

# Taglich Brothers, Inc.

The Standard of Excellence in the Microcap Market

Member: NASD, SIPC

## Research Report - Update

*Investors should consider this report as only a single factor in making their investment decision.*

**UFP Technologies, Inc.**

**Rating: Buy**

John Nobile

**UFPT \$3.26 — (NASDAQ SC)**

June 29, 2004

	FY (2002)	FY (2003)*	FY (2004)E	FY (2005)E
Revenues (millions)	\$61.2	\$60.9	\$65.7	\$76.4
Earnings per share (diluted)	\$(0.05)	\$(0.34)	\$0.14	\$0.59

52week range	\$1.05 – \$4.05	Fiscal year ends:	December
Shares outstanding (millions)	4.6	Revenue per share (TTM)	\$13.58
Trading float (millions)	2.0	Price/Sales (TTM)	0.2X
Insider + 5% ownership	57%	Price/Sales (2005)E	0.2X
Tangible book value/share	\$1.39	Price/Earnings (TTM)	NA
Price/tangible book	2.3X	Price/Earnings (2005)E	5.5X

\*Includes a \$1.4 million restructuring charge.

*UFP Technologies is a designer and manufacturer of a broad range of high performance cushion packaging and molded fiber products and specialty foam and plastic products. These products are custom designed and fabricated or molded to provide protection for fragile and valuable items, and are sold primarily to original equipment manufacturers in the computer, electronics, automotive, medical/pharmaceutical and industrial markets. ([www.ufpt.com](http://www.ufpt.com))*

### **Key investment considerations:**

*We are reiterating our Buy rating for shares of UFP Technologies (UFPT) with a twelve-month price target of \$4.50 per share.*

*For the first quarter ended March 31, 2004, versus the same period in 2003, net sales increased 12% to \$15.9 million from \$14.2 million. Net income was \$0.1 million or \$0.01 per diluted share in the first quarter of 2004 versus a net loss of \$0.4 million or \$(0.08) per share in the same period in 2003.*

*We continue to believe that an investment in shares of UFPT represents good value at the current price when you consider the growth that industry forecasts suggest and the incremental revenue that the \$77 million contract should result in. We also believe that the Company's recent consolidation efforts should result in significant bottom-line increases with moderate increases in revenue.*

*For fiscal 2004, we estimate UFPT's sales will increase by 8% to \$65.7 million and the Company will report net income of \$0.7 million or \$0.14 per diluted share. For fiscal 2005, we estimate UFPT's sales will increase by 16% to \$76.4 million and the Company will report net income of \$2.9 million or \$0.59 per diluted share.*

*\*Please view our disclaimer located on page 8 of this report.*

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## ***Business***

The Company operates in two segments: Packaging Products and Component Products.

UFP Technologies' packaging products are used to contain, display and/or protect manufactured goods during shipment, handling, storage, marketing and use. The interior cushion packaging market is characterized by three primary sectors: (1) custom fabricated or molded products for low volume, high fragility products; (2) molded or die-cut products for high volume, industrial and consumer goods; and (3) loose fill and commodity packaging materials for products which do not require custom-designed packaging. Examples of the Company's packaging products include end-cap packs for computers, corner blocks for telecommunications consoles, anti-static foam packs for printed circuit boards, die-cut inserts for attaché cases and plastic trays for medical devices and components.

The Company's component products segment features specialty foam and plastic products that are sold primarily to customers in the automotive, sporting goods, medical, beauty, leisure and footwear industries. These products include components for automobiles and medical diagnostic equipment, abrasive nail files and anti-fatigue mats, and shock absorbing inserts used in athletic and leisure footwear.

## ***Recent Financial Results***

For the first quarter ended March 31, 2004, versus the same period in 2003:

- Net sales increased 12% to \$15.9 million from \$14.2 million.
- Gross margins increased to 20.3% from 15.9%.
- SG&A expenses increased to \$3.0 million from \$2.7 million.
- Net income was \$0.1 million or \$0.01 per diluted share versus a net loss of \$0.4 million or \$(0.08) per share.

