UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: March 31, 2022

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

For the transition period from __________ to __________

Commission File Number: 000-17363

LIFEWAY FOODS, INC.
(Exact name of registrant as specified in its charter)

Illinois	**36-3442829**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

6431 West Oakton, Morton Grove, IL 60053
(Address of principal executive offices, zip code)

(847) 967-1010
(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	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 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 and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth 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. (Check one)

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 is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Number of shares of Common Stock, no par value, outstanding as of August 12, 2022: 15,489,831.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
March 31, 2022 and December 31, 2021
(In thousands)

	March 31, 2022 Unaudited		December 31, 2021	
Current assets				
Cash and cash equivalents	$	7,987	$	9,233
Accounts receivable, net of allowance for doubtful accounts and discounts & allowances of $1,320 and $1,170 at March 31, 2022 and December 31, 2021 respectively		11,389		9,930
Inventories, net		8,649		8,285
Prepaid expenses and other current assets		1,066		1,254
Refundable income taxes		503		344
Total current assets		**29,594**		**29,046**
Property, plant and equipment, net		**19,822**		**20,130**
Operating lease right-of-use asset		**216**		**216**
Intangible assets				
Goodwill		11,704		11,704
Intangible assets, net		7,843		7,978
Total intangible assets		**19,547**		**19,682**
Other assets		1,800		1,800
Total assets	**$**	**70,979**	**$**	**70,874**
Current liabilities				
Current portion of note payable	$	1,000	$	1,000
Accounts payable		8,723		6,614
Accrued expenses		3,190		3,724
Accrued income taxes		199		725
Total current liabilities		**13,112**		**12,063**
Line of credit		**2,777**		**2,777**
Note payable		**3,222**		**3,470**
Operating lease liabilities		**98**		**85**
Deferred income taxes, net		**3,201**		**3,201**
Other long-term liabilities		**224**		**147**
Total liabilities		**22,634**		**21,743**
Commitments and contingencies		–		–
Stockholders' equity				
Preferred stock, no par value; 2,500 shares authorized; no shares issued or outstanding at March 31, 2022 and December 31, 2021		–		–
Common stock, no par value; 40,000 shares authorized; 17,274 shares issued; 15,435 outstanding at March 31, 2022 and December 31, 2021, respectively		6,509		6,509
Paid-in capital		2,661		2,552
Treasury stock, at cost		(13,436)		(13,436)
Retained earnings		52,611		53,506
Total stockholders' equity		**48,345**		**49,131**
Total liabilities and stockholders' equity	**$**	**70,979**	**$**	**70,874**

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
For the three months ended March 31, 2022 and 2021
(Unaudited)
(In thousands, except per share data)

	2022	2021
Net Sales	**$ 34,099**	**$ 29,376**
Cost of goods sold	27,863	20,512
Depreciation expense	656	815
Total cost of goods sold	28,519	21,327
Gross profit	**5,580**	**8,049**
Selling expense	3,202	3,222
General and administrative expense	3,292	2,891
Amortization expense	135	–
Total operating expenses	**6,629**	**6,113**
(Loss) income from operations	(1,049)	1,936
Other (expense) income:		
Interest expense	(42)	(22)
Loss on sale of property and equipment	–	(7)
Other (expense) income, net	(1)	(8)
Total other (expense) income	(43)	(37)
(Loss) income before provision for income taxes	**(1,092)**	**1,899**
(Benefit) provision for income taxes	(197)	593
Net (loss) income	**$ (895)**	**$ 1,306**
Earnings (loss) per common share:		
Basic	$ (0.06)	$ 0.08
Diluted	$ (0.06)	$ 0.08
Weighted average common shares:		
Basic	15,435	15,604
Diluted	15,435	15,814

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
(Unaudited)
(In thousands)

	Common Stock						
	Issued		In treasury		Paid-In	Retained	Total
	Shares	$	Shares	$	Capital	Earnings	Equity
Balance, January 1, 2021	**17,274**	**$ 6,509**	**(1,669)**	**$ (12,450)**	**$ 2,600**	**$ 50,195**	**$ 46,854**
Stock-based compensation	–	–	–	–	64	–	64
Net income	–	–	–	–	–	1,306	1,306
Balance, March 31, 2021	**17,274**	**$ 6,509**	**(1,669)**	**$ (12,450)**	**$ 2,664**	**$ 51,501**	**$ 48,224**
Balance, January 1, 2022	**17,274**	**$ 6,509**	**(1,839)**	**$ (13,436)**	**$ 2,552**	**$ 53,506**	**$ 49,131**
Stock-based compensation	–	–	–	–	109	–	109
Net loss	–	–	–	–	–	(895)	(895)
Balance, March 31, 2022	**17,274**	**$ 6,509**	**(1,839)**	**$ (13,436)**	**$ 2,661**	**$ 52,611**	**$ 48,345**

