CTI INDUSTRIES CORP
Form 10-K/A
October 13, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K/A
Amendment No. 2
ANNUAL REPORT PURSUANT TO
SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2003

Commission File Number
000-23115

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

Illinois	36-2848943
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
22160 North Pepper Road Barrington, Illinois	60010
(Address of principal executive offices)	(Zip Code)

(847) 382-1000
Registrant's telephone number, including area code

Securities registered pursuant to Sections 12(b) and 12(g) of the Act:

Title of Class	Name of each exchange on which registered:
Common Stock, no par value	NASDAQ SmallCap Market

Check 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.

|X| Yes |_| No

Check if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated in Part III of the Form 10-K or any amendment to the Form 10-K.

The Registrant's revenues for the fiscal year ended December 31, 2003, were $36,259,638

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2) Yes |_| No |X|

Based upon the closing price of $3.00 per share of Registrant's Common Stock as reported on NASDAQ SmallCap Market at March 23, 2004, the aggregate market value of the voting stock held by non-affiliates of the Registrant was then approximately $2,860,335 (Determination of stock ownership by non-affiliates was made solely for the purpose of responding to the requirements

of the Form and the Registrant is not bound by this determination for any other purpose).

The number of shares of the Registrant's Common Stock outstanding as of December 31, 2003 was 1,918,420 (excluding treasury shares).

Transitional Small Business Disclosure Format (check one): Yes |_| No |X|

PART I

Item No. 1 Description of Business

Business Overview

CTI Industries Corporation is engaged in the development, manufacture, sale and distribution of two principal lines of products within a single segment:

- Novelty products, principally balloons, including metalized balloons, latex balloons, punch balls and other inflatable toy items.

- Specialty and printed films and flexible containers, for food packaging, specialized consumer uses and various commercial applications.

The Company was organized in 1976 and initially was principally engaged in the business of manufacturing bag-in-box plastic packaging systems. The Company sold its assets related to bag-in-box packaging systems in 1985. In 1978, the Company began manufacturing metalized balloons (sometimes referred to as "foil" balloons), balloons made of a base material (usually nylon) having vacuum deposited aluminum and polyethylene coatings. These balloons remain buoyant when filled with helium for much longer periods than latex balloons and permit the printing of graphic designs on the surface.

In 1985, the Company began marketing latex balloons and, in 1988, began manufacturing latex balloons. In 1994, the Company sold its latex balloon manufacturing equipment to a company in Mexico and entered into an arrangement for that company to manufacture latex balloons for the Company. The Company since has acquired majority ownership of the Mexican latex manufacturing company.

The Company's metalized and latex balloons and toy products are sold throughout the United States and in 30 foreign countries through a wide variety of retail outlets including general merchandise and drugstore chains, grocery chains, card and gift shops, and party goods stores, as well as through florists and balloon decorators.

Most metalized balloons contain printed characters, designs and social expression messages. The Company maintains licenses on numerous characters and designs, including, for example, Garfield(R), Precious Moments(R) and Hallmark. During 2002, the Company entered into agreements with Hallmark Cards to produce metalized balloons. The Party Express Division of Hallmark distributes these balloons to its customers and the Company also distributes these balloons to its distributors and customers.

On an increasing basis over the past five years, the Company also has engaged in the production, lamination, coating and printing of films and provides custom film products for a variety of commercial applications. These include (i) laminated and printed films for use in packaging applications and (ii) completed products for customer storage applications and for packaging applications. Revenues from this activity have grown rapidly and, during 2003,

represented approximately 48% of total Company revenue.

Background

CTI Industries Corporation (the "Company") was incorporated as Container Merger Company, Inc. under the laws of the State of Delaware on October 14, 1983, and changed its name to CTI Industries Corporation on August 2, 1985. A predecessor company, Creative Technology, Inc., was organized as an Illinois corporation on December 9, 1975 and was merged into the Company in February, 1984. On November 19, 2001, the Company was reincorporated in Illinois and is now an Illinois corporation. CTI Balloons Ltd. ("CTI Balloons"), the Company's wholly-owned subsidiary, was organized as a corporation under the laws of the United Kingdom on October 2, 1996. On October 24, 1996, the Company entered into an agreement with CTI Balloons pursuant to which all of the assets and liabilities of the Company in its branch operation in the United Kingdom were sold and transferred to CTI Balloons and all of the capital stock of CTI Balloons was issued and delivered to the Company. Unless otherwise specified, all references to the Company refer to the Company, its predecessor Creative Technology, Inc., its wholly-owned subsidiaries, CTI Balloons, CTF International, S.A. de C.V., and its majority-owned subsidiaries, CTI Mexico, S.A. de C.V. and Flexo Universal, S.A. de C.V.

In March and May of 1996, a group of investors made an equity investment of $1,000,000 in the Company in return for 366,300 shares of Preferred Stock, $.91 par value. Each share of Preferred Stock was entitled to an annual cumulative dividend of 13% of the purchase price, and was convertible into one share of Common Stock. The shares of Preferred Stock, voting separately as a class, were entitled to elect four of the Company's directors. Members of such investment group included Howard W. Schwan, John H. Schwan and Stephen M. Merrick, current members of management.

In July, 1997, the Company effected a recapitalization (the "Recapitalization") without a formal reorganization. As part of the Recapitalization, the Board of Directors approved the creation of Class B Common Stock, approved a 1 for 2.6 reverse stock split on both the Common Stock and Preferred Stock, and negotiated a conversion of all then outstanding shares of the Company's Convertible Preferred Stock into an aggregate of 366,300 shares of Class B Common Stock. The conversion was effective upon the closing of an initial public offering of 575,000 shares of the Company's Common Stock on November 5, 1997. The shares of Class B Common Stock contained rights identical to shares of Common Stock, except that shares of Class B Common Stock, voting separately as a class, had the right to elect four of the Company's seven directors. Shares of Common Stock and Class B Common Stock, voting together as a class, voted on all other matters, including the election of the remaining directors. The recapitalization, initial public offering and related transactions were approved by written consent of the shareholders. On July 1, 2002, all outstanding shares of Class B Common Stock, by their terms, were converted to common stock.

On October 15, 1999, the Company's Board of Directors approved a 1 for 3 reverse split of the Company's Common Stock and Class B Common Stock. The 1 for 3 reverse stock split became effective at the close of business on November 4, 1999, upon the approval and consent of a majority of Common and Class B Common Stockholders voting together as a single class. As a result of the reverse stock split, every three shares of the Company's Common Stock were reclassified and changed into one share of the Company's Common Stock with a new par value

of $.195 per share, and every three shares of the Company's Class B Common Stock were reclassified and changed into one share of the Company's Class B Common Stock, with a new par value of $2.73 per share. After the reincorporation of the Company in the State of Illinois, the Company's Common and Class B Common Stock ceased to have any par value.

On December 13, 2002, the Board of Directors of the Company declared a stock dividend of one share of Common Stock for each 5.25 shares of Common Stock outstanding. The record date for the dividend was December 27, 2002. Except for the elimination of par values and as otherwise indicated, share figures in this document have been restated to reflect the stock splits and stock dividends described above.

Mexico Operations. Through March, 2003, the Company's latex balloons were manufactured by CTI Mexico S.A. de C.V. ("CTI Mexico"), formerly known as Pulidos y Terminados Finos S.A. de C.V., a Guadalajara, Mexico company engaged principally in the manufacture of latex balloons, and commencing in March, 2003 by Flexo Universal, S.A. de C.V. ("Flexo Universal"). Both CTI Mexico and Flexo Universal are majority owned subsidiaries of the Company.

In 1995, the Company entered into an agreement with CTI Mexico under which (i) the Company sold to CTI Mexico all of its latex balloon manufacturing equipment (for the manufacture of decorator balloons), (ii) CTI Mexico agreed for a period of 10 years to supply balloons exclusively to the Company for sale in the United States and Canada manufactured on such equipment and (iii) for such 10 year period, CTI Mexico agreed to supply to the Company, exclusively in the United States except as to two other companies, all balloons manufactured by CTI Mexico. Commencing in 1996, CTI Mexico began manufacturing latex balloons for the Company.

In a series of transactions during the period 1998 through 2002, the Company acquired capital stock of CTI Mexico and, by August 2002, had acquired 98% ownership of CTI Mexico.

Through March, 2003, CTI Mexico conducted operations at four facilities in Guadalajara, Mexico having, in total, approximately 95,000 square feet of manufacturing, office and warehouse space. At these facilities, CTI Mexico produced, printed and packaged latex balloons, warehoused latex and foil balloons and conducted sales, marketing and administrative activities.

On February 22, 2003, CTI Mexico effected a spin off under Mexico law under which a portion of the assets, liabilities and capital of CTI Mexico were transferred to a newly-organized entity which operates under the name Flexo Universal S.A. de C.V. Flexo Universal is also 98% owned by the Company.

In January, 2003, Flexo Universal entered into a lease for approximately 43,000 square feet of manufacturing, office and warehouse space in Guadalajara, Mexico and all of the assets transferred to Flexo Universal in the spin-off were moved to that facility. On March 1, 2003, Flexo Universal commenced operations at this facility and now conducts balloon production, printing, packaging, warehousing and sales activities there.

In or about April, 2003, CTI Mexico ceased production of balloons at its leased facilities. The leases of one facility, consisting of three buildings, and another facility, consisting of one building, have been terminated and CTI

Mexico has vacated these locations.

Products

Metalized Balloons. The metalized balloon is composed of a base material (usually nylon) which is coated on one side with a vacuum deposited aluminum coating and on the other with polyethylene. Typically, the balloon film is printed with graphic designs and messages.

The Company manufactures over 450 balloon designs, in different shapes and sizes, including the following:

- Superloons(R) - 18" balloons in round or heart shape, generally made to be filled with helium and remain buoyant for long periods. This is the predominant metalized balloon size.
- Ultraloons(R) - 34" balloons made to be filled with helium and remain buoyant.
- Miniloons(R)- 9" balloons made to be air-filled and sold on holder-sticks or for use in decorations.
- Card-B-Loons(R)(4 1/2") - air-filled balloons, often sold on a stick, used in floral arrangements or with a container of candy.
- Shape-A-Loons(R) - shaped balloons made to be filled with helium.
- Minishapes - small shaped balloons designed to be air filled and sold on sticks as toys or inflated characters.
- Walk-abouts(R) - helium filled shaped balloons with attached arms and legs.

In addition to size and shape, a principal element of the Company's metalized balloon products is the printed design or message contained on the balloon. These designs include figures and licensed characters many of which are well-known. The Company maintains many of its own licenses for several characters, and, under an arrangement with Hallmark Cards Incorporated ("Hallmark"), manufactures and distributes balloons bearing a number of additional licensed characters. Some of these characters include Garfield(R), Precious Moments(R), Party Express(R), Kinka(R), Head First(R), Scooby Doo(R), Barbie(R), Batman(R), Spirit(R), Nascar(R), Hotwheels(R), Major League Baseball(R), Justice League(R), Star Wars(R), Butt Ugly Martians(R), Madeline(R), Mucha Lucha(R), Boohbah(R), Shrek(R) and several others. See "Patents, Trademarks and Copyrights" below.

Latex Balloons. The Company sells a high end line of latex balloons under the product line name Hi-Tex(R) and a standard line of latex balloons marketed under the name Partyloons(R). The Company also manufactures toy balloon products including punch balls and water bombs and "Animal Twisties."

Packaging Films. The Company produces and sells films which are utilized for the packaging of various products, principally food products. The Company laminates, extrusion coats and prints films and sells them to customers who utilize the films for packaging applications. The Company sells these products to companies who, generally, convert the film to bags or pouches for the packaging of food products.

Custom Film Products. The Company fabricates custom film products for various commercial and industrial purposes. These now include "dunnage" bags (inflatable pouches used to cushion products in packages) and flexible containers for the storage of clothing and personal items.

Markets

Metalized Balloons

The metalized balloon came into existence in the late 1970s. During the 1980s, the market for metalized balloons grew rapidly. Initially, the product was sold principally to individual vendors, small retail outlets and at fairs, amusement parks, shopping centers and other outdoor facilities and functions. Metalized balloons remain buoyant when filled with helium for extended periods of time and they permit the printing and display of graphics and messages. As a result, the product has significant appeal as a novelty and message item. Metalized balloons became part of the "social expression" industry, carrying graphics designs, characters and messages like greeting cards. In the mid-1980s, the Company and other participants in the market began licensing character and cartoon images for printing on the balloons and directed marketing of the balloons to retail outlets including grocery, general merchandise and drug store chains, card and gift shops, party goods stores as well as florists and balloon decorators. These outlets now represent the principal means for the sale of metalized balloons throughout the United States and in a number of other countries.

Metalized balloons are sold in the United States and in Europe, several countries in the Far East, Canada and to an increasing extent in Latin America. The United States, however, is by far the largest market for these products.

Metalized balloons are sold in the United States and foreign countries directly by producers to retail outlets and through distributors and wholesalers. Often the sale of metalized balloons by the wholesalers/distributors is accompanied by related products including latex balloons, floral supplies, candy containers, mugs, plush toys, baskets and a variety of party goods. Although the latex balloon market overlaps the metalized balloon market, the latex balloon market has been in existence for a longer period than metalized balloons and extends to more customers and market categories than metalized balloons.

Latex Balloons

There are several latex balloon product lines: (i) high quality decorator balloons, (ii) standard novelty balloons; (iii) printed balloons and (iv) toy categories. The high quality decorator balloons are generally sold to and through balloon decorators and floral outlets and are generally of higher quality and price than the standard line of balloons. The standard line of balloons is sold widely in retail stores including many of the same outlets as metalized balloons.

Printed latex balloons are sold both in retail outlets and for balloon decoration purposes including floral designs. "Toy" balloons include novelty balloons sold in toy departments or stores, punch balls, water bombs and other specialty designs.

Latex balloons are sold through many of the same outlets as metalized balloons including grocery, general merchandise and drug store chains, card and gift shops, party goods stores, florists and balloon decorators. Latex balloons

are sold in retail stores in packaged form as well as inflated. Also, certain latex items are sold in retail stores, generally in packaged form, as toy items.

Printed and Specialty Films

The industry and market for printed and specialty films is fragmented and includes many participants. There are hundreds of manufacturers of printed and specialty film products in the United States and in other markets. In many cases, companies who provide food and other products in film packages also produce or process the films used for their packages. The market for the Company's film products, and for its completed containers, consists principally of companies who utilize the films for the packaging of their products, including food products and other items. In addition to the packaging of food products, the flexible containers are used for medical purposes (such as colostomy bags, containers for saline solution and other items), "dunnage" (to cushion products being packaged), storage of personal and household items and other purposes.

The total volume of products manufactured and sold in this industry is estimated to be well in excess of $3 billion.

Marketing, Sales and Distribution

The Company markets and sells its metalized balloon, latex balloon and related novelty products throughout the United States and in a number of other countries. The Company maintains a marketing, sales staff and support staff of 9 individuals and a customer service department of 6 individuals. European sales are conducted by CTI Balloons, the Company's subsidiary located in Rugby, England. CTI Mexico and Flexo Universal conduct sales and marketing activities for the sale of balloon products in Mexico, Latin America, and certain other markets. Sales in other foreign countries are made generally to distributors in those countries and are managed at the Company's principal offices.

The Company sells and distributes its products principally through a network of approximately 600 distributors and wholesalers situated throughout the United States and in several foreign countries. These distributors and wholesalers are engaged principally in the sale of balloons and related products (including such items as plush toys, mugs, containers, floral supplies and other items). These distributors and wholesalers, in turn, sell balloons and related products to retail outlets including grocery, general merchandise and drug store chains, card and gift shops, party goods stores as well as florists and balloon decorators. Most sales are on an individual order basis.

The Company also sells balloons and related products to certain retail outlets including some chain stores. The Company's largest chain store customer is Eckerd Drug Stores.

In March, 2002, the Company entered into an arrangement with Hallmark, under which the Company agreed to produce metalized balloons for the Party Express Division of Hallmark incorporating designs provided by Party Express as well as licensed character designs under licenses held by Hallmark. Under the arrangement, the Company is also entitled to market and sell balloons incorporating these designs to its other customers. During 2003, sales to Hallmark were $4,007,000 or 11% of the Company's total sales revenue.

The Company engages in a variety of advertising and promotional activities to promote the sale of its balloon products. Each year, the Company produces a complete catalog of its balloon products, and also prepares various flyers and

brochures for special or seasonal products, which are disseminated to thousands of customers, potential customers and others. The Company participates in several trade shows for the gift, novelty, balloon and other industries and advertises in several trade and other publications.

The Company markets and sells its printed and laminated films and converted film products directly and through independent sales representatives. The Company sells laminated and printed films to companies that utilize these films to produce packaging for a variety of products, including food products, in both liquid and solid form, such as cola syrup, coffee, juices and other items. The Company markets its custom film products, including its "dunnage" bags (inflatable packaging pouches) and consumer storage bags directly to customers who use the products in their packaging systems or re-sell the products for commercial or consumer applications. During the 2003 fiscal year, the Company sold such products to four principal, and a number of smaller customers. The Company's largest customer in 2003 was ITW Spacebag whose purchases from the Company of consumer storage products totaled $10,298,000 for the year, about 28% of total Company sales. The Company has an agreement with ITW Spacebag under which ITW Spacebag is obligated through July 15, 2005 to purchase all of its requirements for film for use in consumer storage bags. ITW Spacebag has no contractual commitment to the Company for the purchase of finished storage bags. Rapak L.L.C., purchased approximately $5,360,000 in laminated films from the Company in 2003; these sales represented 14.7% of total Company revenues. The Company has an agreement with Rapak under which Rapak is obligated for a term expiring on October 31, 2005, to purchase 65% of its requirements for a certain type of film for packaging applications.

Manufacturing

Production and Operations.

The Barrington, Illinois headquarters incorporates the Company's principal production facilities. The facilities include converting machines which fabricate metalized balloons and packaging bags. These machines have the capacity to manufacture in excess of 60 million 18" balloons annually.

The Company owns and operates equipment for the development of films and plates utilized in the printing of films for metalized balloons and packaging films. The Company owns and operates one state of the art high-speed eight color press and two six color presses at its facility in Barrington, Illinois. The Company utilizes a water-based ink process for printing.

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The Company owns and operates one extrusion coating and lamination machine and one solventless laminator to produce films for use in metalized balloons, packaging films and specialty film products. The extrusion coating and laminating machine was acquired in 1999 and the laminator was acquired in 2002.

The Company maintains a graphic arts and development department which designs its balloon products and graphics. The Creative Department operates a networked, computerized graphic arts system for the production of these designs and of printed materials including catalogues, advertisements and other promotional materials.

The Barrington facility also includes a computerized customer service department which receives and fulfills over 86,000 orders annually.

The Company maintains a finished goods inventory of all balloon products at the Barrington facility and provides fulfillment for orders throughout the

United States and in a number of foreign countries.

