Taglich Brothers, Inc.
The Standard of Excellence in the Microcap Market

Member: NASD, SIPC

# Research Report – Update

## Lifeway Foods, Inc.

**Rating: Speculative Buy**

Howard Halpern

April 30, 2001

## LWAY $6.80 - (NasdaqNM)

| | FYE (12/98) | FYE (12/99) | FYE (12/00) | *FYE (12/01)* | *FYE (12/02)* |
|---|---|---|---|---|---|
| Revenues (in millions) | $6.8 | $7.9 | $9.2 | ***$11.1*** | ***$12.8*** |
| Earnings per share (diluted) | $0.20 | $0.17 | $0.21 | ***$0.25*** | ***$0.32*** |

| | | | |
|---|---|---|---|
| 52week range | 8.00 – 4.25 | Fiscal year ends: | December |
| Shares outstanding | 4.32 million | Revenue/shares (2001) | $2.56 |
| Trading float | 1.6 million | Price/Sales (2001) | 2.7X |
| Insider ownership | 63% | Price/Sales (2002) | 2.3X |
| Tangible Book value/shr a/o 12-31-00 | $2.58 | Price/Earnings (2001) | 27.2X |
| Price/Book | 2.6X | Price/Earnings (2002) | 21.3X |

*Lifeway Foods, Inc., based in Morton Grove, Illinois is a manufacturer of cultured, probiotic and functional food products in the health food industry, and is America's leading supplier of the cultured dairy product known as kefir. Their products are sold to health conscious consumers through health food stores and to the mass-market consumers through supermarkets. They currently have about 45 employees. Web-site address is: www.kefir.com*

***Key investment considerations:***

- ***We are maintaining coverage of Lifeway Foods, Inc. (LWAY), with a Speculative Buy recommendation. Our twenty-one month price target is $10.50. We believe this equity has solid upside potential based on our 2002 earnings estimate and discounted cash flow model.***

- ***Lifeway's products are primarily functional foods. The functional food market, depending on the definition, ranges from annual sales of $15 to $130 billion. We believe the functional foods market, which is likely to expand, provides the Company with excellent growth opportunities for the next three to five years.***

- ***For the full year ended December 31, 2000, revenues increased by 16% to $9.2 million and net income increased by 36% to $0.927 million or $0.21 per share. In comparison, Taglich Brothers' estimates called for full year revenues of $9.27 million and net income of $0.879 million or $0.20 per share.***

- ***We expect revenues to grow by approximately 21.3% to $11.1 million in 2001 and in 2002 LWAY's revenues should grow to $12.8 million. We believe this revenue growth will be achieved through marketing efforts and the rollout of its organic product line during the second half of 2001. Net income should be $1.07 million or $0.25 per share in 2001 and increase to $1.38 million or $0.32 per share in 2002. Earnings growth for 20002 should be achieved through internal revenue growth and gross and operating margin improvements.***

**** Please view our disclaimer located at the end of the text portion of this report.***

## *The Company*

Lifeway Foods, Inc. (LWAY) was founded in 1986 and is based in Morton Grove, Illinois. The Company manufactures a cultured dairy beverage called kefir and also develops kefir related products at its two manufacturing facilities. The Company's 50,000-square-foot facility in Morton Grove is the largest kefir manufacturing facility in the United States. The Company primarily produces products that are considered specialty functional dairy foods for health-conscious consumers.

LWAY distributes its products to over 8,000 stores throughout the United States, using verbal distribution arrangements with various wholesale distributors. In the Company's home state of Illinois, they own and operate nine trucks that distribute Lifeway products directly to 1,200-plus stores, including major retail chains such as Jewel Food Stores, Dominick's Finer Foods, Wild Oats Markets, Treasure Island Food Marts, Whole Foods, Cub Foods and Butera Food Stores. Additionally, the Company distributes its products internationally by exporting to Canada, Russia and the Ukraine.

## *Recent Financials*

Revenues for fiscal 2000 increased by approximately 16% to $9.2 million versus $7.9 million in 1999. The increase was primarily attributable to the Company's marketing program for its various Kefir-based products. EBITDA for the full year increased by 17.7% to $1.8 million versus $1.5 million in 1999 and also exceeded our estimate of $1.66 million.