In comparison, Taglich Brothers' estimates called for first quarter net sales of \$16.0 million and net income of \$0.1 million or \$0.02 per diluted share.

The increase in net sales was primarily due to increased Component Products sales to existing customers in the medical and military markets. The increase in gross margins was primarily due to economies-of-scale realized on increased sales partially offset by start-up costs associated with new automotive programs. The Company expects to continue to incur start-up costs associated with the new automotive program until its scheduled launch in the fourth quarter of 2004. The increase in SG&A expenses were primarily due to investments in the sales and marketing area as well as the ramp-up of the new automotive program.

### *Balance Sheet as of March 31, 2004*

Cash and cash equivalents was approximately \$0.2 million. The Company has working capital of \$1.4 million, a tangible book value of \$1.39 per share and a long-term debt-to-equity ratio of 0.5X. Cash provided by operations in the first quarter of fiscal 2004 was approximately \$0.4 million. UFPT has an available balance under its line of credit of approximately \$2.7 million. We believe that UFPT's current line of credit and future expected cash flows from operations will be sufficient to fund operations for the next twelve months.

## ***Discussion and Outlook***

Approximately one-half of UFPT's sales are generated from its components products segment and one-half from its packaging products segment. A significant portion of the Company's packaging products sales are to manufacturers of computer peripherals and other consumer products while a significant portion of component products sales are to the automotive industry. Because of this, UFPT's sales have a direct correlation with the level of sales in the automotive and computer/electronics Industry.

Although UFP Technologies has been downsizing over the last three years, it has invested in growth opportunities as evidenced by the anticipated launch of a large automotive program. The eight-year \$77 million contract calls for UFPT to provide molded door panels to a large Tier-1 automotive supplier with manufacturing expected to begin in the fourth quarter of 2004 and full rate production estimated for 2006. **We believe this should provide a significant boost to UFPT's components products sales in fiscal 2005 and beyond.**

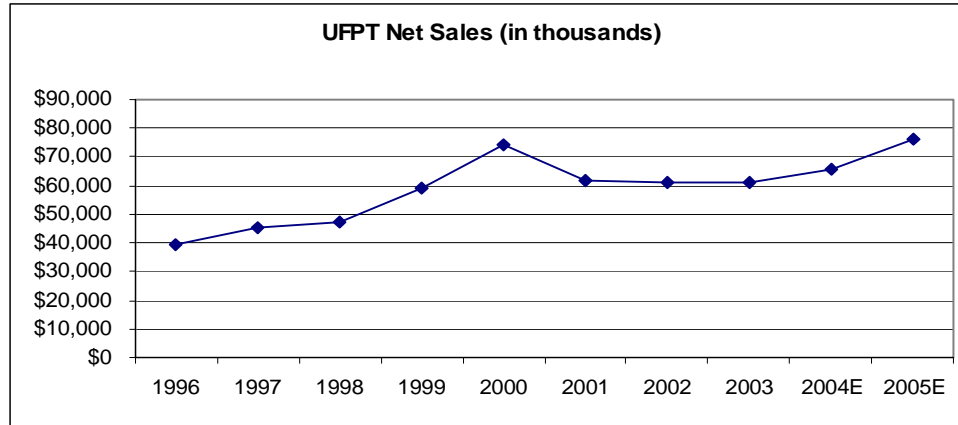
The Company has been preparing for this program for almost two years and has incurred significant operating expenses in 2003. UFP Technologies anticipates the increase in operating expenses associated with the automotive program will continue for the first three quarters of fiscal 2004. The Company originally committed to acquire certain equipment for a total of approximately \$3.4 million of which approximately \$1.7 million has already been incurred as of March 31, 2004.

