

10-K 1 lifeway_10k-123120.htm ANNUAL REPORT

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2020

or

TRANSITION REPORT PURSUANT TO 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.

(Name of registrant as specified in its charter)

Illinois

*(State or other jurisdiction of
incorporation or organization)*

36-3442829

*(IRS Employer
Identification No.)*

6431 West Oakton St., Morton Grove, Illinois 60053

(Address of principal executive offices) (Zip Code)

(847) 967-1010

(Registrant's telephone number, including area code)

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Trading Symbol	Name of each exchange on which registered
Common Stock, No Par Value	LWAY	Nasdaq Global Market

Securities registered under Section 12(g) of the Exchange Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 every Interactive Data File required to be submitted 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 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," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. Yes No

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the stock was last sold as of June 30, 2020 (\$2.28 per share as quoted on the Nasdaq Global Market) was \$9,390,506.

As of March 15, 2021, 15,604,480 shares of the registrant's common stock, no par value, were outstanding.

Portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on June 18, 2021, are incorporated by reference into Part III.

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FORWARD LOOKING STATEMENTS

In connection with the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, readers are advised that this document, any document incorporated by reference herein, and other documents we file with the SEC, contain forward looking statements. In addition, we, or others on our behalf, may make forward looking statements in press releases or written statements, or in our communications and discussions with investors and analysts in the normal course of business through meetings, webcasts, phone calls, and conference calls. Forward looking statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those indicated by the forward looking statements. These statements use words, variations of words, and negatives of words such as “may,” “could,” “believe,” “future,” “depend,” “expect,” “will,” “result,” “can,” “remain,” “assurance,” “subject to,” “require,” “limit,” “impose,” “guarantee,” “restrict,” “continue,” “become,” “predict,” “likely,” “opportunities,” “effect,” “change,” “future,” “predict,” and “estimate.” Examples of forward looking statements include, but are not limited to, (i) projections of revenues, income or loss, earnings or losses per share, capital expenditures, dividends, capital structure and other financial items, (ii) statements of Lifeway Foods, Inc.’s (the “Company”, “Lifeway”, “we”, or “our”) plans and objectives, including the introduction of new products, or estimates or predictions of actions by customers, suppliers, competitors or regulatory authorities, (iii) statements of future economic performance, and (iv) statements of assumptions underlying other statements and statements about Lifeway or its business.

These forward looking statements are based on management’s beliefs, assumptions, estimates and observations of future events based on information available to our management at the time the statements are made and include any statements that do not relate to any historical or current fact. These statements are not guarantees of future performance and they involve certain risks, uncertainties and assumptions that are difficult to predict. Actual outcomes and results may differ materially from what is expressed, implied or forecast by our forward looking statements due in part to the risks, uncertainties, and assumptions that include

- The actions of our competitors and customers, including those related to price competition;
- the decisions of customers or consumers;
- our ability to successfully implement our business strategy;
- changes in the pricing of commodities;
- the effects of government regulation;
- the impact of the COVID-19 outbreak on our business, suppliers, consumers, customers, and employees;
- disruptions to our supply chain, or our manufacturing and distribution capabilities, including those due to cybersecurity threats and the COVID-19 outbreak; and
- the other risks and uncertainties that are set forth in Item 1, “Business”, Item 1A “Risk Factors” and Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and that are described from time to time in our filings with the SEC.

These factors are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of our forward looking statements. Other unknown or unpredictable factors could also have material adverse effects on future results. We intend these forward looking statements to speak only at the date made. Except as otherwise required to be disclosed in periodic reports required to be filed by public companies with the Securities and Exchange Commission (“SEC”) pursuant to the SEC’s rules, we have no duty to update these statements, and we undertake no obligation to publicly update or revise any forward looking statements, whether as a result of new information, future events or otherwise.

PART I

ITEM 1 BUSINESS

OVERVIEW

Lifeway was founded in 1986 by Michael and Ludmila Smolyansky shortly after their emigration from Russia to the United States. Mr. and Mrs. Smolyansky were the first to successfully introduce kefir to the U.S. consumer on a commercial scale, initially catering to ethnic consumers in the Chicago, Illinois metropolitan area. In the over thirty years that have followed, Lifeway has grown to become the largest producer and marketer of kefir in the U.S. and an important player in the broader market spaces of probiotic-based products and natural, “better for you” foods.

PRODUCTS

Our primary product is drinkable kefir, a cultured dairy product. Lifeway Kefir is tart and tangy, high in protein, calcium and vitamin D. Thanks to our exclusive blend of kefir cultures, each cup of kefir contains 12 live and active cultures and 25 to 30 billion beneficial CFU (Colony Forming Units) at the time of manufacture.

We manufacture (directly or through co-packers) and market products under the Lifeway and Fresh Made brand names, as well as under private labels on behalf of certain customers.

Our product categories are:

- Drinkable Kefir, sold in a variety of organic and non-organic sizes, flavors, and types, including low-fat, non-fat, whole milk, protein, and BioKefir (a 3.5 oz. kefir with additional probiotic cultures).
- European-style soft cheeses, including farmer cheese, white cheese, and Sweet Kiss.
- Cream and other, which consists primarily of cream, a byproduct of making our kefir.
- ProBugs, a line of kefir products designed for children.
- Other Dairy, which includes Cupped Kefir and Icelandic Skyr, a line of strained kefir and yogurt products in resealable cups.
- Frozen Kefir, available in both soft serve and pint-size containers.

Net sales of products by category were as follows for the years ended December 31:

In thousands	2020		2019	
	\$	%	\$	%
Drinkable Kefir other than ProBugs	\$ 81,437	80%	\$ 71,822	77%
Cheese	12,905	13%	11,459	12%
Cream and other	2,872	3%	4,228	4%
ProBugs Kefir	2,733	2%	2,780	3%
Other dairy	1,594	1%	1,756	2%
Frozen Kefir (a)	485	1%	1,617	2%
Net Sales	<u>\$ 102,026</u>	<u>100%</u>	<u>\$ 93,662</u>	<u>100%</u>

(a) Includes Lifeway Kefir Shop sales

Product innovation and new product development

Lifeway is committed to maintaining its positions as the leading producer of kefir and a recognized leader in the market for probiotic products. We routinely evaluate opportunities for new product flavors and formulations, improved package design, new product configurations and other innovation opportunities. Beyond our core drinkable kefir products, we have an ongoing effort to extend the strength of the Lifeway brand and leverage the capabilities of the Lifeway organization into categories both inside and outside of the dairy aisle, including into non-food categories and into additional channels, such as gyms and fitness studios. In 2020, we maintained the level of focus on product innovations, packaging innovations, and growth opportunities. These product innovation and development efforts have led to additional revenue opportunities from Plantiful and Kefir minis.

Lifeway considers research and development of new products to be a significant part of our overall business philosophy. Where possible, we leverage our existing staff and facilities to conduct our innovation, research, and development efforts, rather than maintaining a dedicated research and development staff and facilities or relying solely on third parties. In 2020, in light of the Covid-19 outbreak, and our focus was on expanding sales of our current products, and less on new product development.

PRODUCTION

Manufacturing

During 2020 and 2019, approximately 99% of our revenue was derived from products manufactured at our own facilities. We currently operate the following manufacturing and distribution facilities:

- Morton Grove, Illinois, which produces drinkable kefir, drinkable ProBugs kefir, Kefir Cups, and cheese products;
- Waukesha, Wisconsin, which produces drinkable kefir products and from which we store and distribute products;
- Niles, Illinois, which stores and serves as a distribution point for products, including those manufactured by co-packers;
- Philadelphia, Pennsylvania, which produces drinkable kefir, cheese, and butter products, from which we store and distribute products.

We own these manufacturing facilities, and all our fixed assets associated with manufacturing, storage, and distribution of our products are located in the United States.

Co-Packers

In addition to the products manufactured in our own facilities, independent manufacturers (“co-packers”) manufacture some of our products. We have co-packer agreements to manufacture drinkable and frozen kefir in Ireland and the United Kingdom, respectively, to serve our European markets. During 2020 and 2019, approximately 1% of our revenue was derived from products manufactured by co-packers. Our co-packers are audited regularly by our staff and are required to follow our specifications and Good Manufacturing Practices (GMPs). Additionally, the co-packers are required to ensure our products are manufactured in accordance with our quality and safety specifications and that they are compliant with all applicable laws and regulations.

SALES AND DISTRIBUTION

Sales Organization

We sell our products primarily through our direct sales force, brokers, and distributors. Our sales organization strives to cultivate strong, collaborative relationships with our customers that facilitate favorable shelf placement for our products, which we believe will drive sales volumes when combined with our marketing efforts and our brand strength. Our relationships with food brokers provide additional retail customer coverage as a supplement to our direct sales force.

Distribution inside the United States

Lifeway’s products reach the consumer through four primary “route-to-market” pathways:

- Retail-direct;
- Distributor;
- Direct store delivery (“DSD”);
- Retail sales.

Under the retail-direct channel, we sell our products to the retailer that either the retailer’s carrier picks up or Lifeway ships through third party carriers for delivery to those retailers’ distribution centers. In turn, our retailers then deliver the products to their respective stores. Customers in this route-to-market grouping include Kroger, Walmart and Trader Joe’s. Under the retail direct model, optimal product merchandising, assortments and product presentation are attended to by the retailer with limited support from Lifeway’s broker network. Sales to our retail-direct customers represent approximately 45% of our total net sales for the year ended 2020.

Under the distributor channel, we sell our products to distributors that either the distributor’s carrier picks up or Lifeway ships through third party carriers for delivery to those distributors’ designated warehouses. In turn, our distributors then sell and ship our products to their retail customers. Our distributors often use a DSD model of their own to make deliveries directly to individual stores, but they also make deliveries to retailers’ distribution centers. Our distributor customers include United Natural Foods (UNFI), KeHE Distributors, and C&S Wholesale Grocers. The distributor attends to optimal product merchandising, assortments, and product presentations at the retail end of the channel, with support from Lifeway’s direct sales force and broker network. Sales to our distributor customers represent approximately 50% of our total net sales for year ended 2020.

Under the direct store delivery (DSD) route to market, we distribute our products directly to the retailer using Company-owned vehicles and a team of Lifeway merchandisers who engage face-to-face with store management to ensure optimal product assortments and presentations. We operate our DSD model in the Chicago, Illinois metropolitan area only. Sales to our DSD customers represent approximately 3% of our total net sales for the year ended 2020.

In the Chicago, Illinois metropolitan area, Lifeway operates two retail stores and a food truck under its Lifeway Kefir Shop subsidiary. The Lifeway Kefir Shop sells its frozen and drinkable kefir products, as well as certain Lifeway products, through these retail outlets. Sales through these retail outlets represented less than 1% of net sales for the year ended 2020.

Distribution outside of the U.S.

Substantially all of Lifeway's products are distributed within the United States; however, certain of our distributors sell our products to retailers in Mexico and portions of South America and the Caribbean. Additionally, Lifeway products reach consumers in the United Kingdom, Ireland, Norway, Sweden, and the Middle East under third party co-manufacturing agreements and in-country broker and distributor arrangements. Sales outside the United States represents approximately 2% of net sales for the year ended 2020.

Channel- and Market-Specific Distribution and Broker Representation Arrangements

Lifeway's generally standardized agreements with independent distributors and food brokers allow us the latitude to establish new relationships as the opportunities and needs arise. Where appropriate given the relationship, market, and business opportunity, we offer exclusive channels, markets, and/or territories to our distributors and brokers.

We provide our independent distributors with products at wholesale prices for distribution to their retail accounts. Lifeway believes that the prices at which we sell our products to distributors are competitive with the prices generally paid by distributors for similar products in the markets served. Due to the perishable nature of our products and the costs associated with moving product back through the channel, we do not offer return privileges to any of our distributors or channel customers; however, from time to time we do provide our customers with allowances for non-saleable product.

Lifeway engages independent food brokers generally on a commission basis, subject in some cases to a minimum commission guarantee. The commissions vary based on the scope of services provided and customers served. Our brokers represent our products to a variety of prospective buyers. These buyers could be specialty stores, retail grocery chains, wholesalers, foodservice operators and distributors, drug chains, mass merchandisers, industrial users, schools and universities, or military installations. With support from our direct sales force, brokers may provide other value-added services. These may include scheduling and coordinating promotions, merchandising, centralized ordering, and data collection services.

MARKETING

We use a combination of sales incentives, trade promotions, and consumer promotions to market our products.

Sales Incentives and Trade Promotion Allowances

Lifeway offers various sales incentives and trade promotional programs to its retailer and distributor customers from time to time in the normal course of business. These sales incentives and trade promotion programs typically include rebates, in-store display and demo allowances, allowances for non-saleable product, coupons, and other trade promotional activities. Trade promotions support price features, displays, and other merchandising of our products by our retail and distributor customers. We record these arrangements as a reduction to net sales in our consolidated statements of operations.

Consumer Promotions and Marketing Campaigns

We engage in an ongoing and wide variety of marketing and media campaigns - primarily digital and social media, print advertising in some newspapers and magazines, and, to a lesser extent, targeted television advertising. We complement these marketing and media efforts by sponsoring cultural and community events, and various festivals, as well as participating in industry-related trade shows and in-store promotional events. Our consumer marketing efforts also include cooperative advertising programs with our retail customers and various couponing campaigns, online consumer relationship programs, and other similar forms of promotions.

Our marketing efforts are aimed at stimulating demand with new and existing consumers by elevating awareness and consumption of kefir and probiotics, as well as enhancing our brand equity. Our awareness marketing seeks to promote the verifiable nutritional profile, purity, benefits, and good taste of our kefir.

COMPETITION

Lifeway competes with a limited number of other domestic kefir producers and consequently faces a small amount of direct competition for kefir products. However, Lifeway's kefir-based products compete with other dairy products, notably spoonable and drinkable yogurt, and, increasingly, with non-dairy probiotic products that incorporate kefir cultures but are not kefir. Many of our competitors are well-established and have significantly greater financial resources than Lifeway to promote their products.

SUPPLIERS

We purchase our ingredients such as raw milk, pectin, and fruit purees from unaffiliated suppliers. In addition, we purchase significant quantities of packaging materials to package our products and natural gas and electricity to operate our facilities. Purchases are made through purchase orders or contracts, and price, delivery terms, and product specifications vary. Although the prices for our principal inputs can fluctuate based on economic, weather, and other conditions, Lifeway believes it has ready access to multiple suppliers for all ingredient, packaging, and other input requirements.

MAJOR CUSTOMERS

During the year ended December 31, 2020, two customers collectively accounted for approximately 21% of our total net sales. These customers collectively accounted for approximately 22% of net accounts receivable as of December 31, 2020.

SEGMENTS

Lifeway has determined that it has one reportable segment based on how our chief operating decision maker manages the business and in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing Company performance, has been identified collectively as the Chief Financial Officer, the Chief Operating Officer, the Chief Executive Officer and Chairperson of the board of directors. Substantially all of our consolidated revenues relate to the sale of cultured dairy products that we produce using the same processes and materials and are sold to consumers through a common network of distributors and retailers in the United States.

DANONE SA

Since October 1999, Danone SA, through subsidiaries (collectively “Danone”), has been the beneficial owner of approximately 22% of the outstanding common stock of Lifeway. Lifeway and Danone are parties to a Stockholders’ Agreement dated October 1, 1999, which as amended provides Danone the right to designate one director nominee, provides Danone with anti-dilutive rights relating to certain future offerings and issuances of capital stock, and grants Danone limited registration rights.