Gross margins for 2000 increased to 45.7% versus 42.2% in the prior year due to the product sales mix. Operating expenses increased as a percentage of sales to 29.5% versus 27.5% in the prior year. The increase was primarily due to the following (which accounted for about 11% of SG&A expenses):

- Costs for becoming listed on the NASDAQ National Market System;
- Legal fees and costs in its successful defense to protect its trademarks;
- Ongoing fees related to defense of a lawsuit relating to its restaurant property.

Net income for the year increased by 35.9% to $0.927 million or $0.21 per share, versus $0.682 million or $0.17 per share. The Company exceeded Taglich Brothers' full year estimate of $0.879 million or $0.20 per share.

At the end of 2000, cash, cash equivalents and marketable securities were approximately $6.3 million, an increase of $0.262 million from the end of 1999. At year-end working capital was $7 million. The Company's long-term liabilities have decreased to $0.5 million from $1.2 million in the prior year. We believe that the Company will be able to fund its sales growth from its internal operations for the foreseeable future.

## *Kefir*

Kefir, which originated centuries ago in Eastern Europe, is a cultured milk drink with a slightly acidic taste and has a consistency very similar to a milkshake. It is made with probiotic cultures obtained from the kefir grain, which is a complex and specific mixture of bacteria. Kefer is similar to, but distinct from, yogurt because the fermentation process produces a less sour tasting product and less sugar is required. Therefore, the end product contains fewer calories.

Lifeway Kefir contains seven active "friendly" microorganisms and is probiotic in nature because it promotes the growth of those microorganisms naturally. The product is a good source of calcium, protein, minerals, and vitamins (i.e. B-complex vitamins). It is highly digestible due to its acidity and enzymes.

The Company manufactures and distributes the following products:

- **Lifeway Kefir**, the Company's biggest revenue producing product. It is sold in the dairy section of health food stores and supermarkets across the country.

- **Lifeway Farmers Cheese** is currently the Company's second biggest revenue generator. This product is a cultured soft cheese, low in fat, cholesterol and calories.

- **SoyTreat™** is the world's first soy based kefir. Sales of this product should benefit as the health benefits related to soy based products become better known by consumers. The product is made from organic soymilk, which is derived from non-genetically modified soybeans. SoyTreat™ can be consumed by people that desire the benefits of kefir, are lactose intolerant, or by people that eat no animal products at all.

- **Basics Plus™** is a functional food, and is the only dairy-based dietary supplement in existence. In our view, this is an exciting product for the Company as it combines all the benefits of Lifeway Kefir with a unique immune-supporting ingredient called Proventra™. Proventra™, developed by GalaGen Inc. of Minneapolis, a dairy research consortium originated by Land O' Lakes, is an ingredient uniquely processed and extracted from antibodies present in the protein of a dairy cow's 'first milk' or colostrum. It is loaded with immune-enhancing antibodies.

### *Industry and Competition*

It is estimated that the wholesale food industry in the United States has revenues that exceed $500 billion a year. Functional and probiotic foods combined, form a segment within the food industry that has been growing in popularity. Foods in this segment include natural functional foods (i.e. cranberry juice, green tea, etc.), foods and ingredients for specific health use, formulas for infants and elderly, medical foods, nutraceuticals and drug foods. The market is estimated to be approximately $130 billion. There can be differences in the working definition of functional foods, but in general, the American Dietetic Association considers a functional food to be – a modified food or ingredient that provides health benefits beyond the nutrition it contains. Using this definition the annual market for foods designed to provide specific medical benefits is estimated to be $15 billion. Therefore depending on the definition, Lifeway Foods' target market ranges from $15 billion to $130 billion.

The functional food segment continues to be the fastest growing area of the food industry. Some of the factors driving this growth are:

- The perception of nutrition as a tool for disease prevention and the self-treatment of various health concerns;
- An aging population;
- An increase in disposable income.

It is estimated that about 50% of U.S. shoppers are either highly or moderately involved in self-care, this translates into about 50 million consumers who might potentially purchase a functional food. We believe the Company is well position to take advantage of this growing market.