We believe that there may be additional contracts for automotive trim products in the Company's future when you consider the positive outlook for this market. According to CSM Worldwide, the North American automotive interior trim market will grow to over \$10 billion by 2009 for a 33 percent increase from the \$7.5 billion market in 2004. CSM's figures represent the combined market value for the following interior components: door trim panels, floor carpeting, floor consoles, headliners, instrument panels and package trays. Don Montroy, CSM market analyst, North American Component Forecasts, said "there is a big push in North America to have interior trim materials, sound quality, and overall fit and finish to equal that of European and Japanese luxury models."

We believe that sales of UFP Technologies' packaging products should also do well in 2004 and 2005 when you take into consideration forecasts for the markets that the Company sells to. According to global IT researchers Gartner, Inc., U.S. enterprises increased IT spending in February and IT spending is on track for a 10% gain in 2004. The Gartner Technology Demand Index (TDI) showed that companies spent above their budgeted IT dollars in February with a recorded score of 105. The Gartner TDI is an index included in a monthly economic indicator published by Gartner. An index value of 100 means businesses spent exactly what they had budgeted for the month. An index of 105 means a net 5 percent more businesses are spending above their budgeted levels for 2004. This is the first time the monthly index has exceeded 100 since the launch of TDI in March 2003. **An increase in IT spending is what we believe will drive demand for UFPT's packaging products going forward.**

We believe the above information suggests that UFP Technology's sales should increase modestly in 2004 and show stronger growth in 2005.

For fiscal 2004, we estimate UFPT's sales will increase by 8% to \$65.7 million and the Company will report net income of \$0.7 million or \$0.14 per diluted share. For fiscal 2005, we estimate UFPT's sales will increase by 16% to \$76.4 million and the Company will report net income of \$2.9 million or \$0.59 per diluted share. Our earnings estimates have been reduced since our last report primarily due to an increase in the number of shares outstanding. Our estimates are made with the assumption that the \$77 million contract discussed earlier will be operating at approximately 50% of full rate production in 2005.



Source: UFPT reports and Taglich Brothers' estimates

## **Risks**

### *Cash concerns*

Although we believe that the Company will have adequate resources to fund operations for the next twelve months, future cash flows may be less than we anticipate due to depressed market conditions. If market conditions remain at weak levels, we believe UFP Technologies will need to secure additional financing in order to maintain its current level of operations. As there can be no assurance of the Company's success in obtaining additional capital, shares of UFPT should only be purchased by those who are comfortable taking on above average risk.

### *Competition*

The packaging and specialty foam products industry is highly competitive. The Company's foam and fiber packaging products compete against other alternative products made from materials such as expanded polystyrene foams, die-cut corrugated, plastic peanuts, plastic bubbles and foam-in-place urethane. UFP Technologies also faces competition in the specialty foam products area from smaller companies that typically concentrate on production for specific industries.

### *IT spending forecasts*

Although recent forecasts support an increase in IT spending for 2004 and 2005, there can be no assurance that this will actually happen. Should IT spending remain at depressed levels, the operating results of UFP Technologies are likely to be adversely affected.

### *Liquidity*

With only 4.6 million shares outstanding and 2.0 million in the float, liquidity issues must be considered. Average daily volume is approximately 20,000 shares. Any significant trading in shares of UFPT could result in large swings in the price of the stock.