INTELLECTUAL PROPERTY

We believe that our rights in our trademarks and service marks are important to our marketing efforts to develop brand recognition and differentiate our brand from our competitors and are a valuable part of our business. We own many domestic and international trademarks and service marks. In addition, we own numerous registered and unregistered copyrights, registered domain names, and proprietary trade secrets, trade dress, technology, know-how, processes, and other proprietary rights that are not registered. Depending on the jurisdiction, trademarks are generally valid as long as they are in use and/or their registrations are properly maintained and they have not been found to have become generic. Registrations of trademarks can also generally be renewed indefinitely as long as the trademarks are in use. We also have licenses to use certain trademarks inside and outside of the United States and to certain product formulas, all subject to the terms of the agreements under which such licenses are granted. Lifeway’s policy is to pursue registration of intellectual property whenever appropriate. We protect our intellectual property rights by relying on a combination of trademark, copyright, trade dress, trade secret and other intellectual property laws, and domain name dispute resolution systems; as well as licensing agreements, third-party confidentiality, nondisclosure, and assignment agreements; and by policing third-party misuses of our intellectual property. We regard the Lifeway family of trademarks and other intellectual property as having substantial value and as being an important factor in the marketing of our products. The loss of such protection would have a material adverse impact on our operations and share price.

REGULATION

Lifeway is subject to extensive regulation by federal, state, and local governmental authorities. In the United States, agencies governing the manufacture, marketing, and distribution of our products include, among others, the Federal Trade Commission (“FTC”), the United States Food & Drug Administration (“FDA”), the United States Department of Agriculture (“USDA”), the United States Environmental Protection Agency (“EPA”), the Occupational Safety and Health Administration (“OSHA”), and their state and local equivalents. Under various statutes, these agencies prescribe, among other things, the requirements and standards for quality, safety, and representation of our products to consumers. We are also subject to federal laws and regulations relating to our products and production. For example, as required by the National Organic Program (“NOP”), we rely on third parties to certify certain of our products and production locations as organic. Additionally, our facilities are subject to various laws and regulations regarding the release of material into the environment and the protection of the environment in other ways.

Internationally, we are subject to the laws and regulatory authorities of the foreign jurisdictions in which we manufacture and sell our products, including the Food Standards Agency in the United Kingdom; the National Service of Health, Food Safety and Agro-Food Quality (known by its Spanish-language acronym “SENASICA”) and the Federal Commission for the Protection from Sanitary Risks (“COFEPRIS”) in Mexico; the Food Safety Authority in Ireland; and the European Food Safety Authority, which supports the European Commission, as well as individual country, province, state, and local regulations.

MILK INDUSTRY REGULATION

Our primary raw material is conventional and organic raw milk. The federal government establishes minimum prices for raw milk purchased in federally regulated areas. Some states have established their own rules for determining minimum prices. The federal government announces prices for raw milk each month. While we are subject to federal government regulations that establish minimum prices for milk, the prices we pay producers of organic raw milk are generally well above such minimum prices, as organic milk production is generally costlier, and organic milk therefore commands a price premium. In addition to the prices for raw milk, we also pay producer (“over-order”) premiums, federal order administration costs, and other related charges that vary by milk product, location, and supplier.

FOOD SAFETY

Lifeway takes appropriate precautions to ensure the safety of our products. In addition to routine inspections by state and federal regulatory agencies, including the USDA and FDA, we have instituted Company-wide quality systems that address topics such as supplier control; ingredient, packaging, and product specifications; preventive maintenance; pest control; and sanitation. Each of our facilities also has in place a hazard analysis critical control points (“HACCP”) plan that identifies critical pathways for contaminants and mandates control measures that must be used to prevent, eliminate or reduce relevant food-borne hazards. To the extent that the federal Food Safety Modernization Act applies to Lifeway’s business, we develop food safety plans and implement preventive measures to protect against food contamination. We also maintain a product recall plan, including lot identifiability and traceability measures that allow us to act quickly to reduce the risk of consumption of any product that we suspect may pose a health issue.

We maintain various types of insurance, including product liability and product recall coverages, which we believe to be sufficient to cover potential product liabilities.

We have also implemented the Safe Quality Food (“SQF”) program at most of our facilities. SQF is a fully integrated food safety and quality management protocol designed specifically for the food sector. The SQF Code, based on universally accepted CODEX Alimentarius, HACCP guidelines and the Global Food Safety Initiative (“GFSI”) standards, offers a comprehensive methodology to manage food safety and quality simultaneously. SQF certification provides an independent and external validation that a product, process or service complies with international, regulatory and other specified standards. Our Waukesha, Morton Grove, and Niles facilities are SQF certified.

SEASONALITY

Lifeway’s business is not seasonal.

EMPLOYEES

As of December 31, 2020, we employed approximately 316 employees, approximately 103 of which were members of a union bargaining unit.

AVAILABLE INFORMATION

Lifeway maintains a corporate website for investors at www.lifewayfoods.com and it makes available, free of charge, through this website its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports that we file with or furnish to the SEC as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

ITEM 1A RISK FACTORS

In evaluating and understanding us and our business, you should carefully consider the risks described below, in conjunction with all of the other information included in this Annual Report on Form 10-K, including “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained in Part II, Item 7 and “Quantitative and Qualitative Disclosures About Market Risk” contained in Part II, Item 7A. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may become important factors that adversely affect our business. If any of the events or circumstances described in the following risk factors actually occurs, our business, financial condition, results of operations, and future prospects could be materially and adversely affected.

RISKS RELATED TO OUR BUSINESS

Our product categories face a high level of competition, which could negatively impact our sales and results of operations.

We compete with a limited number of other domestic kefir producers and consequently faces a small amount of direct competition for kefir products. However, our kefir-based products compete with other dairy products, notably spoonable and drinkable yogurt, and, increasingly, with non-dairy probiotic products that incorporate kefir cultures but are not kefir. We face significant competition for limited retailer shelf space in each of our product categories. Competition in our product categories is based on product innovation, product quality, price, brand recognition and loyalty, effectiveness of marketing, promotional activity, and our ability to identify and satisfy consumer tastes and preferences. We believe that our brands have benefited in many cases from being the first to introduce products in their categories, and their success has attracted competition from other food and beverage companies that produce branded products, as well as from private label competitors. Some of our competitors, such as Danone, General Mills, Chobani, Hain Celestial Group, and Nestle, have substantial financial and marketing resources. These competitors and others may be able to introduce innovative products more quickly or market their products more successfully than we can, which could cause our growth rate to be slower than we anticipate and could cause sales to decline.

We also compete with producers of non-dairy products, such as Millennium Products and PepsiCo, that have lower ingredient and production-related costs. As a result, these competing producers may be able to offer their products to customers at a lower price point. This could cause us to lower our prices, resulting in lower profitability or, in the alternative, cause us to lose market share if we fail to lower prices. Furthermore, private label competitors are generally able to sell their products at lower prices because private label products typically have lower marketing costs than their branded counterparts. If our products fail to compete successfully with other branded or private label offerings, demand for our products and our sales volumes could be negatively impacted.

Additionally, due to high levels of competition, certain of our key retailers may demand price concessions on our products or may become more resistant to price increases for our products. Increased price competition and resistance to price increases have had, and may continue to have, a negative effect on our results of operations.

We may not be able to successfully implement our business strategy for our brands on a timely basis or at all.

We believe that our future success depends, in part, on our ability to implement our strategy of leveraging our existing brands with our current and new products to maintain our market position in our product categories; drive increased sales; acquire or establish new brands; and create strategic alliances including potential joint ventures. Our ability to implement this strategy depends, among other things, on our ability to:

- enter into distribution and other strategic arrangements with third-party retailers and other potential distributors of our products;
- compete successfully in the product categories in which we choose to operate;
- introduce timely, new, cost-effective, and appealing products and innovate successfully within our existing product categories;
- develop and maintain consumer interest in and demand for our brands considering prevailing consumer tastes and preferences;
- increase our brand recognition and loyalty;

- enter into strategic arrangements with third-party suppliers to obtain necessary raw materials;
- identify suitable acquisition candidates or joint venture partners and accurately assess their value, growth potential, strengths, weaknesses, contingent and other liabilities, and potential profitability;
- negotiate acquisitions and joint ventures on terms acceptable to us; and
- integrate acquired brands, products, or joint ventures into our company and our business strategy.

If we fail to execute these and other important elements of our business strategy, our business and results of operations could be adversely affected.

One key element of our business strategy is to introduce timely, new, cost-effective, and appealing products and to innovate successfully within our existing product categories. However, consumer tastes and preferences change rapidly, and evolve over time. Factors that may affect consumer tastes and preferences include:

- dietary trends and increased attention to nutritional values, such as the sugar, fat, protein, fiber or calorie content of different foods and beverages;
- concerns regarding the health effects of specific ingredients and nutrients, such as sugar, other sweeteners, dairy, soybeans, nuts, oils, vitamins, fiber and minerals;
- concerns regarding the public health consequences associated with obesity, particularly among young people;
- decisions by yogurt and non-dairy beverage manufacturers to mislabel their products as “kefir” in order to benefit from our branding and marketing efforts, a marketing ploy that can cause significant confusion and misunderstanding among consumers; and
- increased awareness of the environmental and social effects of food processing.

Our future investments may not produce the results we expect when we expect them for a variety of reasons including those described herein. Our future product development and innovation will be reliant on our ability to identify and develop potential new growth opportunities. This process is inherently risky and will result in investments of substantial time and resources for which we may not achieve any return or value. Successful product development and innovation is also affected by our ability to launch new or improved products successfully and on a timely and cost-effective basis.

We may have to pay cash, incur debt, or issue equity, equity-linked, or debt securities to fund our business strategy, or may be unable to fund that strategy. Any of these events could adversely affect our financial results and our business. We could experience similar effects if we invest resources in a strategy that ultimately proves unsuccessful. If, due to a failure of our strategy or any other reason, consumer demand for our products declines, our sales volumes, results of operations, and our business could be negatively affected, and we may not be able to create or sustain growth or successfully implement our business strategy.

Interruption of our supply chain could affect our ability to manufacture or distribute products, could adversely affect our business and sales, and/or could increase our operating costs and capital expenditures.

We have several supply agreements with suppliers and co-packers that require them to provide us with specific finished goods, including packaging and kefir. For some of these products, we essentially rely on a single supplier or co-packer as our sole source for the item. The failure for any reason of any such sole source or other co-packer to fulfill its obligations under the applicable agreements with us or the termination or renegotiation of any such sourcing agreement could result in disruptions to our supply of finished goods and have an adverse effect on our results of operations. Additionally, our suppliers and co-packers are subject to risk, including labor disputes, union organizing activities, financial liquidity, inclement weather, natural disasters, supply constraints, and general economic and political conditions that could limit their ability to timely provide us with acceptable products, which could disrupt our supply of finished goods, or require that we incur additional expense by providing financial accommodations to the supplier or co-packer or taking other steps to seek to minimize or avoid supply disruption, such as establishing new arrangements with other providers. A new arrangement may not be available on terms as favorable to us as our existing arrangements, if at all.

Our inability to maintain sufficient internal capacity or establish satisfactory co-packing, warehousing and distribution arrangements could limit our ability to operate our business or implement our strategic plan and could negatively affect our sales volumes and results of operations.

Disruption of our manufacturing or distribution chains or information technology systems, including disruption due to cybersecurity threats, could adversely affect our business.

The success of our business depends, in part, on maintaining a strong production platform and we rely primarily on internal production resources to fulfill our manufacturing needs. Our ongoing initiatives to expand our production platform and our productive capacity could fail to achieve such objectives and, in any case, could increase our operating costs beyond our expectations and could require significant additional capital expenditures. If we cannot maintain sufficient production, warehousing, and distribution capacity, either internally or through third party agreements, we may be unable to meet customer demand and/or our manufacturing, distribution, and warehousing costs may increase, which could negatively affect our business.

Furthermore, damage or disruption to our manufacturing or distribution capabilities due to weather, natural disaster, fire, environmental incident, terrorism, cybersecurity threats and other security breaches, pandemic, strikes, the financial or operational instability of key distributors, warehousing, and transportation providers, or other reasons could impair our ability to manufacture or distribute our products.

We rely on a limited number of production and distribution facilities. A disruption in operations at any of these facilities or any other disruption in our supply chain relating to common carriers, supply of raw materials and finished goods, or otherwise, whether as a result of casualty, natural disaster, power loss, telecommunications failure, cybersecurity threat, terrorism, labor shortages, contractual disputes or other causes, could significantly impair our ability to operate our business and adversely affect our relationship with our customers. Furthermore, our insurance coverage may not be adequate to cover all related costs.

Our information technology systems are also critical to the operation of our business and essential to our ability to successfully perform day-to-day operations. These systems include, without limitation, networks, applications, and outsourced services in connection with the operation of our business. A failure of our information technology systems to perform as we anticipate could disrupt our business and result in transaction errors, processing inefficiencies, and sales losses, causing our business to suffer. In addition, our information technology systems may be vulnerable to damage or interruption from circumstances beyond our control, including fire, natural disasters, systems failures, and cybersecurity threats. Cybersecurity threats in particular are persistent, evolve quickly and include, without limitation, computer viruses, unauthorized attempts to access information, denial of service attacks, and other electronic security breaches. Like our customers, suppliers, subcontractors and other third parties with whom we do business generally, we expect that we will continue to be the subject of cybersecurity threats. In some cases we must rely on the safeguards put in place by the third parties with whom we do business to protect against security threats. We believe we have implemented appropriate measures and controls and have invested in sufficient resources to appropriately identify and monitor these threats and mitigate potential risks, including risks involving our customers and suppliers. However, there can be no assurance that any such actions will be sufficient to prevent cybersecurity breaches, disruptions to mission critical systems, the unauthorized release of sensitive information or corruption of data, or harm to facilities or personnel.

These threats and other events could disrupt our operations, or the operations of our customers, suppliers, subcontractors and other third parties; could require significant management attention and resources; could result in the loss of business, regulatory actions and potential liability; and could negatively impact our reputation among our customers and the public. Any of these outcomes could have a negative impact on our financial condition, results of operations, or liquidity.

Our debt and financial obligations could adversely affect our financial condition, our ability to obtain future financing, and our ability to operate our business.

We have outstanding debt obligations that could adversely affect our financial condition and limit our ability to successfully implement our business strategy. Furthermore, from time to time, we may need additional financing to support our business and pursue our business strategy, including strategic acquisitions. Our ability to obtain additional financing, if and when required, will depend on investor demand, our operating performance, the condition of the capital markets, and other factors. We cannot assure that additional financing will be available to us on favorable terms when required, or at all. If we raise additional funds through the issuance of equity, equity-linked, or debt securities, those securities may have rights, preferences, or privileges senior to those of our common stock, and, in the case of equity and equity-linked securities, our existing stockholders may experience dilution.

As of December 31, 2020, we had outstanding borrowings of \$2,768, net of \$9 of unamortized deferred financing costs, which consisted of a revolving line of credit. Our loan agreements contain certain restrictions and requirements that among other things:

- require us to maintain a quarterly fixed charge coverage ratio and minimum working capital ratio;
- limit our ability to obtain additional financing in the future for working capital, capital expenditures and acquisitions, to fund growth or for general corporate purposes;
- limit our future ability to refinance our indebtedness on terms acceptable to us or at all;
- limit our flexibility in planning for or reacting to changes in our business and market conditions or in funding our strategic growth plan; and
- impose on us financial and operational restrictions.

Our ability to meet our debt service obligations will depend on our future performance, which will be affected by the other risk factors described in this Annual Report on Form 10-K. If we do not generate enough cash flow to pay our debt service obligations, we may be required to refinance all or part of our existing debt, sell our assets, borrow more money or raise equity. There is no guarantee that we will be able to take any of these actions on a timely basis, on terms satisfactory to us, or at all.