Flexo Universal. Flexo Universal operates a facility in Guadalajara, Mexico which incorporates 43,000 square feet of production, printing, warehouse and office space. At the facility, (i) Flexo Universal produces latex balloons on three machines, (ii) prints latex balloons on two high-speed printing machines and several manually operated machines, (iv) produces formers for latex balloon production, (v) conducts mixing and pigment procedures and (vi) conducts sorting, quality control and balloon packaging activities. At this facility, Flexo Universal also warehouses raw materials and latex and metalized balloon products. Administrative and sales functions are also performed at the facility. A fourth balloon production machine is being assembled and a fifth machine has been purchased.

CTI Balloons Ltd. Through its wholly-owned subsidiary, CTI Balloons Ltd, the Company conducts a warehouse, fulfillment and sales operation in Rugby, United Kingdom for metalized and latex balloons. Sales and fulfillment for all of the United Kingdom, Europe and the Middle East are conducted from this facility.

Raw Materials

The principal raw materials used in manufacturing our products are (i) petroleum-based films, (ii) petroleum-based resin, (iii) latex and (iii) printing inks. At least to some degree, we have historically been able to change our product prices in response to changes in raw materials costs. While we currently purchase our raw materials from a relatively limited number of sources, films, resin and inks are available from numerous sources. Therefore, we believe our current suppliers could be replaced without adversely affecting our manufacturing operations in any material respect.

Competition

The balloon and novelty industry is highly competitive, with numerous competitors. There are presently six principal manufacturers of metalized balloons whose products are sold in the United States including Anagram International, Inc., Pioneer Balloon, Convertidora International, Barton Enterprises and Betallic. Several companies market and sell metalized

balloons designed by them and manufactured by others for them. In 1998, Anagram International, Inc. was acquired by Amscan Holdings and in 2000 M&D Balloons was acquired by American Greetings. During 2002, Amscan acquired M&D Balloons from American Greetings.

There are at least seven manufacturers of latex balloons whose products are sold in the United States.

The market for film packaging and custom products is fragmented, and competition in this area is difficult to gauge. However, there are numerous participants in this market and the Company can expect to experience intense quality and price competition.

Many of these companies offer products and services which are the same or similar to those offered by the Company and the Company's ability to compete depends on many factors within and outside its control. There are a number of well-established competitors in each of the Company's product lines, several of which possess substantially greater financial, marketing and technical resources and established, extensive, direct and indirect channels of distribution for

their products and services. As a result, such competitors may be able to respond more quickly to new developments and changes in customer requirements, or devote greater resources to the development, promotion and sale of their products and services than the Company. Competitive pressures include, among other things, price competition, new designs and product development and copyright licensing.

Patents, Trademarks and Copyrights

In connection principally with its metalized balloon business, the Company has developed or acquired a number of intellectual property rights which are significant to its business.

Copyright Licenses. The most significant of these rights are licenses on a number of popular characters. The Company presently maintains 8 licenses and produces balloon designs utilizing the characters covered by the licenses. Licenses are generally maintained for a one or two year term, although the Company has maintained long term relationships with several of its licensors and has been able to obtain renewal of its license agreements with them. Under its agreements with Hallmark, the Company is authorized to produce for Hallmark, and to sell as a distributor for Hallmark, a number of licensed characters.

Trademarks. The Company is the owner of 12 registered trademarks in the United States relating to its products. Many of these trademarks are registered in foreign countries, principally in the European Community.

Patent Rights. The Company is the owner of, or licensee under, several patents which related to both its metalized balloon products and its flexible container products. These include (i) ownership of two patents, and a license under a third, relating to self-sealing valves for metalized balloons and methods of making balloons with such valves, (ii) various metalized balloon design patents and (iii) patents and applications related to the design and structure of, and method of inserting and affixing, zipper-closure systems in a bag.

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Research and Development

The Company maintains a product development and research department of 8 individuals for the development or identification of new balloons and related products, product components and sources of supply. Research and development includes (i) creative product development, (ii) creative marketing, and (iii) engineering development. During the fiscal years ended December 31, 2002, and December 31, 2003, the Company estimates that the total amount spent on research and development activities was approximately $333,000 and $335,000, respectively.

Employees

As of December 31, 2003, the Company had 165 full-time employees in the United States, of whom 14 are executive or supervisory, 8 are in sales, 112 are in manufacturing and 31 are clerical. As of that same date, the Company had 10 full-time employees in England, of whom 2 are executive or supervisory, 1 is in sales, 4 are in warehousing and 3 are clerical. In Mexico, as of December 31, 2003, the Company had 178 full-time employees, of whom 17 are executive or supervisory, 3 are in sales, 143 are in manufacturing and 15 are clerical. The Company is not a party to any collective bargaining agreement in the United States, has not experienced any work stoppages and believes that its relationship with its employees is satisfactory.

Regulatory Matters

The Company's manufacturing operations are subject to the U.S. Occupational Safety and Health Act ("OSHA"). The Company believes it is in material compliance with OSHA. The Environmental Protection Agency regulates the handling and disposal of hazardous materials. As the Company's printing operations utilize only water-based ink, the waste generated by the Company's production process is not deemed hazardous. The Company believes it is in material compliance with applicable environmental rules and regulations. Several states have enacted laws limiting or restricting the release of helium filled metalized balloons. The Company does not believe such legislation will have any material effect on its operations.

International Operations.

The Company sells metalized balloons in a number of foreign countries through distributors situated in those countries. We conduct production, packaging, warehousing and sales operations in Mexico and warehousing and sales operations in the United Kingdom. Our operations in Mexico conduct the sale of metalized and latex balloons in Mexico and other markets in Latin America. Our operations in the United Kingdom conduct warehousing and sale of metalized and latex balloons in the United Kingdom and some countries in Europe. We rely and are dependent on our operations in Mexico for the supply of latex balloons in the United States, Mexico, Europe and other markets. Interruption of that supply would have a material adverse effect on the business of the Company.

Reference is made to Note 18 of the Consolidated Financial Statements contained in Part IV hereof for financial information on revenues and assets in our domestic and international operations.

Item No. 2 Properties

The Company owns its principal plant and offices located in Barrington, Illinois, approximately 45 miles northwest of Chicago, Illinois. The facility includes approximately 75,000 square feet of office, manufacturing and warehouse space. This facility is subject to a mortgage loan in the principal amount of $2,912,000, having a term of 5 years, with payments amortized over 30 years and bearing interest at the rate of 6.25% per year.

In August, 1998, the Company purchased a building that is adjacent to its principal plant and offices. This facility includes approximately 29,000 square feet of combined office and warehouse space. In November, 1999, the Company sold this building to a related party, and entered into a 10 year lease for the building at a monthly rental cost of $17,404. In May, 2003, the monthly rental cost of this building decreased to $15,500 per month.

The Company also leases approximately 15,000 square feet of office and warehouse space in Rugby, England at an annual lease cost of $51,700, expiring 2013. This facility is utilized for product packaging operations and to manage and service the Company's operations in England and Europe.

During 2003, CTI Mexico maintained under lease in Guadalajara, Mexico four buildings having approximately 95,000 square feet, in total, of production, warehouse and office space. One plant, consisting of three buildings, was occupied at a monthly lease rate of $5,500, and the other plant, consisting of one building was occupied under a three-year lease at a monthly lease rate of $4,500. The leases on these buildings have been terminated and CTI Mexico has

vacated these locations. In January, 2003, Flexo Universal entered into a 5 year lease agreement for the lease of approximately 43,000 square feet of manufacturing, warehouse and office space in Guadalajara, Mexico at the cost of $17,000 per month.

We believe that our properties have been adequately maintained, are in generally good condition and are suitable for our business as presently conducted. We believe our existing facilities provide sufficient production capacity for our present needs and for our presently anticipated needs in the foreseeable future. We also believe that, with respect to leased properties, upon the upon the expiration of our current leases, we will be able either to secure renewal terms or to enter into leases for alternative locations at market terms.

Item No. 3 Legal Proceedings

On September 5, 2003, Airgas, Inc., Airgas-Southwest, Inc., Airgas-South, Inc. and Airgas-East, Inc. filed a joint action against CTI Industries Corporation for claimed breach of contract in the Circuit Court of Lake County, Illinois claiming as damages the aggregate amount of $162,242. The Company has filed an answer denying the material claims of the complaint, affirmative defenses and a counterclaim. In the action, the plaintiffs claim that CTI Industries Corporation owes them certain sums for (i) helium sold and delivered, (ii) rental charges with respect to helium tanks and (iii) replacement charges for tanks claimed to have been lost. The Company intends to vigorously defend this action and to pursue its counterclaim.

In addition, the Company is also 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, we do not believe any of these proceedings will have, individually or in the aggregate, a material adverse effect upon our financial condition or future results of operation.

Item No. 4 Submission of Matters to a Vote of Security Holders

Not Applicable.

PART II

Item No. 5 Market for Registrant's Common Equity and Related Stockholder Matters

Market Information. The Company's Common Stock was admitted to trading on the NASDAQ SmallCap Market under the symbol CTIB on November 5, 1997. Prior to that time, there was no established public trading market for the Company's Common Stock.

The high and low sales prices for the last eight fiscal quarters (retroactively adjusted to reflect post-reverse split share and stock dividend values), according to the NASDAQ Stock Market's Stock Price History Report, were:

	High	Low
January 1, 2002 to March 31, 2002	1.55	1.30
April 1, 2002 to June 30, 2002	6.26	1.52
July 1, 2002 to September 30, 2002	4.47	2.05
October 1, 2002 to December 31, 2002	6.90	2.23
January 1, 2003 to March 31, 2003	6.22	4.75

April 1, 2003 to June 30, 2003	5.04	1.76
July 1, 2003 to September 30, 2003	2.45	1.70
October 1, 2003 to December 31, 2003	2.49	1.79

As of March 23, 2004, there were approximately 45 holders of record of the Company's Common Stock. It is estimated that there are in excess of 300 beneficial owners of the Company's Common Stock.

The Company has never paid any cash dividends on its Common Stock and does not currently intend to pay cash dividends on its Common Stock in the foreseeable future. The Company currently intends to retain all its earnings to finance the development and expansion of

its business. Under the terms of its current loan agreement, the Company is restricted from declaring any cash dividends or other distributions on its shares.

Recent Sales of Unregistered Securities

In June, 1999, the Company issued a note to John C. Davis, a former director and officer for $150,000 with a maturity of February 28, 2001, replacing an existing note in that amount. Mr. Davis' June, 1997, warrant to purchase up to 19,078 shares of the Company's common Stock at an exercise price of $7.86 per share was cancelled in September, 1999, and a new warrant to purchase up to 19,078 shares of the Company's Common Stock at an exercise price of $1.418 per share, with an expiration date of June 30, 2003, was issued in its place. Mr. Davis' June, 1999, Note was paid in full by the Company in February, 2001. Mr. Davis' September, 1999 warrant expired unexercised on June 30, 2003.

In June, 1999, notes of the Company to Howard W. Schwan, John Schwan, and Stephen Merrick in the amounts of respectively, $50,000, $350,000 and $315,000, came due. On November 9, 1999, new notes in the same principal amounts were issued to Messrs. H. Schwan, J. Schwan and Merrick, in payment and replacement of the prior notes with maturity dates for each of November 9, 2001. In November, 1999, the June, 1997 warrants of Messrs. H. Schwan, J. Schwan and Merrick to purchase up to (respectively) 6,359, 44,515 and 40,063 shares of the Company's Common Stock at an exercise price of $7.86 per share were cancelled. At that time, new warrants to purchase up to 35,263, 246,840 and 222,157 shares of the Company's Common Stock at an exercise price of $1.418 per share were issued to Messrs. H. Schwan, J. Schwan and Merrick, respectively. Each of these warrants were exercised on June 3, 2002. The respective $50,000, $350,000 and $315,000 notes were cancelled and used as payment for the warrant shares.

In July, 2001, the Company issued warrants to purchase up to 79,364 shares of the Company's Common Stock to John H Schwan and 39,683 shares of the Company's Common Stock to Stephen M. Merrick. The warrants were issued in consideration of Mr. Schwan and Mr. Merrick each personally guaranteeing and securing loans to the Company in the amount of approximately $1,600,000. The warrants are exercisable for a period of five years at a price of $1.50 per share.

During February, 2003, John H. Schwan loaned $930,000 to the Company and Stephen M. Merrick loaned $700,000 to the Company, each in exchange for (i) two year promissory notes bearing interest at 9% per annum and (ii) five year warrants to purchase up to 163,000 shares of Common Stock of the Company at $4.87 per share, the market price of the Common Stock on the date of the Warrants. The proceeds of these loans were to (i) re-finance the bank loan of CTI Mexico in the amount of $880,000 and (ii) to provide financing for CTI

Mexico and Flexo Universal.

Item No. 6 Selected Financial Data

The following selected financial data are derived from the consolidated financial statements of the Company. The data should be read in conjunction with the consolidated financial statements, related notes, and other financial information included herein.

(In thousands, except per share data)

	Year ended December 31,			
	2003	2002	2001	2
Statement of Income Data:				
Net Sales	$ 36,260	$ 41,236	$ 27,446	$ 2
Costs of Sales	$ 29,627	$ 32,344	$ 19,835	$ 1
Gross Profit	$ 6,633	$ 8,892	$ 7,611	$
SG &A	$ 7,312	$ 7,447	$ 6,595	$
(Loss) Income from Operations	$ (679)	$ 1,445	$ 1,016	$
Interest expense	$ 1,103	$ 832	$ 1,030	$
Other (income) expense	$ (433)	$ 278		$
Income (loss) before taxes and minority interest	$ (1,349)	$ 335	$ (14)	$ (
Income tax expense (benefit)	$ (782)	$ 39	$ 276	$
Minority interest	$ 0	$ 6	$ 58	$
Net Income (loss)	$ (566)	$ 302	$ (232)	$ (
Earnings (loss) per common share(1)				
Basic	$ (0.30)	$ 0.18	$ (0.15)	$
Diluted	$ (0.30)	$ 0.16	$ (0.15)	$
Earnings(loss) from operations per Common Share (1)				
Basic	$ (0.35)	$ 0.86	$ 0.67	$
Diluted	$ (0.35)	$ 0.77	$ 0.67	$
Other Financial Data:				
Gross margin percentage	18.29%	21.56%	27.73%	
Capital Expenses	$ 1,141	$ 2,478	$ 1,002	$
Depreciation & Amortization	$ 1,619	$ 1,588	$ 1,666	$
Balance Sheet Data:				
Working capital	$ (706)	$ (2,907)	$ (278)	$ (
Total assets	$ 30,270	$ 30,272	$ 24,664	$ 2
Short-term obligations(3)	$ 6,692	$ 7,385	$ 7,074	$
Long-term obligations	$ 9,220	$ 5,726	$ 5,737	$

Total obligations	$ 15,912	$ 13,111	$ 12,811	$ 1
Stockholders' Equity	$ 5,212	$ 5,474	$ 4,325	$

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(1) Two months ended December 31, 1999 have been omitted.

(3) Short-term obligations consist primarily of borrowings under bank lines of credit and the current portion of long-term debt

Item No. 7 Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company produces 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, and all of our metalized balloons at our facility 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.

In 2003, our revenues as a percentage of total consolidated sales from each of our principal product categories was as follows:

Commercial Films And Containers	48%
Metalized Balloons	34%
Latex Balloons	11%

Over the past several years, revenues from commercial films and containers have increased significantly as a percentage of sales. As a percentage of total sales, revenues in this category have increased from a level of 17% of revenues in 1998 to approximately 48% of total company revenues during the past two years. The increase in sales in this product category have accounted for most of the increase in consolidated sales over the past five years.

Purchases by a limited number of customers represent a significant portion of total Company revenues. In 2003, sales to our top 10 customers represented 68% of total revenues. Of those principal customers, one is a customer for storage containers and represented 28% of total 2003 revenues, one is a customer for packaging film and represented 14.7% of total 2003 revenues and one is a customer for metalized balloons and represented 11% of total 2003 revenues. For the most part, with our principal customers, we do not have long-term purchase agreements or commitments and the risk exists that sales to one or more of these customers will decline or terminate. With one customer for packaging film, however, we do have a contract extending through October, 2005, under which the customer is obligated to purchase at least 65% of that customer's requirements for the packaging film and with our customer for storage containers, we do have

an agreement extending through July, 2005 under which that customer has agreed, subject to certain conditions, to purchase its requirements for the film used in the storage bags. Loss of one or more of these principal customers, or a significant reduction in purchases by one or more of them, could have a material adverse effect on the business of the Company.

We have experienced declines in our gross margins over the past several years. In general, gross margins have declined from almost 28% in 2001 to 18.3% in 2003. Most of this decline in gross margins relates to metalized balloons. Margins in that product category have declined from 27% in 2001 to 10.4% in 2003. The decline in margin is attributable both to price competition and to increases in the costs principally of factory overhead and direct labor, and, to a limited degree in 2003, of raw materials. We have experienced significant increases in factory overhead costs over the past three years, including insurance costs, health insurance costs, supervisory wages, quality control wages and depreciation.

Our business plan includes:

- Continued focus on our existing product categories, including efforts to generate additional revenues in these categories.
- Efforts to control and reduce manufacturing costs, particularly factory overhead and direct labor costs.
- Efforts to develop new products, product improvements and technologies in our existing product categories.
- Development of new sales and marketing channels and relationships.

We have engaged in ongoing efforts during 2003 to achieve reduction in factory overhead. In the fourth quarter of 2003, our factory overhead in the U.S. was 17% less than in the first quarter. We intend to continue these efforts and believe that we will achieve additional reductions in factory overhead and direct labor costs during 2004.

Results of Operations

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Net Sales. For the fiscal year ended December 31, 2003, consolidated revenues from the sale of all products were $36,260,000, compared to consolidated revenues of $41,236,000 for the year ended December 31, 2002, a decrease of 12%. This decrease in revenues is the result principally of (i) an 11% decrease in sales of printed and laminated films from $19,621,000 in 2002 to $17,439,000 in 2003, (ii) a 24% decrease in sales of metalized balloons from $16,392,000 in 2002 to $12,405,000 in 2003 and (iii) a 17% decrease in the sales of latex balloons from $4,948,000 in 2002 to $4,125,000 in 2003. These revenue decreases are attributable principally to decreases in sales to three principal customers. Sales in 2002 to these three customers were as follows: (i) $12,086,000 to a customer for consumer storage bags, (ii) $7,000,000 to a customer for packaging films and (iii) $5,111,000, to a customer for metalized balloons. During 2003, sales to each of those customers, respectively, were: (i) $10,298,000, (ii) $5,360,000 and (iii) $4,006,000.

For the fiscal year 2003, on a consolidated basis, metalized balloons represented 34% of sales, laminated and printed films 48% of sales and latex

balloons 11% of sales. During fiscal 2002, metalized balloons represented 40% of sales, laminated and printed films 48% of sales and latex balloons 12% of sales.

Cost of Sales. For fiscal 2003, cost of sales increased to 81.7% of net sales compared to 78.4% of net sales for fiscal 2002. In fiscal 2003, profit margins on metalized balloons, latex balloons and laminated and printed film were 10.4%, 9.1% and 34.9%, respectively, compared to margins on the same product lines for 2002 of 24.3%, 17.5% and 27.5%. The reduction in margins with respect to metalized balloons in 2003 is attributable principally to pricing affected by price competition and to increases in production overhead.

