LIFEWAY FOODS INC
Form 10-Q
May 15, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: March 31, 2013

o 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 Incorporation or Organization)	(I.R.S. Employer 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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 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 x No o

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

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

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

As of May 13, 2013, 16,346,017 shares of the registrant's common stock, no par value, were outstanding.

LIFEWAY FOODS, INC.

Table of Contents

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Financial Condition
March 31, 2013 and 2012 (Unaudited) and December 31, 2012

	(Unaudited) March 31, 2013	(Unaudited) March 31, 2012	December 31, 2012
ASSETS			
Current assets			
Cash and cash equivalents	$ 2,739,957	$ 1,156,539	$ 2,286,226
Investments	2,062,343	1,723,836	1,869,888
Certificates of deposits in financial institutions	250,000	300,000	450,000
Inventories	7,080,899	5,205,457	5,939,186
Accounts receivable, net of allowance for doubtful accounts and discounts	11,915,981	8,484,371	8,723,737
Prepaid expenses and other current assets	92,827	39,880	97,138
Other receivables	5,165	155,937	8,825
Deferred income taxes	295,701	357,963	234,687
Refundable income taxes	84,828	---	84,828
Total current assets	$ 24,527,701	$ 17,423,983	$ 19,694,515
Property and equipment, net	14,917,260	15,031,364	14,986,776
Intangible assets			
Goodwill and other non-amortizable brand assets	14,068,091	14,068,091	14,068,091
Other intangible assets, net of accumulated amortization of $4,020,598 and $3,276,645 at March 31, 2013 and 2012 and $3,842,756 At December 31, 2012, respectively	4,285,403	5,029,355	4,463,242
Total intangible assets	18,353,494	19,097,446	18,531,333
Other Assets			
Long-term accounts receivable net of current portion	294,000	276,050	294,000
Total assets	$ 58,092,455	$ 51,828,843	$ 53,506,624
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
	$ 0	$ 333,446	$ 0

Checks written in excess of bank balances						
Current maturities of notes payable		543,591		789,933		542,981
Accounts payable		6,465,801		4,597,466		4,256,725
Accrued expenses		1,197,883		755,187		1,155,677
Accrued income taxes		462,593		279,402		254,311
Total current liabilities		8,669,868		6,755,434		6,209,694
Notes payable		4,820,160		5,363,750		4,955,945
Deferred income taxes		2,909,134		3,394,957		3,028,518
Total liabilities		16,399,162		15,514,141		14,194,157
Stockholders' equity						
Common stock, no par value; 20,000,000 shares authorized; 17,273,776 shares issued; 16,346,017 shares outstanding at March 31, 2013; 17,273,776 shares issued; 16,390,417 shares outstanding at March 31, 2012; 17,273,776 shares issued; 16,346,017 shares outstanding at December 31, 2012		6,509,267		6,509,267		6,509,267
Paid-in-capital		2,032,516		2,032,516		2,032,516
Treasury stock, at cost		(8,187,682)		(7,783,580)		(8,187,682)
Retained earnings		41,270,416		35,526,285		38,904,777
Accumulated other comprehensive income (loss), net of taxes		68,776		30,214		53,591
Total stockholders' equity		41,693,293		36,314,702		39,312,469
Total liabilities and stockholders' equity	$	58,092,455	$	51,828,843	$	53,506,626

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Income and Comprehensive Income
March 31, 2013 and 2012 (Unaudited) and December 31, 2012