Our notes bear interest at variable rates. If market interest rates increase, it will increase our debt service requirements, which could adversely affect our cash flow.

Our loan agreements also contain provisions that restrict our ability to:

- borrow money or guarantee debt;
- create liens;
- make specified types of investments and acquisitions;
- pay dividends on or redeem or repurchase stock;
- enter into new lines of business;
- enter into transactions with affiliates; and
- sell assets or merge with other companies.

These restrictions on the operation of our business could harm our ability to execute on our business strategy by, among other things, limiting our ability to take advantage of financing, merger and acquisition opportunities, and other corporate opportunities. Various risks, uncertainties, and events beyond our control could affect our ability to comply with these covenants. Unless cured or waived, a default would permit lenders to accelerate the maturity of the debt under the credit agreement and to foreclose upon the collateral securing the debt.

Loss of our key management or other personnel, or an inability to attract such management and other personnel, could negatively impact our business.

We depend on the skills, working relationships, and continued services of key personnel, including our experienced senior management team. We also depend on our ability to attract and retain qualified personnel to operate and expand our business. If we lose one or more members of our senior management team, or if we fail to attract talented new employees, our business and results of operations could be negatively affected.

Employee strikes and other labor-related disruptions may adversely affect our operations.

We have a union contract governing the terms and conditions of employment for a significant portion of our workforce. Although we believe union relations since the union's certification as the exclusive bargaining representative of this portion of our workforce have been amicable, there is no assurance that this will continue in the future or that we will not be subject to future union organizing activity. There are potential adverse effects of labor disputes with our own employees or by others who provide warehousing, transportation, and distribution, both domestic and foreign, of our raw materials or other products. Strikes or work stoppages or other business interruptions could occur if we are unable to renew collective bargaining agreements on satisfactory terms or enter into new agreements on satisfactory terms, which could impair manufacturing and distribution of our products or result in a loss of sales, which could adversely impact our business, financial condition, or results of operations. The terms and conditions of existing, renegotiated, or new collective bargaining agreements could also increase our costs or otherwise affect our ability to fully implement future operational changes to enhance our efficiency or to adapt to changing business needs or strategy.

Our intellectual property rights are valuable, and any inability to protect them could reduce the value of our products and brands.

We consider our intellectual property rights, particularly our trademarks, but also our copyrights, registered domain names, and proprietary trade secrets, technology, know-how, processes and other proprietary rights to be a significant and valuable aspect of our business. We attempt to protect our intellectual property rights by relying on a combination of trademark, copyright, trade dress, trade secret, and other intellectual property laws, and domain name dispute resolution systems; as well as licensing agreements, third-party confidentiality, nondisclosure, and assignment agreements; and by policing third-party misuses of our intellectual property. Our failure to obtain or maintain adequate protection of our intellectual property rights, or any change in law or other changes that serve to lessen or remove the current legal protections of our intellectual property, may diminish our competitiveness and could materially harm our business.

We also face the risk of claims that we have infringed third parties' intellectual property rights. Any claims of intellectual property infringement, even those without merit, could be expensive and time consuming to defend, cause us to cease making, licensing, or using products that incorporate the challenged intellectual property, require us to redesign or rebrand our products or packaging, divert management's attention and resources, or require us to enter into royalty or licensing agreements to obtain the right to use a third party's intellectual property. Any royalty or licensing agreements, if required, may not be available to us on acceptable terms or at all. Additionally, a successful claim of infringement against us could result in our being required to pay significant damages, enter into costly license or royalty agreements, or stop the sale of certain products, any of which could have a negative effect on our results of operations.

The Smolyansky family controls a majority of our common stock and has the ability to control the outcome of matters submitted for stockholder approval.

A majority of our common stock is controlled by members of the Smolyansky family, and collectively, they have the ability to control the outcome of stockholder votes, including the election of all of our directors and the approval or rejection of any merger, change of control, or other significant corporate transaction. No person interested in acquiring Lifeway will be able to do so without obtaining the consent of the Smolyansky family. We believe that having the Smolyansky family as a significant part of a long-term-focused, committed, and engaged stockholder base provides us with an important strategic advantage, particularly in a business with a mature, well-recognized brand. This advantage could be eroded or lost, however, should Smolyansky family members cease, collectively, to be controlling stockholders of Lifeway. We desire to remain independent and family-owned, and we believe the Smolyansky family shares these interests. However, the Smolyansky family's interests may not always be aligned with other stockholders' interests. By exercising their control, the Smolyansky family could cause Lifeway to take actions that are at odds with the investment goals of institutional, short-term, non-voting, or other non-controlling investors, or that have a negative effect on our stock price.

Because the Smolyansky family, collectively, controls a majority of our common stock (approximately 50.1%), we are considered a "controlled company" under Nasdaq Listing Rules. Controlled companies are exempt from Nasdaq listing standards that require a board composed of a majority of independent directors, a fully independent nominating/corporate governance committee, and a fully independent compensation committee. Our Board of Directors has determined that Lifeway will avail itself of these exemptions, though we currently maintain a Board composed of a majority of independent directors. As a result of the controlled company exemption, our corporate governance practices differ from those of non-controlled companies, which are subject to all of the Nasdaq corporate governance requirements. Specifically, while we continue to maintain a majority of independent directors on the Board and to ensure that a committee of those independent directors select director nominees and determine the compensation of our officers, we have not, in the past, maintained separate compensation or nominating committees. In May, 2020, the Board of Directors formed a separate Compensation Committee and adopted a Compensation Committee Charter. In the event we cease to be a controlled company, we will be required to comply with all of the corporate governance standards under Nasdaq's rules, subject to applicable transition periods.

RISKS RELATED TO OUR INDUSTRY

The consolidation of our customers or the loss of any of our largest customers could negatively impact our sales and results of operations.

Customers, such as supermarkets and food distributors, continue to consolidate. This consolidation has produced larger, more sophisticated organizations with increased negotiating and buying power that are able to resist price increases or demand increased promotional programs, as well as operate with lower inventories, decrease the number of brands that they carry and increase their emphasis on private label products, all of which could negatively impact our business. The consolidation of retail customers also increases the risk that a significant adverse impact on their business could have a corresponding material adverse impact on our business.

Two of our customers together accounted for 21% of our net sales in the fiscal year ended December 31, 2020. Where we enter into written agreements with our customers, they are generally terminable after short notice periods by the customer. In addition, our customers sometimes award contracts based on competitive bidding, which could result in lower profits for contracts we win and the loss of business for contracts we lose. The loss of any large customer, the reduction of purchasing levels, or the cancellation of any business from a large customer for an extended period of time could negatively affect our sales and results of operations.

We rely on sales made by or through our independent distributors to customers. Distributors purchase directly for their own account for resale. The loss of, or business disruption at, one or more of these distributors may harm our business. If we are required to obtain additional or alternative distribution agreements or arrangements in the future, we cannot be certain that we will be able to do so on satisfactory terms or in a timely manner. Our inability to enter into satisfactory distribution agreements may inhibit our ability to implement our business plan or to establish markets necessary to expand the distribution of our products successfully.

We are subject to the risk of product contamination and product liability claims, which could harm our reputation, force us to recall products and incur substantial costs.

The sale of food products for human consumption involves the risk of injury to consumers. Such injuries may result from tampering by unauthorized third parties, inadvertent mislabeling, product contamination or spoilage including the presence of foreign objects, substances, chemicals, other agents, or residues introduced during the storage, processing, handling or transportation phases. We also may be subject to liability if our products or production processes violate applicable laws or regulations, including environmental, health, and safety requirements, or in the event our products cause injury, illness, or death.

Under certain circumstances, we may be required to recall or withdraw products, suspend production of our products, or cease operations, which may lead to a material adverse effect on our business. In addition, customers may cancel orders for such products as a result of such events. Even if a situation does not necessitate a recall or market withdrawal, and even if we and each of our co-packers and suppliers comply in all material respects with all applicable laws and regulations, we may become subject to claims or lawsuits relating to such matters. Even if a product liability claim is unsuccessful or is not fully pursued, the negative publicity surrounding any assertion that our products caused illness or physical harm, including the risk of reputational harm being magnified and/or distorted through the rapid dissemination of information over the Internet, including through news articles, blogs, chat rooms, and social media, could adversely affect our reputation with existing and potential customers and consumers and our corporate and brand image. Moreover, claims or liabilities of this type might not be covered by our insurance or by any rights of indemnity or contribution that we may have against others. We maintain product liability and product recall insurance in amounts that we believe to be adequate. However, we cannot be sure that we will not incur claims or liabilities for which we are not insured or that exceed the amount of our insurance coverage. A product liability judgment against us or a product recall could have a material adverse effect on our business, consolidated financial condition, results of operations or liquidity.

We rely on independent certification for several of our products and facilities.

We rely on independent certification, such as certifications of our products as “organic”, or “gluten-free,” to differentiate our products from others. The loss of any independent certifications could adversely affect our market position as a probiotic-based products and natural, “better for you” foods company, which could harm our business. We rely on independent SQF certification at some of our facilities, a certification that some of our customers require us to maintain.

We must comply with the requirements of independent organizations or certification authorities in order to label our products as certified. For example, we can lose our “organic” certification if a manufacturing plant becomes contaminated with non-organic materials, or if it is not properly cleaned after a production run. In addition, all organic raw materials must be certified organic or organic compliant. Our products could lose their organic certifications if our raw material suppliers lose their organic certifications. Similarly, we could lose our SQF certification if we do not meet the requirements of the SQF Code. The loss of these certifications could cause us to lose customers that require Lifeway products and/or facilities to carry some or all of them, which could negatively affect our sales and results of operations.

Increases in the cost of raw milk could reduce our gross margin and profit.

Conventional and organic raw milk, our primary raw material, is an agricultural commodity that is subject to price fluctuations. Although both conventional and organic milk prices in fiscal 2020 were lower than the prior year, there can be no assurance that such prices will remain at these levels in the future. The supply and price of raw milk may be impacted by, among other things, weather, natural disasters, real or perceived supply shortages, lower dairy and crop yields, general increases in farm inputs and costs of production, political and economic conditions, labor actions, government actions, and trade barriers. Increases in the market price for raw milk or over-order premiums charged by producers may also impact our ability to enter into purchase commitments at a fixed price. There can be no assurance that our purchasing practices will mitigate future price risk. As a result, increases in the cost of raw milk could have an adverse impact on our profitability.

In addition, the dairy industry continues to experience periodic imbalances between supply and demand for organic raw milk. Industry regulation and the costs of organic farming compared to costs of conventional farming can impact the supply of organic raw milk in the market. Oversupply levels of organic raw milk can increase competitive pressure on our products and pricing, while supply shortages can cause higher input costs and reduce our ability to deliver product to our customers. Cost increases in raw materials and other inputs could cause our profits to decrease significantly compared to prior periods, as we may be unable to increase our prices to offset the increased cost of these raw materials and other inputs. If we are unable to obtain raw materials and other inputs for our products or offset any increased costs for such raw materials and inputs, our business could be negatively affected.

Reduced availability of raw materials and other inputs, as well as increased costs for them, could adversely affect us.

Our business depends heavily on raw materials and other inputs in addition to conventional and organic raw milk, such as sweeteners, diesel fuel, packaging material, resin, and other commodities. Our raw materials are generally sourced from third-party suppliers, and we are not assured of continued supply, pricing, or exclusive access to raw materials from any of these suppliers. In addition, some of our raw materials are also agricultural products, and therefore subject to the same vulnerabilities described above for raw milk. Other events that adversely affect our third-party suppliers and that are out of our control could also impair our ability to obtain the raw materials and other inputs that we need in the quantities and at the prices that we desire. Such events include problems with our suppliers' businesses, finances, labor relations, costs, production, insurance, and reputation.

The organic ingredients we use in some of our products are less plentiful and available from a fewer number of suppliers than their conventional counterparts. Competition with other manufacturers in the procurement of organic product ingredients may increase in the future if consumer demand for organic products increases.

Our business is subject to various food, environmental, and health and safety laws and regulations, which may increase our compliance costs, subject us to liabilities, or otherwise adversely affect our business.

Our business operations are subject to numerous requirements in the United States relating to food safety, production, and marketing, as well as the protection of the environment, and health and safety matters. The food production and marketing industry is subject to a variety of federal, state, local, and foreign laws and regulations, including food safety requirements related to the ingredients, manufacture, processing, storage, marketing, advertising, labeling, and distribution of our products, as well as those related to worker health and workplace safety. Our activities, both in and outside of the United States, are subject to extensive regulation. We are regulated by, among other federal and state authorities, the FDA, USDA, the U.S. Federal Trade Commission ("FTC"), and the U.S. Departments of Commerce, and Labor, as well as by similar authorities in the foreign countries in which we do business. Environmental laws including the Clean Air Act, the Clean Water Act, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, and the National Organic Standards of the U.S. Department of Agriculture, as well as similar state and local statutes and regulations in the United States and in each of the foreign countries in which we do business apply to our business operations as well. These laws and regulations govern, among other things, air emissions and the discharge of wastewater and other pollutants, the use of refrigerants, the handling and disposal of hazardous materials, and the cleanup of contamination in the environment.

In addition, the marketing and advertising of our products could make us the target of claims relating to alleged false or deceptive advertising under federal, state, and foreign laws and regulations, and we may be subject to initiatives that limit or prohibit the marketing and advertising of our products to children.

We are also subject to federal laws and regulations relating to our organic products and production. For example, as required by the National Organic Program ("NOP"), we rely on third parties to certify certain of our products and production locations as organic. Regulations and formal and informal positions taken by the NOP pursuant to the Organic Foods Production Act of 1990, which created the NOP, are subject to continued review and scrutiny.

Changes in these laws or regulations or the introduction of new laws or regulations could increase our compliance costs, increase other costs of doing business for us, our customers, or our suppliers, or restrict our actions, which could adversely affect our results of operations. In some cases, new laws and regulations or other federal and state regulatory initiatives could interrupt distribution of our products or force changes in our production processes and our products. Governmental regulations also affect taxes and levies, healthcare costs, energy usage, immigration, and other labor issues, all of which may have a direct or indirect effect on our business or those of our customers or suppliers. These costs could negatively affect our results of operations and financial condition. Further, if we are found to be in violation of applicable laws and regulations in these areas, we could be subject to civil remedies, including third-party claims for property damage or personal injury, fines, injunctions, recalls, clean up costs, and other civil sanctions, as well as potential criminal sanctions, any of which could have a material adverse effect on our business.

RISKS RELATED TO COVID-19 AND OTHER PANDEMIC OR DISEASE OUTBREAKS

Pandemics or disease outbreaks, such as the novel coronavirus (COVID-19 virus), may disrupt consumption and trade patterns, supply chains, and production processes, which could materially affect our operations and results of operations.

The ultimate impact that the COVID-19 pandemic or any future pandemic or disease outbreak will have on our business and our consolidated results of operations is uncertain.

To date we have seen increased customer and consumer demand for our products as consumers initially began pantry loading and have increased their at-home consumption as a result of social distancing and stay-at-home and work-from-home mandates and recommendations. However, this increased customer and consumer demand may decrease in the coming months if and when the need for social distancing and stay-at-home and work-from-home mandates and recommendations decrease, and we are unable to predict the nature and timing of when that impact may occur, if at all. .

Although to date we have not experienced supply chain constraints, and we have continued to be able to fully satisfy customer and consumer demand for our products, the continued unprecedented demand for food and other consumer packaged goods products as a result of the COVID-19 pandemic or any future pandemic may limit the availability of, or increase the cost of, ingredients, packaging and other raw materials necessary to produce our products, and our operations may be negatively impacted. Additionally, pandemics or disease outbreaks could result in a widespread health crisis that could adversely affect economies and financial markets, consumer spending and confidence levels resulting in an economic downturn that could affect customer and consumer demand for our products.