General and Administrative. For fiscal 2003, administrative expenses were $4,055,000, or 11.2% of net sales, as compared to $4,225,000 or 10.2% of net sales for fiscal 2002. The decrease in administrative expenses is attributable to decreases in personnel and compensation expense, audit expenses, legal expenses and consulting fees.

Selling. For fiscal 2003, selling expenses were $1,442,000 or 4% of net sales compared to $1,551,000, or 3.8% of net sales for fiscal 2002. There was no significant change in selling expenses from 2002 to 2003.

Marketing and Advertising. For fiscal 2003, advertising and marketing expenses were $1,816,000 or 5% of net sales, compared to $1,671,000 or 4.1% of sales for fiscal 2002. The increase is attributable principally to increases in artwork and films and trade show expense.

Other Expense. For fiscal 2003, interest expense and loan fees totaled $1,103,000. For fiscal 2002, interest expense was $832,000. The increase in interest expense is attributable principally to increased levels of borrowing and an increased average rate of interest on outstanding indebtedness. The Company had currency exchange losses during 2003 of $36,000 compared to currency exchange losses during fiscal 2002 of $281,000. The Company had other income during 2003 of $428,000 arising principally from the forgiveness of certain indebtedness; the Company had no such income during 2002.

Net Income or Loss. For the fiscal year ended December 31, 2003, the Company had a loss before taxes and minority interest of $1,349,000 compared to income before taxes and minority interest for fiscal 2002 of $335,000. The net loss for fiscal 2003 was $566,000 compared to net income for fiscal 2002 of $303,000.

Income Taxes. For the fiscal year ended December 31, 2003, the Company had an income tax benefit of $782,000 compared to an income tax expense of $39,000 for fiscal 2002. The amount of the income tax expense or benefit recognized by the Company for both 2003 and 2002 reflects adjustments in deferred tax assets and other items arising from the operating results of the Company for each year.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

For the fiscal year ended December 31, 2002, consolidated revenues from the sale of all products were $41,236,000, compared to consolidated revenues of $27,446,000 for the year ended December 31, 2001, an increase of 50%. This increase in revenues was the result principally of (i) a 72% increase in sales of printed and laminated films from 11,438,000 in 2001 to 19,621,000 in 2002 and (ii) a 61% increase in sales of metalized balloons from $10,155,000 in

2001 to $16,392,000 in 2002. These sales revenues increases are attributable principally to increases in sales to three principal customers. Sales in 2002 to these three customers were as follows: (i) $12,086,000, or 29% of total revenues to a customer for consumer storage bags, (ii) $7,000,000 representing 17% of total sales to a customer for packaging films and (iii) $5,111,000, representing 12.4% of total sales, to a customer for metalized balloons.

For the fiscal year 2002, on a consolidated basis, metalized balloons represented 40% of sales, laminated and printed films 48% of sales and latex balloons 12% of sales. During fiscal 2001, metalized balloons represented 37% of sales, laminated and printed films 44% of sales and latex balloons 19% of sales.

Cost of Sales. For fiscal 2002, cost of sales increased to 78.4% of net sales compared to 72.3% of net sales for fiscal 2001. In fiscal 2002, profit margins on metalized balloons, latex balloons and laminated and printed film were 24.3%, 17.5% and 27.5%, respectively, compared to margins on the same product lines for 2001 of 27.1%, 14.1% and 33%. The reduction in margins with respect to metalized balloons in 2002 is attributable principally to sales of balloons to one significant customer at prices and margins lower than other customers. Also, the Company experienced higher than normal production costs during the second half of 2002 arising from the installation of new equipment and the need to respond to large volume requirements. With respect to laminated and printed films, the reduction in margins during 2002 is attributable principally to (i) greater allocation of production overhead costs to this product line, (ii) an increase in resin costs and (iii) increased costs associated with the installation and operation of new equipment.

General and Administrative. For fiscal 2002, administrative expenses were $4,225,000, or 10.2% of net sales, as compared to $3,702,000 or 13.5% of net sales for fiscal 2001. The increase in administrative expenses is attributable to increases in personnel and compensation, insurance premiums, litigation settlement costs, audit expenses, consulting fees and travel expenses. Additionally, in June, 2002, the Company entered into a settlement agreement of pending litigation, incurring an expense of $105,000.

Selling. For fiscal 2002, selling expenses were $1,551,000 or 3.8% of net sales compared to $1,760,000, or 6.4% of net sales for fiscal 2001. The decline in selling expense resulted from reductions in several expense items including royalty payments and commissions.

Marketing and Adverstising. For fiscal 2002, advertising and marketing expenses were $1,671,000 or 4.1% of net sales, compared to $1,133,000 or 4.1% of sales for fiscal 2001. The increase is attributable principally to the expense of additional personnel and compensation expenses.

Other Expense. For fiscal 2002, interest expense and loan fees totaled $832,000. For fiscal 2001, interest expense was $1,126,000. The reduction in interest expense is attributable principally to lower applicable interest rates. The Company had currency exchange losses during 2002 of $281,000 compared to currency gains during fiscal 2001 of $89,000.

Net Income or Loss. For the fiscal year ended December 31, 2002, the Company had income before taxes and minority interest of $335,000 compared to a loss before taxes and minority interest for fiscal 2001 of $14,000. The net income for fiscal 2002 was $303,000 compared to a net loss for fiscal 2001 of $232,000.

Income Taxes. For the fiscal year ended December 31, 2002, the Company had income tax expense of $39,000 compared to an income tax expense of $277,000 for fiscal 2001. The amount of the income tax expense recognized by the Company for both 2002 and 2001 reflects adjustments in deferred tax assets and other items arising from the operating results of the Company for each year.

Contracts with foreign suppliers are stated in U.S. dollars and the Company is not subject to currency rate fluctuations on these transactions. The effect of currency rate fluctuations on intercompany transactions with the Company's England subsidiary and Mexico subsidiary has not been material. As a result, the Company has not hedged against currency rate fluctuations.

Financial Condition

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Cash Flow From Operations. Cash flow provided by operations for the fiscal year ended December 31, 2003 was $3,208,000. Cash flow from operations resulted principally from increases in accounts payable of $1,130,000 and in depreciation and amortization of $1,619,000, and a reduction in, or disposition of, receivables, and inventory and other assets totaling $1,113,000 offset by an increase in the deferred income tax benefit of $782,000. Cash flow generated by operations for the fiscal year ended December 31, 2002, was $3,051,000.

Cash Used in Investing Activities. During fiscal 2003, the Company invested $2,007,000 in machinery and equipment. During fiscal 2002, the Company invested $2,478,000 in machinery and equipment.

Cash From Financing Activities. Cash used in financing activities during fiscal 2003 was $804,000. The net cash use of funds in financing activities during 2003 reflects (i) sources of cash including proceeds from a new term loan, an amended mortgage loan, subordinated loan advances and officer loans and (ii) uses of cash including payments on the term loans and mortgage loan and on vendor notes. During fiscal 2002, cash flow used in financing activities was $513,000.

On December 31, 2003, the Company entered into a Loan and Security Agreement with a bank under which the lender has provided the Company with a credit facility in the amount of $11,000,000, collateralized by equipment, inventory, receivables and other assets of the Company. The credit facility includes a term loan of $3,500,000, at an interest rate of prime plus 1.5% per annum, which is based upon the appraised value of the equipment of the Company, and a revolving line of credit, up to a maximum amount of $7,500,000 at an interest rate of prime plus 1.5% per annum. Advances under the revolving line of credit include advances of up to 85% of eligible receivables and up to 50% of the value of the Company's inventory. The term loan and revolving line of credit are secured by substantially all assets of the Company. In

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connection with the Loan Agreement, two principals of the Company have executed agreements pursuant to which they have agreed, in the event appraisals of the Company's machinery and equipment to be performed during 2004 indicates values less than those specified in the Loan Agreement, to provide guarantees of a portion of the term loan or subordinated loan funds to the Company. The term of this credit facility is for a period of 2 years expiring on December 31, 2005, and is automatically extended after that date from year to year unless (i) the

bank accelerates the payment of the obligations under the Loan Agreement or (ii) either party elects to terminate by giving notice of termination 90 days before the expiration of the original or any renewal term.

Certain terms of the Loan Agreement include: (i) the requirement that the Company maintain a specified level of tangible net worth and a ratio of EBITDA to fixed charges, (ii) mandatory prepayment of the term loan (A) from the proceeds of the sale or disposition of equipment and (B) 50% of excess cash flow of the Company during 2004 and (iii) a prohibition of various acts including (A) incurring new debt, (B) engaging in acquisitions, (C) paying dividends, (D) purchasing stock, without the consent of the Bank.

With respect to the EBITDA to fixed charges and tangible net worth covenants, the bank has issued a waiver of violations of the covenants as of December 31, 2003. For periods after December 31, 2003 the bank has agreed to modify the covenants, both the tangible net worth and ratio of EBITDA of fixed charges, to reduced levels with a measurement date commencing January 1, 2004.

Approximately $6,763,000 in proceeds from this new loan were used to pay to a prior senior lender the entire balance due to that lender consisting of $2,540,000 in term loans and $4,223,000 in revolving loans

In January, 2001, the Company entered in to a Loan and Security Agreement with an institutional lender under which the lender provided the Company with a credit facility in the amount of $9,500,000, collateralized by equipment, inventory, receivables and other assets of the Company. The credit facility included a term loan of $1,426,000, at an interest rate of prime plus 0.75% per annum, which was based upon the appraised value of the equipment of the Company and a revolving line of credit at an interest rate of prime plus 0.5% per annum, the amount of which was based on advances of up to 85% of eligible receivables and up to 40% of the value of the Company's inventory. In 2002, the lender advanced additional funds on the original term loan in the amount of $490,880 and advanced a second term loan in the amount of $1,740,000 and increased the credit facility to $11,500,000. The term loans and revolving line of credit were secured by substantially all assets of the Company. The term of this credit facility was for a period of three years expiring on January 15, 2004. On December 31, 2003, the entire balance due to the lender was paid and the credit facility with that lender terminated.

In January, 2001, another bank loaned to the Company the sum of $2,873,000 in a refinance of the Company's principal office building and property situated in Barrington, Illinois. This loan is secured by this building and property, and has been made in the form of two notes: one note is in the principal amount of $2,700,000, bears interest of 9.75% per annum, and has a term of five years with a 25 year amortization, and the second note is in the principal amount of

$173,000, bears interest at 10% per annum, and has a term of three years. In May, 2003, this loan was amended to increase the principal amount of the first note to $2,912,000 and to reduce the interest rate to 6.25% per annum. The second note was paid in full as of January 5, 2004.

Current assets. As of December 31, 2003, the total current assets of the Company were $15,435,000 compared to total current assets of $16,138,000 as of December 31, 2002. The change in current assets reflects, principally, a decrease in inventory of $770,000 and decrease in receivables of $765,000, partially offset by an increase in prepaid expenses and other current assets of $549,000.

Inventory. The net inventory of the Company decreased from $10,034,000 as

of December 31, 2002 to 9,263,000 as of December 31, 2003. The decrease reflected principally a reduction in latex balloon inventory.

Property, Plant and Equipment. During fiscal 2003, the Company invested $2,007,000 in capital items. Most of this investment was in production equipment. During 2002, the Company invested $2,478,000 in capital items.

Current liabilities. Total current liabilities decreased from $19,045,000 as of December 31, 2002 to $16,140,000 as of December 31, 2003. This decrease is attributable principally to a decrease in accounts payable from $9,581,000 as of December 31, 2002 to $6,799,000 as of December 31, 2003, which occurred principally by reason of the conversion of $3,534,000 of vendor obligations to term debt. Also, the amount outstanding on the line of credit was reduced from $5,643,000 on December 31, 2002 to $3,694,000 on December 31, 2003.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Cash Flow From Operations. Cash flow provided by operations for the fiscal year ended December 31, 2002 was $3,039,000. In addition to earnings, the funds provided resulted principally from increases in accounts payable of $3,910,000 and in depreciation and amortization of $1,588,000, offset by increases in accounts receivable of $1,075,000 and in inventory of $1,965,000. Cash flow generated by operations for the fiscal year ended December 31, 2001, was $624,000.

Cash Used in Investing Activities. During fiscal 2002, the Company invested $2,478,000 in machinery and equipment. During fiscal 2001, the Company invested $1,002,000 in machinery and equipment.

Cash From Financing Activities. Cash used in financing activities during fiscal 2002 was $513,000. The cash used in financing activities was principally to pay down the credit facility. During fiscal 2001, cash flow provided by financing activities was $102,000.

In January, 2001, the Company entered into a Loan and Security Agreement with an institutional lender under which the lender provided the Company with a credit facility in the amount of $9,500,000, collateralized by equipment, inventory, receivables and other assets of the Company. The credit facility included a term loan of $1,426,000, at an interest rate of prime plus 0.75% per annum, which was based upon the appraised value of the equipment of the Company and a revolving line of credit at an interest rate of prime plus 0.5% per annum, the amount of

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which was based on advances of up to 85% of eligible receivables and up to 40% of the value of the Company's inventory. In 2002, the lender advanced additional funds on the original term loan in the amount of $490,880 and advanced a second term loan in the amount of $1,740,000 and increased the credit facility to $11,500,000. The term loans and revolving line of credit were secured by substantially all assets of the Company. The term of this credit facility was for a period of three years expiring in January, 2004.

Also in January, 2001, another bank loaned to the Company the sum of $2,873,000 in a refinance of the Company's principal office building and property situated in Barrington, Illinois. This loan is secured by this building and property, and has been made in the form of two notes: one note is in the principal amount of $2,700,000, bears interest of 9.75% per annum, and has a

term of five years with a 25 year amortization, and the second note was in the principal amount of $173,000, bears interest at 10% per annum, and has a term of three years.

Current assets. As of December 31, 2002, the total current assets of the Company were $16,138,000 compared to total current assets of $14,143,000 as of December 31, 2001. The increase in current assets is attributable principally to increases during 2002 in accounts receivable and inventory.

Inventory. The net inventory of the Company increased from $8,458,000 as of December 31, 2001 to $10,034,000 as of December 31, 2002. This increase was the result principally of (i) higher levels of production arising from increasing sales during 2001, (ii) a seasonal increase in balloon inventory for anticipated levels of sales in the first quarter of 2002 and (iii) production of balloons to order for a customer in the fourth quarter of 2002 for delivery in the first quarter of 2003.

Property, Plant and Equipment. During fiscal 2002, the Company invested $4,709,000 in capital items, of which $2,016,000 was additional capital projects in process substantially all of which will be recorded as capital investment in plant and equipment during 2003. Most of this investment was in production equipment. During 2001, the Company invested $1,002,000 in capital items.

Current liabilities. Total current liabilities increased from $14,421,000 as of December 31, 2001 to $19,045,000 as of December 31, 2002. This increase is attributable principally to an increase in accounts payable from $5,492,000 as of December 31, 2001 to $9,585,000 as of December 31, 2002.

Liquidity and Financial Resources

At December 31, 2003 the Company had negative working capital of $706,000 compared to negative working capital as of December 31, 2002 of $2,907,000. This improvement in working capital occurred principally as the result of the reduction in current liabilities on December 31, 2002 of $19,045,000 to $16,140,000 on December 31, 2003. This reduction occurred because (i) during 2003, approximately $3,534,000 in payables to vendors was converted to term obligations and (ii) in connection with the new senior loan completed on December 30, 2003, the entire balance due to the prior senior lender, all of which was designated

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as short-term, was paid, consisting of $2,540,000 in term loans and $4,223,000 in revolving loan balances.

The Company has maintained relatively small cash balances and reserves and relies on its credit facility for liquidity. Under the credit facility, the Company is able to borrow up to 85% of its eligible receivables and up to 50% of its eligible inventory, and utilizes the proceeds of these borrowings for its cash requirements. On December 31, 2003, the Company had available to it under the revolving loan total availability of $1,648,000. If the Company's sales were to decline significantly in any period, the Company's ability to borrow under this line would be reduced and its ability to meet its current obligations would be adversely affected.

Based upon the current level of operations, we anticipate that our operating cash flow, together with available borrowings under our revolving loan, will be adequate to meet our anticipated future requirements for working capital and operating expenses for at least the next 12 months. However, the Company's ability to make scheduled payments of principal of, or to pay interest

on, its current indebtedness and to satisfy its other obligations will depend upon its future performance, which, to a certain extent, will be subject to general economic, financial, competitive, business and other factors beyond the control of the Company.

The contractual commitments of the Company over the next five years are as follows:

Year	Future Minimum Principal Payments	Operating Leases	Licenses	Total
2004	$2,998,496	$ 542,532	$ 86,664	$3,627,692
2005	$2,948,195	$ 532,905	$ 76,664	$3,557,764
2006	$ 756,065	$ 504,771	--	$1,260,836
2007	$ 759,723	$ 472,728	--	$1,232,451
2008 and thereafter	$3,366,234	$ 620,400	$ --	$3,986,634

The Company does not have any current material commitments for capital expenditures.

Seasonality

In the metalized product line, sales have historically been seasonal with approximately 20% to 30% of annual sales of metalized balloons being generated in December and January, and 11% to 13% of annual metalized balloon sales being generated in June and July in recent years. The sale of latex balloons and laminated film products have not historically been seasonal, and as sales in these products lines increase as a percentage of total sales, the seasonality of the Company's total net sales has decreased.

Critical Accounting Policies

The financial statements of the Company are based on the selection and application of significant accounting policies which require management to make various estimates and assumptions. The following are some of the more critical judgment areas in the application of our accounting policies that currently affect our financial condition and results of operation.

Revenue Recognition. Substantially all of the Company's revenues are derived from the sale of products. With respect to the sale of products, revenue from a transaction is recognized when (i) a definitive arrangement exists for the sale of the product, (ii) delivery of the product has occurred, (iii) the price to the buyer has been fixed or is determinable and (iv) collectibility is reasonably assured. The Company generally recognizes revenue for the sale of products when the products have been shipped and invoiced. In some cases, product is provided on consignment to customers. In those cases, revenue is recognized when the customer reports a sale of the product.

Allowance for Doubtful Accounts. We estimate our allowance for doubtful accounts based on an analysis of specific accounts, an analysis of historical trends, payment and write-off histories. Our credit risks are continually reviewed and management believes that adequate provisions have been made for doubtful accounts. However, unexpected changes in the financial condition of customers or changes in the state of the economy could result in write-offs which exceed estimates and negatively impact our financial results.

Inventory Valuation. Inventories are stated at the lower of cost or

market. Cost is determined using standard costs which approximate costing determined on a first-in, first out basis. Standard costs are reviewed and adjusted periodically based on actual direct and indirect production costs. Labor, overhead and purchase price variances from standard costs are determined on a monthly basis and inventory is adjusted monthly reflecting these variances. On a periodic basis, the Company reviews its inventory levels for estimated obsolescence or unmarketable items, in reference to future demand requirements and shelf life of the products. As of December 31, 2003, the Company had established a reserve for obsolescence, marketability or excess quantities with respect to inventory in the aggregate amount of $492,000. As of December 31, 2002, the amount of the reserve was $354,000. In addition, on a periodic basis, the Company disposes of inventory deemed to be obsolescent or unsaleable and, at such time, records an expense for the value of such inventory.