*Miscellaneous risks*

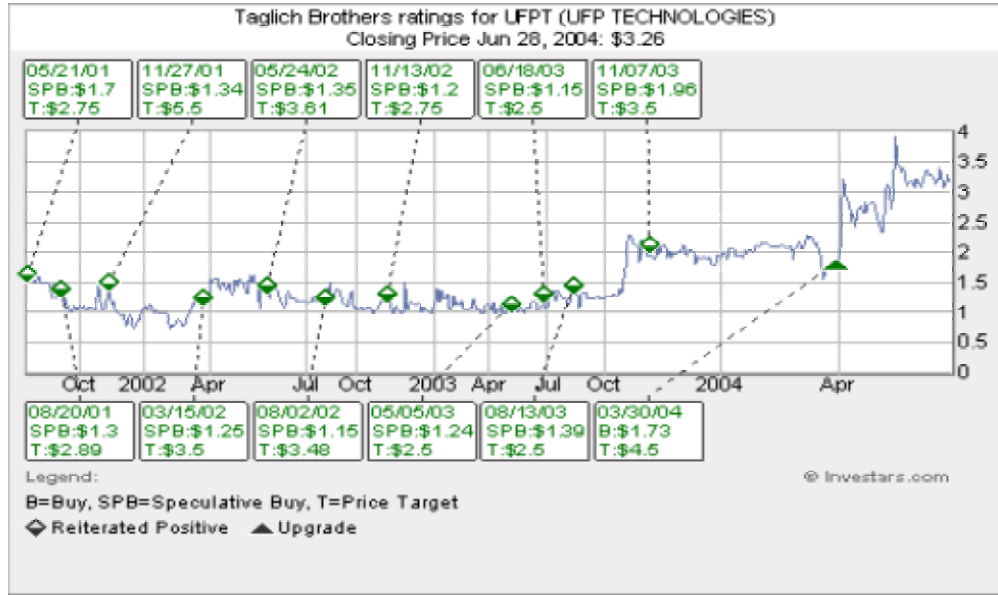
The Company's financial results and equity values are subject to other risks and uncertainties known and unknown, including but not limited to competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

***Conclusion***

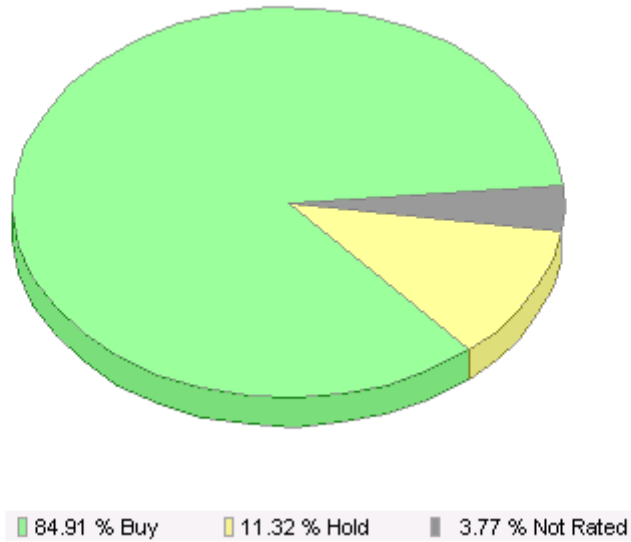
We are reiterating our **Buy** rating for shares of UFP Technologies (UFPT) with a **twelve-month price target of \$4.50 per share**.

We continue to believe that an investment in shares of UFPT represents good value at the current price when you consider the growth that industry forecasts suggest and the incremental revenue that the \$77 million contract should result in. We also believe that the Company's recent consolidation efforts should result in significant bottom-line increases with moderate increases in revenue.

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Taglich Brothers' Current Ratings Distribution



Meaning of Ratings

*Buy*

We believe the Company is undervalued relative to its market and peers. We believe its risk reward ratio strongly advocates purchase of the stock relative to other stocks in the marketplace. Remember, with all equities there is always downside risk.

*Speculative Buy*

We believe that the long run prospects of the Company are positive. We believe its risk reward ratio advocates purchase of the stock. We feel the investment risk is higher than our typical “buy” recommendation. In the short run, the stock may be subject to high volatility and continue to trade at a discount to its market.

*Neutral*

We will remain neutral pending certain developments.

*Underperform*

We believe that the Company may be fairly valued based on its current status. Upside potential is limited relative to investment risk.

*Sell*

We believe that the Company is significantly overvalued based on its current status. The future of the Company's operations may be questionable and there is an extreme level of investment risk relative to reward.

**Some notable Risks within the Microcap Market**

**Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.**

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From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.

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**I, John Nobile, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this report.**



UFP Technologies, Inc.