Our efforts to manage and mitigate these factors may be unsuccessful, and the effectiveness of these efforts depends on factors beyond our control, including the duration and severity of any pandemic or disease outbreak, as well as third party actions taken to contain its spread and mitigate public health effects.

The ultimate impact of the COVID-19 pandemic on our business will depend on many factors, including, among others, the duration of social distancing and stay-at-home and work-from-home mandates and recommendations and whether additional waves of COVID-19 or different variants of COVID-19 will affect the United States and other markets, our ability and the ability of our suppliers to continue to operate our and their manufacturing facilities and maintain the supply chain without material disruption and procure ingredients, packaging and other raw materials when needed despite unprecedented demand in the food industry, and the extent to which macroeconomic conditions resulting from the pandemic and the pace of the subsequent recovery may impact consumer eating and shopping habits. We cannot predict the duration or scope of the disruption. Therefore, the financial impact cannot be reasonably estimated at this time.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

We operate the following facilities:

Location	Owned / Leased	Principal Use
Morton Grove, Illinois	Owned	Production of kefir and cheese, principal executive offices
Waukesha, Wisconsin	Owned	Production of kefir, administrative offices
Niles, Illinois	Owned	Distribution center, administrative offices
Philadelphia, Pennsylvania	Owned	Production of kefir and cheese, administrative offices
Chicago, Illinois	Leased	2 Retail stores

Lifeway believes that its facilities are adequate for its current needs and that suitable additional space will be available on commercially acceptable terms as required. We believe that we have adequate insurance coverage for all our properties.

ITEM 3 LEGAL PROCEEDINGS

From time to time we are engaged in litigation matters arising in the ordinary course of business. While the results of litigation and claims cannot be predicted with certainty, Lifeway believes that no such matter is reasonably likely to have a material adverse effect on our financial position or results of operations.

ITEM 4 MINE SAFETY DISCLOSURES

Not applicable.

PART II**ITEM 5 MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock is listed on the Nasdaq Global Market under the symbol "LWAY." Trading commenced on March 29, 1988. As of March 8, 2021, there were approximately 59 holders of record of Lifeway's Common Stock, one of which was Cede & Co., a nominee for Depository Trust Company, or DTC, and 75 financial institutions as nominees for beneficial owners or in "street name" the shares of which were deposited into participant accounts at DTC and are considered to be held of record by Cede & Co. as one stockholder.

Common stock price

The following table shows the high and low sale prices per share of our common stock as reported on the Nasdaq Global Market for each quarter during the two most recent fiscal years:

	Common Stock Price Range			
	2019			
	Low		High	
First Quarter	\$	1.98	\$	2.75
Second Quarter	\$	1.94	\$	4.00
Third Quarter	\$	2.19	\$	3.59
Fourth Quarter	\$	1.87	\$	2.44
	2020			
	Low		High	
First Quarter	\$	1.50	\$	2.65
Second Quarter	\$	1.71	\$	2.99
Third Quarter	\$	2.30	\$	7.45
Fourth Quarter	\$	4.61	\$	7.81

Dividend Policy

Lifeway does not routinely declare and pay dividends. From time to time however our Board of Directors may declare and pay dividends depending on our operating cash flow, financial condition, capital requirements and such other factors as the Board of Directors may deem relevant.

There were no dividends declared or paid in fiscal 2020 or 2019.

Issuer Purchases of Equity Securities

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of a publicly announced program (a)	Approximate Dollar Value of Shares that may yet be Purchased Under the Plans or Programs (\$ in thousands)
1/1/2019 to 1/31/2019	46,743	\$ 2.54	46,743	\$ 4,384
2/1/2019 to 2/28/2019	9,100	\$ 2.75	9,100	\$ 4,358
3/1/2019 to 3/31/2019	26,932	\$ 2.24	26,932	\$ 4,298
4/1/2019 to 4/30/2019	4,300	\$ 2.24	4,300	\$ 4,288
5/1/2019 to 5/31/2019	57,817	\$ 2.49	57,817	\$ 4,145
6/1/2019 to 6/30/19	11,146	\$ 2.32	11,146	\$ 4,119
8/1/2019 to 8/31/19	37,567	\$ 2.69	37,567	\$ 4,018
9/1/2019 to 9/30/19	17,531	\$ 2.98	17,531	\$ 3,965
Fiscal Year 2019	211,136	\$ 2.55	211,136	\$ 3,965
1/1/2020 to 1/31/2020	97,739	\$ 2.33	97,739	\$ 3,738
2/1/2020 to 2/28/2020	35,198	\$ 2.49	35,198	\$ 3,650
3/1/2020 to 3/31/2020	45,469	\$ 1.98	45,469	\$ 3,560
4/1/2020 to 4/30/2020	11	\$ 2.01	11	\$ 3,560
Fiscal Year 2020	178,417	\$ 2.27	178,417	\$ 3,560

- (a) During the fourth quarter of 2015, Lifeway publicly announced a share repurchase program. On November 1, 2017, the our Board of Directors amended the 2015 stock repurchase program (the “2017 amendment”), by adding to (i.e., exclusive of the shares previously authorized under the 2015 stock program repurchase) the authorization the lesser of \$5,185 or 625 shares. The program has no expiration date. As of April 2020, the Company had reached the amended threshold of 625 shares and therefore no shares of common stock remain available to be purchased under the 2017 Repurchase Plan Amendment.

ITEM 6 SELECTED FINANCIAL DATA

Not applicable

ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of the financial condition and results of operations for the years ended December 31, 2020 and December 31, 2019 should be read in conjunction with the audited consolidated financial statements and the notes to those statements that are included elsewhere in this report on Form 10-K. In addition to historical information, the following discussion contains certain forward-looking statements within the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These statements relate to our future plans, objectives, expectations and intentions. These statements may be identified by the use of words such as "may," "could," "believe," "future," "depend," "expect," "will," "result," "can," "remain," "assurance," "subject to," "require," "limit," "impose," "guarantee," "restrict," "continue," "become," "predict," "likely," "opportunities," "effect," "change," "future," "predict," and "estimate," and similar terms or terminology, or the negative of such terms or other comparable terminology. Although we believe the expectations expressed in these forward-looking statements are based on reasonable assumptions within the bounds of our knowledge of our business, our actual results could differ materially from those discussed in these statements. Factors that could contribute to such differences include, but are not limited to, those discussed in the "Risk Factors" section in Part I, Item 1A. We undertake no obligation to update publicly any forward-looking statements for any reason even if new information becomes available or other events occur in the future.

Results of Operations

Comparison of Year Ended December 31, 2020 to Year Ended December 31, 2019 (in 000's)

	December 31,		Change	
	2020	2019	\$	%
Net sales	\$ 102,026	\$ 93,662	\$ 8,364	8.9%
Cost of goods sold	\$ 72,006	\$ 68,367	\$ (3,639)	–
Depreciation expense	3,087	3,146	59	–
Total cost of goods sold	75,093	71,513	(3,580)	(5.0%)
Gross profit	\$ 26,933	\$ 22,149	\$ 4,784	21.6%
<i>Gross Profit % to net sales</i>	<i>26.4%</i>	<i>23.6%</i>		
Selling expenses	\$ 10,197	\$ 11,062	\$ 865	7.8%
<i>Selling expenses % to net sales</i>	<i>10.0%</i>	<i>11.8%</i>		
General & administrative expenses	11,661	12,828	1,167	9.1%
<i>General & administrative % to net sales</i>	<i>11.4%</i>	<i>13.7%</i>		
Amortization expense	152	192	40	20.8%
Total operating expenses	\$ 22,010	\$ 24,082	\$ 2,072	8.6%
<i>Total operating expense % to net sales</i>	<i>21.6%</i>	<i>25.7%</i>		
Income (loss) from operations	\$ 4,923	\$ (1,933)	\$ 6,856	354.7%
<i>Income (loss) from operations % to net sales</i>	<i>4.8%</i>	<i>(2.1%)</i>		

Net Sales

Net sales were \$102,026 for the year ended December 31, 2020, an increase of \$8,364 or 8.9% versus prior year. The net sales increase was primarily driven by higher volumes of our branded drinkable kefir, partially offset by lower cream revenues associated with a decline in the market price of butter fat.

Gross Profit

Gross profit as a percentage of net sales increased to 26.4% during the year ended December 31, 2020 from 23.6% during the same period in 2019. The increase versus the prior year was primarily due to the impact of favorable milk pricing, and to a lesser extent favorable freight costs.

Selling Expenses

Selling expenses decreased by \$865 or 7.8% to \$10,197 during the year ended December 31, 2020 from \$11,062 during the same period in 2019. The decrease versus prior year primarily reflects a reduction in advertising and marketing expense, such as trade shows and other marketing events which were postponed due to COVID-19 and the lower planned spending on in-store demonstrations in 2020 compared to 2019. Selling expenses as a percentage of net sales were 10.0% during the year ended December 31, 2020 compared to 11.8% for the same period in 2019.

General and Administrative Expenses

General and administrative expenses decreased \$1,167 or 9.1% to \$11,661 during the year ended December 31, 2020 from \$12,828 during the same period in 2019. The decrease is primarily a result of lower compensation expense due to organizational changes made in 2019 and lower incentive compensation, partially offset by increased professional fee expense.

Provision for Income Taxes

The provision for income taxes includes federal, state and local income taxes. Income tax expense was \$1,596 and \$782 during the year ended December 31, 2020 and 2019, respectively.

Our effective income tax rate (ETR) for the year ended December 31, 2020 was 33.1% compared to an ETR of 63.3% in the same period last year. The decrease in effective tax rate is primarily the result of separate state tax rates, non-deductible compensation expense related to equity incentive awards, the provision for unrecognized tax benefits and a benefit recognized in 2020 due to the enactment of the "Coronavirus Aid, Relief, and Economic Security Act" (the CARES Act). The Company consistently reflects non-deductible officer compensation expense, non-deductible compensation expense related to equity incentive awards and separate state tax rates from year to year. Although similar items were reflected in 2019, the percentage effect is substantially different due to the difference in pre-tax income in 2020 compared to 2019.

Our effective tax rate may change from period to period based on recurring and non-recurring factors including the relative mix of pre-tax earnings (or losses), the underlying income tax rates applicable to various state and local taxing jurisdictions, enacted tax legislation, the impact of non-deductible items, changes in valuation allowances, and the expiration of the statute of limitations in relation to unrecognized tax benefits. We record discrete income tax items such as enacted tax rate changes in the period in which they occur.

Section 162(m) of the Internal Revenue Code (the "Code") limits the deductibility of compensation paid to certain of our executives. Under the Tax Cuts and Jobs Act (the "Act") amendments to Section 162(m), no tax deduction in taxable years beginning after December 31, 2017 is allowed for compensation paid to any covered employee to the extent that the total compensation for that covered employee exceeds \$1,000,000 in any taxable year. Although the Act eliminated the prior tax deduction under Section 162(m) for performance-based executive compensation, it included a transition rule under which the changes to Section 162(m) will not apply to awards made to our covered employees who had the right to participate in our 2015 Omnibus Incentive Plan pursuant to written binding contracts in effect as of November 2, 2017, as long as those contracts have not subsequently been modified in any material respect. Accordingly, subject to further guidance from the Treasury Department and the Internal Revenue Service ("IRS"), the performance-based compensation paid to our executives under our Omnibus Plan remained eligible for the Section 162(m) exemption in 2019. Beginning in 2020, compensation exceeding the threshold for covered employees is non-deductible for income tax purposes.

Income taxes are discussed in Note 10 in the Notes to the Consolidated Financial Statements.

Net Income (Loss)

We reported net income of \$3,232 or \$0.21 per basic and diluted common share for the year ended December 31, 2020 compared to net income of \$453 or \$0.03 per basic and diluted common share in the same period in 2019.

Liquidity and Capital Resources

The ultimate impact that the COVID-19 pandemic or any future pandemic or disease outbreak will have on our business and our consolidated results of operations is uncertain.

To date we have seen increased customer and consumer demand for our products as consumers initially began pantry loading and have increased their at-home consumption as a result of social distancing and stay-at-home and work-from-home mandates and recommendations. However, this increased customer and consumer demand may decrease in the coming months if and when the need for social distancing and stay-at-home and work-from-home mandates and recommendations decrease, and we are unable to predict the nature and timing of when that impact may occur, if at all. .

Although to date we have not experienced supply chain constraints, and we have continued to be able to fully satisfy customer and consumer demand for our products, the continued unprecedented demand for food and other consumer packaged goods products as a result of the COVID-19 pandemic or any future pandemic may limit the availability of, or increase the cost of, ingredients, packaging and other raw materials necessary to produce our products, and our operations may be negatively impacted. Additionally, pandemics or disease outbreaks could result in a widespread health crisis that could adversely affect economies and financial markets, consumer spending and confidence levels resulting in an economic downturn that could affect customer and consumer demand for our products.

Our efforts to manage and mitigate these factors may be unsuccessful, and the effectiveness of these efforts depends on factors beyond our control, including the duration and severity of any pandemic or disease outbreak, as well as third party actions taken to contain its spread and mitigate public health effects.

The ultimate impact of the COVID-19 pandemic on our business will depend on many factors, including, among others, the duration of social distancing and stay-at-home and work-from-home mandates and recommendations and whether additional waves of COVID-19 or different variants of COVID-19 will affect the United States and other markets, our ability and the ability of our suppliers to continue to operate our and their manufacturing facilities and maintain the supply chain without material disruption and procure ingredients, packaging and other raw materials when needed despite unprecedented demand in the food industry, and the extent to which macroeconomic conditions resulting from the pandemic and the pace of the subsequent recovery may impact consumer eating and shopping habits. We cannot predict the duration or scope of the disruption. Therefore, the financial impact cannot be reasonably estimated at this time.

To date, our manufacturing facilities have not been significantly impacted. We have full production capacity available at all locations at this time. On March 16, 2020, the food industry, including grocery stores and their suppliers, and transportation were classified by the U.S. federal government as critical infrastructure industry. As a result, our employees and facilities, as well as the retailers and distributors that sell our products, will be able to remain in operation. During the first quarter of 2020, Management, anticipating the spread of Covid-19 and its effects, implemented a plan to mitigate effects of Covid-19 on supply and transportation of materials used to make and package our products, staffing, and transportation of our products to customers. While the situation is fluid, we have evaluated all manufacturing locations and do not anticipate any staffing shortages or interruption of our production, transportation and sale of products in the near term.

Cash Flow

At this time, the COVID-19 pandemic has not materially impacted on our operations. We expect to meet our foreseeable liquidity and capital resource requirements through anticipated cash flows from operations; our revolving credit facility; and cash and cash equivalents to ensure the continuation of the Company as a going concern. The success of our business and financing strategies will continue to provide us with the financial flexibility to take advantage of various opportunities as they arise. Given the dynamic nature of COVID-19, we will continue to assess our liquidity needs while continuing to manage our discretionary spending and investment strategies.

Sources and Uses of Cash

Lifeway had a net increase in cash and cash equivalents of \$4,090 during the year ended December 31, 2020 and a net increase in cash and cash equivalents of \$838 in the same period in 2019. The drivers of the year over year change are as follows:

Net cash provided by operating activities was \$6,385 and \$3,811 during the year ended December 31, 2020 and 2019, respectively. The increase in cash provided by operating activities is primarily due to the increase in cash generated through higher revenues and reduced expenses in 2020, offset by the change in working capital.