To meet the needs of consumers, some supermarket chains have created a store within a store concept, thus allowing consumers to find health foods easily within the larger supermarket store. This trend should be helpful to Lifeway Foods as they can position its products in the health food section of a national or regional supermarket chain.

The Company faces very little direct competition in the United States for its drinkable kefir product, although the Company's kefir-based products are subject to competition from other yogurt and dairy products. Many producers of yogurt and other dairy products are well established and have significantly greater financial resources than Lifeway Foods.

### *Strategy*

Lifeway Foods remains at the forefront of the specialty dairy and functional foods market. This is evidenced by the recent introduction of its new line of organic kefir products at the Natural Products Expo in California during the beginning of March 2001. Lifeway Organic™ will meet the organic standards and specifications necessary to provide customers with a high quality product. By offering an organic kefir and cheese product line the Company will build upon its non-dairy SoyTreat™ products and thus allow for the opportunity to broaden its customer base. We believe the rollout of this new product line will not impact revenues until the second half of 2001.

**Marketing:** The Company remains focused on its promotion of the verifiable nutritional characteristics, and the purity and taste aspects of its products. Advertising is done through local radio stations and is directed to both users and non-users of cultured milk products of all kinds. In addition, newspaper and magazine advertising is used to impart educational information to potential customers. This information is intended to show consumers that the ingredient(s) used to manufacture its kefir products may be beneficial to a person's overall health.

The Company will attempt to gain further exposure through participation in various trade and consumer sampling shows, inside store demonstrations throughout the United States. Last year, Lifeway demonstrated its products at the Fancy Food Show and Food Marketing Institute Show and at various events including the Chicago Marathon. In addition, the benefits of its SoyTreat™ product were highlighted on *MSNBC* and in Self Magazine.

**Distribution:** The Company has over fifty distributors nationwide and in certain large geographical locations such as the East Coast, the Company has a higher concentration of distributors. In addition, the Company has five international distributors representing such regions such as Eastern Europe, Asia, and the Middle East. In the Chicago region the Company has its own direct distribution through a company-owned fleet of trucks, as well as numerous independent distributors. Management believes that as product lines expand and name recognition grows, they will attract additional distributors, particularly for the nation's 1,700 food chains.

In April 2001, Lifeway announced the broadening of its distribution channel through the signing of an exclusive distribution agreement with Jelian Foods, Inc. of Concord, Ontario in Canada. Jelian Foods will be the exclusive distributor in Canada for the Company's SoyTreat™ product, and will also have the opportunity to distribute other products made by Lifeway Foods. Jelian Foods distributes natural and specialty products to over 500 stores in Canada, including mainstream grocery store chains. We view this as a positive step since it continues the Company's goal of broadening its customer base.

**Innovation:** We believe that management is likely to continue developing new and innovative product lines. An example occurred last year when LWAY acquired a specific ingredient called Proventra™ and used it to create a new product called Basics Plus™. This product should provide an opportunity to grow its sales within the functional food market.

## *Outlook*

We are optimistic about Lifeway's future based on the promise inherent in its kefir products and the development of its new organic product line. We believe revenues should grow to $11.1 million in 2001 and $12.8 million in 2002, from $9.2 million in 2000. Revenue growth will depend on the Company's ability to maintain and grow its shelf space within the United States and grow its shelf space rapidly in Canada as a result of its recently announced agreement with a Canadian distributor.

Lifeway will be able to leverage its assets as sales grow. The Company has two manufacturing facilities that have a potential for capacity of approximately $65 million in annual sales. Currently management has enough equipment in its facilities to generate about $30 million in annual revenue. This in our view is extremely positive, since any increase in consumer demand will allow management to leverage existing capacity.

## *Other Considerations*

Danone Foods, Inc. the U.S. subsidiary of Groupe Danone of Paris, France, has a 20% ownership interest in the Company. A support agreement was entered into stating that each party would not compete with each other during the term of the agreement and for three years after termination of the agreement with respect to certain yogurt, cheese and kefir products. Specifically, the Company agreed not to produce or sell any type of yogurt, Italian style cheese, chilled desserts or any soy-based products, other than those that are kefir based or are already being produced and sold by the Company, in the U.S. and Western Europe. Danone agreed not to produce or sell any type of kefir-based products in the United States.

