

LIFEWAY FOODS INC
Form 10-Q
August 17, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark
One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934

For the quarterly period ended: June 30, 2016

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 000-17363

LIFEWAY FOODS, INC.
(Exact Name of Registrant as Specified in its Charter)

Illinois 36-3442829
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

6431 West Oakton, Morton Grove, IL 60053
(Address of Principal Executive Offices, Zip Code)

(847) 967-1010
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405

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of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

As of August 8, 2016, 16,140,633 shares of the registrant's common stock, no par value, were outstanding.

LIFEWAY FOODS, INC.

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ITEM 1. FINANCIAL STATEMENTS.

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2016 and December 31, 2015

(In thousands)

	June 30, 2016 (Unaudited)	December 31, 2015
Current assets		
Cash and cash equivalents	\$ 6,064	\$ 5,646
Investments, at fair value	1,763	2,216
Certificates of deposits in financial institutions	—	513
Inventories	9,312	7,664
Accounts receivable, net of allowance for doubtful accounts and discounts & allowances of \$1,700 and \$1,800 at June 30, 2016 and December 31, 2015 respectively	10,136	9,604
Prepaid expenses and other current assets	650	201
Deferred income taxes	509	556
Refundable income taxes	519	449
Total current assets	28,953	26,849
Property and equipment, net	21,301	21,375
Intangible assets		
Goodwill & indefinite-lived intangibles	14,068	14,068
Other intangible assets, net	1,991	2,344
Total intangible assets	16,059	16,412
Other Assets		
Long-term accounts receivable, net of current portion	252	282
Total assets	\$ 66,565	\$ 64,918
Current liabilities		
Current maturities of notes payable	\$ 840	\$ 840
Accounts payable	6,681	8,393
Accrued expenses	2,302	1,538
Accrued income taxes	628	52
Total current liabilities	10,451	10,823
Notes payable	6,699	7,119
Deferred income taxes	1,719	1,719
Total liabilities	18,869	19,661
Stockholders' equity		
Common stock, no par value; 40,000 shares authorized; 17,274, shares issued; 16,141 and 16,210 shares outstanding at June 30, 2016 and December 31, 2015 respectively	6,509	6,509
Paid-in-capital	2,075	2,033

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Treasury stock, at cost	(10,468)	(9,730)
Retained earnings	49,578	46,516
Accumulated other comprehensive income (loss), net of taxes	2	(71)
Total stockholders' equity	47,696	45,257
Total liabilities and stockholders' equity	\$ 66,565	\$ 64,918

See accompanying notes to consolidated financial statements

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Consolidated Statements of Income and Comprehensive Income

For the Three Months and Six Months ended June 30, 2016 and 2015

(Unaudited)

(In thousands, except per share data)

	Three Months		Six Months Ended	
	Ended		June 30,	June 30,
	2016	2015	2016	2015
Net sales	\$31,131	\$29,821	\$63,701	\$59,443
Cost of goods sold	20,306	22,201	43,026	42,849
Depreciation expense	633	604	1,264	1,195
Total cost of goods sold	20,939	22,805	44,290	44,044
Gross profit	10,192	7,016	19,411	15,399
Selling expenses	3,463	2,618	6,427	5,920
General and administrative	3,503	4,170	7,968	7,662
Amortization expense	177	179	353	358
Total operating expenses	7,143	6,967	14,748	13,940
Income from operations	3,049	49	4,663	1,459
Other income (expense):				
Interest expense	(47)	(59)	(105)	(124)
Loss on sale of investments, net reclassified from OCI	(15)	(17)	(27)	(22)
Impairment of investments	—	—	—	(180)
(Loss) / Gain on sale of property and equipment	(151)	207	(151)	243
Other income (expense), net	60	38	77	147
Total other income (expense)	(153)	169	(206)	64
Income before provision for income taxes	2,896	218	4,457	1,523
Provision for income taxes	789	120	1,395	770
Net income	\$2,107	\$98	\$3,062	\$753
Basic and diluted earnings per common share	\$0.13	\$0.01	\$0.19	\$0.05
Weighted average number of shares outstanding	16,149	16,346	16,169	16,346
COMPREHENSIVE INCOME				
Net income	\$2,107	\$98	\$3,062	\$753

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Other comprehensive income (loss), net of tax:

Unrealized gains (losses) on investments, net of taxes	12	(31)	56	(65)
Reclassifications to earnings:				
Other than temporary impairment of investments, net of taxes	—	4	—	108
Realized (gains) losses on investments, net of taxes	24	18	17	15
Comprehensive income	\$2,143	\$89	\$3,135	\$811

See accompanying notes to consolidated financial statements

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LIFEWAY FOODS, INC. AND SUBSIDIARIES
 Consolidated Statements of Changes in Stockholders' Equity
 For the Six Months Ended June 30, 2016 and 2015
 (Unaudited)
 (In thousands)