Net cash used in investing activities was \$1,890 during the year ended December 31, 2020 compared to net cash provided by investing activities of \$838 in the same period in 2019. The increase of net cash used in investing activities in 2020 reflects higher capital spending. In addition, during 2019, the Company tendered approximately 45.6% of one of its investments recorded under the cost method on the consolidated balance sheets for cash proceeds of \$1,509. See financing section below for use of those proceeds. We received net proceeds of \$474 related to the sale of our Skokie, IL facility during 2019. Capital spending was \$1,895 during the year ended December 2020 compared to \$1,178 in 2019. Our capital spending is focused in three core areas: growth, cost reduction, and facility improvements. Growth capital spending supports new product innovation and enhancements. Cost reduction and facility improvements support manufacturing efficiency, safety and productivity.

Net cash used in financing activities was \$405 and \$3,811 during the years ended December 31, 2020 and 2019, respectively. Under the terms of our line of credit agreement (see Note 7), we utilized proceeds from our federal and state income tax refunds to repay \$1,330 on our revolving line of credit during 2019. We utilized the proceeds from the sale of our Skokie, IL facility to repay \$459 on our revolving line of credit during 2019. We utilized proceeds from the sale of our investment described in the investing section above to make a mandatory prepayment of \$1,484 on our revolving line of credit during 2019.

On November 1, 2017, Lifeway's Board approved an increase in the aggregate amount under our previously announced 2015 stock repurchase program (the "2017 Repurchase Plan Amendment"), by adding to (i.e., exclusive of the shares previously authorized under the 2015 stock repurchase program) the authorization the lesser of \$5,185 or 625 shares. We repurchased approximately 179 shares of common stock at a cost of \$405 during the year ended December 31, 2020 under the 2017 Repurchase Plan Amendment. We repurchased approximately 211 shares of common stock at a cost of \$538 during the year ended December 31, 2019 under the 2017 Repurchase Plan Amendment. We may execute transactions from time to time in the open market or by private negotiation, in accordance with all applicable securities laws and regulations. We intend to hold repurchased shares in treasury for general corporate purposes, including issuances under our 2015 Omnibus Incentive Plan.

Debt Obligations

On September 30, 2020, Lifeway entered into the Third Modification to the Amended and Restated Loan and Security Agreement, as amended, (the "Third Modification") with its existing lender. The Third Modification amends the Amended and Restated Loan and Security Agreement, as amended, by removing the monthly borrowing base reporting requirement effective September 30, 2020, including a covenant to maintain a quarterly minimum working capital financial covenant, as defined, of no less than \$11.25 million each of the fiscal quarters commencing the fiscal quarter ended December 31, 2020 through the expiration date, and eliminating the tier interest pricing structure. The Amended and Restated Loan and Security Agreement continues to provide Lifeway with a revolving line of credit up to a maximum of \$5 million (the "Revolving Loan") and provides the Borrowers with an incremental facility not to exceed \$5 million (the "Incremental Facility" and together with the Revolving Loan, the "Loans"). The Termination Date of the Revolving Loan was extended to June 30, 2025, unless earlier terminated.

Except as described above, amended, the Modified Revolving Credit Facility remains substantively unchanged and in full force and effect, including customary representations, warranties, and covenants on the part of Lifeway, including financial covenants requiring us to maintain a fixed charge coverage ratio of no less than 1.25 to 1.00 each of the fiscal quarters ending through the expiration date. The Modified Revolving Credit Facility continues to provide for events of default, including failure to repay principal and interest when due and failure to perform or violation of the provisions or covenants of the agreement, as a result of which amounts due under the Modified Revolving Credit Facility may be accelerated.

As of December 31, 2020, we had \$2,768 net of \$9 of unamortized deferred financing costs, outstanding under the Revolving Credit Facility. We had \$2,223 available for future borrowings as of December 31, 2020.

As amended, all outstanding amounts under the Loans bear interest, at Lifeway's election, at either the lender Base Rate (the Prime Rate minus 1.00%) or the LIBOR plus 1.95%, payable monthly in arrears. Lifeway is also required to pay a quarterly unused line fee of 0.20% and, in conjunction with the issuance of any letters of credit, a letter of credit fee of 0.20%. Lifeway's interest rate on debt outstanding under our Revolving Credit Facility as of December 31, 2020 was 2.10%.

We are in compliance with all applicable financial debt covenants as of December 31, 2020. See Note 7 to our Consolidated Financial Statements for additional information regarding our indebtedness and related agreements.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet financing arrangements as defined in Item 303(a)(4) of Regulation S-K.

Contractual Obligations

Not applicable.

Critical Accounting Policies and Use of Estimates

Critical accounting policies are defined as those most important to the portrayal of a company's financial condition and results, and require the most difficult, subjective, or complex judgments. In many cases, the accounting treatment of a particular transaction is specifically dictated by US GAAP with no need for the application of our judgement. In certain circumstances, the preparation of our Consolidated Financial Statements in conformity with US GAAP requires us to use our judgment to make certain estimates and assumptions. These estimates affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of net sales and expenses during the reporting period. We believe in the quality and reasonableness of our critical accounting estimates; however, materially different amounts might be reported under different conditions or using assumptions, estimates or making judgments different from those that we have applied. Management has discussed the development and selection of these critical accounting policies, as well as our significant accounting policies (see Note 2 to the Consolidated Financial Statements), with the Audit Committee of our Board of Directors. We have identified the policies described below as our critical accounting policies.

Goodwill and intangible asset valuation

Goodwill totaled \$9,124 as of December 31, 2020. The Company completed its annual goodwill impairment analysis as of December 31, 2020. Our assessment did not result in an impairment. Goodwill represents the excess purchase price over the fair value of the net tangible and other identifiable intangible assets acquired. We estimate the fair value of our one reporting unit annually (as of December 31), or more frequently if certain conditions exist, using a combination of the fair values derived from both the income approach and the market approach. Under the income approach, we calculate the fair value of a reporting unit based on the present value of estimated future cash flows. Cash flow projections are based on our estimates of revenue growth rates and operating margins, taking into consideration industry and market conditions. The discount rate used to determine the present value of future cash flows is based on the weighted-average cost of capital adjusted for the relevant risk associated with business-specific characteristics and the uncertainty related to the business's ability to execute on the projected cash flows. The market approach estimates fair value based on market multiples of revenue and earnings derived from comparable publicly-traded companies with similar operating and investment characteristics. The resulting fair value, based on the income and market approaches, is then compared to the carrying value to determine if impairment is necessary.

We reviewed our indefinite lived intangible assets, which consist of brand names totaling \$3,700 as of December 31, 2020, using the relief from royalty method. Significant assumptions include the royalty rate, revenue growth rates, and discount rates. Our assumptions were based on historical performance and management estimates of future performance. Our assessment did not result in an impairment in 2020.

Sales discounts & allowance.

We offer various trade promotions and sales incentive programs to customers and consumers. From time to time, we grant certain sales discounts to customers which are classified as a reduction in sales. The measurement and recognition of discounts and allowances involve the use of judgment and our estimates are made based on historical experience and specific customer program accruals. Differences between estimated and actual discount and allowance costs are normally not material and are recognized in earnings in the period such differences are determined. The process for analyzing trade promotion programs could impact our results of operations and trade spending accruals depending on how actual results of the programs compare to original estimates. As of December 31, 2020, we had \$1 million of accrued discounts and allowances.

Share-based compensation.

Certain employees and non-employee directors receive various forms of share-based payment awards and we recognize compensation expense for these awards based on their grant date fair values. The fair values of stock option awards are estimated on the grant date using the Black-Scholes option pricing model, which incorporates certain assumptions regarding the expected term of an award and expected stock price volatility. The expected term is determined under the simplified method, using an average of the contractual term and vesting period of the stock options. The expected volatility is based on the historic volatility of our common stock. We do not estimate forfeitures in measuring the grant date fair value, but rather account for forfeitures as they occur. Key assumptions are described in further detail in Note 11 to our consolidated financial statements.

Income taxes.

We pay income taxes based on tax statutes, regulations, and case law of the various jurisdictions in which we operate. At any given time, multiple tax years are subject to audit by the various taxing authorities. Income taxes are accounted for under the asset and liability method. Deferred income tax assets and liabilities are recognized for the future tax effects of temporary differences between financial and income tax reporting using tax rates in effect for the years in which the differences are expected to reverse.

We recognize an income tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. The income tax benefit recognized in our financial statements from such a position is measured based on the largest estimated benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. These judgments and estimates made at a point in time may change based on the outcome of tax audits and changes to, or further interpretations of, regulations. If such changes take place, there is a risk that our tax rate may increase or decrease in any period, which would impact our earnings. Future business results may affect deferred tax liabilities or the valuation of deferred tax assets over time.

Recent Accounting Pronouncements.

See Note 2, Summary of Significant Accounting Policies, in the Notes to the Consolidated Financial Statements included in Item 8 of this Form 10-K for information regarding recent accounting pronouncements.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable

ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Stockholders of Lifeway Foods, Inc. and Subsidiaries:

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Lifeway Foods, Inc. and Subsidiaries (the "Company") as of December 31, 2020 and 2019, the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2020, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2020, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

Critical audit matters are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. We determined that there are no critical audit matters.

/s/ Mayer Hoffman McCann P.C.

We have served as the Company's auditor since 2015
Chicago, Illinois
March 25 2021

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
December 31, 2020 and 2019
(In thousands)

	December 31,	
	2020	2019
Current assets		
Cash and cash equivalents	\$ 7,926	\$ 3,836
Accounts receivable, net of allowance for doubtful accounts and discounts & allowances of \$1,350 and \$1,100 at December 31, 2020 and 2019, respectively	8,002	6,692
Inventories, net	6,930	6,392
Prepaid expenses and other current assets	1,163	1,598
Refundable income taxes	31	681
Total current assets	24,052	19,199
Property, plant and equipment, net	21,048	22,274
Operating lease right-of use asset	345	738
Intangible assets		
Goodwill and indefinite-lived intangibles	12,824	12,824
Other intangible assets, net	—	152
Total intangible assets	12,824	12,976
Other Assets	1,800	1,800
Total assets	\$ 60,069	\$ 56,987
Current liabilities		
Accounts payable	\$ 5,592	\$ 5,282
Accrued expenses	2,196	4,087
Accrued income taxes	653	154
Total current liabilities	8,441	9,523
Line of credit	2,768	2,745
Operating lease liabilities	165	488
Deferred income taxes, net	1,764	922
Other long-term liabilities	77	58
Total liabilities	13,215	13,736
Commitments and contingencies		
Stockholders' equity		
Preferred stock, no par value; 2,500 shares authorized; no shares issued or outstanding at 2020 and 2019	—	—
Common stock, no par value; 40,000 shares authorized; 17,274 shares issued; 15,604 and 15,710 shares outstanding at 2020 and 2019	6,509	6,509
Paid-in capital	2,600	2,380
Treasury stock, at cost	(12,450)	(12,601)
Retained earnings	50,195	46,963
Total stockholders' equity	46,854	43,251
Total liabilities and stockholders' equity	\$ 60,069	\$ 56,987

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
For the Years Ended December 31, 2020 and 2019
(In thousands, except per share data)

	<u>2020</u>	<u>2019</u>
Net sales	\$ 102,026	\$ 93,662
Cost of goods sold	72,006	68,367
Depreciation expense	3,087	3,146
Total cost of goods sold	<u>75,093</u>	<u>71,513</u>
Gross profit	<u>26,933</u>	<u>22,149</u>
Selling expenses	10,197	11,062
General and administrative	11,661	12,828
Amortization expense	152	192
Total operating expenses	<u>22,010</u>	<u>24,082</u>
Income (loss) from operations	<u>4,923</u>	<u>(1,933)</u>
Other income (expense):		
Interest expense	(118)	(249)
Fair value gain on investments	-	1,731
Realized gain on investments, net	4	1,413
(Loss) gain on sale of property and equipment	(28)	189
Other income	47	84
Total other (expense) income	<u>(95)</u>	<u>3,168</u>
Income before provision for income taxes	4,828	1,235
Provision for income taxes	<u>1,596</u>	<u>782</u>
Net income	<u>\$ 3,232</u>	<u>\$ 453</u>
Basic earnings per common share	<u>\$ 0.21</u>	<u>\$ 0.03</u>
Diluted earnings per common share	<u>\$ 0.21</u>	<u>\$ 0.03</u>
Weighted average number of shares outstanding - Basic	<u>15,597</u>	<u>15,748</u>
Weighted average number of shares outstanding - Diluted	<u>15,766</u>	<u>15,804</u>

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
For the Years Ended December 31, 2020 and 2019
(In thousands)

	Common Stock				Paid-In Capital	Retained Earnings	Total Equity
	Issued		In treasury				
	Shares	\$	Shares	\$			
Balance, January 1, 2019	17,274	\$ 6,509	(1,460)	\$ (12,970)	\$ 2,303	\$ 46,563	\$ 42,405
Cumulative impact of change in accounting principles, net of tax	-	-	-	-	-	(53)	(53)
Treasury stock purchased	-	-	(211)	(538)	-	-	(538)
Issuance of common stock in connection with stock-based compensation	-	-	107	907	(438)	-	469
Stock-based compensation	-	-	-	-	515	-	515
Net income	-	-	-	-	-	453	453
Balance, December 31, 2019	17,274	\$ 6,509	(1,564)	\$ (12,601)	\$ 2,380	\$ 46,963	\$ 43,251
Treasury stock purchased	-	-	(179)	(405)	-	-	(405)
Issuance of common stock in connection with stock-based compensation	-	-	74	556	(62)	-	494
Stock-based compensation	-	-	-	-	282	-	282
Net Income	-	-	-	-	-	3,232	3,232
Balance, December 31, 2020	17,274	\$ 6,509	(1,669)	\$ (12,450)	\$ 2,600	\$ 50,195	\$ 46,854

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2020 and 2019
(In thousands)

	<u>2020</u>	<u>2019</u>
<u>Cash flows from operating activities:</u>		
Net income	\$ 3,232	\$ 453
<i>Adjustments to reconcile net income to operating cash flow:</i>		
Depreciation and amortization	3,239	3,338
Non-cash interest expense	23	23
Non-cash rent expense	(37)	(17)
Bad debt expense	(6)	7
Deferred Revenue	(91)	(97)
Reserve for inventory obsolescence	–	(52)
Stock-based compensation	393	838
Deferred income taxes	841	533
Fair value gain on investment	–	(1,731)
Net gain on sale of investment	–	(1,413)
(Loss) gain on sale of property and equipment	28	(189)
<i>(Increase) decrease in operating assets:</i>		
Accounts receivable	(1,304)	(423)
Inventories	(538)	(523)
Refundable income taxes	649	2,067
Prepaid expenses and other current assets	423	(526)
<i>Increase (decrease) in operating liabilities:</i>		
Accounts payable	311	710
Accrued expenses	(1,278)	783
Operating lease asset amortization/liability	–	(17)
Accrued income taxes	500	47
Net cash provided by operating activities	<u>6,385</u>	<u>3,811</u>
<u>Cash flows from investing activities:</u>		
Purchases of investments	–	(15)
Proceeds from sale of investments	–	1,509
Purchases of property and equipment	(1,895)	(1,178)
Proceeds from sale of property and equipment	5	522
Net cash (used in) provided by investing activities	<u>(1,890)</u>	<u>838</u>
<u>Cash flows from financing activities:</u>		
Purchase of treasury stock	(405)	(538)
Repayment of line of credit	–	(3,273)
Net cash used in financing activities	<u>(405)</u>	<u>(3,811)</u>
Net increase in cash and cash equivalents	4,090	838
Cash and cash equivalents at the beginning of the period	3,836	2,998
Cash and cash equivalents at the end of the period	<u>\$ 7,926</u>	<u>\$ 3,836</u>
<u>Supplemental cash flow information:</u>		
Cash paid for income taxes, net of (refunds)	\$ (426)	\$ (1,865)
Cash paid for interest	99	259
Non-cash investing activities		
Right-of-use assets recognized at ASU 2016-02 transition	–	944
Operating lease liability recognized at ASU 2016-02 transition	–	997
Increase (decrease) in right-of-use assets and operating lease obligations	(44)	305

Non-cash financing activities

Issuance of common stock under equity incentive plans

522

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See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2020 and 2019
(In thousands)

Note 1 – Basis of presentation

The accompanying consolidated financial statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Our consolidated financial statements include all of the assets, liabilities and results of operations of Lifeway’s wholly owned subsidiaries (collectively “Lifeway” or the “Company”). All inter-company balances and transactions have been eliminated in the consolidated financial statements.