Lifeway Foods founder, Mr. Smolyansky, plays an extremely important role, overseeing virtually all aspects of the Company's operations. Mr. Smolyansky has begun the process of delegating authority to others within the Company and will hire additional management personnel as the Company continues to grow.

In 2000, the Niles Park District of Illinois filed a lawsuit in the Circuit Court of Cook County, Illinois, against Lifeway Foods. The Park District is attempting to exercise its rights of eminent domain to acquire and take possession of the Company's Moscow Nights Restaurant. The Company is vigorously defending the lawsuit.

An equity specific concern relates to average daily volume. Based on our calculations, since the beginning of 2001, the average daily-volume has been approximately 2,300 shares. Investors need to be aware that by nature, a thinly traded equity can have significant price volatility.

## ***Conclusion***

We are maintaining our coverage of Lifeway Foods, Inc., with a **Speculative Buy** recommendation, and twenty-one month price target of $10.50. Our price target is based on an average valuation using our earnings per share estimate for 2001 and a discounted cash flow model using EBITDA as a proxy for cash flow.

We believe the Company will post earnings of $0.25 per share, on revenues of $11.1 million for 2001 and $0.32 per share on revenues of $12.8 million for 2002. Our revenue estimate for 2002 represents an annual compounded growth rate of 18.1% based on the $7.9 million in revenues that the Company reported in 2000. Based on our model, we expect EBITDA to be $1.99 million in 2001 and $2.76 million in 2002.

We believe Lifeway Foods is undervalued based on our earnings for 2001 and discounted cash flow model. In our opinion the primary reason for the Company's undervaluation is the lack of Wall Street coverage and lack of information on Kefir. Until consumers and investors are educated about the potential benefits of kefir and kefir based products, the Company is likely to remain undervalued.

To obtain our price target we averaged the following valuations:

- A 25.1X P/E (based on the trailing twelve month average for the Food Processing Industry) applied to our 2002 earnings per share estimate of $0.32 provides a valuation of $8.03 per share;
- Our discounted cash flow model, using EBITDA as a proxy for cash flow and an 8.5% discount factor using the capital asset pricing model (provides a valuation of $13.00 per share)


** The information and statistical data contained herein have been obtained from sources, which we believe to be reliable but in no way are warranted by us as to accuracy or completeness. We do not undertake to advise you as to change in figures or our views. This is not a solicitation of any order to buy or sell. Taglich Brothers, Inc. is not a market maker and does not sell to or buy from customers on a principal basis. We, our affiliates, any officer, director or stockholder or any member of their families may from time to time purchase or sell any of the above-mentioned or related securities. The above statement is the opinion of Taglich Brothers, Inc. and is not a guarantee that the target price for the stock will be met or that predicted business results for the company will occur. As of the date of this report, we, our affiliates, any officer, director or stockholder, or any member of their families do not have a position in the stock of the company mentioned in this report. Taglich Brothers, Inc., does not currently have an Investment Banking relationship with the company. Since December 2000, the company pays a monthly monetary fee of $1,500 (USD) to Taglich Brothers, Inc. for the creation and dissemination of research reports.*

Lifeway Foods, Inc.
Consolidated Balance Sheets
(in thousands)