Consolidated Balance Sheets  
(in thousands)

	<u>March 31, 2004</u>	<u>December 31, 2003</u>
<b>Assets</b>		
Current assets	\$ 16,560	\$ 15,835
Net property, plant and equipment	11,119	11,473
Other assets	<u>9,433</u>	<u>9,441</u>
<b>Total Assets</b>	<b><u>\$ 37,112</u></b>	<b><u>\$ 36,749</u></b>
<b>Liabilities &amp; stockholders' equity</b>		
Current liabilities	\$ 15,131	\$ 14,626
Long-term debt	7,857	8,119
Other liabilities	<u>1,223</u>	<u>1,313</u>
<b>Total liabilities</b>	<b><u>24,211</u></b>	<b><u>24,058</u></b>
<b>Total stockholder's equity</b>	<b><u>12,901</u></b>	<b><u>12,691</u></b>
<b>Total liabilities &amp; stockholder's equity</b>	<b><u>\$ 37,112</u></b>	<b><u>\$ 36,749</u></b>

UFP Technologies, Inc.

Annual Income Statements for the Years Ended  
(in thousands)

	<u>FY(12/01)</u>	<u>FY(12/02)</u>	<u>FY(12/03)</u>	<u>FY(12/04)E</u>	<u>FY(12/05)E</u>
<b>Net sales</b>	<b>\$ 61,574</b>	<b>\$ 61,189</b>	<b>\$ 60,902</b>	<b>\$ 65,684</b>	<b>\$ 76,400</b>
Cost of sales	<u>50,649</u>	<u>49,084</u>	<u>50,178</u>	<u>52,190</u>	<u>58,064</u>
Gross profit	10,925	12,105	10,724	13,494	18,336
<i>Gross Margin</i>	17.74%	19.78%	17.61%	20.54%	24.00%
Restructuring charge	1,016	-	1,405	-	-
SG&A	<u>13,649</u>	<u>11,639</u>	<u>10,827</u>	<u>11,681</u>	<u>13,000</u>
Operating income	(3,740)	466	(1,508)	1,813	5,336
<i>Operating Margin</i>	-6.07%	0.76%	-2.48%	2.76%	6.98%
Interest expense, other income and expenses	<u>(1,014)</u>	<u>(843)</u>	<u>(847)</u>	<u>(774)</u>	<u>(800)</u>
Income before taxes	(4,754)	(377)	(2,355)	1,039	4,536
Income tax	<u>(1,711)</u>	<u>(143)</u>	<u>(839)</u>	<u>376</u>	<u>1,633</u>
<i>Tax rate</i>	35.99%	37.93%	35.63%	36.19%	36.00%
<b>Net Income / (Loss)</b>	<b><u>\$ (3,043)</u></b>	<b><u>\$ (234)</u></b>	<b><u>\$ (1,516)</u></b>	<b><u>\$ 663</u></b>	<b><u>\$ 2,903</u></b>
<b>Basic EPS</b>	<b><u>\$ (0.72)</u></b>	<b><u>\$ (0.05)</u></b>	<b><u>\$ (0.34)</u></b>	<b><u>\$ 0.15</u></b>	<b><u>\$ 0.62</u></b>
<b>Diluted EPS</b>	<b><u>\$ (0.72)</u></b>	<b><u>\$ (0.05)</u></b>	<b><u>\$ (0.34)</u></b>	<b><u>\$ 0.14</u></b>	<b><u>\$ 0.59</u></b>
Basic Shares Outstanding	4,248	4,343	4,490	4,519	4,650
Diluted Shares Outstanding	4,248	4,343	4,490	4,580	4,900
<u>Percent of Revenue</u>					
Cost of goods sold	82.26%	80.22%	82.39%	79.46%	76.00%
SG&A	22.17%	19.02%	17.78%	17.78%	17.02%
<u>Year / Year Growth</u>					
Total Revenues	-17.34%	-0.63%	-0.47%	7.85%	16.31%
Net Income	NA	NA	NA	143.73%	337.86%
EPS	NA	NA	NA	142.87%	309.26%

UFP Technologies, Inc.