Note 2 – Summary of 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 valuation of goodwill and intangible assets, stock-based and incentive compensation, and deferred income taxes.

Going Concern

The Company follows the guidance in Accounting Standards Codification (“ASC”) 205-40, Presentation of Financial Statements - Going Concern which requires management to assess an entity’s ability to continue as a going concern and to provide related disclosure in certain circumstances. There were no conditions or events, when considered in the aggregate, that raise substantial doubt about the Company’s ability to continue as a going concern within one year after the date the financial statements are issued.

Revenue Recognition

We sell food and beverage products across select product categories to customers predominantly within the United States (see Note 12, Segments, Products and Customers). We also sell bulk cream, a byproduct of our fluid milk manufacturing process. In accordance with ASC 606, Revenue from Contracts with Customers, we recognize revenue when control over the products transfers to our customers, which generally occurs upon delivery to our customers or their common carriers. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these goods or services, using the five-step method required by ASC 606.

For the Company, the contract is the approved sales order, which may also be supplemented by other agreements that formalize various terms and conditions with customers. The Company applies judgment in determining the customer’s ability and intention to pay, which is based on a variety of factors including the customer’s historical payment experience or, in the case of a new customer, published credit and financial information pertaining to the customer.

Performance obligations promised in a contract are identified based on the goods or services that will be transferred to the customer, which is the delivery of food products which provide immediate benefit to the customer.

We account for product shipping and handling as fulfillment activities with revenues for these activities recorded within net revenue and costs recorded within cost of goods sold. Any taxes collected on behalf of government authorities are excluded from net revenues.

Variable consideration, which typically includes volume-based rebates, known or expected pricing or revenue adjustments, such as trade discounts, allowances for non-saleable products, product returns, trade incentives and coupon redemption, is estimated utilizing the most likely amount method.

Key sales terms, such as pricing and quantities ordered, are established on a frequent basis such that most customer arrangements and related incentives have a one year or shorter duration. As such, we do not capitalize contract inception costs and we capitalize product fulfillment costs in accordance with U.S. GAAP and our inventory policies. We do not have any significant deferred revenue or unbilled receivables at the end of a period. We generally do not receive noncash consideration for the sale of goods, nor do we grant payment financing terms greater than one year.

Accounts Receivable

We provide credit terms to customers in-line with industry standards and maintain allowances for potential credit losses based on historical experience. Customer balances are written off after all collection efforts are exhausted. Estimated product returns, which have not been material, are deducted from sales at the time of revenue recognition. The Company does not charge interest on past due accounts receivable.

Cash and cash equivalents

Lifeway considers cash and all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents are stated at cost, which approximates or equals fair value due to their short-term nature.

Lifeway from time to time may have bank deposits in excess of insurance limits of the Federal Deposit Insurance Corporation. Lifeway has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk related to its cash and cash equivalents.

Inventories

Inventories are stated at the lower of cost or net realizable value, valued on a first in, first out basis ("FIFO"). The costs of finished goods inventories include raw materials, direct labor, and overhead costs. Inventories are stated net of reserves for excess or obsolete inventory.

Property, plant and equipment

Property, plant and equipment are recorded at cost. Depreciation and amortization are calculated using the straight-line method over the estimated useful lives of the assets as follows:

Asset	Useful Life
Buildings and improvements	31 and 39 years
Machinery and equipment	5 – 12 years
Office equipment	3 – 7 years
Vehicles	5 years
Leasehold improvements	Shorter of expected useful life or lease term

We perform impairment tests when circumstances indicate that the carrying value of an asset may not be recoverable. Expenditures for repairs and maintenance, which do not improve or extend the life of the assets, are expensed as incurred.

Intangible Assets

Goodwill and indefinite-lived intangible assets

Goodwill represents the excess purchase price over the fair value of the net tangible and other identifiable intangible assets acquired. We estimate the fair value of our one reporting unit annually (as of December 31), or more frequently if certain conditions exist, using a combination of the fair values derived from both the income approach and the market approach. Under the income approach, we calculate the fair value of a reporting unit based on the present value of estimated future cash flows. Cash flow projections are based on our estimates of revenue growth rates and operating margins, taking into consideration industry and market conditions. The discount rate used to determine the present value of future cash flows is based on the weighted-average cost of capital adjusted for the relevant risk associated with business-specific characteristics and the uncertainty related to the business's ability to execute on the projected cash flows. The market approach estimates fair value based on market multiples of revenue and earnings derived from comparable publicly traded companies with similar operating and investment characteristics. The resulting fair value, based on the income and market approaches, is then compared to the carrying value to determine if impairment is necessary.

We assess whether indefinite-lived intangible asset impairment exists using both qualitative and quantitative assessments annually in the fourth quarter or more frequently, if certain conditions exist. The qualitative assessment involves determining whether events or circumstances exist that indicate it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount. If, based on this qualitative assessment, we determine it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount or if we elect not to perform a qualitative assessment, a quantitative assessment is performed to determine whether an indefinite-lived intangible asset impairment exists. We test the indefinite-lived intangible assets for impairment by comparing the carrying value to the fair value based on current revenue projections of the related operations, under the relief from royalty method. Any excess of the carrying value over the amount of fair value is recognized as an impairment. Any such impairment would be recognized in full in the reporting period in which it has been identified.

Definite lived intangible assets

Intangible assets acquired in a business combination are recorded at their estimated fair values at the date of acquisition. Identifiable intangible assets with finite lives are amortized over their estimate useful lives as follows:

Asset	Useful Life
Recipes	4 years
Trade names	8-15 years
Formula	10 years
Customer lists	5-10 years
Customer relationships	12 years

All amortization expense related to intangible assets is recorded in Amortization expense in the consolidated statements of operations.

Amortizable intangible assets are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Lifeway conducts more frequent impairment assessments if certain conditions exist, such as 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 our products or changes in the size of the market for our products. If an evaluation of the undiscounted cash flows indicates impairment, the asset is written down to its estimated fair value, which is generally based on discounted future cash flows. If the estimated remaining useful life of an intangible asset is changed, the remaining carrying amount of the intangible asset is amortized prospectively over the revised remaining useful life.

Fair value measurements

Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3. Inputs that are generally unobservable and typically reflect management's estimate of assumptions that market participants would use in pricing the asset or liability.

Lifeway's financial assets and liabilities that are not carried at fair value on a recurring basis include cash and cash equivalents, accounts receivable, other receivables, accounts payable, accrued expenses and revolving line of credit for which carrying value approximates fair value.

The Company records its investments in equity securities without a readily determinable fair value at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. During October 2019, the Company sold approximately 45.6% of one of its investments recorded under the cost method and recognized a \$1,438 gain on sale of investment, which is recorded in other income (expense) on the consolidated statements of operations. The Company also recorded an unrealized gain of \$1,731 resulting from the observable price change of this transaction, which is recorded in other income (expense) on the consolidated statements of operations. As of December 31, 2020, and 2019, the Company has one investment without a readily determinable fair value which is recorded at \$1,800 in other assets on the consolidated balance sheet.

Income taxes

The Provision for income taxes includes federal, state, local and foreign income taxes currently payable, and those deferred because of temporary differences between the financial statement and tax bases of assets and liabilities. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using enacted tax rates expected to apply to taxable income in the year in which the deferred tax assets or liabilities are expected to be realized or settled. The principal sources of temporary differences are different depreciation and amortization methods for financial statement and tax purposes, incentive compensation, unrealized gain, capitalization of indirect inventory costs for tax purposes, reserves for excess and obsolete inventory and the allowance for doubtful accounts.

Valuation allowances are recorded to reduce deferred tax assets when it is more likely not that a tax benefit will not be realized. Deferred income tax expense or benefit is based on the changes in the asset or liability from period to period.

Lifeway has analyzed filing positions in all the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. We recognize the income tax benefit from an uncertain tax position when it is more likely than not that, based on technical merits, the position will be sustained upon examination, including resolutions of any related appeals or litigation processes. We apply a more likely than not threshold to the recognition and derecognition of uncertain tax positions. Accordingly, we recognize the amount of tax benefit that has a greater than 50% likelihood of being ultimately realized upon settlement. Future changes in judgment related to the expected ultimate resolution of uncertain tax positions will affect earnings in the period of such change. For those income tax positions where it is not more likely than not that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. The total amount of unrecognized tax benefits can change due to audit settlements, tax examination activities, statute expirations and the recognition and measurement criteria under accounting for uncertainty in income taxes. Lifeway recognizes penalties and interest related to unrecognized tax benefits in the provision (benefit) for income taxes in the consolidated statements of operations.

Share-based compensation

Share-based compensation expense is recognized for equity awards over the vesting period based on their grant date fair value. The fair value of restricted stock awards is equal to the closing price of our stock on the date of grant. We do not estimate forfeitures in measuring the grant date fair value, but rather account for forfeitures as they occur. The Company issues share based equity awards from treasury shares.

Treasury stock

Treasury stock is recorded using the cost method.

Advertising costs

Lifeway expenses advertising costs as incurred and reported in Selling expense in our consolidated statements of operations. For the years ended December 31, 2020 and 2019 total advertising expenses were \$2,407 and \$3,394, respectively.

Earnings (loss) per common share

Basic earnings (loss) per common share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares issued and outstanding during the reporting period. Diluted earnings (loss) per common share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares issued and outstanding and the effect of all dilutive common stock equivalents related to the Company's outstanding stock-based compensation awards outstanding during the reporting period. For the years ended December 31, 2020 and 2019, there were 169 and 56 common stock equivalents outstanding, respectively.

Recent accounting pronouncements

Issued by not yet effective

In March 2020, the FASB issued Accounting Standards Update ("ASU") No. 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting. The new guidance provides optional expedients and exceptions for applying generally accepted accounting principles (GAAP) to contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform. The guidance will be effective prospectively as of March 12, 2020 through December 31, 2022 and interim periods within those fiscal years. Management is currently evaluating the impact that the new guidance will have on the consolidated financial statements.

In December 2019, the FASB issued ASU No. 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes. The new guidance is intended to enhance and simplify various aspects of the accounting for income taxes. The new guidance eliminates certain exceptions to the general approach to the income tax accounting model and adds new guidance to reduce the complexity in accounting for income taxes. The guidance will be effective for fiscal years beginning after December 15, 2020 and interim periods within those fiscal years. Early adoption of the amendments is permitted, including adoption in any interim period for public business entities for periods for which financial statements have not yet been issued. Management does not anticipate the adoption of this ASU will have a material impact on our consolidated financial statements and disclosures.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, in November 2018 issued an amendment, ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments - Credit Losses, and in November 2019 issued two amendments, ASU 2019-10, Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates, and ASU 2019-11, Codification Improvements to Topic 326, Financial Instruments—Credit Losses. The series of new guidance amends the impairment model by requiring entities to use a forward-looking approach based on expected losses rather than incurred losses to estimate credit losses on certain types of financial instruments, including trade receivables. This may result in the earlier recognition of allowances for losses. The guidance should be applied on either a prospective transition or modified-retrospective approach depending on the subtopic. The guidance is effective for annual periods beginning after December 15, 2022, including interim periods within those fiscal years, with early adoption permitted. Management is currently evaluating the impact that the new guidance will have on the consolidated financial statements.

Note 3 – Inventories, net

Inventories consisted of the following:

	December 31,	
	2020	2019
Ingredients	\$ 1,725	\$ 1,942
Packaging	2,234	2,230
Finished goods	2,971	2,220
Total inventories, net	<u>\$ 6,930</u>	<u>\$ 6,392</u>

Note 4 – Property, Plant and Equipment, net

Property, plant and equipment consisted of the following:

	December 31,	
	2020	2019
Land	\$ 1,565	\$ 1,565
Buildings and improvements	17,834	17,332
Machinery and equipment	31,707	30,670
Vehicles	778	778
Office equipment	857	851
Construction in process	228	362
	<u>52,969</u>	<u>51,558</u>
Less accumulated depreciation	(31,921)	(29,284)
Total property, plant and equipment, net	<u>\$ 21,048</u>	<u>\$ 22,274</u>

Note 5 – Goodwill and Intangible Assets

Goodwill and indefinite-lived intangible assets consisted of the following:

	December 31,	
	2020	2019
Goodwill	\$ 10,368	\$ 10,368
Accumulated impairment losses	(1,244)	(1,244)
Goodwill	9,124	9,124
Brand names	3,700	3,700
Goodwill and indefinite lived intangible assets	<u>\$ 12,824</u>	<u>\$ 12,824</u>

Goodwill

The Company performed the annual impairment assessment of goodwill for our single reporting unit as of December 31, 2020 and 2019, noting no impairment loss. Considerable management judgment is necessary to evaluate goodwill for impairment. We estimate fair value using widely accepted valuation techniques including discounted cash flows and market multiples analysis with respect to our single reporting unit. These valuation approaches are dependent upon a number of factors, including estimates of future growth rates, our cost of capital, capital expenditures, income tax rates, and other variables. Assumptions used in our valuations were consistent with our internal projections and operating plans. Our discounted cash flows forecast could be negatively impacted by 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 our products or changes in the size of the market for our products. Additionally, under the market approach analysis, we used significant other observable inputs including various guideline company comparisons. We base our fair value estimates on assumptions we believe to be reasonable, but which are unpredictable and inherently uncertain. Changes in these estimates or assumptions could materially affect the determination of fair value and the conclusions of the quantitative goodwill test for our one reporting unit.

Indefinite-lived Intangible Assets

The Company performed the annual impairment assessment on the indefinite-lived intangible asset as of December 31, 2020 and 2019, resulting in no impairment losses.

Finite-lived Intangible Assets

Other intangible assets, net consisted of the following:

	December 31,	
	2020	2019
Recipes	\$ 44	\$ 44
Customer lists and other customer related intangibles	4,529	4,529
Customer relationships	985	985
Trade names	2,248	2,248
Formula	438	438
	<u>8,244</u>	<u>8,244</u>
Accumulated amortization	(8,244)	(8,092)
Intangible assets, net	<u>\$ –</u>	<u>\$ 152</u>

Note 6 – Accrued Expenses

Accrued expenses consisted of the following:

	December 31,	
	2020	2019
Payroll and incentive compensation	\$ 1,366	\$ 3,009
Real estate taxes	341	398
Current portion of operating lease liabilities	179	285
Other	310	395
Total accrued expenses	<u>\$ 2,196</u>	<u>\$ 4,087</u>

Note 7 – Debt*Line of Credit*

On May 7, 2018, Lifeway entered into an Amended and Restated Loan and Security Agreement (the “Revolving Credit Facility”) with its existing lender. On April 10, 2019, effective March 31, 2019, Lifeway entered into the First Modification to the Amended and Restated Loan and Security Agreement (the “Modified Revolving Credit Facility”) with its existing lender. Under the amendment, the Modified Revolving Credit Facility provides for a revolving line of credit up to a maximum of \$9 million (the “Revolving Loan”) with an incremental facility not to exceed \$5 million (the “Incremental Facility” and together with the Revolving Loan, the “Loans”).