	(Unaudited) Three Months Ended March 31, 2013				2012 (as restated)			
Sales	$	27,590,622	$		$	21,545,896	$	
Less: discounts and allowances		(3,203,591)				(2,148,699)		
Net sales		24,387,031		24,387,031		19,397,197		19,397,197
Cost of goods sold				15,402,875				12,906,722
Depreciation expense				394,125				399,045
Total cost of goods sold				15,797,000				13,305,767
Gross profit				8,590,030				6,091,430
Selling expenses				2,813,572				2,721,973
General and administrative				1,868,100				1,308,222
Amortization expense				177,842				188,705
Total operating expenses				4,859,514				4,218,900
Income from operations				3,730,517				1,872,530
Other income (expense):								
Interest and dividend income				15,009				11,573
Rental income				3,269				3,000
Interest expense				(36,299)				(50,186)
Gain (loss) on sale of investments, net				64,335				17,985
Other Expense				0				0
Total other income (expense)				46,314				17,628
Income before provision for income taxes				3,776,831				1,854,902
Provision for income taxes				1,411,192				759,913
Net income			$	2,365,639			$	1,094,989
Basic and diluted earnings per common share				.14				.07
Weighted average number of shares outstanding				16,346,017				16,397,998
COMPREHENSIVE INCOME								
Net income			$	2,365,639			$	1,094,989
Other comprehensive income (loss), net of tax:								
Unrealized gains on								

investments (net of tax)	51,535	29,000
Less reclassification adjustment for (gains) losses included in net income (net of taxes)	(36,349)	10,162
Comprehensive income	$ 2,380,824	$ 1,134,151

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
For the Three Months Ended March 31, 2013 and 2012 (Unaudited)
and For the Year Ended December 31, 2012

	Common Stock, No Par Value 20,000,000 Shares Authorized								
	# of Shares Issued	# of Shares Outstanding	# of Shares of Treasury Stock	Common Stock	Paid In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensiv Income (Loss), Net of Tax	
Balances at December 31, 2011	17,273,776	16,409,317	864,459	$6,509,267	$2,032,516	$(7,606,974)	$34,431,296	$(8,948)	$35
Redemption of stock	0	(63,300)	63,300	0	0	(580,708)	0	0	(5
Other comprehensive income (loss): Unrealized gains on securities, net of taxes	0	0	0	0	0	0	0	62,539	62
Net income for the year ended December 31, 2012	0	0	0	0	0	0	5,619,798	0	5,
Dividends ($.07) per share	0	0	0	0	0	0	(1,146,317)	0	(1
Balances at December 31, 2012	17,273,776	16,346,017	927,759	$6,509,267	$2,032,516	$(8,187,682)	$38,904,777	$53,591	$39
Balances at January 1, 2012	17,273,776	16,409,317	864,459	$6,509,267	$2,032,516	$(7,606,974)	$34,431,296	$(8,948)	$35
Redemption of stock	0	(18,900)	18,900	0	0	(176,606)	0	0	(1
Other comprehensive									

income (loss): Unrealized gains on securities, net of taxes	0	0	0	0	0	0	0	39,162	39
Net income for the three months ended March 31, 2012	0	0	0	0	0	0	1,094,989	0	1,0
Dividends ($.07) per share	0	0	0	0	0	0	0	0	0
Balances at March 31, 2012	17,273,776	16,390,417	883,359	$6,509,267	$2,032,516	$(7,783,580)	$35,526,285	$30,214	$36
Balances at January 1, 2013	17,273,776	16,346,017	927,759	$6,509,267	$2,032,516	$(8,187,682)	$38,904,777	$53,591	$39
Redemption of stock	0			0	0		0	0	0
Other comprehensive income (loss): Unrealized gains on securities, net of taxes	0	0	0	0	0	0	0	15,185	15
Net income for the three months ended March 31, 2013	0	0	0	0	0	0	2,365,639	0	2,3
Dividends ($.07) per share	0	0	0	0	0	0	0	0	0
Balances at March 31, 2013	17,273,776	16,346,017	$927,759	$6,509,267	$2,032,516	$(8,187,682)	$41,270,416	$68,776	$41

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Three Months Ended March 31, 2013 and 2012 (Unaudited)