	Common Stock				Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Issued Shares	\$	In treasury Shares	\$			(Loss), Net of Tax	
Balances at January 1, 2015	17,274	\$6,509	(928)	\$(8,188)	\$2,033	\$44,544	\$ (198)	\$ 44,700
Other comprehensive income	—	—	—	—	—	—	58	58
Net income for the six months ended June 30, 2015	—	—	—	—	—	753	—	753
Balances at June 30, 2015	17,274	\$6,509	(928)	\$(8,188)	\$2,033	\$45,297	\$ (140)	\$ 45,511
Balances at January 1, 2016	17,274	\$6,509	(1,064)	\$(9,730)	\$2,033	\$46,516	\$ (71)	\$ 45,257
Other comprehensive income	—	—	—	—	—	—	73	73
Treasury stock purchased	—	—	(69)	(738)	—	—	—	(738)
Stock based compensation	—	—	—	—	42	—	—	42
Net income for the six months ended June 30, 2016	—	—	—	—	—	3,062	—	3,062
Balances at June 30, 2016	17,274	\$6,509	(1,133)	\$(10,468)	\$2,075	\$49,578	\$ 2	\$ 47,696

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
 Consolidated Statements of Cash Flows
 For the Six Months Ended June 30, 2016 and 2015
 (Unaudited)
 (In thousands)

<u>Cash flows from operating activities:</u>	2016	2015
Net income	\$3,062	\$753
Adjustments to reconcile net income to operating cash flow:		
Depreciation and amortization	1,617	1,553
Loss on sale of investments, net	27	22
Impairment of investments	—	180
Deferred income taxes	—	(352)
Stock based compensation	42	—
Loss / (Gain) on sale of property and equipment	151	(243)
(Increase) decrease in operating assets:		
Accounts receivable	(532)	(167)
Inventories	(1,649)	(476)
Refundable income taxes	(70)	399
Prepaid expenses and other current assets	(418)	244
Increase (decrease) in operating liabilities:		
Accounts payable	(1,710)	138
Accrued expenses	765	2,637
Income taxes payable	576	15
Net cash provided by operating activities	1,861	4,703
<u>Cash flows from investing activities:</u>		
Purchases of investments	(479)	(1,287)
Proceeds from sale of investments	1,024	1,134
Redemption of certificates of deposits	513	100
Investments in certificates of deposit	—	(385)
Purchases of property and equipment	(1,382)	(1,377)
Proceeds from sale of equipment	39	342
Net cash used in investing activities	(285)	(1,473)
<u>Cash flows from financing activities:</u>		
Purchase of treasury stock	(738)	—
Repayment of notes payable	(420)	(617)
Net cash used in financing activities	(1,158)	(617)
Net increase in cash and cash equivalents	418	2,613
Cash and cash equivalents at the beginning of the period	5,646	3,260
Cash and cash equivalents at the end of the period	\$6,064	\$5,873
Supplemental cash flow information:		
Cash paid for income taxes, net of refunds	\$886	\$883
Cash paid for interest	\$105	\$124

See accompanying notes to consolidated financial statements

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2016 and December 31, 2015

(Unaudited)

(In thousands, except per share data)

Note 1 – Basis of Presentation

Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") for interim financial information, and do not include all of the information and disclosures required for complete, audited financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation, have been included. For further information, refer to the consolidated financial statements and disclosures included in the consolidated financial statements included in the Company's Annual Report on Form 10-K as of and for the year ended December 31, 2015. Certain amounts in prior-year financial statements were reclassified to conform to the current-year presentation. The results for the period are not necessarily indicative of the results to be expected for other interim periods or the full year.

New presentation format. In prior periods, the Company presented gross sales, discounts and promotional allowances and net sales as distinct financial statement captions in our statements of income and comprehensive income. During the second quarter of 2016, the Company concluded that it was appropriate to simply present net sales. All prior periods have been conformed to the new presentation.

Principles of consolidation

Our Consolidated Financial Statements include the accounts of Lifeway Foods, Inc. and all of its wholly owned subsidiaries (collectively "Lifeway" or the "Company"). All significant intercompany accounts and transactions have been eliminated.

Note 2 – Significant Accounting Policies

Use of estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates made in preparing the consolidated financial statements include the reserve for promotional allowances, the fair value of investment securities, the valuation of goodwill and intangible assets, and deferred income taxes.

Revenue Recognition

The Company records sales when the following four criteria have been met: (i) The product has been shipped and the Company has no significant remaining obligations; (ii) Persuasive evidence of an agreement exists; (iii) The price to the buyer is fixed or determinable; and (iv) Collection is probable. In addition, shipping costs invoiced to the customers are included in net sales and the related costs are included in cost of sales.