On December 10, 2019, Lifeway entered into the Second Modification to the Amended and Restated Loan and Security Agreement, as amended, (the “Second Modification”) with its existing lender. The Second Modification amends the Amended and Restated Loan and Security Agreement, as amended, by redefining the “Borrowing Base” and further clarifying the definitions of “Eligible Accounts” and “Eligible Inventory.” The “Borrowing Base” under this amendment means, generally, an amount equal to the sum of (a) 85% of the unpaid amount of all eligible accounts receivable, plus (b) 50% of the value of all eligible inventory. The Second Modification also addresses the calculation of interest after the potential discontinuance of LIBOR and its replacement with a replacement benchmark interest rate.

On September 30, 2020, Lifeway entered into the Third Modification to the Amended and Restated Loan and Security Agreement, as amended, (the “Third Modification”) with its existing lender. The Third Modification amends the Amended and Restated Loan and Security Agreement, as amended, by removing the monthly borrowing base reporting requirement effective September 30, 2020, including a covenant to maintain a quarterly minimum working capital financial covenant, as defined, of no less than \$11.25 million each of the fiscal quarters commencing the fiscal quarter ending December 31, 2020 through the expiration date, and eliminating the tier interest pricing structure. The Amended and Restated Loan and Security Agreement continues to provide Lifeway with a revolving line of credit up to a maximum of \$5 million (the “Revolving Loan”) and provides the Borrowers with an incremental facility not to exceed \$5 million (the “Incremental Facility” and together with the Revolving Loan, the “Loans”). The Termination Date of the Revolving Loan was extended to June 30, 2025, unless earlier terminated.

Except as described above, as amended, the Modified Revolving Credit Facility remains substantively unchanged and in full force and effect, including customary representations, warranties, and covenants on the part of Lifeway, including financial covenants requiring us to maintain a fixed charge coverage ratio of no less than 1.25 to 1.00 each of the fiscal quarters ending through the expiration date. The Modified Revolving Credit Facility continues to provide for events of default, including failure to repay principal and interest when due and failure to perform or violation of the provisions or covenants of the agreement, as a result of which amounts due under the Modified Revolving Credit Facility may be accelerated. The loans and all other amounts due and owed under the Revolving Credit Facility and related documents are secured by substantially all of our assets.

As of December 31, 2020, we had \$2,768 net of \$9 of unamortized deferred financing costs, outstanding under the Revolving Credit Facility. We had \$2,223 available for future borrowings as of December 31, 2020.

As amended, all outstanding amounts under the Loans bear interest, at Lifeway's election, at either the lender Base Rate (the Prime Rate minus 1.00%) or the LIBOR plus 1.95%, payable monthly in arrears. Lifeway is also required to pay a quarterly unused line fee of 0.20% and, in conjunction with the issuance of any letters of credit, a letter of credit fee of 0.20%. Lifeway's interest rate on debt outstanding under our Revolving Credit Facility as of December 31, 2020 was 2.10%.

We were in compliance with the fixed charge coverage ratio and minimum working capital covenants at December 31, 2020.

Note 8 – Leases

Lifeway has operating leases for two retail stores for its Lifeway Kefir Shop subsidiary and office space which includes fixed base rent payments as well as variable rent payments to reimburse the landlord for operating expenses and taxes. The Company terminated its office space leases in June 2020. The Company also lease certain machinery and equipment with fixed base rent payments and variable costs based on usage. Remaining lease terms for these leases range from less than 1 year to 4 years. Some of our leases include options to extend the leases for up to 5 years and have been included in our calculation of the right-of-use asset and lease liabilities. Lifeway includes only fixed payments for lease components in the measurement of the right-of-use asset and lease liability. Variable lease payments are those that vary because of changes in facts or circumstances occurring after the commencement date, other than the passage of time. There are no residual value guarantees. We do not currently have leases which meet the finance lease classification as defined under ASC 842.

We do not record leases with an initial term of 12 months or less on the balance sheet. Expense for these short-term leases is recorded on a straight-line basis over the lease term. Total lease expense was \$440 and \$688 (including short term leases) for the years ended December 31, 2020 and 2019, respectively.

Lifeway treats contracts as a lease when the contract conveys the right to use a physically distinct asset for a period of time in exchange for consideration, we direct the use of the asset and obtain substantially all the economic benefits of the asset.

Right-of-use assets and lease liabilities are measured and recognized based on the present value of the future minimum lease payments over the lease term at the commencement date. We have elected the practical expedient to combine lease and non-lease components into a single component for all of its leases. For many of our leases such as real estate leases, we are unable to determine an implicit rate; therefore, we use our incremental borrowing rate based on the information available at the commencement date in determining the present value of future payments for those leases. We include options to extend or terminate the lease in the measurement of the right-of-use asset and lease liability when it is reasonably certain that we will exercise such options. Lease expense for minimum lease payments is recognized on a straight-line basis over the lease term.

Future maturities of lease liabilities were as follows

Year	Operating Leases
2021	\$ 198
2022	154
2023	18
2024	<u>2</u>
Total lease payments	372
Less: Interest	(28)
Present value of lease liabilities	<u>\$ 344</u>

The weighted-average remaining lease term for our operating leases was 2.0 years as of December 31, 2020. The weighted average discount rate of our operating leases was 7.75% as of December 31, 2020. Cash paid for amounts included in the measurement of lease liabilities was \$384 for the year ended December 31, 2020.

Note 9 – Commitments and Contingencies

Litigation

Lifeway is engaged in various legal actions, claims, audits, and proceedings arising in the normal course of business, including commercial disputes, product liabilities, intellectual property matters and employment-related matters resulting from our business activities.

We record accruals for outstanding legal matters when we believe it is probable that a loss will be incurred and the amount of such loss can be reasonably estimated. We evaluate, on a periodic basis, developments in legal matters that could affect the amount of any accrual and developments that would make a loss contingency both probable and reasonably estimable. If a loss contingency is not both probable and estimable, we do not establish an accrued liability. Currently, none of our accruals for outstanding legal matters are material individually or in the aggregate to our financial position and it is management's opinion that the ultimate resolution of these outstanding legal matters will not have a material adverse effect on our business, financial condition, results of operations, or cash flows. However, if we ultimately are required to make payments in connection with an adverse outcome, it is possible that it could have a material adverse effect on our business, financial condition, results of operations or cash flows.

Lifeway's contingencies are subject to substantial uncertainties, including for each such contingency the following, among other factors: (i) the procedural status of the case; (ii) whether the case has or may be certified as a class action suit; (iii) the outcome of preliminary motions; (iv) the impact of discovery; (v) whether there are significant factual issues to be determined or resolved; (vi) whether the proceedings involve a large number of parties and/or parties and claims in multiple jurisdictions or jurisdictions in which the relevant laws are complex or unclear; (vii) the extent of potential damages, which are often unspecified or indeterminate; and (viii) the status of settlement discussions, if any, and the settlement posture of the parties. Consequently, Lifeway cannot predict with any reasonable certainty the timing or outcome of such contingencies, and we are unable to estimate a possible loss or range of loss.

Note 10 – Income taxes

The provision (benefit) for income taxes consists of the following:

	<u>For the Years Ended December 31,</u>	
	<u>2020</u>	<u>2019</u>
Current:		
Federal	\$ 398	\$ (27)
State and local	357	276
Total current	<u>755</u>	<u>249</u>
Deferred	841	533
Provision for income taxes	<u>\$ 1,596</u>	<u>\$ 782</u>

A reconciliation of the U.S. federal statutory rate to the effective tax rate used in the provision for income taxes is as follows:

	2020		2019	
	Amount	Percentage	Amount	Percentage
Federal income tax at statutory rate	\$ 1,015	21.0%	\$ 259	21.0%
State and local tax, net	428	8.9%	180	14.5%
Other permanent differences	12	0.3%	14	1.1%
Section 162m	296	6.1%	105	8.5%
Stock based compensation	157	3.2%	149	12.1%
Uncertain tax positions	(43)	(0.9%)	79	6.4%
Change in tax rates	(245)	(5.0%)	8	0.7%
Change in tax estimate	-	0.0%	(12)	(1.0%)
Other	(24)	(0.5%)	-	0.0%
Provision for income taxes	<u>\$ 1,596</u>	<u>33.1%</u>	<u>\$ 782</u>	<u>63.3%</u>

The tax effects of temporary differences giving rise to deferred income tax assets and liabilities are as follows:

	December 31,	
	2020	2019
Deferred tax liabilities attributable to:		
Accumulated depreciation and amortization	\$ (2,101)	\$ (2,015)
Unrealized gains	(467)	(465)
Total deferred tax liabilities	<u>(2,568)</u>	<u>(2,480)</u>
Deferred tax assets attributable to:		
Net operating losses	6	507
Accrued compensation	149	89
Incentive compensation	168	473
Inventory	323	312
Allowances for doubtful accounts and discounts	109	115
Deferred revenue	15	40
Other	34	22
Total net deferred tax assets	<u>804</u>	<u>1,558</u>
Net deferred tax liabilities	<u>\$ (1,764)</u>	<u>\$ (922)</u>

The following table details the Company's tax attributes related to net operating losses for which it has recorded deferred tax assets.

Tax Attributes	Gross Amount	Net Amount	Expiration Years
State net operating losses	\$ 116	\$ 6	2035
		<u>\$ 6</u>	

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2020	2019
Balance at January 1	\$ 142	\$ 63
Additions based on tax positions of prior years	–	79
Reduction for tax positions of prior years	(47)	–
Balance at December 31	<u>\$ 95</u>	<u>\$ 142</u>

Lifeway is subject to U.S. federal income tax as well as income tax in multiple state and city jurisdictions. With limited exceptions, our calendar year 2017 and subsequent federal and state tax years remain open by statute. The amount of unrecognized tax benefits that, if recognized, would impact the annual effective tax rate was not significant as of December 31, 2020. The annual effective tax rate would have decreased by 2.0% as of December 31, 2019 if the unrecognized tax benefits were recognized.

The amount of interest and penalties recognized in the consolidated statements of operations was \$(16) and \$41 during 2020 and 2019, respectively. The amount of accrued interest and penalties recognized in the consolidated balance sheets was \$44 and \$60 at December 31, 2020 and 2019, respectively.

Note 11 – Stock-based and Other Compensation

In December 2015, Lifeway stockholders approved the 2015 Omnibus Incentive Plan, which authorized the issuance of an aggregate of 3.5 million shares to satisfy awards of stock options, stock appreciation rights, unrestricted stock, restricted stock, restricted stock units, performance shares and performance units to qualifying employees. Under the Plan, the Board or its Audit and Corporate Governance Committee approves stock awards to executive officers and certain senior executives, generally in the form of restricted stock or performance shares. The number of performance shares that participants may earn depends on the extent to which the corresponding performance goals have been achieved. Stock awards generally vest over a three-year performance or service period. At December 31, 2020, 3.317 million shares remain available under the Omnibus Incentive Plan. While we plan to continue to issue awards pursuant to the Plan at least annually, we may choose to suspend the issuance of new awards in the future and may grant additional awards at any time including issuing special grants of restricted stock, restricted stock units, and stock options to attract and retain new and existing executives.

Stock Options

The following table summarizes stock option activity during the year ended December 31, 2020:

	Options	Weighted average exercise price	Weighted average remaining contractual life	Aggregate intrinsic value
Outstanding at December 31, 2019	41	\$ 10.42	6.22	\$ –
Granted	–	–	–	–
Exercised	–	–	–	–
Forfeited	–	–	–	–
Outstanding at December 31, 2020	<u>41</u>	<u>\$ 10.42</u>	<u>5.22</u>	<u>\$ –</u>
Exercisable at December 31, 2020	<u>41</u>	<u>\$ 10.42</u>	<u>5.22</u>	<u>\$ –</u>

As of December 31, 2019, all outstanding options were vested and there was no remaining unearned compensation expense. For the year ended December 31, 2019 total stock-based compensation expense recognized in the consolidated statements of operations was \$1. For the year ended December 31, 2019, no tax-related benefits were recognized.

We measure the fair value of stock options using the Black-Scholes option pricing model. The expected term of options granted was based on the weighted average time of vesting and the end of the contractual term. We utilized this simplified method as we did not have sufficient historical exercise data to provide a reasonable basis upon which to estimate the expected term.

Restricted Stock Awards

A Restricted Stock Award (“RSA”) represents the right to receive one share of common stock in the future. RSAs have no exercise price. The grant date fair value of the awards is equal to our closing stock price on the grant date. The following table summarizes RSA activity during the year ended December 31, 2020.

	RSA's
Outstanding at December 31, 2019	47
Granted	57
Shares issued upon vesting	(13)
Forfeited	(13)
Outstanding at December 31, 2020	<u>78</u>
Weighted average grant date fair value per share outstanding	<u>\$ 3.06</u>

We expense RSA's over the service period. For the years ended December 31, 2020 and 2019 total stock-based compensation expense recognized in the consolidated statements of operations was \$83 and \$109, respectively. For the years ended December 31, 2020 and 2019 tax-related benefits of \$22 and \$30, respectively, were also recognized. As of December 31, 2020, the total remaining unearned compensation related to non-vested RSA's was \$134, which is expected to be amortized over the weighted-average remaining service period of 1.36 years.

Long-Term Incentive Plan Compensation

Lifeway established long-term incentive-based compensation programs for fiscal year 2017 (the “2017 Plan”) and for fiscal year 2019 (the “2019 Plan”) for certain senior executives and key employees (the “participants”). Under both the 2017 Plan, long-term incentive compensation is based on Lifeway's achievement of certain sales and adjusted EBITDA performance levels versus respective targets established by the Board for each fiscal year. Under the 2019 Plan, long-term equity incentive compensation is based on Lifeway's achievement of four strategic milestones over a three-year period from Fiscal 2019 through Fiscal 2021.

2017 Plan

Under the 2017 Plan, collectively the participants had the opportunity to earn cash and equity-based incentive compensation in amounts ranging from \$0 to \$11,025 depending on Lifeway's performance levels compared to the respective targets and the participants performance compared to their individual objectives. The equity portion of the incentive compensation is payable in restricted stock that vests one-third in each of the three years from the 2017 grant dates. For the years ended December 31, 2020 and 2019, \$49 and \$288 was expensed as stock-based compensation expense in the consolidated statements of operations, respectively. As of December 31, 2020, there was no remaining expense.

2019 Plan

Under the 2019 Plan, collectively the participants have the opportunity to earn equity-based incentive compensation in amounts ranging from \$0 to \$1,733 depending on Lifeway's performance levels compared to the respective targets. The equity-based incentive compensation is payable in restricted stock that vests 50% of unvested shares in year one, 50% of unvested shares in year two, and 100% of remaining unvested shares in year three from the 2019 grant date. For the years ended December 31, 2020 and 2019, \$112 and \$51 was expensed under the 2019 Plan as stock-based compensation expense in the consolidated statements of operations, respectively.

2019 Retention Award

During 2019, we awarded a special retention grant (the "2019 Retention Award") of restricted stock to senior executives and key employees (the "participants"). The equity-based incentive compensation is payable in restricted stock that vests one-third in March 2019, one-third in March 2020 and one-third in March 2021. For the years ended December 31, 2020 and 2019, \$87 and \$342 was expensed as stock-based compensation expense in the consolidated statements of operations, respectively. As of December 31, 2020, the total remaining unearned compensation was \$14, which will be recognized in 2021, subject to vesting.