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Three months ended March 31,	
	2022	**2021**
Cash flows from operating activities:		
Net (loss) income	**$ (895)**	**$ 1,306**
Adjustments to reconcile net (loss) income to operating cash flow:		
Depreciation and amortization	791	815
Non-cash interest expense	2	6
Deferred revenue	(8)	(8)
Stock-based compensation	315	153
Loss on sale of property and equipment	–	7
(Increase) decrease in operating assets:		
Accounts receivable	(1,458)	(1,959)
Inventories	(364)	193
Refundable income taxes	(159)	(15)
Prepaid expenses and other current assets	188	54
Increase (decrease) in operating liabilities:		
Accounts payable	2,109	(301)
Accrued expenses	(643)	398
Accrued income taxes	(526)	561
Net cash (used in) provided by operating activities	**(648)**	**1,210**
Cash flows from investing activities:		
Purchases of property and equipment	(348)	(518)
Net cash used in investing activities	**(348)**	**(518)**
Cash flows from financing activities:		
Repayment of note payable	(250)	–
Net cash used in financing activities	**(250)**	–
Net (decrease) increase in cash and cash equivalents	**(1,246)**	**692**
Cash and cash equivalents at the beginning of the period	9,233	7,926
Cash and cash equivalents at the end of the period	**$ 7,987**	**$ 8,618**
Supplemental cash flow information:		
Cash paid for income taxes, net	$ 95	$ 47
Cash paid for interest	$ 40	$ 16
Non-cash investing activities		
Increase (decrease) in right-of-use assets and operating lease obligations	$ 36	$ 21

See accompanying notes to consolidated financial statements

Note 1 – Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. ("U.S. GAAP") for interim financial information, and do not include certain information and footnote disclosures required for complete, audited financial statements. In the opinion of management, these statements include all adjustments necessary for a fair presentation of the results of all interim periods reported herein. The consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2021. Results of operations for any interim period are not necessarily indicative of future or annual results.

Principles of consolidation

The consolidated financial statements include the accounts of Lifeway Foods, Inc. and all its wholly owned subsidiaries (collectively "Lifeway" or the "Company"). All significant intercompany accounts and transactions have been eliminated.

Restatement of Previously Issued Consolidated Financial Statements

As previously disclosed in Note 1 to the Company's consolidated financial statements included in the 2021 Form 10-K, the Company identified past errors in the accounting for deferred income tax liabilities and goodwill that resulted from a 2009 acquisition when preparing the 2021 consolidated financial statements. In the 2021 Form 10-K, the Company restated its historical consolidated financial statements to properly reflect the impact of the 2009 acquisition, which resulted in adjustments to goodwill and deferred income tax liabilities in the affected periods. The consolidated financial statements for the three months ended March 31, 2021 included in this Quarterly Report on Form 10-Q have been similarly restated to reflect the correction of these errors and should be read in conjunction with Notes 1 and 17 to the Company's consolidated financial statements included in the 2021 Form 10-K.

Note 2 – Summary of Significant Accounting Policies

A detailed description of our significant accounting policies can be found in the Annual Report on Form 10-K for the fiscal year ended December 31, 2021.

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.

Cash and cash equivalents

The Company has $580 of restricted cash which is included in cash and cash equivalents as of March 31, 2022. The restricted cash balance represents escrow funds deposited by Lifeway in connection with the August 18, 2021 acquisition of certain assets of GlenOaks Farms, Inc. The funds are security for the liability and indemnity obligations of seller as defined under the asset purchase agreement. The funds will remain in escrow for twelve months from the acquisition closing date, at which time the funds, less any amounts for outstanding seller obligations, will be remitted to the sellers.

Revenue recognition

Lifeway sells food and beverage products across select product categories to customers predominantly within the United States (see Note 12 - Segments, Products and Customers). The Company also sells bulk cream, a byproduct of its fluid milk manufacturing process. In accordance with ASC 606, Revenue from Contracts with Customers, Lifeway recognizes revenue when control over the products transfers to its customers, which generally occurs upon delivery to its 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.

Lifeway accounts 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, the Company does not capitalize contract inception costs and it capitalizes product fulfillment costs in accordance with U.S. GAAP and its inventory policies. Lifeway does not have any significant deferred revenue or unbilled receivables at the end of a period. It generally does not receive noncash consideration for the sale of goods, nor does it grant payment financing terms greater than one year.

Advertising and promotional costs

Lifeway expenses advertising costs as incurred and is reported in Selling expense in the Company's consolidated statement of operations. Total advertising expense was $1,204 and $1,393 for the three months ended March 31, 2022 and 2021, respectively.