Quarterly Income Statement for the Year Ending 2003  
(in thousands)

	<u>Q1(3/03)</u>	<u>Q2(6/03)</u>	<u>Q3(9/03)</u>	<u>Q4(12/03)</u>	<u>FY(12/03)</u>
<b>Net sales</b>	<b>\$ 14,245</b>	<b>\$ 15,353</b>	<b>\$ 16,056</b>	<b>\$ 15,248</b>	<b>\$ 60,902</b>
Cost of sales	<u>11,985</u>	<u>12,614</u>	<u>12,904</u>	<u>12,676</u>	<u>50,178</u>
Gross profit	2,260	2,739	3,152	2,572	10,724
<i>Gross Margin</i>	15.87%	17.84%	19.63%	16.87%	17.61%
Restructuring charge	-	-	-	1,405	1,405
SG&A	<u>2,686</u>	<u>2,640</u>	<u>2,906</u>	<u>2,595</u>	<u>10,827</u>
Operating income	(426)	99	246	(1,428)	(1,508)
<i>Operating Margin</i>	-2.99%	0.64%	1.53%	-9.37%	-2.48%
Interest expense, other income & expenses	<u>(168)</u>	<u>(208)</u>	<u>(184)</u>	<u>(288)</u>	<u>(847)</u>
Income before taxes	(594)	(109)	62	(1,716)	(2,355)
Income tax	<u>(226)</u>	<u>(13)</u>	<u>21</u>	<u>(621)</u>	<u>(839)</u>
<i>Tax rate</i>	38.05%	11.93%	33.87%	36.19%	35.63%
<b>Net Income / (Loss)</b>	<b><u>\$ (368)</u></b>	<b><u>\$ (96)</u></b>	<b><u>\$ 41</u></b>	<b><u>\$ (1,095)</u></b>	<b><u>\$ (1,516)</u></b>
<b>Basic EPS</b>	<b><u>\$ (0.08)</u></b>	<b><u>\$ (0.02)</u></b>	<b><u>\$ 0.01</u></b>	<b><u>\$ (0.24)</u></b>	<b><u>\$ (0.34)</u></b>
<b>Diluted EPS</b>	<b><u>\$ (0.08)</u></b>	<b><u>\$ (0.02)</u></b>	<b><u>\$ 0.01</u></b>	<b><u>\$ (0.24)</u></b>	<b><u>\$ (0.34)</u></b>
Basic Shares Outstanding	4,429	4,492	4,601	4,520	4,490
Diluted Shares Outstanding	4,429	4,492	4,601	4,520	4,490
<u>Percent of Revenue</u>					
Cost of goods sold	84.13%	82.16%	80.37%	83.13%	82.39%
SG&A	18.86%	17.20%	18.10%	17.02%	17.78%
<u>Year / Year Growth</u>					
Total Revenues	-8.28%	-7.78%	5.06%	11.08%	-0.47%
Net Income	NA	NA	NA	NMF	NA
EPS	NA	NA	NA	NMF	NA

UFP Technologies, Inc.

Quarterly Income Statement for the Year Ending 2004  
(in thousands)