2020 CEO Incentive Award

During the fourth quarter 2020, we awarded a long-term equity-based incentive of \$750 to our Chief Executive Officer (the "2020 CEO Award") depending on Lifeway's 2020 performance levels compared to the respective targets. The equity-based incentive compensation is payable in restricted stock that vests one-third in March 2022, one-third in March 2023, and one-third in March 2024. The issuance of vested equity awards is subject to approval under the Stock Purchase Agreement dated October 1, 1999. For the year ended December 31, 2020, \$50 was expensed as stock-based compensation expense in the consolidated statements of operations. As of December 31, 2020, the total remaining unearned compensation was \$700, of which \$364 will be recognized in 2021, \$221 in 2022, \$98 in 2023, and \$17 in 2024, respectively, subject to vesting.

Retirement Benefits

Lifeway has a defined contribution plan which is available to substantially all full-time employees. Under the terms of the plan we match employee contributions under a prescribed formula. For the years ended December 31, 2020 and 2019 total contribution expense recognized in the consolidated statements of operations was \$420 and \$367, respectively.

Note 12 – Segments, Products and Customers

Lifeway's primary product is drinkable kefir, a cultured dairy product. Lifeway Kefir is tart and tangy, high in protein, calcium and vitamin D. Thanks to our exclusive blend of kefir cultures, each cup of kefir contains 12 live and active cultures and 25 to 30 billion beneficial CFU (Colony Forming Units) at the time of manufacture.

We manufacture (directly or through co-packers) and market products under the Lifeway and Fresh Made brand names, as well as under private labels on behalf of certain customers.

Our product categories are:

- Drinkable Kefir, sold in a variety of organic and non-organic sizes, flavors, and types, including low-fat, non-fat, whole milk, protein, and BioKefir (a 3.5 oz. kefir with additional probiotic cultures).
- European-style soft cheeses, including farmer cheese, white cheese, and Sweet Kiss.
- Cream and other, which consists primarily of cream, a byproduct of making our kefir.
- ProBugs, a line of kefir products designed for children.
- Other Dairy, which includes Cupped Kefir and Icelandic Skyr, a line of strained kefir and yogurt products in resealable cups.
- Frozen Kefir, available in soft serve and pint-size containers.

Lifeway has determined that it has one reportable segment based on how our chief operating decision maker manages the business and in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing our performance, has been identified collectively as the Chief Financial Officer, the Chief Operating Officer, the Chief Executive Officer, and Chairperson of the board of directors. Substantially all of our consolidated revenues relate to the sale of cultured dairy products that we produce using the same processes and materials and are sold to consumers through a common network of distributors and retailers in the United States.

Net sales of products by category were as follows for the years ended December 31:

In thousands	2020		2019	
	\$	%	\$	%
Drinkable Kefir other than ProBugs	\$ 81,437	80%	\$ 71,822	77%
Cheese	12,905	13%	11,459	12%
Cream and other	2,872	3%	4,228	4%
ProBugs Kefir	2,733	2%	2,780	3%
Other dairy	1,594	1%	1,756	2%
Frozen Kefir (a)	485	1%	1,617	2%
Net Sales	<u>\$ 102,026</u>	<u>100%</u>	<u>\$ 93,662</u>	<u>100%</u>

(a) Includes Lifeway Kefir Shop sales

Significant Customers – Sales are predominately to companies in the retail food industry located within the United States. Two major customers accounted for approximately 21% and 22% of net sales for the years ended December 31, 2020 and 2019, respectively. Two major customers accounted for approximately 22% and 17% of accounts receivable as of December 31, 2020 and 2019, respectively.

Note 13 – Share repurchase program

On September 24, 2015, Lifeway’s Board of Directors authorized a stock repurchase program (the “2015 stock repurchase program”) under which we may, from time to time, repurchase shares of our common stock for an aggregate purchase price not to exceed the lesser of \$3,500 or 250 shares. On November 1, 2017, the Board amended the 2015 stock repurchase program (the “2017 amendment”), by adding to (i.e., exclusive of the shares previously authorized under the 2015 stock repurchase program) the authorization the lesser of \$5,185 or 625 shares. Under the amended authorization, share repurchases may be executed through various means, including without limitation in the open market or in privately negotiated transactions, in accordance with all applicable securities laws and regulations, including without limitation Rule 10b-18 of the Securities Exchange Act of 1934, as amended. The extent to which Lifeway repurchases its shares and the timing of such repurchases will depend upon a variety of factors, including market conditions, regulatory requirements and other corporate considerations. The repurchase program does not obligate us to purchase any shares, and the program may be terminated, suspended, increased, or decreased by our Board in its discretion at any time.

Pursuant to the share repurchase program, during the year ended December 31, 2020, the Company repurchased 179 shares at a cost of \$405 or approximately \$2.27 per share. During the year ended December 31, 2019, the Company repurchased 211 shares at a cost of \$538 or approximately \$2.55 per share. During the year, the Company reached the amended threshold of 625 shares and therefore no shares of common stock remain available to be purchased under the 2017 Repurchase Plan Amendment as of December 31, 2020.

Note 14 – Related party transactions

Lifeway obtains consulting services from the Chairperson of its board of directors. Fees earned are included in general and administrative expenses in the accompanying consolidated statements of operations and were \$1,000 during the years ended December 31, 2020 and 2019.

On December 28, 2020, Lifeway entered into an amended and restated consulting agreement (the “Agreement”), effective as of December 31, 2020, with the Chairperson. Under the terms and conditions of the Agreement, the Chairperson will continue to provide consulting services with respect to, among other things, our business strategy, international expansion and product management and expansion. For the services, the Company will pay an annual service fee of \$500. The Chairperson will also be eligible for an annual performance fee target of \$500 based on the achievement of specified performance criteria. The Chairpersons annual service fee and target bonus amounts are subject to periodic change by the Compensation Committee of the Company’s Board of Directors on 30 days’ prior written notice to the Chairperson. The Agreement shall continue until either party provides at least a 10-day written notice of termination.

Lifeway is also a party to a royalty agreement with the Chairperson of its board of directors under which we pay the Chairperson a royalty based on the sale of certain Lifeway products, not to exceed \$50 in any fiscal month. Royalties earned are included in selling expenses in the accompanying consolidated statements of operations and were \$600 and \$588 during the years ended December 31, 2020 and 2019, respectively.

Note 15 – COVID-19

The ultimate impact that the COVID-19 pandemic or any future pandemic or disease outbreak will have on our business and our consolidated results of operations is uncertain.

To date we have seen increased customer and consumer demand for our products as consumers initially began pantry loading and have increased their at-home consumption as a result of social distancing and stay-at-home and work-from-home mandates and recommendations. However, this increased customer and consumer demand may decrease in the coming months if and when the need for social distancing and stay-at-home and work-from-home mandates and recommendations decrease, and we are unable to predict the nature and timing of when that impact may occur, if at all. .

Although to date we have not experienced supply chain constraints, and we have continued to be able to fully satisfy customer and consumer demand for our products, the continued unprecedented demand for food and other consumer packaged goods products as a result of the COVID-19 pandemic or any future pandemic may limit the availability of, or increase the cost of, ingredients, packaging and other raw materials necessary to produce our products, and our operations may be negatively impacted. Additionally, pandemics or disease outbreaks could result in a widespread health crisis that could adversely affect economies and financial markets, consumer spending and confidence levels resulting in an economic downturn that could affect customer and consumer demand for our products.

Our efforts to manage and mitigate these factors may be unsuccessful, and the effectiveness of these efforts depends on factors beyond our control, including the duration and severity of any pandemic or disease outbreak, as well as third party actions taken to contain its spread and mitigate public health effects.

The ultimate impact of the COVID-19 pandemic on our business will depend on many factors, including, among others, the duration of social distancing and stay-at-home and work-from-home mandates and recommendations and whether additional waves of COVID-19 or different variants of COVID-19 will affect the United States and other markets, our ability and the ability of our suppliers to continue to operate our and their manufacturing facilities and maintain the supply chain without material disruption and procure ingredients, packaging and other raw materials when needed despite unprecedented demand in the food industry, and the extent to which macroeconomic conditions resulting from the pandemic and the pace of the subsequent recovery may impact consumer eating and shopping habits. We cannot predict the duration or scope of the disruption. Therefore, the financial impact cannot be reasonably estimated at this time.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None

ITEM 9A. CONTROLS AND PROCEDURES.**Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure material information required to be disclosed in our reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer, principal financial officer and principal accounting officer, as appropriate, to allow timely decisions regarding required financial disclosure. In designing and evaluating the disclosure controls and procedures, we recognize that a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

As of December 31, 2020 (the "Evaluation Date"), we conducted an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934 (the "Exchange Act")). Based on this evaluation, our principal executive officer and principal financial officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective at the reasonable assurance level as of December 31, 2020 in ensuring that information required to be disclosed by us under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified under the Exchange Act rules.

Management's Annual Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is identified in Exchange Act Rules 13a-15(f). Internal control over financial reporting is a process designed by, or under the supervision of, our principal executive officer, principal financial officer and principal accounting officer, and effected by the Board of Directors, management, and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Our internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets;
- provide reasonable assurance that our transactions are recorded as necessary to permit preparation of our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and that our receipts and expenditures of the company are being made only in accordance with authorizations of our management and our directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our consolidated financial statements.

Internal control over financial reporting has inherent limitations which may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or because the level of compliance with related policies or procedures may deteriorate.

Management, including our Chief Executive Officer and our Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting as of December 31, 2020. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control - Integrated Framework (2013). Based on this assessment, management has concluded that our internal control over financial reporting was effective as of December 31, 2020.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Corporate Governance Guidelines and Code of Ethics

We have adopted Corporate Governance Guidelines and a Code of Ethics applicable to all members of the Board, executive officers, and employees, including our principal executive officer and principal financial officer. The Corporate Governance Guidelines, the Code of Ethics, and other corporate governance documents are available on Lifeway's website at www.lifewayfoods.com. Any person may, without charge, request a copy of the Corporate Governance Guidelines and/or Code of Ethics by contacting Lifeway at (847) 967-1010 or by email at info@lifeway.net.

Other information required by this Item 10 will be included in our definitive Proxy Statement to be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this Item 11 will be included in our definitive Proxy Statement to be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Information required by this Item 12 will be included in our definitive Proxy Statement to be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.

Information required by this Item 13 will be included in our definitive Proxy Statement to be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

Information required by this Item 14 will be included in our definitive Proxy Statement to be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

1. A list of the Financial Statements and Financial Statement Schedules filed as part of this Report is set forth in Part II, Item 8, which list is incorporated herein by reference.
2. Financial Statement Schedules – Separate financial statement schedules have been omitted either because they are not applicable or because the required information is included in the consolidated financial statements
3. Exhibits.

No.	Description	Form	Period Ending	Exhibit	Filing Date
3.1	Amended and Restated Bylaws.	10-K	12/31/2017	3.1	3/30/2018
3.2	Articles of Incorporation, as amended and currently in effect	10-K	12/31/2013	3.2	4/2/2014
10.1	Stock Purchase Agreement dated October 1, 1999 by and among Danone Foods, Inc., Lifeway Foods, Inc., Michael Smolyansky and certain other parties	8-K	0	10.1	10/12/1999
10.2	Stockholders' Agreement dated October 1, 1999 by and among Danone Foods, Inc., Lifeway Foods, Inc., Michael Smolyansky and certain other parties	8-K	0	10.11	10/12/1999
10.3	Letter Agreement dated December 24, 1999	8-K	0	10.12	1/12/2000
10.4	Employment Agreement, dated September 12, 2002, between Lifeway Foods, Inc. and Julie Smolyansky	10-QSB/A No. 2	9/30/2002	10.14	4/30/2003
10.5	Consulting Agreement by and between the Company and Ludmila Smolyansky, dated as of March 8, 2016	10-K	12/31/2015	10.23	3/16/2016
10.6	Endorsement Agreement by and between the Company and Ludmila Smolyansky, dated as of March 14, 2016	10-K	12/31/2015	10.24	3/16/2016
10.7	Amended and Restated Loan and Security Agreement dated as of May 7, 2018 among Lifeway Foods, Inc., Fresh Made, Inc., The Lifeway Kefir Shop, LLC, Lifeway Wisconsin, Inc., and CIBC Bank USA, as Lender.	8-K		10.1	5/11/2018

10.8	Employment Agreement by and between the Company and Amy Feldman, dated as of October 29, 2018	8-K		10.1	11/1/2018
10.9	Employment Agreement by and between the Company and Eric Hanson, dated as of January 18, 2019				1/23/2019
10.10	First Modification to Amended and Restated Loan and Security Agreement dated as of April 10, 2019 among Lifeway Foods, Inc., Fresh Made, Inc., The Lifeway Kefir Shop, LLC, Lifeway Wisconsin, Inc., and CIBC Bank USA, as Lender.	10-K	12/31/18	10.1	4/15/2019
10.11	Second Modification to Amended and Restated Loan and Security Agreement, effective as of December 10, 2019 by and among Lifeway Foods, Inc., Fresh Made, Inc., The Lifeway Kefir Shop, LLC, Lifeway Wisconsin, Inc., and CIBC Bank USA, as Lender.	8-K		10.1	12/10/2019
10.12	Third Modification to Amended and Restated Loan and Security Agreement dated as of September 30, 2020 among Lifeway Foods, Inc., Fresh Made, Inc., The Lifeway Kefir Shop, LLC, Lifeway Wisconsin, Inc., and CIBC Bank USA, as Lender.	8-K	9/30/20	10.1	10/6/2020
10.13	Amended and Restated Consulting Agreement dated December 28, 2020 by and between the Company and Ludmila Smolyansky	8-K	12/28/20	10.1	12/28/20
14	Code of Conduct and Ethics	10-K	12/31/13	14	4/2/2014
21	List of Subsidiaries of the Registrant				
23.1	Consent of Mayer Hoffman McCann P.C.				
31.1	Rule 13a-14(a)/15d-14(a) Certification of Julie Smolyansky				
31.2	Rule 13a-14(a)/15d-14(a) Certification of Eric Hanson				
32.1	Section 1350 Certification of Julie Smolyansky				
32.2	Section 1350 Certification of Eric Hanson				
99.1	Press release dated March 25, 2021 reporting the Company's financial results for year ended December 31, 2020.				
101	Interactive Data Files				

ITEM 16. FORM 10-K SUMMARY.

Not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LIFEWAY FOODS, INC.

Date: March 25, 2021

By: /s/ Julie Smolyansky
Julie Smolyansky
Chief Executive Officer, President, and
Director

Date: March 25, 2021

By: /s/ Eric Hanson
Eric Hanson
Chief Financial & Accounting Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: March 25, 2021

/s/ Julie Smolyansky
Julie Smolyansky
Chief Executive Officer, President, and Director
(Principal Executive Officer)

Date: March 25, 2021

/s/ Edward Smolyansky
Edward Smolyansky
Chief Operating Officer and Director

Date: March 25, 2021

/s/ Eric Hanson
Eric Hanson
Chief Financial & Accounting Officer
(Principal Financial & Accounting Officer)

Date: March 25, 2021

/s/ Ludmila Smolyansky
Ludmila Smolyansky
Chairperson of the Board of Directors

Date: March 25, 2021

/s/ Jason Scher
Jason Scher
Lead Independent Director

Date: March 25, 2021

/s/ Pol Sikar
Pol Sikar
Director

Date: March 25, 2021

/s/ Jody Levy
Jody Levy
Director

Date: March 25, 2021

/s/ Dorri McWhorter
Dorri McWhorter
Director