Segments

The Company is managed as a single reportable segment. The Chief Executive Officer, who is the Company's Chief Operating Decision Maker ("CODM"), reviews financial information on an aggregate basis for purposes of allocating resources and assessing financial performance, as well as for making strategic operational decisions and managing the organization. Substantially all of Lifeway's consolidated revenues relate to the sale of cultured dairy products that it produces using the same processes and materials and are sold to consumers through a common network of distributors and retailers in the United States.

Recent accounting pronouncements

Issued by not yet effective

In October 2021, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2021-08, Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers. The new guidance provides a single comprehensive accounting model on revenue recognition for contracts with customers and requires that the acquirer in a business combination recognize and measure contract assets and liabilities acquired in a business combination in accordance with Topic 606 (Revenue from Contracts with Customers). The amendments in this ASU are effective for fiscal years beginning after December 15, 2022. Early adoption is permitted, including adoption in an interim period. With early adoption, the amendments are applied retrospectively to all business combinations for which the acquisition date occurs on or after the beginning of the fiscal year that includes the interim period of adoption and prospectively to all business combinations that occur on or after the date of initial application. Management is evaluating the impact of the new guidance and does not currently expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In March 2020, the FASB issued 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 U.S. 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 evaluating the impact of the new guidance and does not currently expect the adoption of this ASU to have a material impact on its consolidated financial statements.

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:

	March 31, 2022	December 31, 2021
Ingredients	$ 2,207	$ 2,279
Packaging	2,933	2,723
Finished goods	3,509	3,283
Total inventories	$ 8,649	$ 8,285

Note 4 – Property, Plant and Equipment, net

Property, plant and equipment consisted of the following:

	March 31, 2022	December 31, 2021
Land	$ 1,565	$ 1,565
Buildings and improvements	17,961	17,920
Machinery and equipment	32,420	32,073
Vehicles	640	640
Office equipment	900	900
Construction in process	378	417
	53,864	53,515
Less accumulated depreciation	(34,042)	(33,385)
Total property, plant and equipment, net	$ 19,822	$ 20,130

Note 5 – Goodwill and Intangible Assets

Goodwill

Goodwill consisted of the following:

	Total
Balance at December 31, 2021, before accumulated impairment loses	$ 12,948
Accumulated impairment losses	(1,244)
Balance at December 31, 2021	$ 11,704
Balance at March 31, 2022	$ 11,704

Intangible Assets

Other intangible assets, net consisted of the following:

	March 31, 2022			December 31, 2021		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets with finite lives:						
Recipes	$ 44	$ (44)	$ –	$ 44	$ (44)	$ –
Customer lists and other customer related intangibles	4,529	(4,529)	–	4,529	(4,529)	–
Customer relationship	3,385	(1,092)	2,293	3,385	(1,052)	2,333
Brand names	7,948	(2,398)	5,550	4,248	(2,303)	1,945
Formula	438	(438)	–	438	(438)	–
Total finite lived intangible assets	16,344	(8,501)	7,843	12,644	(8,366)	4,278
Intangible assets with indefinite lives:						
Brand names (1)	–	–	–	3,700	–	3,700
Total intangible assets	$ 12,644	$ (8,501)	$ 7,843	$ 16,344	$ (8,366)	$ 7,978

(1) During the fourth quarter of 2021, the Company completed an assessment of the useful life of its one indefinite-lived brand name intangible asset and determined that it should adjust the estimated useful life from an indefinite length to 15 years. The change in accounting estimate was effective January 1, 2022, at which time the Company began amortizing the intangible asset over 15 years. The cost and accumulated amortization is included in Brand Names in the intangible assets with finite lives in the table above as of January 1, 2022. The Company has reclassified the $3,700 net book value as of December 31, 2021 from goodwill to finite lived intangible assets to conform the presentation as of March 31, 2022.

Estimated amortization expense on intangible assets for the next five years is as follows:

Year	Amortization
Nine months ended December 31, 2022	$ 405
2023	$ 540
2024	$ 540
2025	$ 540
2026	$ 540

Note 6 – Accrued Expenses

Accrued expenses consisted of the following:

	March 31, 2022	**December 31, 2021**
Payroll and incentive compensation	$ 2,444	$ 2,951
Real estate taxes	295	359
Current portion of operating lease liabilities	118	131
Other	333	283
Total accrued expenses	$ 3,190	$ 3,724

Note 7 – Debt

Note payable consisted of the following:

