balance of 2008. Further, we believe that with our present cash and working capital and the amounts available to us under our line of credit and through sales of common stock, we will have sufficient funds to enable us to meet our obligations through the next twelve months.

The loan agreement provides for interest at varying rates in excess of the Bank's prime rate, depending on the level of senior debt to EBITDA over time. As of March 31, 2008, the applicable premium being applied was 0.75%.

Also, under the loan agreement, we were required to purchase a swap agreement with respect to at least 60% of the mortgage and term loan portions of our loan. On April 5, 2006, we entered into a swap arrangement with RBS Citizens N.A. (formerly Charter One Bank) with respect to 60% of the principal amounts of the mortgage loan and the term loan, which had the effect of fixing the interest rate for such portions of the loans at 8.49% for the balance of the loan terms. On January 28, 2008 we entered into a swap arrangement with RBS Citizens for an additional $3,000,000 on our revolving line of credit, which had the effect of fixing the interest rate at 6.17%. These swap arrangements are subject to some market variation due to market interest rate variability. Management believes that these variations will not materially affect the results of the Company. As of March 31, 2008, the net effect of these market adjustments were $260,000, which has been recorded in the Company's consolidated financial statements. As the swap agreement has been designated as a hedge, the net effect for the three months ending March 31, 2008 was $137,000 which is recorded in our equity section.

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

We are permitted to make draws on the Standby Equity Distribution Agreement only so long as Cornell Capital's beneficial ownership of our common stock remains lower than 9.9% and a possibility exists that Cornell Capital may own more than 9.9% of CTI's outstanding common stock at a time when we would otherwise plan to make an advance under the Standby Equity Distribution Agreement. We do not have any agreements with Cornell Capital regarding the distribution of such stock, although Cornell Capital has indicated that it intends promptly to sell any stock received under the Standby Equity Distribution Agreement.

We have registered 400,000 shares of common stock for the sale under the Standby Equity Distribution Agreement. The Company and Cornell have agreed that the Company will not sell to Cornell Capital in excess of 400,000 shares unless and until the Company shall have obtained shareholder approval for such sales.

On December 28, 2006, we filed a Registration Statement for the registration of 403,500 shares of our common stock. On January 26, 2007, the Registration Statement was declared effective. Since that time, we have sold an aggregate of 323,625 shares of common stock to Cornell under the SEDA and have received net proceeds from the sale of those shares in the amount of $1,355,000.

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 our Annual Report on Form 10-K for the year ended December 31, 2007 presented on pages 38-40, 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 months ended March 31, 2008.

In September 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, or SFAS No. 157. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption permitted. Subsequently, the FASB provided for a one-year deferral of the provisions of SFAS No. 157 for non-financial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements on a non-recurring basis. We adopted with no impact on our financial statements all requirements of SFAS No. 157 on January 1, 2008, except as they relate to nonfinancial assets and liabilities, which will be adopted on January 1, 2009, as allowed under SFAS No. 157. We have not yet determined the impact, if any, on our financial statements for nonfinancial assets and liabilities.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, or SFAS No. 159, which permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS No. 159, an entity may elect the fair value option for eligible items that exist at the adoption date. Subsequent to the initial adoption, the election of the fair value option should only be made at the initial recognition of the asset or liability or upon a re-measurement event that gives rise to the new-basis of accounting. All subsequent changes in fair value for that instrument are reported in earnings. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be recorded at fair value nor does it eliminate disclosure requirements included in other accounting standards. SFAS No. 159 is effective as of the beginning of each reporting entity's first fiscal year that begins after November 15, 2007. We adopted SFAS No. 159 on January 1, 2008 and there was no impact on our financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations, or SFAS No. 141(R). SFAS No. 141(R) changes the requirements for an acquirer's recognition and measurement of the assets acquired and the liabilities assumed in a business combination. SFAS No. 141(R) is effective for annual periods beginning after December 15, 2008 and should be applied prospectively for all business combinations entered into after the date of adoption.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, Non-controlling Interests in Consolidated Financial Statements — an amendment of ARB No. 51, or SFAS No. 160. SFAS No. 160 requires (i) that non-controlling (minority) interests be reported as a component of shareholders' equity, (ii) that net income attributable to the parent and to the non-controlling interest be separately identified in the consolidated statement of operations, (iii) that changes in a parent's ownership interest while the parent retains its controlling interest be accounted for as equity transactions, (iv) that any retained non-controlling equity investment upon the deconsolidation of a subsidiary be initially measured at fair value, and (v) that sufficient disclosures are provided that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS No. 160 is effective for annual periods beginning after December 15, 2008 and should be applied prospectively. The presentation and disclosure requirements of the statement shall be applied retrospectively for all periods presented. We will adopt SFAS No. 160 on January 1, 2009 and have not yet determined the impact, if any, on our financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133, or SFAS No. 161. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in hedged positions. The statement also requires enhanced disclosures regarding how and why entities use derivative instruments, how derivative instruments and related hedged items are accounted and how derivative instruments and related hedged items affect entities' financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. We will adopt SFAS No. 161 on January 1, 2009 and do not expect the adoption to have a material impact on our financial statements.