Valuation of Long-Lived Assets. We evaluate whether events or circumstances have occurred which indicate that the carrying amounts of long-lived assets (principally property and equipment and goodwill) may be impaired or not recoverable. Significant factors which may trigger an impairment review include: changes in business strategy, market conditions, the manner of use of an asset, underperformance relative to historical or expected future operating results, and negative industry or economic trends. In 2001, the FASB issued Statement No. 142, "Goodwill and Other Intangible Assets," which among other things, eliminates the amortization of goodwill and certain other intangible assets and requires that goodwill be evaluated annually for impairment by applying a fair-value based test. We retained valuation consulting firms to conduct an evaluation of our goodwill in our Mexico subsidiary in June, 2002, December, 2002 and December, 2003. In the opinion of these firms our goodwill valuation of our Mexico subsidiary on these dates, in the amount of $1,113,000 was not impaired.

Income Taxes and Deferred Tax Assets. Income taxes are accounted for as prescribed in SFAS No. 109-Accounting for Income Taxes. Under the asset and liability method of Statement 109, the Company recognizes the amount of income taxes currently payable and deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences

between the financial statement carrying amounts of existing assets and liabilities, and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years these temporary differences are expected to be recovered or settled.

As of December 31, 2003, the Company had a net deferred tax asset of $1,341,000, representing the amount the Company may recover in future years from future taxable income. As of December 31, 2002, the amount of the deferred tax asset was $689,000. Each year and period management must make a judgment to determine the extent to which the deferred tax asset will be recovered from future taxable income. As of December 31, 2003, management has determined that an appropriate allowance against the deferred tax asset, for the possibility that such amount will not be recovered, is $739,000. As of December 31, 2002, the amount of this reserve was $739,000. These determinations involve the exercise of significant management judgment and are made based upon historical, current and projected levels of revenue and profit.

Safe Harbor Provision of the Private Securities Litigation Act of 1995 and Forward Looking Statements

The Company operates in a dynamic and rapidly changing environment that involves numerous risks and uncertainties. The market for mylar and latex

balloon products is generally characterized by intense competition, frequent new product introductions and changes in customer tastes which can render existing products unmarketable. The statements contained in Item 1 (Description of Business) and Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations) that are not historical facts may be forward-looking statements (as such term is defined in the rules promulgated pursuant to the Securities Exchange Act of 1934) that are subject to a variety of risks and uncertainties more fully described in the Company's filings with the Securities and Exchange Commission including, without limitation, those described under "Risk Factors" in the Company's Form SB-2 Registration Statement (File No. 333-31969) effective November 5, 1997. The forward-looking statements are based on the beliefs of the Company's management, as well as assumptions made by, and information currently available to the Company's management. Accordingly, these statements are subject to significant risks, uncertainties and contingencies which could cause the Company's actual growth, results, performance and business prospects and opportunities in 2003 and beyond to differ materially from those expressed in, or implied by, any such forward-looking statements. Wherever possible, words such as "anticipate," "plan," "expect," "believe," "estimate," and similar expressions have been used to identify these forward-looking statements, but are not the exclusive means of identifying such statements. These risks, uncertainties and contingencies include, but are not limited, to competition from, among others, national and regional balloon, packaging and custom film product manufacturers and sellers that have greater financial, technical and marketing resources and distribution capabilities than the Company, the availability of sufficient capital, the maturation and success of the Company's strategy to develop, market and sell its products, risks inherent in conducting international business, risks associated with securing licenses, changes in the Company's product mix and pricing, the effectiveness of the Company's efforts to control operating expenses, general economic and business conditions affecting the Company and its customers in the United States and other countries in which the Company sells and anticipates selling its products and services and the

Company's ability to (i) adjust to changes in technology, customer preferences, enhanced competition and new competitors; (ii) protect its intellectual property rights from infringement or misappropriation; (iii) maintain or enhance its relationships with other businesses and vendors; and (iv) attract and retain key employees. There can be no assurance that the Company will be able to identify, develop, market, sell or support new products successfully, that any such new products will gain market acceptance, or that the Company will be able to respond effectively to changes in customer preferences. There can be no assurance that the Company will not encounter technical or other difficulties that could delay introduction of new or updated products in the future. If the Company is unable to introduce new products and respond to industry changes or customer preferences on a timely basis, its business could be materially adversely affected. The Company is not obligated to update or revise these forward-looking statements to reflect new events or circumstances.

Item No. 7A - Qualitative And Quantitative 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 averaged 1% more than the interest rate actually paid for the years ending December 31, 2003, 2002 and 2001, our interest rate expense would have increased, and income before income taxes would have decreased by $39,033,

$48,745 and $47,326, for these years, 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 U.K. 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 effects.

We have performed a sensitivity analysis as of December 31, 2003 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 2003, 2002 and 2001 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, for each of those years, $173,034, $175,973 and $176,509.

Item No. 8 Financial Statements and Supplementary Data

Reference is made to the Consolidated Financial Statements attached hereto.

Item No. 9 Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Effective July 22, 2003, CTI Industries Corporation (the "Registrant") engaged Eisner, LLP as the Registrant's principal accountants to audit the Registrant's financial statements for the year ending December 31, 2003. Eisner, LLP replaced McGladrey & Pullen, LLP, which had previously been engaged for the same purpose, and whose dismissal was effective July 22, 2003. The decision to change the Registrant's principal accountants was approved by the Registrant's Board of Directors on July 22, 2003.

The reports of McGladrey & Pullen, LLP, on the Registrant's financial statements for the fiscal year ended December 31, 2002 did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principles.

Effective July 24, 2002, the Company engaged McGladrey & Pullen, LLP as

the Registrant's principal accountants to audit the Company's financial statements for the year ending December 31, 2002. McGladrey & Pullen, LLP replaced Grant Thornton, LLP, which had previously been engaged for the same purpose, and whose dismissal was effective July 24, 2002. The decision to change the Company's principal accountants was approved by the Company's Audit Committee and Board of Directors on July 24, 2002.

During the Company's fiscal year ended December 31, 2002 and in the subsequent interim period through March 31, 2003, there were no disagreements with McGladrey & Pullen, LLP on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of McGladrey & Pullen, LLP would have caused it to make reference to the subject matter of the disagreements in connection with its reports on the financial statements for such periods.

McGladrey & Pullen, LLP has not informed the Company of any reportable events during the Company's fiscal year ended December 31, 2002 or in the subsequent interim period ending March 31, 2003.

The reports of Grant Thornton LLP, on the Company's financial statements for the prior two fiscal years ended December 31, 2000, and December 31, 2001 did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principles.

During the Company's fiscal years ended December 31, 2000, and December 31, 2001, and in the subsequent interim periods through July 24, 2002, there were no disagreements with Grant Thornton, LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Grant Thornton, LLP, would have caused it to make reference to the subject matter of the disagreements in connection with its reports on the financial statements for such periods.

Grant Thornton, LLP has not informed the Company of any reportable events during the Company's two fiscal years ended December 31, 2000 and 2001 and in subsequent interim periods through July 24, 2002.

Item No. 9A - Controls and Procedures

Disclosure Controls and Procedures

(a) Evaluation of disclosure controls and procedures. Our principal executive officer and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by of this report, have concluded that, as of such date our disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company would be made known to them by others within the Company.

(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 III

Item No. 10 Directors and Executive Officers of the Registrant

Directors and Executive Officers

The Company's current directors and executive officers and their ages, as of March 15, 2004, are as follows:

Name	Age	Position With The Company
John H. Schwan	59	Chairman and Director
Howard W. Schwan	49	President and Director
Stephen M. Merrick	62	Executive Vice President, Secretary and Director
Mark Van Dyke	54	Senior Vice President
Brent Anderson	37	Vice President of Manufacturing
Samuel Komar	47	Vice President
Stanley M. Brown	57	Director
Bret Tayne	45	Director
Michael Avramovich	52	Director
Timothy Patterson	43	Vice President-Finance and Administration

All directors hold office until the annual meeting next following their election and/or until their successors are elected and qualified. Officers are elected annually by the Board of

Directors and serve at the discretion of the Board. Information with respect to the business expenses and affiliation of the directors and the executive officers of the Company is set forth below:

John H. Schwan, Chairman. Mr. Schwan has been an officer and director of the Company since January, 1996. Mr. Schwan has been the President and principal executive officer of Packaging Systems and affiliated companies for over the last 15 years. Mr. Schwan has over 20 years of general management experience, including manufacturing, marketing and sales. Mr. Schwan served in the U.S. Army Infantry in Vietnam from 1966 to 1969, where he attained the rank of First Lieutenant.

Howard W. Schwan, President. Mr. Schwan has been associated with the Company for 21 years, principally in the management of the production and engineering operations of the Company. Mr. Schwan was appointed as Vice President of Manufacturing in November, 1990, was appointed as a director in January, 1996, and was appointed as President in June, 1997.

Stephen M. Merrick, Executive Vice President and Secretary. Mr. Merrick was President of the Company from January, 1996 to June, 1997 when he became Chief Executive Officer of the Company. In October, 1999, Mr. Merrick became Executive Vice President. Mr. Merrick is a principal of the law firm of Merrick & Klimek, P.C. of Chicago, Illinois and has been engaged in the practice of law for more than 35 years. Mr. Merrick is also Senior Vice President, Director and a member of the Management Committee of Reliv International, Inc. (NASDAQ), a manufacturer and direct marketer of nutritional supplements and food products.

Mark Van Dyke, Senior Vice President. Mr. Van Dyke rejoined the Company in August, 2001. Mr. Van Dyke has over 25 years experience in the balloon industry and was previously employed by the Company for 12 years. Prior to rejoining the

Company, Mr. Van Dyke was employed by M&D Balloons, Inc. for eight years and became Executive Director of that Company.

Brent Anderson, Vice President of Manufacturing. Mr. Anderson has been employed by the Company since January, 1989, and has held a number of engineering positions with the Company including Plant Engineer and Plant Manager. In such capacities Mr. Anderson was responsible for the design and manufacture of much of the Company's manufacturing equipment. Mr. Anderson was appointed Vice President of Manufacturing in June, 1997.

Samuel Komar, Vice President of Sales. Mr. Komar has been employed by the Company since March of 1998, and was named Vice-President of Sales in September of 2001. Mr. Komar has worked in sales for 16 years, and prior to his employment with the Company, Mr. Komar was with Bob Gable & Associates, a manufacturer of sporting goods. Mr. Komar received a Bachelor of Science Degree in Sales and Marketing from Indiana University.

Timothy Patterson, Vice President of Finance and Administration. Mr. Patterson has been employed by the Company as Vice President of Finance and Administration since September, 2003. Prior to his employment with the Company, Mr. Patterson was Manager of Controllers for the Thermoforming group at Solo Cup Company for two years. Prior to that, Mr.

Patterson was Manager of Corporate Accounting for Transilwrap Company for three years. Mr. Patterson received a Bachelor of Science degree in finance from Northern Illinois University and an MBA from the University of Illinois at Chicago.

Stanley M. Brown, Director. Mr. Brown was appointed as a director of the Company in January, 1996. Since March, 1996, Mr. Brown has been President of Inn-Room Systems, Inc., a manufacturer and lessor of in-room vending systems for hotels. From 1968 to 1989, Mr. Brown was with the United States Navy as a naval aviator, achieving the rank of Captain.

Bret Tayne, Director. Mr. Tayne was appointed as a director of the Company in December, 1997. Mr. Tayne has been the President of Everede Tool Company, a manufacturer of industrial cutting tools, since January, 1992. Prior to that, Mr. Tayne was Executive Vice President of Unifin, a commercial finance company, since 1986. Mr. Tayne received a Bachelor of Science degree from Tufts University and an MBA from Northwestern University.

Michael Avramovich, Director. Mr. Avramovich is a principal of the law firm of Avramovich & Associates, P.C. of Chicago, Illinois, and has been engaged in the practice of law for over 6 years. Prior to the practice of law, Mr. Avramovich was an Associate Professor of Accounting and Finance at National-Louis University in Chicago, Illinois. Mr. Avramovich has also worked in various financial accounting positions at Molex International, Inc. of Lisle, Illinois. Mr. Avramovich received a Bachelor of Arts degree in History and International Relations from North Park University, a Master of Management, Accounting and Information Systems, and Finance from Northwestern University, a Juris Doctorate from the John Marshall Law School and an L.L.M. in International and Corporate Law from Georgetown University Law Center.

John H. Schwan and Howard W. Schwan are brothers.

Audit Committee

Since 2000, the Company has had a standing Audit Committee, which is

presently composed of Mr. Tayne, Mr. Brown and Mr. Avramovich. Mr. Avramovich has been designated and is the Company's "Audit Committee Financial Expert" pursuant to paragraph (h)(1)(i)(A) of Item 401 of Regulation S-K of the Exchange Act. The Audit Committee held five meetings during fiscal year 2003, including quarterly meetings with management and independent auditors to discuss the Company's financial statements. Mr. Avramovich and each appointed member of the Audit Committee satisfies the definition of "independent" as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act. The Company's Board of Directors has adopted a written charter for the Company's Audit Committee, a true and correct copy of which has been included in the exhibits to this report. The Audit Committee reviews and makes recommendations to the Company about its financial reporting requirements. Information regarding the functions performed by the Committee is set forth in the "Report of the Audit Committee," as follows:

Report of the Audit Committee

The Audit Committee oversees the Company's financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements

and the reporting process including the systems of internal controls. In fulfilling its oversight responsibilities, the Committee reviewed the audited financial statements in the Annual Report with management including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements.

The Committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgments as to the quality, not just the acceptability, of the Company's accounting principles and such other matters as are required to be discussed with the Committee under generally accepted auditing standards, including but not limited to those matters required to be discussed by SAS 61 (Codification of Statements on Auditing Standards, AU ss.380). In addition, the Committee has discussed with the independent auditors the auditor's independence from management and the Company including the matters in the written disclosures required by the Independence Standards Board.

The Committee discussed with the Company's independent auditors the overall scope and plans for their respective audits. The Committee meets with the independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the Company's internal controls, and the overall quality of the Company's financial reporting.

In reliance on the reviews and discussions referred to above, the Committee recommended to the Board of Directors (and the Board has approved) that the audited financial statements be included in the Annual Report on Form 10-K for the year ended December 31, 2003 for filing with the Securities and Exchange Commission. The Committee and the Board have also recommended, subject to future shareholder approval at the Company's 2004 annual meeting of shareholders, the selection of Eisner, LLP as the Company's independent auditors.

Bret Tayne,, Audit Committee Chair

Stanley M. Brown, III, Audit Committee Member

Michael Avramovich, Audit Committee Member

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's officers and directors, and persons who own more than ten percent of a registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission and with the NASDAQ Stock Market. Officers, directors and greater than ten-percent shareholders are required by SEC regulation to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on a review of such forms furnished to the Company, or written representations that no Form 5's were required, the Company believes that during calendar year 2003, all Section 16(a) filing requirements applicable to the officers, directors and ten-percent

beneficial shareholders were complied with, except that Brent Anderson was late in filing one Form 4 for an aggregate of 8,750 shares.

Code of Ethics

The Company has adopted a code of ethics that applies to its senior executive and financial officers. The Company's Code of Ethics seeks to promote (i) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships, (2) full, fair, accurate, timely and understandable disclosure of information to the Commission, (3) compliance with applicable governmental laws, rules and regulations, (4) prompt internal reporting of violations of the Code to predesignated persons, and (5) accountability for adherence to the Code. A copy of the Company's Code of Ethics has been included in the Exhibits to this report.

Item No. 11 Executive Compensation

The following table sets forth certain information with respect to the compensation paid or accrued by the Company to its President, Chief Executive Officer and any other officer who received compensation in excess of $100,000 ("Named Executive Officers").

Summary Compensation Table

		Annual Compensation		Long Term Compensation	
Name and Principal Position	Year	Salary $	Other Annual Compensation	Underlying Options	All Other Compensatio ($)
Howard W. Schwan	2003	$162,500	$ 5,520	--	--
President	2002	$162,500	$ 8,100	14,285(1)	$1,925(5)
	2001	$150,000	$ 5,000	--	$1,765(5)
Mark Van Dyke	2003	$125,000	--	--	--
Senior Vice President	2002	$123,100	--	--	--

	2001	$ 45,900	--	23,809(2)	--
Brent Anderson	2003	$ 95,000	--	--	--
Vice President of	2002	$ 95,000	--	8,928(3)	--
Manufacturing	2001	$ 86,700	--	17,857(3)	--
Samuel Komar	2003	$104,200	--	--	--
Vice President of Sales	2002	$104,200	--	--	--
	2001	$ 94,450	--	11,904(4)	--

(footnotes continued on next page)

(1) Stock options to purchase up to 14,285 shares of the Company's Common Stock at $2.31 per share, and stock options to purchase up to 23,809 shares of the Company's Common Stock at $1.89 per share.

(2) Stock options to purchase up to 23,809 shares of the Company's Common Stock at $1.47 per share.

(3) Stock options to purchase up to 8,928 shares of the Company's Common Stock at $2.31 per share, and stock options to purchase up to 17,857 shares of the Company's Common Stock at $1.47 per share.

(4) Stock options to purchase up to 11,904 shares of the Company's Common Stock at $1.47 per share.

(5) Company contribution to the Company's 401(k) Plan as a pre-tax salary deferral.

Certain Named Executive Officers have received warrants to purchase Common Stock of the Company in connection with their guarantee of certain bank loans secured by the Company and in connection with their participation in a private offering of notes and warrants conducted by the Company. See "Board of Director Affiliations and Related Transactions" below. The following stock option grants were made to certain of the Company's executive officers in the fiscal year ending December 31, 2003:

Option Grants in Last Fiscal Year

Individual Grants

Name	Number of Securities Underlying Options Granted	% of Total Options Granted to Employees in Fiscal Year	Exercise Price ($/share)	Expiration Date
Timothy Patterson	5,000	71.4%	$2.26	2/3/2013

Aggregated Option Exercises in Last Fiscal Year and FY-End Option Values

Shares	Value	Number of Securities Underlying	Value Money

Name	Acquired on Exercise (#)	Realized ($)	Unexercised Options at Year End (#) Exercisable/Unexercisable	Exer
John H. Schwan	0	0	29,762/0	
Howard W. Schwan	0	0	53,968/0	
Stephen M. Merrick	0	0	29,762/0	
Mark Van Dyke	0	0	23,809/0	
Brent Anderson	0	0	31,546/0	
Samuel Komar	0	0	24,641/0	

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(1) The value of unexercised in-the-money options is based on the difference between the exercise price and the fair market value of the Company's Common Stock on December 31, 2003.

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Compensation Committee

During 2003, the Compensation Committee was composed of John H. Schwan, Stanley M. Brown and Bret Tayne. The Compensation Committee reviews and makes recommendations to the Board of Directors concerning the compensation of officers and key employees of the Company. The Compensation Committee met one time during 2003.