| | December 1998 Full Year | December 1999 Full Year | December 2000 Full Year |
|---|---|---|---|
| **ASSETS** | | | |
| Current assets: | | | |
| Cash and cash equivalents | $ 628 | $ 4,641 | $ 1,437 |
| Marketable securities | 340 | 1,564 | 4,850 |
| Accounts receivable, net | 847 | 966 | 1,182 |
| Other receivables | 16 | 57 | - |
| Inventories | 852 | 844 | 920 |
| Prepaid expenses and other assets | 12 | - | - |
| Deferred income taxes | 37 | 52 | 167 |
| **Total current assets** | **2,732** | **8,124** | **8,556** |
| Property, plant and equipment, net | 4,148 | 4,528 | 5,020 |
| Intangible assets, net | 10 | 5 | - |
| **Total assets** | **$ 6,890** | **$ 12,658** | **$ 13,575** |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | |
| Current liabilities: | | | |
| Current maturities of notes payable | 85 | 92 | 706 |
| Accounts payable | 514 | 480 | 518 |
| Accrued expenses | 166 | 192 | 242 |
| Taxes payable | - | - | 65 |
| **Total current liabilities** | **765** | **764** | **1,531** |
| Long-term liabilities | 1,315 | 1,234 | 529 |
| Deferred income taxes | 172 | 248 | 376 |
| **Stockholders' equity:** | | | |
| Common stock, no par value; authorized 10,000,000 shares; outstanding 3,785,677 at December 31, 1998 and 4,318,444 at December 31, 1999 and December 31, 2000 | 1,427 | 6,509 | 6,509 |
| Stock subscription receivable | - | (15) | (15) |
| Retained earnings | 3,241 | 3,924 | 4,851 |
| Accumulated other comprehansive income, net of tax | (12) | (7) | (205) |
| Treasury stock, at cost | (19) | - | - |
| **Total stockholders' equity** | **4,638** | **10,411** | **11,140** |
| **Total liabilities and stockholders' equity** | **$ 6,889** | **$ 12,657** | **$ 13,575** |
| SHARES OUT | 3,786 | 4,318 | 4,318 |

Lifeway Foods, Inc.
Annual Income Statement Model
For the Years Ended December 31,
(in thousands)

| | FY1997 | FY1998 | FY1999 | FY2000 | **FY2001E** | **FY2002E** |
|---|---|---|---|---|---|---|
| Sales | $ 5,961 | $ 6,795 | $ 7,908 | $ 9,177 | **$ 11,135** | **$ 12,805** |
| Cost of goods sold | 3,435 | 3,697 | 4,665 | 5,308 | **6,050** | **6,935** |
| **Gross Profit** | 2,526 | 3,098 | 3,243 | 3,869 | **5,085** | **5,870** |
| *Gross Margins* | 42.38% | 45.59% | 41.01% | 42.16% | **45.67%** | **45.84%** |
| Sales, general and administrative | 1,486 | 1,759 | 2,178 | 2,707 | **3,690** | **3,750** |
| *EBITDA* | 1,316 | 1,730 | 1,506 | 1,772 | **1,995** | **2,760** |
| **Operating Income** | 1,040 | 1,339 | 1,065 | 1,162 | **1,395** | **2,120** |
| *Operating Margin* | 17.45% | 19.71% | 13.47% | 12.66% | **12.53%** | **16.56%** |
| Other Income (Expense) | | | | | | |
| Interest income | 47 | 38 | 110 | 369 | **385** | **125** |
| Interest expense | (124) | (106) | (112) | (93) | **(70)** | **(50)** |
| Gain on sale of marketable securities | - | 35 | 7 | 15 | **-** | **-** |
| Rental income | 214 | - | - | - | **-** | **-** |
| Total Other Income (Expense) | 137 | (33) | 5 | 291 | **315** | **75** |
| **Pre-Tax Income** | 1,177 | 1,306 | 1,070 | 1,453 | **1,710** | **2,195** |
| *Pre-Tax Margins* | 19.75% | 19.22% | 13.53% | 15.84% | **15.36%** | **17.14%** |
| Income Tax Expense (Benefit) | 477 | 543 | 387 | 526 | **620** | **815** |
| *Tax Rate* | 40.51% | 41.60% | 36.21% | 36.21% | **36.26%** | **37.13%** |
| **Net Income** | $ 700 | $ 763 | $ 682 | $ 927 | **$ 1,090** | **$ 1,380** |
| **EPS -- Fully Diluted** | $ 0.19 | $ 0.20 | $ 0.17 | $ 0.21 | **$ 0.25** | **$ 0.32** |
| Avg Shares Out-Fully Diluted | 3,776 | 3,781 | 3,933 | 4,318 | **4,350** | **4,350** |
| Percent of Revenue | | | | | | |
| Cost of Revenues | 57.62% | 54.41% | 58.99% | 57.84% | 54.33% | 54.16% |
| Sales, General and Administrative expenses | 24.93% | 25.88% | 27.54% | 29.50% | 33.14% | 29.29% |
| YEAR / YEAR GROWTH | | | | | | |
| Total Revenues | | 13.99% | 16.37% | 16.05% | 21.34% | 15.00% |
| Operating Income | | 28.80% | -20.49% | 9.12% | 20.04% | 51.97% |
| Pre-Tax Income | | 10.94% | -18.08% | 35.86% | 17.66% | 28.36% |
| Net Income | | 8.90% | -10.51% | 35.85% | 17.57% | 26.61% |