	(Unaudited) March 31, 2013	2012
Cash flows from operating activities:		
Net income	$ 2,365,639	$ 1,094,989
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	571,967	587,750
Loss (gain) on sale of investments, net	(64,335)	(17,985)
Deferred income taxes	(192,090)	(185,805)
Bad Debt Expense	51,819	6,384
(Increase) decrease in operating assets:		
Accounts receivable	(3,244,063)	(526,979)
Other receivables	3,660	68,267
Inventories	(1,141,713)	(250,982)
Refundable income taxes	0	41,316
Prepaid expenses and other current assets	4,311	39,750
Increase (decrease) in operating liabilities:		
Accounts payable	2,209,076	211,227
Accrued expenses	42,206	201,462
Income taxes payable	208,282	279,402
Net cash provided by operating activities	814,759	1,548,796
Cash flows from investing activities:		
Purchases of investments	(1,271,516)	(318,123)
Proceeds from sale of investments	1,170,271	404,028
Redemption of certificates of deposits	200,000	0
Purchases of property and equipment	(324,608)	(231,243)
Net cash used in investing activities	(225,853)	(145,338)
Cash flows from financing activities:		
Checks written in excess of bank balances	0	(258,594)
Purchases of treasury stock	0	(176,606)
Repayment of notes payable	(135,175)	(926,869)
Net cash used in financing activities	(135,175)	(1,362,069)
Net (decrease) increase in cash and cash equivalents	453,731	41,389
Cash and cash equivalents at the beginning of the period	2,286,226	1,115,150
Cash and cash equivalents at the end of the period	$ 2,739,957	$ 1,156,539

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
March 31, 2013 and 2012
and December 31, 2012

Note 1 – NATURE OF BUSINESS

Lifeway Foods, Inc. (the “Company” or “Lifeway”) commenced operations in February 1986 and incorporated under the laws of the state of Illinois on May 19, 1986. The Company’s principal business activity is the production of dairy products. Specifically, the Company produces Kefir, a drinkable product which is similar to but distinct from yogurt, in several flavors sold under the name “Lifeway’s Kefir;” a plain farmer’s cheese sold under the name “Lifeway’s Farmer’s Cheese;” a fruit sugar-flavored product similar in consistency to cream cheese sold under the name of “Sweet Kiss;” and a dairy beverage, similar to Kefir, with increased protein and calcium, sold under the name “Basics Plus.” The Company also produces a vegetable-based seasoning under the name “Golden Zesta.” The Company currently distributes its products throughout the Chicago Metropolitan area and various cities on the East Coast through local food stores. In addition, products are sold throughout the United States and Ontario, Canada by distributors. The Company also distributes some of its products to Eastern Europe.

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the preparation of the accompanying financial statements follows:

Basis of presentation
The accompanying unaudited financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by general accepted accounting principles for complete financial statements. However, such information reflects all adjustments (consisting of normal recurring adjustments), which are, in the opinion of Management, necessary for fair statement of results for the interim periods.

Principles of consolidation
The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Helios Nutrition, Ltd., Pride of Main Street, L.L.C., Starfruit, L.L.C., Fresh Made, Inc. and Starfruit Franchisor, L.L.C. All significant intercompany accounts and transactions have been eliminated.

Use of estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 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 allowance for doubtful accounts, the valuation of investment securities, the valuation of goodwill, intangible assets, and deferred taxes.

Revenue Recognition
Sales of Company produced dairy products are recorded at the time of shipment and 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 cost in cost of sales.

Discounts and allowances are reported as a reduction of gross sales unless the allowance is attributable to an identifiable benefit separable from the purchase of the product, the value of which can be reasonably estimated, which would be charged to the appropriate expense account.

Customer Concentration

Sales are predominately to companies in the retail food industry, located within the United States of America. Two major customers accounted for approximately 31 percent and 31 percent of gross sales for the three months ended March 31, 2013 and 2012, respectively. These customers accounted for approximately 36 percent, 30 percent, and 30 percent of accounts receivable as of March 31, 2013, March 31, 2012, and December 31, 2012, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
March 31, 2013 and 2012
and December 31, 2012

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Cash and cash equivalents

All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents.

The Company maintains cash deposits at several institutions located in the greater Chicago, Illinois and Philadelphia, Pennsylvania metropolitan areas.