Compensation Committee Report on Executive Compensation

The Compensation Committee of the Board of Directors of the Company is composed of three members of the Board of Directors. The Compensation Committee is responsible for establishing the standards and philosophy of the Board of Directors regarding executive compensation, for reviewing and evaluating executive compensation and compensation programs, and for recommending levels of salary and other forms of compensation for executives of the Company to the Board of Directors. The full Board of Directors of the Company is responsible for setting and administering salaries, bonus payments and other compensation awards to executives of the Company.

Compensation Philosophy

The philosophy of the Compensation Committee, and of the Board of Directors of the Company, regarding executive compensation includes the following principal components:

To attract and retain quality executive talent, which is regarded as critical to the long and short-term success of the Company, in substantial part by offering compensation programs which provide attractive rewards for successful effort.

To provide a reasonable level of base compensation to senior executives.

To create a mutuality of interest between executive officers of the Company and shareholders through long-term compensation structures, particularly stock option programs, so that executive officers share the risks and rewards of strategic decision making and its effect on shareholder value.

The Compensation Committee has recommended, and the Board of Directors has determined, to take appropriate action to comply with the provisions of Section 162(m) of the Internal Revenue Code so that executive compensation will be

deductible as an expense to the fullest extent allowable.

The Company's executive compensation program consists of two key elements: (i) an annual component consisting of base salary and (ii) a long-term component, principally stock options.

Annual Base Compensation

The Compensation Committee recommends annual salary levels for each of the Named Executives, and for other senior executives of the Company, to the Board of Directors. The recommendations of the Compensation Committee for base salary levels for senior executives of the Company are determined annually, in part, by evaluating the responsibilities of the position and examining market compensation levels and trends for similar positions in the marketplace.

Additional factors which the Compensation Committee considers in recommending annual adjustments to base salaries include: results of operation of the Company, sales, shareholder returns, and the experience, work-performance, leadership and team building skills of each executive. The Company receives information from the Chief Executive Officer with regard to these matters. While each of these factors is considered in relatively equal weight, the Compensation Committee does not utilize performance matrices or measured weightings in its review. Each year, the Compensation Committee conducts a structured review of base compensation of senior executives with input from the Chief Executive Officer.

Long-Term Component - Stock Options

The long-term component of compensation provided to executives of the Company has been in the form of stock options. The Compensation Committee has recommended to the Board of Directors that a significant portion of the total compensation to executives be in the form of incentive stock options. Stock options are granted with an exercise price equal to or greater than the fair market value of the Company's Common Stock on the date of the grant. Stock options are exercisable between one and ten years from the date granted. Such stock options provide incentive for the creation of shareholder value over the long-term since the full benefit of the compensation package for an executive cannot be realized unless an appreciation in the price of the Company's Common Stock occurs over a specified number of years.

The magnitude of the stock option awards are determined annually by the Compensation Committee and the Board of Directors. Generally, the number of options granted to an executive has been based on the relative salary level of the executive.

On October 12, 2002, incentive stock options to purchase up to 14,285, 8,928, 5,952 and 5, 952 shares of the Company's Common Stock were granted to Messrs. Howard Schwan, Brent Anderson, Stephen M. Merrick and John Schwan, respectively, under the 2002 Stock Option Plan (the "2002 Plan"). In addition, on October 12, 2002, non-qualified stock options to purchase up to 2,926 shares of the Company's Common Stock were granted to each of Messrs. Stan Brown and Bret Tayne respectively, under the 2002 Plan, and incentive stock options to purchase up to 5,000 shares of the Company's Common Stock were granted to Timothy Patterson under the 2002 Stock Option Plan on December 31, 2003.

There were no other stock options granted to any of the Named Executives in 2001, 2002 or 2003.

CEO Compensation

The Compensation Committee utilizes the same standards and methods for recommending annual base compensation for the Chief Executive Officer of the Company as it does for other senior executive officers of the Company.

In 1997, the Company entered into an Employment Agreement with Howard W. Schwan, President of the Company, providing that Mr. Schwan's base annual compensation would not be less than $135,000. During 2001, 2002 and 2003, upon the recommendation of the Compensation Committee, the base salary of Mr. Schwan was $150,000, $162,500 and $162,500 respectively. In 2001, 2002 and 2003, annual incentive compensation was paid to Mr. Schwan in the amounts of $5,000, $8,100 and $5,520, respectively.

The Compensation Committee recommended that Mr. Schwan (and other senior executives of the Company), receive incentive stock options, consistent with observed market practices, so that a significant portion of his total compensation will be based upon, and consistent with, returns to shareholders. In 2002, Mr. Schwan was granted incentive stock options to purchase up to 14,285 shares of the Company's Common Stock.

Compensation Committee:
John H. Schwan, Bret Tayne, Stanley M. Brown, III

Compensation Committee Interlocks and Insider Participation

John H. Schwan, a member of the Compensation Committee, is Chairman of the Company. Mr. Schwan is President of Packaging Systems, L.L.C. and affiliated companies. The Company made purchases of packaging materials from the entities in the amount of $118,011 and $273,910 during each of the years ended December 31, 2002 and December 31, 2003, respectively. John Schwan and Howard W. Schwan are brothers.

Comparative Stock Price Performance Graph

The following graph compares, for the period January 1, 1999 to December 31, 2003, the cumulative total return (assuming reinvestment of dividends) on the Company's Common Stock with (i) NASDAQ Stock Market Index (U.S.) and (ii) a peer group including the following companies: S&P 500 Specialty Stores. The graph assumes an investment of $100 on January 1, 1999, in the Company's Common Stock and each of the other investment categories.

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Total Return To Shareholders
(Includes reinvestment of dividends)

ANNUAL RETURN PERCENTAGE

	Years Ending					
Company / Index	Oct99	Oct00	Dec00	Dec01	Dec02	Dec0
CTI INDUSTRIES CORP	-74.39	-4.76	-46.67	75.00	325.85	-63.9

NASDAQ U.S. INDEX	68.75	13.06	-27.05	-20.63	-30.86	49.5
S&P 500 SPECIALTY STORES	-16.29	-4.69	-13.37	61.41	-11.11	34.6

INDEXED RETURNS

Company / Index	Base Period Oct98	Years Ending Oct99	Oct00	Dec00	Dec01	Dec02	Dec0
CTI INDUSTRIES CORP	100	25.61	24.39	13.01	22.76	96.94	35.0
NASDAQ U.S. INDEX	100	168.75	190.80	139.19	110.48	76.38	114.2
S&P 500 SPECIALTY STORES	100	83.71	79.78	69.12	111.56	99.16	133.5

Employment Agreements

In June, 1997, the Company entered into an Employment Agreement with Howard W. Schwan as President, which provides for an annual salary of not less than $135,000. The term of the Agreement was through June 30, 2002 and is automatically renewed thereafter for successive one year terms. The Agreement contains covenants of Mr. Schwan with respect to the use of the Company's confidential information, establishes the Company's right to inventions created by Mr. Schwan during the term of his employment, and includes a covenant of Mr. Schwan not to compete with the Company for a period of three years after the date of termination of the Agreement.

Director Compensation

John Schwan was compensated in the amount of $76,500 in fiscal 2003 for his services as Chairman of the Board of Directors. Directors other than members of management received a fee of $1,000 for each Board meeting attended.

Item No. 12 Security Ownership of Certain Beneficial Owners and Management

Principal Stockholders

The following table sets forth certain information with respect to the beneficial ownership of the Company's capital stock, as of April 1, 2004, by (i) each stockholder who is known by the Company to be the beneficial owner of more than 5% of the Company's Common Stock, (ii) each director and executive officer of the Company who owns any shares of Common Stock and (iii) all executive officers and directors as a group. Except as otherwise indicated, the Company

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believes that the beneficial owners of the shares listed below have sole investment and voting power with respect to such shares.

Name and Address (1)	Shares of Common Stock Beneficially Owned (2)	Perce
John H. Schwan	642,237(3)	
Stephen M. Merrick	525,758(5)	

Howard W. Schwan	178,904(6)
Brent Anderson	42,795(7)
Samuel Komar	24,879(8)
Mark Van Dyke	23,809(9)
Timothy Patterson	5,000(10)
Stanley M. Brown 1140 Larkin Wheeling, IL 60090	11,250(11)
Bret Tayne 6834 N. Kostner Avenue Lincolnwood, IL 60712	9,923(12)
Frances Ann Rohlen 1140 Larkin Wheeling, IL 60090	169,933
Michael Avramovich 70 W. Madison Street, Suite 1400 Chicago, IL 60602	0
All Directors and Executive Officers as a group (10 persons)	1,464,555

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* Less than one percent

(1) Except as otherwise indicated, the address of each stockholder listed above is c/o CTI Industries Corporation, 22160 North Pepper Road, Barrington, Illinois 60010.

(2) A person is deemed to be the beneficial owner of securities that can be acquired within 60 days from the date set forth above through the exercise of any option, warrant or right. Shares of Common Stock subject to options, warrants or rights that are currently exercisable or exercisable within 60 days are deemed outstanding for purposes of computing the percentage ownership of the person holding such options, warrants or rights, but are not deemed outstanding for purposes of computing the percentage ownership of any other person.

(3) Includes warrants to purchase up to 79,364 shares of Common Stock at $1.50 per share, warrants to purchase up to 93,000 shares of Common Stock at $4.87 per share, options to purchase up to 23,810 shares of Common Stock at $2.08 per share granted under the Company's 1999 Stock Option Plan and options to purchase up to 5,952 shares of Common Stock at $2.55 per share granted under the Company's 2002 Stock Option Plan. Also includes indirect beneficial ownership of 130,821 shares of Common Stock through shares owned through CTI Investors, L.L.C. See "Board of Directors Affiliations and Related Transactions."

(4) Assumes the exercise of all warrants and options owned by the named person into shares of Common Stock and all shares of Common Stock beneficially owned by the named person through CTI Investors, L.L.C.

(footnotes continued on next page)

(5) Includes warrants to purchase up to 39,683 shares of Common Stock at $1.50 per share, warrants to purchase up to 70,000 shares of Common Stock at $4.87 per share, options to purchase up to 23,810 shares of Common Stock at $2.08 per share granted under the Company's 1999 Stock Option Plan and

options to purchase up to 5,952 shares of Common Stock at $2.55 per share granted under the Company's 2002 Stock Option Plan. Also includes indirect beneficial ownership of 87,214 shares of Common Stock through shares owned through CTI Investors, L.L.C. See "Board of Directors Affiliations and Related Transactions."

(6) Includes options to purchase up to 15,873 shares of Common Stock at $6.30 per share granted under the Company's 1997 Stock Option Plan, options to purchase up to 23,810 shares of Common Stock at $1.89 per share granted under the Company's 1999 Stock Option Plan and options to purchase up to 14,285 shares of Common Stock at $2.31 per share granted under the Company's 2002 Stock Option Plan. Also includes indirect beneficial ownership of 65,410 shares of Common Stock through shares owned through CTI Investors, L.L.C. See "Board of Directors Affiliations and Related Transactions."

With respect to the financial covenants, the bank has issued a waver of violations of the covenants as of December 31, 2003. For periods after December 31, 2003 the bank has agreed to modify the covenants, both the tangible net worth and ratio of EDITDA of fixed charges, to reduce levels.

(7) Includes options to purchase up to 4,761 shares of Common Stock at $6.30 per share granted under the Company's 1997 Stock Option Plan, options to purchase up to 17,857 shares of Common Stock at $1.47 per share, granted under the Company's 2001 Stock Option Plan and options to purchase up to 8,928 shares of Common Stock at $2.31 per share granted under the Company's 2002 Stock Option Plan.

(8) Includes options to purchase up to 4,761 shares of Common Stock at $6.30 per share granted under the Company's 1997 Stock Option Plan, options to purchase up to 7,976 shares of Common Stock at $1.89 per share granted under the Company's 1999 Stock Option Plan, options to purchase up to 11,904 shares of Common Stock at $1.47 per share granted under the Company's 2001 Stock Option Plan, and 238 shares of Common Stock held by immediate family members.

(9) Includes options to purchase up to 23,809 shares of Common Stock at $1.47 per share granted under the Company's 2001 Stock Option Plan.

(10) Includes options to purchase up to 5,000 shares of Common Stock at $2.26 per share granted under the Company's 2002 Stock Option Plan.

(11) Includes options to purchase up to 1,984 shares of Common Stock at $6.30 per share and options to purchase up to 1,984 shares of Common Stock at $10.08 per share, both granted under the Company's 1997 Stock Option Plan, options to purchase up to 3,571 shares of Common Stock at $1.89 per share granted under the Company's 1999 Stock Option Plan and options to purchase up to 2,976 shares of Common Stock at $2.31 per share granted under the Company's 2002 Stock Option Plan.

(footnotes continued on next page)

(12) Includes options to purchase up to 1,984 shares of Common Stock at $6.30 per share granted under the Company's 1997 Stock Option Plan, options to purchase up to 3,571 shares of Common Stock at $1.89 per share granted under the Company's 1999 Stock Option Plan and options to purchase up to 2,976 shares of Common Stock at $2.31 per share granted under the Company's 2002 Stock Option Plan.

Item No. 13 Certain Relationships and Related Transactions

Stephen M. Merrick, Executive Vice President and Secretary of the Company, is a principal of the law firm of Merrick & Klimek, P.C., which serves as general counsel of the Company. In addition, Mr. Merrick is a principal stockholder of the Company. Other principals of the firm of Merrick & Klimek, P.C. own less than 1% of the Company's outstanding Common Stock. Legal fees incurred from the firm of Merrick & Klimek, P.C. for the fiscal years ended December 31, 2003, 2002 and 2001 were $106,750, $102,245 and $121,305, respectively. Mr. Merrick is also an officer and director of Reliv International, Inc. (NASDAQ-RELV).

John H. Schwan is President of Packaging Systems, L.L.C. and affiliated companies. The Company made purchases of packaging materials from these entities in the amount of $118,011 and $273,910 during each of the years ended December 31, 2002 and December 31, 2003, respectively.

In June, 1999, notes of the Company to Howard W. Schwan, John Schwan, and Stephen Merrick in the amount of, respectively, $50,000, $350,000 and $315,000, came due. On November 9, 1999, new notes in the same principal amounts were issued to Messrs. H. Schwan, J. Schwan and Merrick, in payment and replacement of the prior notes with maturity dates for each of November 9, 2001. As of that date, each payee under the Notes had executed a consent to extend the maturity of the Notes to March 1, 2004. In November, 1999, the June, 1997 warrants of Messrs. H. Schwan, J. Schwan and Merrick to purchase up to (respectively) 6,359, 44,515 and 40,063 shares of the Company's Common Stock at an exercise price of $7.86 per share were cancelled. At that time, new warrants to purchase up to 35,263, 246,840 and 222,157 shares of the Company's Common Stock at an exercise price of $1.418 per share were issued to Messrs. H. Schwan, J. Schwan and Merrick, respectively. Each of these warrants were exercised on June 3, 2002. The respective $50,000, $350,000 and $315,000 notes were cancelled and used as payment for the warrant shares.

In July, 2001, the Company issued Warrants to purchase up to 79,364 shares of the Company's Common Stock to John H. Schwan and 39,683 shares of the Company's Common Stock to Stephen M. Merrick. The warrants were issued in consideration of Mr. Schwan and Mr. Merrick guaranteeing and securing loans to the Company in the aggregate amount of approximately $1,600,000. The warrants are exercisable for a period of five years at a price of $1.50 per share.

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On December 12, 2002, Messrs. John Schwan, Howard Schwan and Stephen Merrick exercised warrants to purchase 24,572, 30,525 and 28,780 shares of the Company's Common Stock, respectively. In each instance, the warrant holder tendered shares of the Company's Common Stock on the date of exercise.

During February, 2003, John H. Schwan loaned $930,000 to the Company and Stephen M. Merrick loaned $700,000 to the Company, in exchange for (i) two year promissory notes bearing interest at 9% per annum and (ii) five year warrants to purchase up to an aggregate of 163,000 shares of Common Stock of the Company at $4.87 per share, the market price of the Common Stock on the date of the Warrants. The proceeds of these loans were to (i) re-finance the loan of bank loan of CTI Mexico in the amount of $880,000 and (ii) to provide financing for CTI Mexico and Flexo Universal.

During 2003, John H. Schwan loaned to the Company an additional aggregate amount of $795,024 . Such amount is due on demand and bears interest at the rate of 8% per annum.

During 2003, John H. Schwan loaned to Flexo Universal the aggregate amount of $225,000 and Stephen M. Merrick loaned to Flexo Universal the sum of $25,000. These advances are reflected in notes and bear interest at the rate of 8% per annum. The notes are unsecured.

On November 10, 1999, the Company entered into a Lease Agreement with Pepper Road, Inc., an Illinois corporation, to lease certain warehouse and office space located at 22222 North Pepper Road, Barrington, Illinois, the building and property immediately adjacent to the Company's manufacturing facilities at 22160 North Pepper Road, Barrington, Illinois. The lease has a 10 year term and provides for monthly rent payments of $15,500 ($186,000 annually), plus all utility charges associated with the property. John Schwan, Howard Schwan and Stephen M. Merrick are officers, directors, and the sole shareholders of Pepper Road, Inc.

The Company believes that each of the transactions set forth above were entered into, and any future related party transactions will be entered into, on terms as fair as those obtainable from independent third parties. All related party transactions must be approved by a majority of disinterested directors and subject to review in the context of the Company's Code of Ethics.

PART V

Item No. 14 Principal Accountant Fees and Services

Fees Billed By Independent Public Accountants

The following table sets forth the aggregate amount of audit fees and all other fees billed or expected to be billed by Eisner, LLP, the Company's principal auditor, for the year ended December 31, 2003:

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	Amount
Audit fees (1)	$ 98,500
Other audit related fees (2)	$ 15,000
All other fees(3)	$ 15,000
Total fees	$128,500

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(1) Includes the annual financial statement audit and limited quarterly reviews and expenses.

(2) Includes fees and expenses for other audit related activity provided by Eisner, LLP.

(3) Primarily represents tax services, which include preparation of tax returns and other tax consulting services.

Eisner, LLP became the Company's principal auditor in July, 2003, replacing the Company's principal auditor for the fiscal year ended December 31, 2002, McGladrey & Pullen, LLP, (See Item No. 9 - "Changes in and Disagreements with Accountants on Accounting and Financial Disclosure"). Consequently, Eisner,

LLP billed no fees to the Company in 2002.

The audit-related fees charged to the Company by McGladrey & Pullen, LLP and RSM McGladrey, Inc. (an affiliate of McGladrey & Pullen, LLP) for the fiscal year ended December 31, 2002 and in 2003 were as follows:

	2002 Amount	2003 Amount
Audit fees (1)	$301,000	$ 84,200
Other audit related fees (2)	$ 8,900	$ 0
All other fees (3)	$ 19,100	$ 0
Total fees	$329,000	$ 84,200

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(1) Includes the annual financial statement audit and limited quarterly reviews and expenses.

(2) Includes fees and expenses for other audit related activity provided by McGladrey & Pullen, LLP.

(3) Primarily represents tax services provided by RSM McGladrey, Inc. which include preparation of tax returns and other tax consulting services.