	March 31, 2022	December 31, 2021
Term loan due August 18, 2026. Interest (2.42% at March 31, 2022) payable monthly.	$ 4,250	$ 4,500
Unamortized deferred financing costs	(28)	(30)
Total note payable	4,222	4,470
Less current portion	(1,000)	(1,000)
Total long-term portion	$ 3,222	$ 3,470

The scheduled maturities of the term loan, excluding deferred financing costs, at March 31, 2022 are as follows:

Nine months ended December 31, 2022	$ 750
2023	1,000
2024	1,000
2025	1,000
2026	500
Total term loan	$ 4,250

Credit Agreement

On August 18, 2021, Lifeway entered into the Fourth Modification (the "Fourth Modification") to the Amended and Restated Loan and Security Agreement (as amended and modified from time to time, the "Credit Agreement" and, as amended and modified by the Fourth Modification, the "Modified Credit Agreement") with its existing lender and certain of its subsidiaries. The Fourth Modification amends the Credit Agreement to provide for, among other things, a $5 million term loan by the existing lender to the borrowers to be repaid in quarterly installments of principal and interest over a term of five years (the "Term Loan"). The termination date of the Term Loan is August 18, 2026, unless earlier terminated. 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 for the addition of the Term Loan, the Credit Agreement remains substantively unchanged and in full force and effect.

As amended, all outstanding amounts under the revolving line of credit and term loan 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 revolving line of credit fee of 0.20% and, in conjunction with the issuance of any letters of credit, a letter of credit fee of 0.20%.

The Modified Credit Agreement includes 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, and a minimum working capital financial covenant, as defined, of no less than $11.25 million, in each of the fiscal quarters ending through the expiration date. The Modified Credit Agreement 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 Credit Agreement may be accelerated. The loans and all other amounts due and owed under the Credit Agreement and related documents are secured by substantially all of the Company's assets.

Lifeway was in compliance with the fixed charge coverage ratio and minimum working capital covenants at March 31, 2022.

Revolving Credit Facility

As of March 31, 2022, the Company had $2,777 outstanding under the Revolving Credit Facility. The Company had $2,223 available for future borrowings under the Revolving Credit Facility as of March 31, 2022. Lifeway's interest rate on debt outstanding under the Revolving Credit Facility as of March 31, 2022 was 2.24%.

Note 8 – Leases

The Company leases 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 one year to five years. Some of its 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. Lifeway does not currently have leases which meet the finance lease classification as defined under ASC 842.

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, it directs the use of the asset and obtain substantially all the economic benefits of the asset.

The Company does 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 $65 and $78 (including short term leases) for the three months ended March 31, 2022 and 2021, respectively.

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. Lifeway has elected the practical expedient to combine lease and non-lease components into a single component for all of its leases. When the Company is unable to determine an implicit interest rate, it uses its incremental borrowing rate based on the information available at the commencement date in determining the present value of future payments for those leases. Lifeway includes 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 it 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
Nine months ended March 31, 2022	$ 120
2023	63
2024	46
2025	22
2026	6
Thereafter	–
Total lease payments	257
Less: Interest	(41)
Present value of lease liabilities	$ 216

The weighted-average remaining lease term for its operating leases was 2.4 years as of March 31, 2022. The weighted average discount rate of its operating leases was 12.9% as of March 31, 2022. Cash paid for amounts included in the measurement of lease liabilities was $43 and $142 for the three months ended March 31, 2022 and 2021, respectively.

Note 9 – Commitments and contingencies

Litigation

Lifeway is involved in various legal proceedings, claims, disputes, regulatory matters, audits, and proceedings arising in the ordinary course of, or incidental to the Company's business, including commercial disputes, product liabilities, intellectual property matters and employment-related matters.

Lifeway records provisions in the consolidated financial statements for pending legal matters when it believes it is probable that a loss will be incurred and the amount of such loss can be reasonably estimated. The Company evaluates, 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, it does not establish an accrued liability. Currently, none of its accruals for outstanding legal matters are material individually or in the aggregate to its 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 its business, financial condition, results of operations, or cash flows. However, if the Company is ultimately required to make payments in connection with an adverse outcome, it is possible that such contingency could have a material adverse effect on the Company's business, financial condition, results of operations or cash flows.

Note 10 – Income taxes

Income taxes were recognized at effective rates of 18.1% and 31.2% for the three months ended March 31, 2022 and 2021, respectively.

The Company has historically calculated the provision for income taxes during interim reporting periods by applying an estimate of the annual effective tax rate for the full fiscal year income, excluding unusual or infrequently occurring discrete items, for the reporting period. In accordance with the authoritative guidance, the Company used a discrete effective tax rate method to calculate income taxes for the quarter ended March 31, 2022 because small changes in the estimated level and mix of annual income or loss by jurisdiction would result in significant changes in the estimated annual effective tax rate making the historical method unreliable.