Investments

All investment securities are classified as available-for-sale and are carried at fair value. Unrealized gains and losses on available-for-sale securities are reported as a separate component of stockholders' equity. Amortization, accretion, interest and dividends, realized gains and losses, and declines in value judged to be other-than-temporary on available-for-sale securities are recorded in other income. All of the Company's securities are subject to a periodic impairment evaluation. This evaluation depends on the specific facts and circumstances. Factors that we consider in determining whether an other-than-temporary decline in value has occurred include: the market value of the security in relation to its cost basis; the financial condition of the investee; and the intent and ability to retain the investment for a sufficient period of time to allow for possible recovery in the market value of the investment.

Accounts receivable

Credit terms are extended to customers in the normal course of business. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral. Balances expected to be paid beyond one year are classified as long-term.

Accounts receivable are recorded at invoice amounts, and reduced to their estimated net realizable value by recognition of an allowance for doubtful accounts and anticipated discounts. The Company's estimate of the allowances for doubtful accounts and anticipated discounts are based upon historical experience, its evaluation of the current status and contract terms of specific receivables, and unusual circumstances, if any. Accounts are considered past due if payment is not made on a timely basis in accordance with the Company's credit terms. Accounts considered uncollectible are charged against the allowance.

Inventories

Inventories are stated at the lower of cost or market, cost being determined by the first-in, first-out method.

Property and equipment

Property and equipment is stated at depreciated cost or fair value where depreciated cost is not recoverable. Depreciation is computed using the straight-line method. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to income as incurred; significant renewals and betterments are capitalized.

Property and equipment is being depreciated over the following useful lives:

Category	Years
Buildings and improvements	31 and 39
Machinery and equipment	5 – 12
Office equipment	5 – 7
Vehicles	5

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
March 31, 2013 and 2012
and December 31, 2012

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Intangible assets acquired in business combinations
The Company accounts for intangible assets at historical cost. Intangible assets acquired in a business combination are recorded under the purchase method of accounting at their estimated fair values at the date of acquisition. Goodwill represents the excess purchase price over the fair value of the net tangible and other identifiable intangible assets acquired. Goodwill is not amortized, but is reviewed for impairment at least annually. Brand assets represent the fair value of brands acquired. Brand assets have an indefinite life and therefore are not amortized, rather are reviewed periodically for impairment. The Company amortizes other intangible assets over their estimated useful lives, as disclosed in the table below.

The Company reviews intangible assets and their related useful lives at least once per year to determine if any adverse conditions exist that would indicate the carrying value of these assets may not be recoverable. The Company conducts more frequent impairment assessments if certain conditions exist, including: a change in the competitive landscape, any internal decisions to pursue new or different strategies, a loss of a significant customer, or a significant change in the market place including changes in the prices paid for the Company’s products or changes in the size of the market for the Company’s products.

If the estimate of an intangible asset’s remaining useful life is changed, the remaining carrying amount of the intangible asset is amortized prospectively over the revised remaining useful life.

Intangible assets are being amortized over the following useful lives:

Category	Years
Recipes	4
Customer lists and other customer related intangibles	7-10
Lease agreement	7
Trade names	15
Formula	10
Customer relationships	12

Income taxes
Deferred income taxes are the result of temporary differences that arise from income and expense items reported for financial accounting and tax purposes in different periods. Deferred taxes are classified as current or non-current, depending on the classification of the assets and liabilities to which they relate. Deferred taxes arising from temporary differences that are not related to an asset or liability are classified as current or non-current depending on the periods in which the temporary differences are expected to reverse.

The principal sources of temporary differences are different depreciation and amortization methods for financial statement and tax purposes, unrealized gains or losses related to investments, capitalization of indirect costs for tax purposes, purchase price adjustments, and the recognition of an allowance for doubtful accounts for financial statement purposes.

The Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The only periods subject to examination for the Company's federal returns are the 2010 and 2011 tax years. The Company believes that its income tax filing positions and deductions would be sustained on audit and does not anticipate any adjustments that would result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
March 31, 2013 and 2012
and December 31, 2012

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Treasury stock
Treasury stock is recorded using the cost method.