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Item No. 15 Exhibits and Reports on Form 8-K

Exhibits

*	3.1	Third Restated Certificate of Incorporation of CTI Industries Corporation
**	3.2	By-laws of CTI Industries Corporation
**	4.1	Form of Certificate for Common Stock of CTI Industries Corporation
***	10.1	CTI Industries Corporation 1999 Stock Option Plan
****	10.2	CTI Industries Corporation 2001 Stock Option Plan
*****	10.3	CTI Industries Corporation 2002 Stock Option Plan
**	10.4	Employment Agreement dated June 30, 1997, between CTI Industries Corporation and Howard W. Schwan
******	10.5	November, 1999 Lease Agreement between Pepper Road, Inc. and CTI Industries Corporation
******	10.6	Warrant dated July 17, 2001 to purchase 79,364 shares of Common Stock John H. Schwan
******	10.7	Warrant dated July 17, 2001 to purchase 39,683 shares of Common Stock Stephen M. Merrick

******	10.8	Note dated January 28, 2003, CTI Industries Corporation to Stephen M. Merrick in the sum of $500,000
******	10.9	Note dated February 28, 2003, CTI Industries Corporation to Stephen M. Merrick in the sum of $200,000
******	10.10	Note dated February 10, 2003, CTI Industries Corporation to John H. Schwan in the sum of $150,000
******	10.11	Note dated February 15, 2003, CTI Industries Corporation to John Schwan in the sum of $680,000
******	10.12	Note dated March 3, 2003, CTI Industries Corporation to John H. Schwan in the sum of $100,000
******	10.13	Warrant dated March 20, 2003, to purchase 70,000 shares of Common Stock - Stephen M. Merrick
******	10.14	Warrant dated March 20, 2003, to purchase 93,000 shares of Common Stock - John H. Schwan
********	10.15	Loan and Security Agreement dated December 30, 2003, between the Company and Cole Taylor Bank
********	10.16	Term Note in the sum of $3,500,000 dated December 30, 2003 made by CTI Industries Corporation to Cole Taylor Bank
********	10.17	Revolving Note in the sum of $7,500,000 dated December 30, 2003, made by CTI Industries Corporation to Cole Taylor Bank
*******	10.18	Mortgage dated January 12, 2001 for the benefit of Banco Popular, N.A.
*******	10.19	Secured Promissory Note in the sum of $2,700,000 dated December 15, 2000 made by CTI Industries Corporation to Banco Popular, N.A.
*******	10.20	Secured Promissory Note in the sum of $173,000 dated December 15, 2000 made by CTI Industries Corporation to Banco Popular, N.A.
*******	10.21	Guaranties dated January 12, 2001 by John H. Schwan, Stephen M. Merrick and Howard W. Schwan for the benefit of Banco Popular, N.A.
	11.1	Computation of Earnings Per Share (Incorporated by reference to Note 17 of the Consolidated Financial Statements contained in Part IV)
	14	Code of Ethics
	21	Subsidiaries (description incorporated in Form 10-K under Item No. 1)

23.1	Consent of Independent Auditors, Eisner, LLP
23.2	Consent of Independent Auditors, McGladrey & Pullen, LLP
23.3	Consent of Independent Auditors, Grant Thornton, LLP
27	Financial Data Schedule
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and rule 15d-14(a) of the Securities Exchange Act, as amended
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Code of Ethics

*	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 the Commission on October 25, 1999.
**	Incorporated by reference to Exhibits, contained in Registrant's Form SB-2 Registration Statement (File No. 333-31969) effective November 5, 1997.
***	Incorporated by reference to Exhibit contained in Registrant's Schedule 14A Definitive Proxy Statement, as filed with the Commission on March 26, 1999.
****	Incorporated by reference to Exhibit contained in Registrant's Schedule 14A Definitive Proxy Statement, as filed with the Commission on May 21, 2001
*****	Incorporated by reference to Exhibit contained in Registrant's Schedule 14A Definitive Proxy Statement, as filed with the Commission on May 15, 2002
******	Incorporated by reference to Exhibits contained in the Registrant's 2002 10-KSB, as filed with the Commission on May 1, 2003
*******	Incorporated by reference to Exhibits contained in the Registrant's Restated 2001 10-KSB, as filed with the Commission on May 1, 2003
********	Incorporated by reference to Exhibits contained in the Registrant's Form 10-K/A Amendment No. 1, as filed with the Commission on April 15, 2004

Reports on Form 8-K

On May 28, 2003, the Company filed a report on Form 8-K to report its

First Quarter Earnings.

On July 28, 2003, the Company filed a report on Form 8-K to report the replacement of its then auditors, McGladrey & Pullen, LLP, with Eisner, LLP, effective July 22, 2003.

On August 20, 2003, the Company filed a report on Form 8-K to report its Second Quarter Earnings.

On November 20, 2003, the Company filed a report on Form 8-K to report its Third Quarter Earnings.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act the Registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized on October 8, 2004.

CTI INDUSTRIES CORPORATION
By: /s/ Howard W. Schwan
Howard W. Schwan, President

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

Signatures	Title	Date
/s/ Howard W. Schwan Howard W. Schwan	President and Director	October 8, 2004
/s/ John H. Schwan John H. Schwan	Chairman and Director	October 8, 2004
/s/ Stephen M. Merrick Stephen M. Merrick	Executive Vice President, Secretary, Chief Financial Officer and Director	October 8, 2004
/s/ Stanley M. Brown Stanley M. Brown	Director	October 8, 2004
/s/ Bret Tayne Bret Tayne	Director	October 8, 2004

/s/ Michael Avramovich	Director	October 8, 2004
Michael Avramovich		

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
CTI Industries Corporation and Subsidiaries
Barrington, Illinois

We have audited the accompanying consolidated balance sheets of CTI Industries Corporation and Subsidiaries as of December 31, 2002, and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CTI Industries Corporation and Subsidiaries as of December 31, 2002, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13 to the consolidated financial statements, on January 1, 2002, the Company changed its method of accounting for goodwill to adopt Statement of Financial Accounting Standards No. 142.

/s/ McGladrey & Pullen, LLP

Schaumburg, Illinois
April 15, 2003

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of CTI Industries Corporation

We have audited the accompanying consolidated balance sheet of CTI Industries Corporation and Subsidiaries as of December 31, 2001, and the related consolidated statement of operations, changes in stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility

of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above presently fairly, in all material respects, the consolidated financial position of CTI Industries Corporation and Subsidiaries as of December 31, 2001, and the consolidated results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As indicated in Note 3 to these accompanying consolidated financial statements, the Company has restated its consolidated financial statements for the year ended December 31, 2001.

/s/ Grant Thornton, LLP

Chicago, Illinois
April 10, 2002, except as to Note 2,
which is as of April 15, 2003

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
CTI Industries Corporation

We have audited the accompanying consolidated balance sheet of CTI Industries Corporation and subsidiaries (the "Company") as of December 31, 2003, and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of CTI Industries Corporation and subsidiaries as of December 31, 2003, and the

consolidated results of their operations and their cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

/s/ Eisner LLP

New York, New York
February 18, 2004

With respect to the first paragraph of Note 6
April 14, 2004

With respect to the third paragraph of Note 3
October 1, 2004

CTI Industries Corporation and Subsidiaries
Consolidated Balance Sheets

	December 31, 2003
ASSETS	
Current assets:	
Cash	$ 329,742
Accounts receivable, (less allowance for doubtful accounts of $316,047 and $391,406, respectively)	4,620,276
Inventories	9,263,160
Deferred tax assets	361,751
Prepaid expenses and other current assets	859,635
Total current assets	15,434,564
Property and equipment:	
Machinery and equipment	18,939,535
Building	2,678,581
Office furniture and equipment	1,931,831
Land	250,000
Leasehold improvements	582,052
Fixtures and equipment at customer locations	2,232,285
Projects under construction	408,961
	27,023,245
Less: accumulated depreciation	(14,815,596)
Total property and equipment, net	12,207,649
Other assets:	
Deferred financing costs, net	222,696
Goodwill	1,113,108
Deferred tax assets	1,012,365
Other assets	279,800

Total other assets	2,627,969
TOTAL ASSETS	30,270,182

See accompanying notes

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CTI Industries Corporation and Subsidiaries
Consolidated Balance Sheets (cont'd.)

	December 31, 2003	Dec
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Checks written in excess of bank balance	341,108	
Accounts payable	6,799,490	
Line of credit	3,694,241	
Notes payable - current portion	2,998,496	
Accrued liabilities	2,306,745	
Total current liabilities	16,140,080	
Long-term liabilities:		
Other liabilities	1,079,041	
Notes payable	5,766,091	
Notes payable - officers	2,064,126	
Total long-term liabilities	8,909,258	
Minority interest	9,263	
Commitments, Contingencies and Litigation (Notes 14 & 15)		
Stockholders' equity:		
Preferred Stock - no par value 2,000,000 shares authorized, 0 shares issued and outstanding	0	
Common stock - no par value, 5,000,000 shares authorized, 2,150,216 and 2,141,882 shares issued, 1,918,420 and 1,910,086 shares outstanding, respectively	3,764,020	
Class B Common stock - no par value, 500,000 shares authorized, 0 shares issued and outstanding	0	
Paid-in-capital	5,554,332	
Warrants issued in connection with subordinated debt and bank debt	595,174	
Accumulated deficit	(3,528,063)	
Accumulated other comprehensive earnings	(234,768)	
Less:		
Treasury stock - 231,796 shares	(939,114)	
Notes receivable from stockholders	0	

Total stockholders' equity	5,211,581
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$ 30,270,182

See accompanying notes

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CTI Industries Corporation and Subsidiaries
Consolidated Statements of Operations

	Year Ended December 31, 2003	2002
Net Sales	$ 36,259,638	$ 41,236,476
Cost of Sales	29,626,450	32,344,115
Gross profit on sales	6,633,188	8,892,361
Operating expenses:		
Administrative	4,054,607	4,224,777
Selling	1,441,501	1,551,538
Advertising and marketing	1,816,301	1,671,106
Total operating expenses	7,312,409	7,447,421
(Loss) income from operations	(679,221)	1,444,940
Other income (expense):		
Interest expense	(1,103,395)	(831,600)
Interest income	13,618	3,157
Gain on sale of assets	28,007	0
Foreign currency (loss) gain	(36,132)	(281,186)
Other	428,126	0
Total other income (expense)	(669,776)	(1,109,629)
(Loss) income before income taxes (benefit) and minority interest	(1,348,998)	335,311
Income tax (benefit) expense	(782,468)	39,065
(Loss) income before minority interest	(566,530)	296,246
Minority interest in income of subsidiary	(483)	(6,266)

Net (loss) income	$ (566,047)	$ 302,512
(Loss) income applicable to common shares	$ (566,047)	$ 302,512
(Loss) income per common share - basic	$ (0.30)	$ 0.18
(Loss) income per common share - diluted	$ (0.30)	$ 0.16
Weighted average number of shares and equivalent shares of common stockoutstanding:		
Basic	1,918,260	1,688,384
Diluted	1,918,260	1,884,405

See accompanying notes

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CTI Industries Corporation and Subsidiaries
Consolidated Statements of Cash Flows

	For the Year En	
	2003 (as restated)	20
Cash flows from operating activities:		
Net (loss) income	$ (566,047)	$ 30
Adjustment to reconcile net (loss) income to cash provided by operating activities:		
Depreciation and amortization	1,618,563	1,58
Deferred gain on sale/leaseback	(30,047)	(3
Amortization of Debt Discount	238,199	2
Minority interest in loss of subsidiary	(483)	(
Provision for losses on accounts receivable & inventory	355,000	30
Deferred income taxes	(782,468)	(2
Change in assets and liabilities:		
Accounts receivable	619,113	(1,07
Inventory	560,433	(1,96
Other assets	66,313	(12
Accounts payable and accrued expenses	1,129,596	4,05
Net cash provided by operating activities	3,208,172	3,05
Cash flows from investing activity:		
Purchases of property, plant and equipment	(2,007,104)	(2,47
Net cash used in investing activities	(2,007,104)	(2,47
Cash flows from financing activities:		

Checks written in excess of bank balance	227,648	11
Net change in revolving line of credit	(1,948,408)	(5
Proceeds from issuance of long-term debt	6,768,759	
Repayment of long-term debt	(5,649,214)	(59
Repayment of short-term debt	0	
Repayment of subordinated debt	0	
Collection of Stockholder note	56,456	
Proceeds from exercise of Stock options	15,750	
Proceeds from exercise of warrants		1
Cash paid for deferred financing fees	(275,044)	
Purchase of Treasury Stock	0	
Net cash (used in) provided by financing activities	(803,853)	(51

CTI Industries Corporation and Subsidiaries
Consolidated Statements of Cash Flows (cont'd.)

	For the Year En	
	2003	20
Effect of exchange rate changes on cash	(227,966)	(1
Net increase (decrease) in cash	169,249	5
Cash and Equivalents at Beginning of Period	160,493	11
Cash and Equivalents at End of Period	$ 329,742	$ 16
Supplemental disclosure of cash flow information:		
Cash payments for interest	$ 865,196	$ 77
Cash payments for taxes	42,295	14
Supplemental non-cash investing and financing activities:		
Issuance of stock for subordinated debt	0	71
Long-term debt incurred for the purchase of equipment	0	2,23
Note payable incurred to purchase 21.8% of minority interest in CTI Mexico S. A. de C.V	0	14
Stock Dividend	0	1,28
Conversion of accounts payable to notes payable	3,534,326	
Common stock exchanged to exercise warrants	0	19
Refinance mortgage	2,671,243	

See accompanying notes

CTI Industries Corporation and Subsidiaries
Consolidated Statements of Stockholders'
Equity

	Common Stock		Class B Common Stock	
	Shares	Amount	Shares	Amount
Balance, December 31, 2000	966,327	$ 188,434	366,300	$ 1,000,000
Expiration of stock redemption period				
Warrants issued in connection with subordinated debt				
Purchase of Treasury Stock				
Net Loss				
Other comprehensive income Foreign currency translation				
Total comprehensive loss				
Balance, December 31, 2001	966,327	$ 188,434	366,300	$ 1,000,000
Options Excersised	11,000	$ 19,750		
Class B Conversion	366,300	$ 1,000,000	($366,300)	($1,000,000)
Stock Dividend	304,218	$ 1,280,758		
Warrant exercise for subordinated debt	423,579	$ 1,066,978		
Cashless exercise of warrants	70,458	$ 192,350		
Net Income				

	Accumulated Deficit	Accumulated Other Comprehensive Earnings	Less Treasury Sto	
			Shares	
Balance, December 31, 2000	$ (1,751,478)	$ (42,244)	124,683	$
Expiration of stock redemption period				
Warrants issued in connection with subordinated debt				

Purchase of Treasury Stock			74,513	$
Net Loss	$ (232,292)			
Other comprehensive income Foreign currency translation		$ (75,763)		
Total comprehensive loss				
Balance, December 31, 2001	$ (1,983,770)	$ (118,007)	199,196	$
Options Excersised				
Class B Conversion				
Stock Dividend	($1,280,758)			
Warrant exercise for subordinated debt				
Cashless exercise of warrants			$ 32,600	$
Net Income	$ 302,512			

	Less			
	Redeemable Common Stock	Stock Sub Recvble	Notes Recvble Shareholders	T
Balance, December 31, 2000	$ --	$ 4,700	$ (56,456)	$ 4,
Expiration of stock redemption period	$ --	$ (4,700)		$
Warrants issued in connection with subordinated debt				$
Purchase of Treasury Stock				$ (
Net Loss				$ (
Other comprehensive income Foreign currency translation				$
Total comprehensive loss				$ (
Balance, December 31, 2001	$ --	$ --	$ (56,456)	$ 4,
Options Excersised				$
Class B Conversion				$
Stock Dividend				$
Warrant exercise for subordinated debt				$

Cashless exercise of warrants					$
Net Income					$

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Other comprehensive income Foreign currency translation					
Total comprehensive loss					
Balance, December 31, 2002	2,141,882	$ 3,748,270	0	$	--
Options Excersised	8,334	$ 15,750			
Warrant exercise for subordinated debt					
Collection of Notes Receivable					
Net Income					
Other comprehensive income Foreign currency translation					
Total comprehensive loss					
Balance, December 31, 2003	2,150,216	$ 3,764,020	--	$	--

Other comprehensive income Foreign currency translation		$ 112,005		
Total comprehensive loss				
Balance, December 31, 2002	$ (2,962,816)	$ (6,002)	231,796	$
Options Excersised				
Warrant exercise for subordinated debt				
Collection of Notes Receivable				
Net Loss	($566,047)			

Other comprehensive income				
Foreign currency translation		($228,776)		
Total comprehensive loss				
Balance, December 31, 2003	$ (3,528,063)	$ (234,768)	231,796	$

Other comprehensive income				
Foreign currency translation				$
Total comprehensive loss				$
Balance, December 31, 2002	$ --	$ --	$ (56,456)	$ 5,
Options Excersised				$
Warrants issued in connection with subordinated debt				$
Collection of Notes Receivable			$ 56,456	$
Net Income				$ (
Other comprehensive income				
Foreign currency translation				$ (
Total comprehensive loss				$ (
Balance, December 31, 2003	$ --	$ --	$ --	$ 5,

See accompanying notes.

CTI Industries Corporation and Subsidiaries
Notes to the Consolidated Financial Statements

1. Nature of Operations

CTI Industries Corporation (the "Company"), its United Kingdom subsidiary (CTI Balloons Limited), and Mexican subsidiaries (Flexo Universal, S.A. de C.V., CTI Mexico Corporation, S.A. de C.V. and CTF International S.A. de C.V.) (i) design, manufacture and distribute metallized and latex 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.

2. Basis of Presentation

During the year ended December 31, 2003, the Company incurred a net operating loss before taxes of $1,349,000. As of December 31, 2003 and 2002, the Company had a working capital deficiency of $706,000 and $2,907,000, respectively. The Company depends on its line of credit, including a term loan and revolving line of credit with its principal lenders, and continued financial support from its principal stockholders/officers for liquidity. This line of credit expires on December 31, 2005.

For the year ending December 31, 2004, management anticipates improvement in its operating results and in cash generated from operating activities resulting from, among other things, restructuring certain operations. However, there is no assurance that such improvements in operating results will occur or that the funds provided from the Company's line of credit and operations will be sufficient to meet the Company's current obligations.

3. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of CTI Industries Corporation, its wholly owned subsidiaries CTI Balloons Ltd. ("CTI Balloons") and CTF International S.A. de C.V., and its majority owned subsidiaries, Flexo Universal S.A. de C.V. ("Flexo Universal") and CTI Mexico Corporation S.A. de C.V. ("CTI Mexico"). All significant intercompany accounts and transactions have been eliminated upon consolidation.

Foreign Currency Translation

The financial statements of foreign subsidiaries are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities, the historical exchange rate for stockholders' equity, and a weighted average exchange rate for each period for revenues and expenses. Translation adjustments are recorded in accumulated other comprehensive income (loss) as the local currencies of the subsidiaries are the functional currencies.

Restatements

The Company's December 31, 2001 financial statements have been restated as further discussed in Amendment No. 1 to the Company's 2001 Form 10-KSB.