	<u>Q1(3/04)</u>	<u>Q2(6/04)E</u>	<u>Q3(9/04)E</u>	<u>Q4(12/04)E</u>	<u>FY(12/04)E</u>
<b>Net sales</b>	<b>\$ 15,934</b>	<b>\$ 16,250</b>	<b>\$ 16,500</b>	<b>\$ 17,000</b>	<b>\$ 65,684</b>
Cost of sales	<u>12,692</u>	<u>12,984</u>	<u>13,101</u>	<u>13,413</u>	<u>52,190</u>
Gross profit	3,242	3,266	3,399	3,587	13,494
<i>Gross Margin</i>	20.35%	20.10%	20.60%	21.10%	20.54%
SG&A	<u>2,981</u>	<u>2,850</u>	<u>2,900</u>	<u>2,950</u>	<u>11,681</u>
Operating income	261	416	499	637	1,813
<i>Operating Margin</i>	1.64%	2.56%	3.02%	3.75%	2.76%
Interest expense, other income & expenses	<u>(174)</u>	<u>(200)</u>	<u>(200)</u>	<u>(200)</u>	<u>(774)</u>
Income before taxes	87	216	299	437	1,039
Income tax	<u>33</u>	<u>78</u>	<u>108</u>	<u>157</u>	<u>376</u>
<i>Tax rate</i>	37.93%	36.00%	36.00%	36.00%	36.16%
<b>Net Income / (Loss)</b>	<b><u>\$ 54</u></b>	<b><u>\$ 138</u></b>	<b><u>\$ 191</u></b>	<b><u>\$ 280</u></b>	<b><u>\$ 663</u></b>
<b>Basic EPS</b>	<b><u>\$ 0.01</u></b>	<b><u>\$ 0.03</u></b>	<b><u>\$ 0.04</u></b>	<b><u>\$ 0.06</u></b>	<b><u>\$ 0.14</u></b>
<b>Diluted EPS</b>	<b><u>\$ 0.01</u></b>	<b><u>\$ 0.03</u></b>	<b><u>\$ 0.04</u></b>	<b><u>\$ 0.06</u></b>	<b><u>\$ 0.14</u></b>
Basic Shares Outstanding	4,574	4,650	4,650	4,650	4,631
Diluted Shares Outstanding	4,821	4,900	4,900	4,900	4,880
<u>Percent of Revenue</u>					
Cost of goods sold	79.65%	79.90%	79.40%	78.90%	79.46%
SG&A	18.71%	17.54%	17.58%	17.35%	17.78%
<u>Year / Year Growth</u>					
Total Revenues	11.86%	5.84%	2.77%	11.49%	7.85%
Net Income	114.67%	244.17%	-366.73%	-125.54%	143.76%
EPS	114.21%	239.27%	-338.25%	-123.56%	140.26%

UFP Technologies, Inc.

Statement of Cash Flows for the Three Months Ended  
(in thousands)

	<u>March 31, 2004</u>	<u>March 31, 2003</u>
<i>Cash Flows from Operating Activities</i>		
Net income (loss)	\$ 54	\$ (368)
Depreciation & amortization	632	652
Minority interest earnings	15	-
Equity in income of uncons. affiliate and partnership	(12)	(17)
Stock issued in lieu of compensation	132	108
<i>Changes in assets and liabilities</i>		
Receivables	(410)	35
Inventories	(390)	(182)
Prepaid expenses and other	(48)	(771)
Accounts payable	345	768
Accrued restructuring charge, net	(185)	(103)
Accrued expenses and payroll	316	(728)
Other assets	-	(2)
<b>Net Cash Provided by Operations</b>	<b>449</b>	<b>(608)</b>
<i>Cash Flows from Investing Activities</i>		
Additions to property, plant and equipment	(93)	(136)
Payments from affiliated company	13	52
<b>Net Cash Used in Investing</b>	<b>(80)</b>	<b>(84)</b>
<i>Cash Flows from Financing Activities</i>		
Repayments of notes payable	(341)	(442)
Change in book overdrafts	288	333
Principal repayments of long-term debt	(258)	(6,678)
Principle repayments of capital lease obligations	(100)	(41)
Proceeds from long-term borrowings	-	7,500
Distribution to United Development Company partners	(105)	-
Net proceeds from sale of common stock	24	22
<b>Net cash Provided Financing</b>	<b>(492)</b>	<b>694</b>
<b>Net change in Cash</b>	<b>(124)</b>	<b>3</b>
<b>Cash - Beginning of Period</b>	<b>310</b>	<b>26</b>
<b>Cash - End of Period</b>	<b><u>\$ 186</u></b>	<b><u>\$ 29</u></b>