Advertising and promotional costs
The Company expenses advertising costs as incurred. For the three months ended March 31, 2013 and 2012 total advertising expenses were $606,398 and $755,666, respectively.

Earnings per common share
Earnings per common share were computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. For the three months ended March 31, 2013 and 2012, diluted and basic earnings per share were the same, as the effect of dilutive securities options outstanding was not significant.

Correction of Prior Year Amounts
Management has restated the unaudited statements of income and comprehensive income for interim period ending March 31, 2012. During the period ending March 31, 2012, amounts related to costs of production of inventory were not presented as part of cost of goods sold and were erroneously included as general and administrative operation expenses in our previously issued financial statements (see Note 14).

There was no impact on previously reported income, consolidated balance sheets or consolidated statement of cash flows.

Note 3 – INTANGIBLE ASSETS

Intangible assets, and the related accumulated amortization, consist of the following:

	March 31, 2013		March 31, 2012		December 31, 2012	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Recipes	$ 43,600	$ 43,600	$ 43,600	$ 43,600	$ 43,600	$ 43,600
Customer lists and other customer related intangibles	4,504,200	2,137,640	4,504,200	1,666,438	4,504,200	2,025,736
Lease acquisition	87,200	87,200	87,200	87,200	87,200	87,200
Customer relationship	985,000	544,222	985,000	465,135	985,000	526,701
Trade names	2,248,000	915,936	2,248,000	766,068	2,248,000	878,469
Formula	438,000	292,000	438,000	248,200	438,000	281,050
	$ 8,306,000	$ 4,020,598	$ 8,306,000	$ 3,276,645	$ 8,306,000	$ 3,842,756

Amortization expense is expected to be approximately the following for the 12 months ending March 31:

2014	$	711,367
2015		711,367
2016		711,367
2017		682,166
2018		667,567
Thereafter		801,568
	$	4,285,402

Amortization expense during the three months ended March 31, 2013 and 2012 was $177,842 and $188,705, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
March 31, 2013 and 2012
and December 31, 2012

Note 4 – INVESTMENTS

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

March 31, 2013	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	$ 769,743	$ 126,498	$ (8,861)	$ 887,380
Preferred Securities	100,005	0	(405)	99,600
Corporate Bonds	1,070,867	13,355	(8,859)	1,075,363
Total	$ 1,940,615	$ 139,853	$ (18,125)	$ 2,062,343

March 31, 2012	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	$ 525,657	$ 77,348	$ (3,519)	$ 599,486
Mutual Funds	56,840	959	(105)	57,694
Preferred Securities	189,452	10,950	(5,152)	195,250
Corporate Bonds	870,671	11,312	(10,577)	871,406
Total	$ 1,642,620	$ 100,569	$ (19,353)	$ 1,723,836

December 31, 2012	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	$ 639,974	$ 90,875	$ (5,190)	$ 725,659
Corporate Bonds	1,135,064	16,212	(7,047)	1,144,229
Total	$ 1,775,038	$ 107,087	$ (12,237)	$ 1,869,888

Proceeds from the sale of investments were $1,170,271 and $404,028 for the three months ended March 31, 2013 and 2012, respectively.

Gross gains of $66,218 and $22,349 and gross losses of $1,882 and $4,364 were realized on these sales during the three months ended March 31, 2013 and 2012, respectively.

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2013 and 2012 and at December 31, 2012:

	Less Than 12 Months		12 Months or Greater		Total	
March 31, 2013	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

Equities	$ 138,409	$ (6,916)	$ 33,371	$ (1,945)	$ 171,780	$ (8,861)
Preferred Securities	99,600	(405)	0	0	99,600	(405)
Corporate Bonds	519,549	$ (8,075)	72,715	(784)	592,264	(8,859)
	$ 757,558	$ (15,396)	$ 106,086	$ (2,729)	$ 863,644	