The Company's 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 jurisdictional mix of earnings, enacted tax legislation, state income taxes, the impact of non-deductible items, changes in valuation allowances, settlement of tax audits, and the expiration of the statute of limitations in relation to unrecognized tax benefits. The Company records discrete income tax items such as enacted tax rate changes and completed tax audits in the period in which they occur.

Unrecognized tax benefits were $0 and $96 at March 31, 2022 and 2021, respectively. The Company settled its one unrecognized tax benefit during the quarter ended March 31, 2022. The Company does not expect material changes to its unrecognized tax benefits during the next twelve months. However, the outcome of tax audits cannot be predicted with certainty. If a tax audit is resolved in a manner inconsistent with its expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

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 March 31, 2022, 3.281 million shares remain available under the Omnibus Incentive Plan. While the Company plans to continue to issue awards pursuant to the Plan at least annually, it 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 three months ended March 31, 2022:

	Options	Weighted average exercise price	Weighted average remaining contractual life	Aggregate intrinsic value
Outstanding at December 31, 2021	41	$ 10.42	4.22	$ –
Granted	–	–	–	–
Exercised	–	–	–	–
Forfeited	–	–	–	–
Outstanding at March 31, 2022	41	$ 10.42	3.97	$ –
Exercisable at March 31, 2022	41	$ 10.42	3.97	$ –

As of December 31, 2019, all outstanding options were vested and there was no remaining unearned compensation expense.

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 the Company's closing stock price on the grant date. Lifeway expenses RSAs over the service period. Board members may elect to defer receipt of their awards until their departure from the Board of Directors, subject to shareholder ratification at the 2022 annual shareholders meeting. The following table summarizes RSA activity during the three months ended March 31, 2022.

	Restricted Stock Awards	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2021	94	$ 4.50
Granted	–	–
Shares issued upon vesting	–	–
Forfeited	–	–
Outstanding at March 31, 2022	94	4.50
Vested and deferred at March 31, 2022	35	$ 5.69

For the three months ended March 31, 2022 and 2021 total pre-tax stock-based compensation expense recognized in the consolidated statements of operations was $63 and $36, respectively. For the three months ended March 31, 2022 and 2021 tax-related benefits of $18 and $11, respectively, were also recognized. Future compensation expense related to restricted stock awards was $135 as of March 31, 2022 and will be recognized on a weighted average basis over the next 1.12 years.

Long-Term Incentive Plan Compensation

Lifeway established long-term incentive-based compensation programs for fiscal year 2019 (the "2019 Plan") and for fiscal year 2021 (the "2021 Plan") for certain senior executives and key employees (the "participants"). 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. The 2021 Plan long-term incentive compensation is based on Lifeway's achievement of adjusted EBITDA performance versus the respective target established by the Board for 2021.

2020 CEO Incentive Award

During the fourth quarter 2020, Lifeway awarded a long-term equity-based incentive of $750 to its Chief Executive Officer (the "2020 CEO Award") depending on Lifeways 2020 performance levels compared to the respective targets. The equity-based incentive compensation is payable in restricted stock that vests one-third in April 2022, one-third in April 2023, and one-third in April 2024. The issuance of vested equity awards is subject to approval under the Stock Purchase Agreement dated October 1, 1999. For the three months ended March 31, 2022 and 2021, $85 and $90 was expensed as stock-based compensation expense in the consolidated statements of operations, respectively. As of March 31, 2022, the total remaining unearned compensation was $274, of which $144 will be recognized in 2022, $106 in 2023, $24 in 2024, respectively, subject to vesting. During Q2 2021, the number of shares awarded became fixed and determinable. Therefore, the award liability was reclassified from long-term liabilities to paid in capital.

2021 Equity Award

Under the 2021 Plan, collectively the participants can earn equity-based incentive compensation in amounts ranging from $0 to $1,069 depending on Lifeway's achievement of the respective financial target. The equity-based incentive compensation is payable in restricted stock that is expected to vest one-third in March 2022, one-third in March 2023, and one-third in March 2024. For the three months ended March 31, 2022 and 2021, $166 and $0 was expensed as stock-based compensation expense in the consolidated statements of operations, respectively. As of March 31, 2022, the total remaining unearned compensation was $516, of which $283 will be recognized in 2022, $194 in 2023, $39 in 2024, respectively, subject to vesting. As of March 31, 2022, the number of shares to be awarded is not fixed and determinable. Therefore, the liability is classified in accrued expenses and other long-term liabilities as of March 31, 2022. When the number of shares awarded becomes fixed and determinable, the award liability will be reclassified from liabilities to paid in capital.