Lifeway Foods, Inc.
For the Years Ended December 31, 2001
(in thousands)

| | Q1(03/01)E | Q2 (06/01)E | Q3 (09/01)E | Q4 (12/01)E | **FY2001E** |
|---|---|---|---|---|---|
| Sales | $ 2,585 | $ 2,800 | $ 2,850 | $ 2,900 | **$ 11,135** |
| Cost of goods sold | 1,375 | 1,500 | 1,550 | 1,625 | **6,050** |
| **Gross Profit** | 1,210 | 1,300 | 1,300 | 1,275 | **5,085** |
| *Gross Margins* | *46.81%* | *46.43%* | *45.61%* | *43.97%* | **45.67%** |
| Sales, general and administrative | 990 | 975 | 900 | 825 | **3,690** |
| *EBITDA* | 370 | 475 | 550 | 600 | **1,995** |
| **Operating Income** | 220 | 325 | 400 | 450 | **1,395** |
| *Operating Margin* | *8.51%* | *11.61%* | *14.04%* | *15.52%* | **12.53%** |
| Other Income (Expense) | | | | | |
| Interest income | 125 | 100 | 85 | 75 | **385** |
| Interest expense | (20) | (20) | (15) | (15) | **(70)** |
| Total Other Income (Expense) | 105 | 80 | 70 | 60 | **315** |
| **Pre-Tax Income** | 325 | 405 | 470 | 510 | **1,710** |
| *Pre-Tax Margins* | *12.57%* | *14.46%* | *16.49%* | *17.59%* | **15.36%** |
| Income Tax Expense (Benefit) | 125 | 145 | 165 | 185 | **620** |
| *Tax Rate* | *38.46%* | *35.80%* | *35.11%* | *36.27%* | **36.26%** |
| **Net Income** | $ 200 | $ 260 | $ 305 | $ 325 | **$ 1,090** |
| **EPS -- Fully Diluted** | $ 0.05 | $ 0.06 | $ 0.07 | $ 0.07 | **$ 0.25** |
| Avg Shares Out-Fully Diluted | 4,350 | 4,350 | 4,350 | 4,350 | **4,350** |
| Percent of Revenue | | | | | |
| Cost of Revenues | 53.19% | 53.57% | 54.39% | 56.03% | 54.33% |
| Sales, General and Administrative expenses | 38.30% | 34.82% | 31.58% | 28.45% | 33.14% |
| YEAR / YEAR GROWTH | | | | | |
| Total Revenues | 13.74% | 22.42% | 24.80% | 24.30% | 21.34% |
| Operating Income | -2.83% | 179.86% | 12.50% | -3.02% | 20.04% |
| Pre-Tax Income | 5.43% | 34.65% | -2.20% | 40.19% | 17.66% |
| Net Income | 5.90% | 41.08% | 10.61% | 16.83% | 17.57% |

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2002
(in thousands)