The Company's December 31, 2003 financial statements have been restated to properly classify additions to property and equipment on the Statement of Cash Flows.

Accounting 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 amounts reported of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues 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 lower of cost to market of inventory and recovery value of good will.

Cash and Cash Equivalents

Cash and cash equivalents includes cash on hand, demand deposits and short term investments with original maturities of three months or less.

Trade Receivables

Trade receivables are carried at original invoice amount less an estimate for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by identifying troubled accounts, evaluating the individual customer receivables then considering the customer's

3. Summary of significant accounting policies, continued

financial condition, credit history and current economic conditions and by using historical experience applied to an aging of accounts. A trade receivable is considered to be past due if any portion of the receivable balance is outstanding for a period over the customers normal terms. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using standard costs which approximates costing determined on a first-in, first-out basis, and periodic adjustments to reflect the actual cost of production of inventories.

Property and Equipment

Property and equipment are stated at cost. Expenditures for maintenance and repairs are charged to operations as incurred. Depreciation is computed using the straight-line and declining-balance methods over estimated useful lives of the related assets. Leasehold improvements are amortized on a straight-line method over the lesser of the estimated useful life or the lease term. The estimated useful lives range as follows:

Building	25 - 30 years
Machinery and equipment	3 - 15 years
Office furniture and equipment	5 - 8 years
Leasehold improvements	5 - 8 years
Furniture & equipment at customer locations	2 - 3 years

Goodwill

Prior to January 1, 2002, goodwill was amortized over 15 years using the straight-line method. Subsequent to that date, the Company has followed, and does now follow, the provisions of Statement of Financial Accounting Standards 142. "Goodwill and Other Intangible Assets," under which goodwill is not amortized but is tested at least annually for impairment. Goodwill on the accompanying balance sheets relates to Flexo Universal/CTI Mexico. It is the Company's policy to perform impairment testing for Flexo Universal/CTI Mexico annually as of December 31.

Impairment of long lived assets

The Company evaluates whether events or circumstances have occurred which indicate that the carrying amounts of long-lived assets (principally property and equipment) may be impaired or not recoverable. The significant factors that are considered that could trigger an impairment review include: changes in business strategy, market conditions, or the manner of use of an asset; underperformance relative to historical or expected future operating results; and negative industry or economic trends. In evaluating an asset for possible impairment, management estimates that asset's future undiscounted cash flows and appraised values to measure whether the asset is recoverable, the Company measures the impairment based on the projected discounted cash flows of the asset over its remaining life. While the Company believes that our estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect these evaluations.

Deferred Financing Costs

Deferred financing costs relates to the refinancing of debt in December, 2003. These costs are being amortized on a straight-line basis over the term of the loans.

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CTI Industries Corporation and Subsidiaries
Notes to the Consolidated Financial Statements

3. Summary of significant accounting policies, continued

Income Taxes

The Company accounts for income taxes using the asset and liability method. As such, deferred income taxes reflect the net tax effects of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Deferred tax assets and liabilities are measured using enacted tax rates expected to be in effect when the anticipated reversal of these differences is scheduled to occur. The effect of a change in tax rates on deferred tax assets or liabilities is recognized in income in the period and includes the enactment date. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Fair Value of Financial Instruments

The fair value of financial instruments are not materially different from their carrying values.

Other Comprehensive Income

For years ended December 31, 2003, 2002 and 2001, other comprehensive income consisted of foreign currency translation adjustments, net of related taxes.

Revenue Recognition

The Company recognizes revenue when title transfers upon shipment. Revenue from a transaction is not recognized until (i) a definitive arrangement exists, (ii) delivery of the product has occurred or the services have been performed, (iii) the price to the buyer has been fixed or is determinable and (iv) collectibility is reasonably assured. In some cases, product is provided on consignment to customers. For these cases, revenue is recognized when the customer reports a

sale of the product.

Stock-Based Compensation

At December 31, 2003, the Company has four stock-based compensation plans, which are described more fully in Note 15. The Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations. The Company recognizes compensation cost for stock-based compensation awards equal to the difference between the quoted market price of the stock at the date of grant or award and the price to be paid by the employee upon exercise in accordance with the provisions of APB No. 25. Based upon the terms of Company's current stock option plans, the stock price on the date of grant and price paid upon exercise are the same. Accordingly, no stock-based employee compensation cost has been recognized, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income (loss) and earnings (loss) per share had compensation cost for all of the stock-based compensation plans been determined based on the grant date fair values of awards (the method described in FASB Statement No. 123, Accounting for Stock-Based Compensation):

	Years Ended December 31,		
	2003	2002	2001
Net (Loss) Income:			
As reported	(566,047)	302,512	(232,292)
Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(8,583)	(117,375)	(152,901)
Pro forma net income (loss)	(574,630)	185,137	(385,193)
Net income (loss) per share:			
Basic - As reported	(0.30)	0.18	(0.15)
Basic - Proforma	(0.30)	0.11	(0.25)
Diluted - As reported	(0.30)	0.16	(0.15)
Diluted - Proforma	(0.30)	0.10	(0.25)

The fair value of each option was estimated as of the date of the grant using the Black-Scholes option pricing model based on the following assumptions:

	2003	2002	2001
Expected life (years)	5	5	7.5
Volatility	136.6%	123.3%	117%
Risk-free interest rate	4.4%	2.9%	4.5%
Dividend yield	--	--	--

Research and Development

The Company conducts product development and research activities which includes (i) creative product development, (ii) creative marketing, and (iii) engineering. During the years ended December 31, 2003, 2002 and 2001, research and development activities totaled $335,000 $333,000 and $325,000, respectively.

New Accounting Pronouncements

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosures Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. FIN 45 is effective on a prospective basis to guarantees issued or modified after December 31, 2002, but has certain disclosure requirements effective for financial statements of interim or annual periods ending after December 15, 2002. The Company does not currently have any guarantees. The Company does not anticipate that the adoption of the disclosure requirements will have a material effect on its financial position or results of operations.

In January, 2003 the Financial Accounting Standards Board issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," which addresses consolidation by business enterprises of variable interest entities ("VIE's") either: (1) that do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) in which the equity investors lack an essential characteristic of a controlling financial interest. In December, 2003, the FASB completed deliberations of proposed modifications to FIN 46 resulting in multiple effective dates based on the nature as well as the creation date of the VIE. Special purpose entities created prior to February 1, 2003 may be accounted for under the original or revised interpretation's provisions no later than the Company's first quarter of 2004. Non-special purpose entities created prior to February 1, 2003 are to be accounted for under the revised interpretation's provisions no later than the Company's second quarter of 2004. Management has concluded that the provisions of FIN 46 do not apply to the Company with respect to its transactions with Pepper Road, Inc. (see Note 17).

4. Major Customers

For the year ended December 31, 2003, the Company had three customers that accounted for approximately 28.4%, 14.7% and 11%, respectively, of consolidated net sales. Corresponding percentages of consolidated net sales generated by

these customers for the year ended December 31, 2002, were approximately 29%, 17% and 12% respectively, and in 2001, were approximately 23.0%, 14.0% and 2.7%, respectively. At December 31, 2003, the outstanding accounts receivable balances due from these three customers were $464,183, $566,557 and $862,407 respectively. At December 31, 2002 the outstanding accounts receivable balances due from these three customers were $1,149,856, $932,707 and $1,697,852. At December 31, 2001, the balance due from these three customers were $568,931, $579,035, and $367,677.

5. Inventory

Inventory is comprised of the following:

	December 31, 2003	December 31, 2002
Raw materials	$ 866,111	$ 1,865,871
Work in process	1,365,317	2,135,503
Finished goods	7,523,889	6,386,719
Allowance, Excess Quantities ...	(492,157)	(354,500)
Total inventory	$ 9,263,160	$ 10,033,593

6. Notes Payable

Long-term debt consists of:

	Dec 31, 2003
Term Loan with bank, payable in monthly installments of $22,222 plus interest at prime plus 0.75%	$ --
Term Loan with bank, payable in monthly installments of $58,333 plus interest at prime (4% at December 31, 2003) plus 1.5%; balance due February 1, 2009	3,500,000
Term Loan with bank, payable in monthly installments of $19,209 including interest at 6.25% due May 5, 2008 (loan renegotiated May 2003)	2,879,886
Term Loan with bank, payable in monthly installments of $5,582 including interest at 10.00% due and paid in January 5, 2004	1,399
Term Loan with bank, payable in monthly installments of $26,139 including interest at 5.75% due January, 2004 and paid December, 2003	--
Vendor notes, at various rates of interest, (weighted average of 6%), maturing through August, 2005	2,299,647
Subordinated Notes due to officers in 2005, Interest at 9% Net of Debt Discount of $310,898	1,269,102
Subordinated Notes due to officers, interest at 9%	795,024
Loan payable to a Mexican finance institution denominated in Mexican Pesos bearing interest at 9.81%	83,655
Loan with bank, with interest payable monthly at prime (4.25%	

at December 31, 2002)	--
Total	$ 10,828,713
Less current portion	(2,998,496)
Total long-term debt	$ 7,830,217

6. Notes Payable, continued

On December 31, 2003, the Company entered into a Loan and Security Agreement with a Bank under which the Bank provided to the Company a credit facility in the aggregate amount of $11,000,000, collateralized by substantially all assets of the Company. The credit facility expires on December 31, 2005; it is automatically renewed for successive one year terms unless terminated by either of the parties. The credit facility includes a term loan of $3,500,000, at an interest rate of prime plus 1.5% per annum (and is being amortized over a period of 60 months), which is based primarily upon the appraised value of the equipment of the Company and a revolving line of credit at an interest rate of prime plus 1.5% per annum (5.5% at December 31, 2003), the amount of which is based on advances of up to 85% of eligible receivables and up to 50% of the value of the Company's domestic inventory. Upon the receipt of any proceeds of sale or other disposition of equipment, or any proceeds from damage, destruction or condemnation, such proceeds must be paid as a mandatory prepayment of the term loan. In addition, 50 % of excess cash flow as of December 31, 2004, is required to be paid as a prepayment of the term loan. The Loan Agreement includes financial covenants requiring a minimal level of tangible net worth and ratio of EBITDA to fixed charges. The Company was in violation of the EBITDA to fixed charges at December 31, 2003 for which the bank has issued a waiver.

The loan agreement also prohibits new debt, loans by the Company, purchase of stock and dividends, without the consent of the Bank.

As of December 31, 2003, the balance outstanding on the credit facility was $3,694,241.

In January, 2001, the Company entered into a Loan and Security Agreement with an institutional lender under which the lender provided the Company with a credit facility in the amount of $9,500,000, collateralized by equipment, inventory, receivables and other assets of the Company. The credit facility included a term loan of $1,426,000, at an interest rate of prime plus 0.75% per annum, which was based upon the appraised value of the equipment of the Company and a revolving line of credit at an interest rate of prime plus 0.5% per annum, the amount of which was based on advances of up to 85% of eligible receivables and up to 40% of the value of the Company's inventory. In 2002, the lender advanced additional funds on the original term loan in the amount of $490,880, advanced a second term loan in the amount of $1,740,000 and increased the credit facility to $11,500,000. The term loans and revolving line of credit were secured by substantially all assets of the Company. The term of this credit facility was

for a period of three years expiring in January 31, 2004. This line of credit was paid in full at December 31, 2003 and was terminated.

Also in January 2001, another lender loaned to the Company the sum of $2,873,000 in a refinance of the Company's principal office building and property situated in Barrington, Illinois. The loan is collateralized by this building and property, with a net carrying value of $2,886,595, and has been made in the form of two notes. The first note is in the principal amount of $2,700,000, bears interest at the rate of 9.75%, and has a term of five years with an amortization period of 25 years. In May 2003, the terms of this note was renegotiated to a note in the principal amount of $2,912,000 bearing 6.25% with a term of 5 years amortized over 30 years.

The second note is in the principal amount of $173,000 with an interest rate of 10%, and has a term of three years. The balance on this Note of $1,399 as of December 31, 2003, was paid on January 5, 2004.

Future Minimum principal payments, exclusive of debt discount, for amounts outstanding under these long-term debt agreements at December 31, 2003 are as follows:

2004	2,998,496
2005	2,948,195
2006	756,065
2007	759,723
2008	3,362,530
Thereafter	3,704
Less Current Portion .	(2,998,496)
	$ 7,830,217

7. Subordinated Debt

In November, 1999, warrants to purchase up to 35,263, 246,840 and 222,157 shares of the Company's Common Stock at an exercise price of $1.418 per share were issued to Messrs. H. Schwan, J. Schwan and Merrick, respectively in consideration of subordinated loans by such individuals to the Company in the amounts, respectively, of $50,000, $350,000 and $315,000. Each of these warrants were exercised on June 3, 2002. The respective $50,000, $350,000 and $315,000 notes were cancelled and used as payment for the warrant shares.

In February, 2003, the Company received $1,630,000 from certain officers in exchange for (a) two year 9% subordinated notes, and (b) five year warrants to purchase 163,000 common shares at $4.87 per share. The proceeds were to (i) re-finance the bank loan of CTI Mexico in the amount of $880,000 and (ii) to provide financing for CTI Mexico and Flexo Universal. As a result of valuing the warrants and allocating a portion of the proceeds to the warrants, the Company recorded additional paid in capital attributable to the warrants of $459,712 and a related discount in the subordinated debt of the same amount. The subordinated debt is recorded at December 31, 2003, net of unamortized debt discount of $310,898. The debt discount is amortized using the effective interest method over the term of the debt.

At various times during 2003, a shareholder/officer loaned an aggregate of $795,024 to the Company in exchange for notes bearing interest at 8%. These notes are subordinated to the bank loan of the Company.

8. Other Income

Other income of $428,126 set forth on the Comany's Consolidated Statements of Operations for the year ended December 31, 2003 includes income derived from the settlement of certain outstanding liabilities due to vendors for less than the amount recorded on the books of the Company.

9. Other Liabilities

Items identified as Other Liabilities in the Company's Consolidated Balance Sheet as of Decmeber 31, 2003 include (i) deferred gain of the Company in the amount of $175,376 on the sale of a building to Pepper Road, Inc., (ii) loans by officers/shareholders to Flexo Universal totaling $250,000 which is subordinated to bank obligations and bearing interest at 8%, (iii) obligations of Flexo Universal to a financial institution in the amount of $83,665 and (iv) obligations of CTI Mexico, Flexo and CTF International totaling $570,000 to vendors on deferred payment terms.

10. Income Taxes

The income tax provisions are comprised of the following:

	Year ended December 31,		
	2003	2002	2001
Current:			
Federal	$ --	$ --	$ --
State	--	--	--
Foreign	--	--	22,316
	--	--	22,316
Deferred:			
Federal	(361,881)	25,859	199,340
State	(51,281)	3,665	--
Foreign	(369,306)	9,541	54,897
	(782,468)	39,065	254,237
Total income tax (benefit) provision	$(782,468)	$ 39,065	$276,553

The components of the net deferred tax asset (liability) at December 31 are as follows:

	2003	2002	20
Deferred tax assets:			
Allowance for doubtful accounts	$ 139,845	$ 135,667	$ 1
Inventory valuation	162,248	203,032	1
Accrued liabilities	151,017	126,804	1
Sale Leaseback	68,037	79,701	(3
Unicap 263A Adjustment	52,380	--	
Net operating loss carryforwards	2,185,357	1,840,916	1,7
Alternative minimum tax credit carryforward ...	338,612	338,612	3

State Investment Tax Credit carryforward	18,041	26,225	
Other Foreign Tax Items	137,993	--	
Foreign Asset Tax Credit carryforward	160,784	166,790	
Total deferred tax assets	3,414,314	2,917,747	2,2
Deferred tax liabilities:			
Book over tax basis of capital assets	(1,069,395)	(989,197)	8
Cash basis of foreign inventory purchases	(264,933)	(500,578)	
	(1,334,328)	(1,489,775)	8
Net Deferred Assets before Valuation Allowance	2,079,986	1,427,972	1,3
Less: Valuation allowance	(738,600)	(738,600)	(7
Net deferred tax asset	$ 1,341,386	$ 689,372	$ 6

CTI Industries Corporation and Subsidiaries
Notes to the Consolidated Financial Statements

10. Income Taxes, continued

The Company maintains a valuation allowance with respect to deferred tax assets as a result of the uncertainty of ultimate realization. At December 31, 2003 the Company has net operating loss carryforwards of approximately $5,393,000 expiring in various years through 2023. The Company has approximately $338,600 of alternative minimum tax credits as of December 31, 2003, which have no expiration date. Future use of net operating loss carryforwards and income tax credits may be limited pursuant to Section 382 of the Internal Revenue Code. In addition, as per Mexican tax regulations, Flexo Universal has net operating loss carryforwards of approximately $2,822,000, expiring in 2013. Unremitted earnings of foreign subsidiaries have been indefinitely reinvested.

Income tax provisions differed from the taxes calculated at the statutory federal tax rate as follows:

	Year Ended December 31,		
	2003	2002	2001
Taxes at statutory rate	$(393,154)	$ 114,000	$ (4,600
State income taxes	(55,504)	16,000	0
Nondeductible Expenses	20,564	41,000	--
Increase in deferred tax Valuation allowance	0	--	27,300
State credit created in current year	0	(22,000)	--
Foreign taxes and other	(354,374)	(109,935)	253,853

Income tax provision	$(782,468)	$ 39,065	$ 276,553
	=========	=========	=========

11. Employee Benefit Plan

The company has a defined contribution plan for substantially all employees. Prior to January 1, 2004, the plan provided for the Company matching contributions on the first $300 of employee contributions with an additional bonus match of 1% of compensation for all participants who were employees on the last date of the plan year. Profit sharing contributions may also be made at the discretion of the Board of Directors. Effective January 1, 2004 the Company amended its defined contribution plan. Under the amended plan the maximum contribution for the Company is 2% of gross wages. Employer contributions to the plan totaled $54,836 for the year ended December 31, 2003, and $53,680 for the year ended December 31, 2002, and $57,160 for the year ending December 31, 2001.

12. Related Party Transactions

The Company obtains legal services from a law firm in which two shareholders of the law firm are also shareholders of the Company, and in which one shareholder of the law firm is both a director and a shareholder of the Company. Legal fees incurred with this firm were $107,000 for the year ended December 31, 2003 and $102,000 for the year ended December 31, 2002, and $121,000 for the year ended December 31, 2001.

In 1998, the Company advanced funds totaling $81,352 to officers of the Company. $56,456 of these funds were used to purchase common stock of the Company and were reflected as a contra equity account at December 31, 2002 and 2001. During 2003, these obligations have been repaid in their entirety.

A shareholder/officer of the Company is President of Packaging Systems, L.L.C. and affiliated companies. The Company made purchases of packaging materials from these entities in the amount of $118,011 and $273,910 during each of the years ended December 31, 2002 and 2003, respectively.

In November, 1999, the Company sold a building to a related party. See Note 15.