Retirement Benefits

Lifeway has a defined contribution plan which is available to substantially all full-time employees. Under the terms of the plan, the Company matches employee contributions under a prescribed formula. For the three months ended March 31, 2022 and 2021 total contribution expense recognized in the consolidated statements of operations was $129 and $113, respectively.

Note 12 – Products and Customers

Lifeway's primary product is drinkable kefir. The Company manufactures (directly or through a co-manufacturer) and markets products under the Lifeway, Fresh Made, and GlenOaks Farms brand names, as well as under private labels on behalf of certain customers.

The Company's product categories are:

- Drinkable Kefir, a cultured dairy product sold in a variety of organic and non-organic sizes, flavors, and types.
- European-style soft cheeses, including farmer cheese, white cheese, and Sweet Kiss.
- Cream and other, which primarily consists of cream, a byproduct of raw milk processing.
- Drinkable Yogurt, sold in a variety of sizes and flavors.
- ProBugs, a line of kefir products designed for children.
- Other Dairy, which primarily consists of Fresh Made butter and sour cream.

Net sales by product category were as follows for the three months ended March 31:

	2022		2021	
	$	%	$	%
Drinkable Kefir other than ProBugs	$ 26,362	77%	$ 24,203	82%
Cheese	3,024	9%	3,199	11%
Cream and other	1,968	6%	863	3%
Drinkable yogurt	1,551	5%	–	0%
ProBugs Kefir	782	2%	680	2%
Other dairy	412	1%	431	2%
Net Sales	$ 34,099	100%	$ 29,376	100%

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 three months ended March 31, 2022 and 2021, respectively.

Note 13 – Related Party Transactions

Lifeway obtains consulting services from the Chairperson of its Board of Directors. 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, the Company's 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.

On January 4, 2022, the Company notified the Chairperson that it was terminating the agreement effective January 17, 2022. The Chairperson will continue as Chairperson of the Board of Directors.

Service fees earned are included in general and administrative expenses in the accompanying consolidated statements of operations and were $22 and $125 during each of the three months ended March 31, 2022 and 2021, respectively.

Lifeway is also a party to a royalty agreement with the Chairperson of its Board of Directors under which it pays 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 $150 during each of the three months ended March 31, 2022 and 2021.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) in this Form 10-Q is provided as a supplement to, and should be read in conjunction with, our audited consolidated financial statements, the accompanying notes, and the MD&A included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2021 (the “Form 10-K”). Unless otherwise specified, any description of “our”, “we”, and “us” in this MD&A refer to Lifeway Foods, Inc. and our subsidiaries.

Cautionary Statement Regarding Forward-Looking Statements

In addition to historical information, this quarterly report contains “forward-looking” statements within the meaning of the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. These statements may be identified by the use of words such as “anticipate,” “from time to time,” “intend,” “plan,” “ongoing,” “realize,” “should,” “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," "predict," and "estimate,” and similar terms or terminology, or the negative of such terms or other comparable terminology. Examples of forward-looking statements include, among others, statements we make regarding:

- Expectations of the effect on our financial condition of claims, litigation, environmental costs, contingent liabilities and governmental and regulatory investigations and proceedings;
- Strategy for acquisitions, customer retention, growth, product development, market position, financial results and reserves; Estimates of the amounts of sales allowances and discounts to our customers and consumers;
- Our belief that we will maintain compliance with our loan agreements and have sufficient liquidity to fund our business operations.

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 COVD-19 outbreak; and
- Such other factors as discussed throughout Part I, Item 1 “Business”; Part I, Item 1A “Risk Factors”; and Part II, Item 7 “Management's Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the year ended December 31, 2021 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. The Company intends 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 SEC pursuant to the SEC's rules, Lifeway has no duty to update these statements, and it undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Recent Developments

COVID-19 Pandemic Impact

We have seen increased customer and consumer demand for our products during the pandemic as consumers increased their food purchases for in-home consumption. We have not experienced significant supply chain disruptions or labor supply shortages and have continued to satisfy customer and consumer demand for our products. Management continues to proactively manage the supply and transportation of materials used to make and package our products, staffing, and transportation of our products to customers. This proactive planning has allowed the Company to avoid disruption to its manufacturing facilities and production, transportation, and sales and to meet the increased demand. The Company has maintained full production capacity available at all locations and does not anticipate manufacturing or staffing disruptions in the near term.

However, the COVID-19 pandemic, or any future pandemic, may limit the availability of, or increase the cost of, employees, ingredients, packaging and other inputs necessary to produce our products, and our operations may be negatively impacted. In 2022, our costs increased primarily due to inflationary price increases of milk, other ingredients, packaging materials, and transportation to our customers. However, because of market conditions or for competitive reasons, our pricing actions may sometimes lag input cost changes, or we may not be able to pass along the full effect of increases in raw materials and other input costs as we incur them.