Item 3. Quantitative and Qualitative Disclosures Regarding Market Risk

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

The Company's earnings are affected by changes in interest rates as a result of variable rate indebtedness. If market interest rates for our variable rate indebtedness average 1% more than the interest rate actually paid for the first quarter ended March 31, 2008 and 2007, our interest rate expense would have increased, and income before income taxes would have decreased by $18,000 and $23,000 for these quarters, respectively. These amounts are determined by considering the impact of the hypothetical interest rates on our borrowings. This analysis does not consider the effects of the reduced level of overall economic activity that could exist in such an environment. Further, in the event of a change of such magnitude, management would likely take actions to reduce our exposure to such change. However, due to the uncertainty of the specific actions we would take and their possible effects, the sensitivity analysis assumes no change in our financial structure.

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

We have performed a sensitivity analysis as of March 31, 2008 that measures the change in the results of our foreign operations arising from a hypothetical 10% adverse movement in the exchange rate of all of the currencies the Company presently has operations in. Using the results of operations for the first quarter of 2008 and 2007 for the Company's foreign operations as a basis for comparison, an adverse movement of 10% would create a potential reduction in the Company's net income, or increase its net loss before taxes, in the amount of $45,000 and $45,000 for each of those quarters, respectively.

The Company is also exposed to market risk in changes in commodity prices in some of the raw materials it purchases for its manufacturing needs. However, this presents a risk that would not have a material effect on the Company's results of operations or financial condition.

Item 4. Controls and Procedures

(a) 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 March 31, 2008. 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, as amended (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.

(b) Changes in internal controls: There were no significant changes in our internal controls or in other factors that could significantly affect the Company's disclosure controls and procedures subsequent to the date of their evaluation, nor were there any significant deficiencies or material weaknesses in the Company's internal controls. As a result, no corrective actions were required or undertaken.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

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

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

Item 1A. Risk Factors

There have been no material changes from the risk factors as disclosed in the Company's Form 10-K in response to Item 1A to Part I of Form 10-K.

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

On April 10, 2008, the Company agreed to issue 50,000 shares of common stock to Babe Winkelman Productions, Inc. (BWP) in consideration of the services of BWP to be performed over the period of our agreement with them. The shares are to be issued on a restricted basis, for investment and are to be earned over a two year period, and the sale was not registered in reliance upon an exemption from registration for non-public offerings.

In February 2003, the Company received $1,630,000, in the aggregate, from John H. Schwan and Stephen M. Merrick in exchange for (a) two year 9% subordinated notes and (b) five year warrants to purchase an aggregate of 163,000 shares of common stock of the Company at the price of $4.87 per share. On February 8, 2008, those individuals exercised the warrants in exchange for the shares, based upon the principal amount of $794,000 of the subordinated notes. The notes, warrants and shares were issued on a restricted basis, for investment, and the sale of such notes, warrants and shares was not registered in reliance upon an exemption from registration for non-public offerings.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

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: *

Exhibit No.	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	Supply and License Agreement among Registrant and S.C. Johnson & Son, Inc. dated February 1, 2008 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 8-K/A dated March 19, 2008)
10.2	Agreement between Babe Winkelman Productions, Inc and the Company dated April 10, 2008 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 8-K dated April 14, 2008)
10.3	Amendment to License Agreement between Rapak, LLC and the Company dated May 6, 2008 (Incorporated by reference to Exhibit contained in Registrant's Report on Form 8-K dated May 8, 2008)
31.1	Sarbanes-Oxley Act Section 302 Certification for Howard W. Schwan
31.2	Sarbanes-Oxley Act Section 302 Certification for Stephen M. Merrick
32.1	Sarbanes-Oxley Act Section 906 Certification for Stephen M. Merrick, Chief Financial Officer
32.2	Sarbanes-Oxley Act Section 906 Certification for Howard W. Schwan, Chief Executive Officer

* 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: May 14, 2008	CTI INDUSTRIES CORPORATION		
		By:	/s/ Howard W. Schwan Howard W. Schwan, President
		By:	/s/ Stephen M. Merrick Stephen M. Merrick Executive Vice President and Chief Financial Officer

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