The Company routinely offers sales allowances and discounts to our customers and consumers. These programs include rebates, in-store display and demo allowances, allowances for non-salable product, coupons and other trade

promotional activities. These allowances are considered reductions in the price of our products and thus are recorded as reductions to gross sales. Some of these incentives are recorded by estimating incentive costs based on our historical experience and expected levels of performance of the trade promotion. We maintain a reserve for the estimated allowances incurred but unpaid. Differences between estimated and actual allowances are normally insignificant and are recognized in income in the period such differences are determined. Product returns have historically not been material.

Bulk cream is a by-product of the Company's fluid milk manufacturing process. The Company does not use bulk cream in any of its end products, but rather disposes of it through sales to other companies. Bulk cream by-product sales are included in net sales.

Advertising and promotional costs

The Company expenses advertising costs as incurred. For the six months ended June 30, 2016 and 2015 total advertising expenses were \$2,753 and \$2,821 respectively. For the three months ended June 30, 2016 and 2015 total advertising expenses were \$1,811 and \$910 respectively.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued new guidance regarding certain aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new guidance will be effective for fiscal years beginning on or after December 15, 2016 and interim periods within those years. Early adoption of the guidance is permitted. Management is currently evaluating the impact that the new guidance will have on the consolidated financial statements.

In February 2016, the FASB issued new guidance regarding leases. The guidance requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize on the balance sheet a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The new guidance is effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those years. Management is currently evaluating the impact that the new guidance will have on the consolidated financial statements.

In January, 2016, the FASB issued new guidance regarding the recognition and measurement of financial assets and liabilities. The new guidance modifies how entities measure equity investments and present changes in the fair value of certain financial liabilities. Under the new guidance, entities will have to measure equity investments that do not result in consolidation and are not accounted under the equity method at fair value and recognize any changes in fair value in net income unless certain conditions exist. The new guidance will be effective for fiscal years beginning on or after December 15, 2017 and interim periods within those years. Other than for recognition and measurement, early adoption of the guidance is permitted. Management is currently evaluating the impact that the new guidance will have on the consolidated financial statements.

In November 2015, the FASB issued new guidance regarding the balance sheet classification of deferred income taxes. This new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. Previous guidance required deferred tax assets and liabilities to be separated into current and noncurrent amounts on the balance sheet. The guidance is effective for fiscal years beginning on or after December 15, 2016, and interim periods within those years. Management is currently evaluating the impact that the new guidance will have on the consolidated financial statements.

In July 2015, the FASB issued new accounting guidance for measuring inventory. The core principal of the guidance is that an entity should measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This guidance does not apply to inventory that is being measured using the Last-In, First-Out (LIFO) or the retail inventory method. The guidance is effective for financial statements issued for annual and interim periods beginning after December 15, 2016 on a prospective basis. Early adoption is permitted. Management is currently evaluating the impact this will have on the consolidated financial statements.

In May 2014, the FASB issued new guidance regarding revenue recognition. Additional revenue recognition guidance clarifications have been issued subsequent to May 2014. Collectively the new revenue recognition guidance supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific requirements. The new guidance establishes a five-step revenue recognition process in which an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the

consideration to which the company expects to be entitled in exchange for those goods or services. The new guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers. The Company is required to adopt the new guidance not later than January 1, 2018. Management is currently evaluating the impact that the new guidance will have on the consolidated financial statements and the method of retrospective application, either full or modified.

Note 3 – Intangible Assets

Goodwill & indefinite-lived intangible assets consists of the following:

	June 30, 2016	December 31, 2015
Goodwill	\$10,368	\$ 10,368
Brand names	3,700	3,700
Goodwill & indefinite lived intangible assets	\$14,068	\$ 14,068

Other intangible assets, net consists of the following:

	June 30, 2016	December 31, 2015
Recipes	\$44	\$ 44
Customer lists and other customer related intangibles	4,529	4,529
Customer relationship	985	985
Trade names	2,248	2,248
Formula	438	438
	8,244	8,244
Accumulated amortization	(6,253)	(5,900)
Intangible assets, net	\$1,991	\$ 2,344

Note 4 – Investments

The cost and fair value of investments classified as available for sale are as follows:

June 30, 2016	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Common stocks & ETF's	\$654	\$ 59	\$ (66)	\$647
Mutual Funds	18	1	—	19
Preferred Securities	97	9	—	106
Corporate Bonds	991	39	(39)	991

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Total \$1,760 \$ 108 \$ (105) \$1,763

December 31, 2015	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Common stocks & ETF's	\$690	\$ 17	\$ (94)	\$ 613
Mutual Funds	27	—		