During 2022, social distancing, shelter-in-place and work-from-home mandates and recommendations have continued to be reduced or eliminated. The increased customer demand for our products as consumers increased their at-home consumption and e-commerce purchasing during the COVID-19 pandemic may change or decrease due to the decrease in social distancing and stay-at-home and work-from-home mandates and recommendations. We are unable to predict the nature and timing of when such change may occur, if at all.

Results of Operations

Three Months Ended March 31, 2022 Compared to Three Months Ended March 31, 2021

The following table presents certain information concerning our financial results, including information presented as a percentage of consolidated net sales:

	Three Months Ended March 31,			
	2022		2021	
	$	%	$	%
Net sales	34,099	100.0%	29,376	100.0%
Cost of goods sold	27,863	81.7%	20,512	69.8%
Depreciation expense	656	1.9%	815	2.8%
Total cost of goods sold	28,519	83.6%	21,327	72.6%
Gross profit	5,580	16.4%	8,049	27.4%
Selling expenses	3,202	9.4%	3,222	11.0%
General & administrative expenses	3,292	9.7%	2,891	9.8%
Amortization expense	135	0.4%	–	0.0%
Total operating expenses	**6,629**	**19.5%**	**6,113**	**20.8%**
(Loss) income from operations	**(1,049)**	**(3.1%)**	**1,936**	**6.6%**
Other (expense) income:				
Interest expense	(42)	(0.1%)	(22)	(0.1%)
Loss on sales or property and equipment	–	0.0%	(7)	0.0%
Other (expense) income, net	(1)	0.0%	(8)	0.0%
Total other (expense) income	(43)	(0.1%)	(37)	(0.1%)
(Loss) income before provision for income taxes	**(1,092)**	**(3.2%)**	**1,899**	**6.5%**
(Benefit) provision for income taxes	(197)	(0.6%)	593	2.0%
Net (loss) income	**(895)**	**(2.6%)**	**1,306**	**4.5%**

Net Sales

Net sales finished at $34,099 for the three-month period ended March 31, 2022, an increase of $4,723 or 16.1% versus prior year. The net sales increase was primarily driven by higher volumes of our branded drinkable kefir and the impact of price increases implemented during the quarter, and to a lesser extent the favorable impact of our acquisition of GlenOaks Farms during the third quarter of 2021.

Gross Profit

Gross profit as a percentage of net sales was 16.4% during the three-month period ended March 31, 2022. Gross profit percentage was 27.4% in the prior year. The decrease versus the prior year was primarily due to the unfavorable impact of milk pricing, and to a lesser extent the increased pricing of freight and other inputs, partially offset by the decrease in depreciation expense. We expect to see continued pressure in milk pricing and other input costs during the fiscal year 2022.

Selling Expenses

Selling expenses decreased by $20 to $3,202 during the three-month period ended March 31, 2022 from $3,222 during the same period in 2021.

General and Administrative Expenses

General and administrative expenses increased $401 to $3,292 during the three-month period ended March 31, 2022 from $2,891 during the same period in 2021. The increase is primarily a result of increased legal and professional fees, which includes expense related to the fiscal year 2020 Form 10-K restatement.

Provision for Income Taxes

The provision for income taxes was $197 and $593 during the three months ended March 31, 2022 and 2021, respectively.

The effective income tax rate for the three months ended March 31, 2022 was 18.1% compared to 31.2% in the same period last year. The statutory Federal and state tax rates remained consistent from 2021 to 2022. The Company has items that are nondeductible or are discrete adjustments to tax expense. The company consistently reflects non-deductible officer compensation expense, non-deductible compensation expense related to equity incentive awards and separate state tax rates from period to period. Although similar items were reflected in 2022, the percentage effect is different due to the difference in pre-tax (loss) income in 2022 compared to 2021.

The Company’s 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 jurisdictional mix of earnings, enacted tax legislation, state income taxes, the impact of non-deductible items, changes in valuation allowances, settlement of tax audits, and the expiration of the statute of limitations in relation to unrecognized tax benefits. The Company records discrete income tax items such as enacted tax rate changes and completed tax audits in the period in which they occur.

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

Liquidity and Capital Resources

Management assesses the Company's liquidity in terms of its ability to generate cash to fund its operating, investing, and financing activities. The Company remains in a strong financial position, and while it has been impacted by the macroeconomic challenges with commodity inflation and other input cost increases, the Company believes that its cash flow from operations, revolving credit and term loan facility, and cash and cash equivalents will continue to provide sufficient liquidity for its working capital needs, capital resource requirements, and growth initiatives and to ensure the continuation of the Company as a going concern.