| | Q1(03/02)E | Q2 (06/02)E | Q3 (09/02)E | Q4 (12/02)E | **FY2002E** |
|---|---|---|---|---|---|
| Sales | $ 2,965 | $ 3,200 | $ 3,265 | $ 3,375 | **$ 12,805** |
| Cost of goods sold | 1,590 | 1,715 | 1,735 | 1,895 | **6,935** |
| **Gross Profit** | 1,375 | 1,485 | 1,530 | 1,480 | **5,870** |
| *Gross Margins* | *46.37%* | *46.41%* | *46.86%* | *43.85%* | **45.84%** |
| Sales, general and administrative | 950 | 975 | 950 | 875 | **3,750** |
| *EBITDA* | 585 | 670 | 740 | 765 | **2,760** |
| **Operating Income** | 425 | 510 | 580 | 605 | **2,120** |
| *Operating Margin* | *14.33%* | *15.94%* | *17.76%* | *17.93%* | **16.56%** |
| Other Income (Expense) | | | | | |
| Interest income | 50 | 30 | 25 | 20 | **125** |
| Interest expense | (15) | (15) | (10) | (10) | **(50)** |
| Total Other Income (Expense) | 35 | 15 | 15 | 10 | **75** |
| **Pre-Tax Income** | 460 | 525 | 595 | 615 | **2,195** |
| *Pre-Tax Margins* | *15.51%* | *16.41%* | *18.22%* | *18.22%* | **17.14%** |
| Income Tax Expense (Benefit) | 180 | 195 | 215 | 225 | **815** |
| *Tax Rate* | *39.13%* | *37.14%* | *36.13%* | *36.59%* | **37.13%** |
| **Net Income** | $ 280 | $ 330 | $ 380 | $ 390 | **$ 1,380** |
| **EPS -- Fully Diluted** | $ 0.06 | $ 0.08 | $ 0.09 | $ 0.09 | **$ 0.32** |
| Avg Shares Out-Fully Diluted | 4,350 | 4,350 | 4,350 | 4,350 | **4,350** |
| Percent of Revenue | | | | | |
| Cost of Revenues | 53.63% | 53.59% | 53.14% | 56.15% | 54.16% |
| Sales, General and Administrative expenses | 32.04% | 30.47% | 29.10% | 25.93% | 29.29% |
| YEAR / YEAR GROWTH | | | | | |
| Total Revenues | 14.70% | 14.29% | 14.56% | 16.38% | 15.00% |
| Operating Income | 93.18% | 56.92% | 45.00% | 34.44% | 51.97% |
| Pre-Tax Income | 41.54% | 29.63% | 26.60% | 20.59% | 28.36% |
| Net Income | 40.00% | 26.92% | 24.59% | 20.00% | 26.61% |

Lifeway Foods, Inc.
Cash Flow Statement
(in thousands)

| | FY1998A | FY1999A | FY2000A |
|---|---|---|---|
| *Cash Flows from Operating Activities* | | | |
| Net Income | $ 763 | $ 682 | $ 927 |
| Depreciation and amortization | 391 | 441 | 610 |
| Amortization of discounts on securities | - | (7) | - |
| Gain on sale of marketable securities | (35) | (7) | (15) |
| Issuance of common stock in exchange for services rendered | 31 | - | - |
| Decrease in allowance for doubtful accounts | (48) | - | - |
| Deferred income taxes | 115 | 54 | 150 |
| | 1,217 | 1,165 | 1,672 |
| *Changes In:* | | | |
| Accounts receivable | 19 | (118) | (216) |
| Other receivables | (1) | (41) | 57 |
| Inventories | (237) | 8 | (76) |
| Prepaid expenses and other assets | (4) | 12 | - |
| Accounts payable | 119 | (34) | 38 |
| Accrued expenses | (262) | 26 | 50 |
| Taxes payable | - | - | 65 |
| Net Changes in Working Capital | (366) | (148) | (83) |
| **Net cash Provided by Operations** | 850 | 1,017 | 1,589 |
| | | | |
| *Cash Flows from Investing Activities* | | | |
| Purchase of marketable securities | (305) | (1,846) | (8,808) |
| Sale of marketable securities | 218 | 646 | 5,202 |
| Purchase of property, plant and equipment | (593) | (794) | (1,096) |
| **Net cash used in Investing** | (680) | (1,994) | (4,702) |
| | | | |
| *Cash Flows from Financing Activities* | | | |
| Repayment of notes payable | (92) | (96) | (91) |
| Proceeds from issuance of common stock | - | 5,138 | - |
| Stock issuance costs | - | (52) | - |
| **Net cash provided by Financing** | (92) | 4,990 | (91) |
| | | | |
| Net change in Cash | 78 | 4,013 | (3,204) |
| Cash Beginning of Period | 551 | 628 | 4,641 |
| | | | |
| Cash End of Period | $ 628 | $ 4,641 | $ 1,437 |