13. Goodwill and Intangible Assets

On January 1, 2002, the Company implemented Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets. Under the provisions of SFAS 142, goodwill is no longer subject to amortization over its estimated useful life, but instead will be subject to at least annual assessments for impairment by applying a fair- value based test. SFAS 142 also requires that an acquired intangible asset should be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the asset can be sold, licensed, rented or exchanged, regardless of the acquirer's intent to do so. The Company has no acquired intangible assets other than goodwill. The Company determined that no transitional impairment loss was required at January 1, 2002.

The Company retained an independent consulting firm to conduct a study and make a determination whether the goodwill reflected on the Company's financial statements was impaired as of January 1, 2002, December 31, 2002 and December

31, 2003. For each of such times, the Company has received the report and opinion of such consulting firms to the effect that there was no impairment of goodwill reflected on the financial statements of the Company as of each of January 1, 2002, December 31, 2002 and December 31, 2003.

The gross carrying amount of goodwill as of December 31, 2003 and 2002 is $1,113,108.

The following information is provided with respect to amortization of good will during 2001:

	Year Ended December 31		
	2003	2002	2001
Reported net income (loss)	$ (566,047)	$ 302,512	$ (232,292)
Add back: Goodwill amortization	$ --	$	$ 86,664
Adjusted net income (loss)	$ (566,047)	$ 302,512	$ (145,628)
Basic earnings per share			
Reported net income (loss)	$ (0.30)	$ 0.18	$ (0.15)
Add back: Goodwill amortization	$ --	$ --	$ 0.07
Adjusted net income (loss)	$ (0.30)	$ 0.18	$ (0.08)
Fully diluted earnings per share:			
Reported net income (loss)	$ (0.30)	$ 0.16	$ (0.15)
Add back: Goodwill amortization	$ --	$ --	$ 0.07
Adjusted net income (loss)	$ (0.30)	$ 0.16	$ (0.08)

14. Commitments and Contingencies

Operating Leases

The Company entered into a 10-year lease agreement for office and warehouse facilities in November 1999, requiring monthly payments of $17,404, to Pepper Road, Inc., an entity which is owned by certain principal stockholders/officers of the Company. In 2003 the rent was reduced to $15,500 per month. Approximately 50% of the facility was subleased through March 2002, and after that, the Company assumed the remaining 50% of the facility. The Company's United Kingdom subsidiary also maintains a lease for office and warehouse space which expires in 2019.

The Company leases office equipment under operating leases which expire on various dates between April 2004 and December 2006.

The net lease expense was $555,197, $348,631 and $269,643 for the years ended December 31, 2003, 2002 and 2001, which includes $193,613 in 2003 and $208,844 in 2002 and 2001 to Pepper Road, Inc.

The future aggregate minimum net lease payments under existing agreements as of December 31, as follows:

	Pepper Road, Inc.	Other	Total Lease Payments
2004	$ 186,000	$ 356,532	$ 542,532
2005	186,000	346,905	532,905
2006	186,000	315,771	501,771
2007	186,000	286,728	472,728
2008	186,000	51,700	237,700

Thereafter	155,000	568,700	723,700
Total	$1,085,000	$1,926,336	$3,011,336

Licenses

At December 31, 2003, Company had certain merchandising license agreements which are of a one to two year duration that require royalty payments based upon the Company's net sales of the respective products. The agreements call for guaranteed minimum commitments that are determined on a calendar year basis. Future guaranteed commitments due, as computed on a pro rata basis, as of December 31, are as follows:

14. Commitments and Contingencies, continued

2004....................	$86,664
2005....................	$76,664

15. Litigation

On September 5, 2003, Airgas Inc., Airgas-Southwest, Inc., Airgas-South, Inc. and Airgas-East, Inc. filed a joint action against CTI Industries Corporation for claimed breach of contract in the Circuit Court of Lake County, Illinois claiming as damages the aggregate amount of $162,242. The Company has filed an answer denying the material claims of the complaint, affirmative defenses and a counterclaim. In the action, the plaintiffs claim that CTI Industries Corporation owes them certain sums for (i) helium sold and delivered, (ii) rental charges with respect to helium tanks and (iii) replacement charges for tanks claimed to have been lost. The Company intends to vigorously defend this action and to pursue its counterclaim.

In addition, the Company is also 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.

16. Sale/Leaseback of Building

In November, 1999, the Company sold its building located next to its headquarters in Barrington, Illinois to Pepper Road, Inc. ("Pepper Road") for a gain of $300,467, and entered into an agreement to lease back the facility. Pepper Road is an entity in which officers/shareholders of the Company have a controlling interest. The gain realized on the sale was deferred and is being recognized into income over the 10 year lease term.

17. Relationship with Pepper Road, Inc.

Pepper Road, Inc. ("Pepper Road") purchased from the Company certain real estate, including a building and leases that property to the Company under a 10 year lease. The unaudited financial statements of Pepper Road for its fiscal year ended December 31, 2003 include:

Gross Lease Income	$ 193,615

Net Income	$ 3,483
Assets, primarily land and building	$1,819,328
Liabilities, primarily notes payable to bank	$1,818,272
Equity	$ 1,056

The Company paid a total of $193,615 in lease payments to Pepper Road during 2003, and $208,844 in lease payments during 2002 and 2001, respectively. The lease commitments of the Company to Pepper Road are included in Note 14. Each of the following persons owns a one-third equity interest in Pepper Road: Howard Schwan, President, John Schwan, Chairman of the Board and Stephen Merrick, Executive Vice President. Each of the foregoing persons is a director and a significant shareholder of the Company. Management has concluded that the provisions of FIN 46 do not apply to the Company with respect to its transactions with Pepper Road, Inc.

18. Authorized Preferred Stock

The Certificate of Incorporation of the Company authorizes the issuance, by the Board of Directors fixing all rights, preferences and designations, of up to 2,000,000 shares of Preferred Stock of the Company, no par value. No shares of this Preferred Stock have been issued and there are no shares of such stock issued or outstanding.

19. Stock Options and Warrants

Under the Company's 1997 Stock Option Plan, options to purchase 98,416 shares of Common Stock have been granted as of October 31, 1998, and remain outstanding at December 31, 2003. The options are exercisable immediately upon grant and have a term of ten years. The Plan provides 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. The Plan is administered by the Board or a committee appointed by the Board (the "Administrator"). Officers,

19. Stock Options and Warrants, continued

directors, and employees of, and consultants to, the Company or any parent or subsidiary corporation selected by the Administrator are eligible to receive options under the Plan. Subject to certain restrictions, the Administrator is authorized to designate the number of shares to be covered by each award, the terms of the award, the date on which and the rates at which options or other awards may be exercised, the method of payment and other terms.

On March 19, 1999, the Board of Directors approved for adoption, effective May 6, 1999, the 1999 Stock Option Plan ("Plan"). The Plan authorizes the grant of options to purchase up to an aggregate of 158,733 shares of the Company's Common Stock. As of December 31, 2003, 147,027 options had been granted under the 1999 Stock Option Plan. The options are exercisable immediately upon grant, and have a term of ten years.

On April 12, 2001 the Board of Directors approved for adoption, effective December 27, 2001, the 2001 Stock Option Plan ("Plan"). The Plan authorizes the grant of options to purchase up to an aggregate of 158,733 shares of the Company's Common Stock. As of December 31, 2003, 106,550 options had been granted under the 2001 Stock Option Plan. The options are exercisable immediately upon grant and have a term of ten years.

On April 24, 2002 the Board of Directors approved for adoption, effective October 12, 2002, the 2002 Stock Option Plan ("Plan"). The Plan authorizes the grant of options to purchase up to an aggregate of 142,860 shares of the Company's Common Stock. As of December 31, 2003, 58,930 options had been granted under the 2002 Stock Option Plan. The options are exercisable immediately upon grant and have a term of ten years.

The exercise price for ISOs cannot be less than the fair market value of the stock subject to the option on the grant date (110% of such fair market value in the case of ISOs granted to a stockholder who owns more than 10% of the Company's Common Stock). The exercise price of a NQO shall be fixed by the Administrator at whatever price the Administrator may determine in good faith. Unless the Administrator determines otherwise, options generally have a 10-year term (or five years in the case of ISOs granted to a participant owning more than 10% of the total voting power of the Company's capital stock). Unless the Administrator provides otherwise, options terminate upon the termination of a participant's employment, except that the participant may exercise an option to the extent it was exercisable on the date of termination for a period of time after termination.

In December, 1996, certain members of company management were issued warrants to purchase 76,923 shares of the Company's Common Stock at an exercise price of $2.73 per share in consideration of their facilitating and guaranteeing a bank loan to the Company in the amount of $6.3 million. The warrants had a term of six years and were exercised in 2002.

In September, 1998 the Company issued an option to purchase 11,905 shares of the Company's Common Stock at an exercise price of $2.10 per share to Thornhill Capital LLC in consideration for services. The option has a term of 10 years. In September, 1999, warrants to purchase 19,079 shares of the Company's Common Stock at an exercise price of $9.36 per share were cancelled and reissued at an exercise price of $1.42 per share. In April, 2002, the Company issued an option to purchase 11,905 shares of the Company's Common Stock at an exercise price of $2.10 per share to Thornhill Capital in consideration of services.

In November 1999, warrants issued in 1997 to purchase up to 76,389 shares of the Company's Common Stock for $9.36 were cancelled. New warrants to purchase up to 423,579 shares of the Company's Common Stock at $1.688 were issued. The new warrants had a term of 3 years and were exercised in 2002.

In July, 2001, certain members of management were issued warrants to purchase 119,050 shares of the Company's Common Stock at an exercise price of $1.50 per share in consideration of their facilitating and guaranteeing and securing bank loans to the Company in the amount of $1.4 million and for advancing additional monies to the company that were repaid in 2001. The warrants have a term of five years.

In March, 2003, certain members of management were issued warrants to purchase an aggregate of 163,000 shares of common stock of the Company at an exercise price of $4.87, per share, the then market price, in consideration of such persons making subordinated loans to the Company in the aggregate of $1,630,000, the warrants have a term of five years. See Note 7.

CTI Industries Corporation and Subsidiaries
Notes to the Consolidated Financial Statements

19. Stock Options and Warrants, continued

The following is a summary of the activity in the Company's stock option plans and other options and warrants issued, as restated for the stock dividend, for the years ended December 31, 2003, 2002 and 2001:

	Dec. 31, 2003	Weighted Avg. Exercise Price	Dec. 31, 2002	We Ex
Outstanding and exercisable, beginning of period ...	572,862	$2.58	1,094,739	
Granted	170,000	2.22	79,764	
Exercised	(8,334)	1.54	(601,245)	
Cancelled	(8,929)	6.51	(396)	
Outstanding and exercisable at the end of period ...	725,599	$2.58	572,862	

At December 31, 2003, available options to grant were 76,930.

Significant option and warrant groups outstanding at December 31, 2003 and related weighted average price and remaining life information are as follows:

Grant Date	Outstanding	Exercisable	Exercise Price	Remaining Life (Years)
September 1997	5,953	5,953	$6.28	3
September 1998	92,463	92,463	$6.51	4
September 1998	11,905	11,905	$2.10	4
September 1999	19,079	19,079	$1.42	0
March 2000	138,693	138,693	$1.95	6
July 2001	119,050	119,050	$1.50	2
December 2001	100,597	100,597	$1.46	7
April 2002	11,905	11,905	$2.10	8
December 2002	55,954	55,954	$2.36	8
February 2003	163,000	163,000	$4.87	4
December 2003	7,000	7,000	$2.26	10
Total Options and Warrants Outstanding ..	725,599	725,799		

The weighted average fair value of options granted during the year ending December 31, 2003, 2002 and 2001 were $2.26, $1.92 and $1.48 per share, respectively.

20. Stock Dividend and Class B Common Stock Conversion

On December 27, 2002, the Company distributed 304,218 shares of common stock in connection with a 19.05% dividend. As a result of the stock dividend, common stock was increased by $1,280,758 and accumulated deficit was increased by $1,280,758. All references in the accompanying financial statements to the number of common shares and pre-share amounts for 2001 have been restated to

reflect the stock dividend.

In July, 1997, the Company effected a recapitalization (the "Recapitalization") without a formal reorganization. As part of the Recapitalization, the Board of Directors approved the creation of Class B Common Stock, approved a 1 for 2.6 reverse stock split on both the Common Stock and Preferred Stock, and negotiated a conversion of all then outstanding shares of the Company's Convertible Preferred Stock into an aggregate of 366,300 shares of Class B Common Stock. The conversion was effective upon the closing of an initial public offering of 575,000 shares of the Company's Common Stock on November 5, 1997. The shares of Class B Common Stock contained rights identical to shares of Common Stock, except that shares of Class B Common Stock, voting separately as a class, had the right

20. Stock Dividend and Class B Common Stock Conversion, continued

to elect four of the Company's seven directors. Shares of Common Stock and Class B Common Stock, voting together as a class, vote on all other matters, including the election of the remaining directors. The recapitalization, initial public offering and related transactions were approved by written consent of the shareholders. On July 1, 2002, all outstanding shares of Class B Common Stock, by their terms, were converted to common stock.

21. Earnings Per Share

Basic earnings per share is computed by dividing the income available to common shareholders, net earnings, 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 and common stock equivalents (redeemable common stock, stock options and warrants), unless anti-dilutive, during each period.

Earnings per share for the years ended December 31, 2003, December 31, 2002 and December 31, 2001 was computed as follows:

	Year Ended December 31, 2003	Year Ended December 31, 2002
BASIC		
Average shares outstanding:		
Weighted average shares		
Outstanding during period	1,918,260	1,688,384
Earnings:		
Net (loss) income	$ (566,047)	$ 302,512
Amount for per share		

Computation	$ (566,047)	$ 302,512
Net (loss) earnings applicable to Common shares	$ (0.30)	$ 0.18

DILUTED

Average shares outstanding:		
Weighted average shares Outstanding	1,918,260	1,688,384
Common stock equivalents (options/warrants)		196,021
Weighted average shares Outstanding during period	1,918,260	1,884,405
Earnings:		
Net (loss) income	$ (566,047)	$ 302,512
Amount for per share Computation	$ (566,047)	$ 302,512
Net (loss) earnings applicable to Common shares	$ (0.30)	$ 0.16

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CTI Industries Corporation and Subsidiaries
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22. Geographic Segment Data

The Company's operations consist of a business segment which designs, manufactures, and distributes balloon products. Transfers between geographic areas were primarily at cost. The Company's subsidiaries have assets consisting primarily of trade accounts receivable, inventory and machinery and equipment. Sales and selected financial information by geographic area for the periods ended December 31, 2002, and December 31, 2003 are as follows:

	United States	United Kingdom	Mexico	Elimination
Year ended 12/31/03				
Revenues	$ 32,686,979	$ 2,415,028	$ 4,003,217	$ (2,845,58
Operating income	(246,299)	190,521	(527,767)	(95,67
Net income (loss)	(883,369)	163,218	249,297	(95,19
Total Assets	$ 27,602,666	$ 1,412,352	$ 5,475,850	$ (4,220,68
Year ended 12/31/02				
Revenues	$ 37,418,425	$ 1,965,736	$ 5,235,119	$ (3,382,80
Operating income	1,259,905	68,535	212,174	(95,67
Net income (loss)	451,582	40,065	(99,724)	(89,41
Total Assets	$ 26,311,194	$ 979,959	$ 4,982,751	$ (2,002,04

Year ended 12/31/01				
Revenues	$ 24,706,305	$ 1,672,672	$ 5,940,039	$ (4,872,52
Operating income	1,089,865	66,594	128,002	(267,73
Net income (loss)	(104,384)	49,697	46,451	(224,05
Total Assets	$ 20,354,875	$ 620,228	$ 5,785,584	$ (2,096,46

23. Fourth Quarter Adjustments, 2002

During the fourth quarter of 2002, the Company determined that adjustments to inventory, intercompany accounts, and other accounts were necessary. The net effect of these fourth quarter adjustments did not materially effect the operating results of the first three quarters of 2002.

During the fourth quarter of 2003, the Company determined that adjustments to inventory and projects in process accounts were necessary. The net effect of these fourth quarter adjustments did not materially affect the operating results of the first three quarters of 2003.

24. Quarterly Financial Data (Unaudited):

	Quarters ended,			
	03/31/2003	06/30/2003	09/30/2003	12/31/2003
Net sales	$10,162,495	$ 8,661,939	$ 8,428,784	$ 9,006,420
Gross profit	$ 1,937,053	$ 1,906,029	$ 1,775,387	$ 1,014,719
Net income (loss)	$ (689,788)	$ 133,178	$ 128,740	$ (138,177)
Earnings (loss) per common share				
Basic	$ (0.36)	$ 0.07	$ 0.07	$ (0.07)
Diluted	$ (0.36)	$ 0.06	$ 0.06	$ (0.07)

	Quarters ended,			
	03/31/2002	06/30/2002	09/30/2002	12/31/2002
Net sales	$ 9,738,097	$10,905,748	$10,873,147	$ 9,719,484
Gross profit	$ 2,554,252	$ 2,606,231	$ 2,685,187	$ 1,046,691
Net income (loss)	$ 370,431	$ 133,527	$ 386,958	$ (588,404)

Earnings (loss) per common share

Basic	$	0.33	$	0.11	$	0.25	$	(0.35)
Diluted	$	0.30	$	0.09	$	0.22	$	(0.35)

SCHEDULE II: VALUATION AND QUALIFYING ACCOUNTS

The following is a summary of the allowance for doubtful accounts related to accounts receivable for the years ended December 31:

	2003	2002	2001
Balance at beginning of year	$391,406	$375,755	$312,572
Charged to expenses	$145,000	$120,000	$90,000
Uncollectible accounts written off	($220,359)	($104,349)	($26,817)
Balance at end of year	$316,047	$391,406	$375,755

The following is a summary of the allowance for obsolete inventory for the years ended December 31:

	2003	2002	2001
Balance at beginning of year	$392,142	$303,100	$251,723
Charged to expenses	$210,000	$180,000	$150,000
Obsolete inventory written off	($109,985)	($90,958)	($98,623)
Balance at end of year	$492,157	$392,142	$303,100

The following is a summary of property and equipment and the related accounts of accumulated depreciation for the years ended December 31:

	2003	2002	2001
Cost Basis			
Balance at beginning of year	$25,881,777	$21,700,060	$20,516,030
Additions	$2,007,104	$1,498,967	$1,184,030
Disposals	($865,636)	($332,764)	
Balance at end of year	$27,023,245	$25,881,777	$21,700,060

Accumulated depreciation			
Balance at beginning of year	$14,166,764	$13,000,561	$11,342,792
Depreciation	$1,514,468	$1,588,187	$1,657,769
Disposals	($865,636)	($421,984)	
Balance at end of year	$14,815,596	$14,166,764	$13,000,561
Property and equipment, net	$12,207,649	$11,715,013	$8,699,499

The following is a summary of costs in excess of fair value of net assets acquired and the related accumulated amortization for the years ended December 31:

	2003	2002	2001
Cost Basis			
Balance at beginning and end of year	$1,299,954	$1,299,954	$1,299,954
Accumulated amortization			
Balance at beginning of year	$186,846	$186,846	$100,182
Amortization	$0	$0	$86,664
Balance at end of year	$186,846	$186,846	$186,846
Cost in excess of fair value of net assets acquired	$1,113,108	$1,113,108	$1,113,108