If additional borrowings are needed, $2,223 was available under the Revolving Credit Facility as of March 31, 2022 (see Note 7, Debt). We are in compliance with the terms of the Credit Agreement and expect to meet foreseeable financial requirements. 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. To date, we have been successful in generating cash and obtaining financing as needed. However, in connection with the COVID-19 pandemic or other circumstances, if a serious economic or credit market crisis ensues, it could have a negative effect on our liquidity, results of operations and financial condition.

The Company' most significant ongoing short-term cash requirements relate primarily to funding operations (including expenditures for raw materials, labor, manufacturing and distribution, trade and promotions, advertising and marketing, and income tax liabilities) as well as expenditures for property, plant and equipment.

Long-term cash requirements primarily relate to funding long-term debt repayments (see Note 7, Debt) and deferred income taxes (see Note 10, Income Taxes, in our Annual Report on Form 10-K).

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. 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.

Cash Flow

The following table is derived from our Consolidated Statement of Cash Flows:

	Three Months Ended March 31,	
	2022	**2021**
Net cash (used in) provided by operating activities	$ (648)	$ 1,210
Net cash (used in) provided by investing activities	(348)	(518)
Net cash (used in) provided by financing activities	(250)	–

Operating Activities

Net cash used in operating activities was $648 during the three-month period ended March 31, 2022 compared to net cash provided by operating activities of $1,210 in the same period in 2021. The decrease was primarily due to lower cash earnings, which reflect the impact of input and freight cost inflation in 2022, partially offset by the change in working capital.

Investing Activities

Net cash used in investing activities was $348 during the three-month period ended March 31, 2022 compared to $518 in the same period in 2021. The decrease in cash used reflects lower capital spending. 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.

Financing Activities

Net cash used in financing activities was $250 during the three-month period ended March 31, 2022 compared to net cash provided by financing activities of $0 in the same period in 2021. The increase in cash used relates to quarterly principal payments under the term loan entered into during August 2021 in connection with the acquisition of GlenOaks Farms, Inc.

Debt Obligations

As of March 31, 2022, the Company had $2,777 outstanding and $2,223 available for future borrowings under the revolving line of credit. Under the credit agreement, the Revolving Credit facility matures on June 30, 2025. The were no letters of credit issued or outstanding as of March 31, 2022.

The Company had $4,222 outstanding under the note payable, net of $28 of unamortized deferred financing fees, as of March 31, 2022,

The Company’s interest rate on debt outstanding under the revolving line of credit and note payable as of March 31, 2022 was 2.15%.

The Company is in compliance with all applicable financial debt covenants as of March 31, 2022. See Note 7 to our Consolidated Financial Statements for additional information regarding our indebtedness and related agreements.

Recent Accounting Pronouncements

Information regarding recent accounting pronouncements is provided in Note 2 – Summary of Significant Accounting Policies.

Critical Accounting Policies and Estimates

A description of the Company's critical accounting policies and estimates is contained in its Annual Report on Form 10-K for the year ended December 31, 2021. There were no material changes to the Company’s critical accounting policies and estimates in the three months ended March 31, 2022, except for the change in estimated useful life of one brand name intangible asset which is disclosed in Note 5 – Goodwill and Intangible assets.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

The Company has established disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission ("SEC"), and such information is accumulated and communicated to management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as appropriate, to allow timely decisions regarding required disclosure. Management, together with our CEO and CFO, evaluated the effectiveness of the Company's disclosure controls and procedures as of March 31, 2022. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of March 31, 2022.

Changes in Internal Control over Financial Reporting

As previously disclosed under "Item 9A—Controls and Procedures" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2021, we concluded that our internal control over financial reporting was not effective based on the material weakness identified.

Our remediation efforts were ongoing during the three months ended March 31, 2022. Remediation generally requires making changes to how controls are designed and implemented and then adhering to those changes for a sufficient period of time such that the effectiveness of those changes is demonstrated with an appropriate amount of consistency. We have continued to emphasize the importance of, and monitor the sustained compliance with, the execution of our internal controls over financial reporting. The Company has continued to work with its third-party service provider to ensure that our accounting and reporting for income taxes is accurate. If not remediated the deficiency could result in material misstatements to our consolidated financial statements.

Other than as described in the preceding paragraph, there have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the quarter ended March 31, 2022 that has materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Information regarding legal preceding is available in Note 9, Commitment and Contingencies.

ITEM 1A. RISK FACTORS.

There have been no material changes from the risk factors disclosed in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2021.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

No.	Description	Form	Period Ending	Exhibit	Filing Date
31.1	Rule 13a-14(a)/15d-14(a) Certification of Julie Smolyansky	Filed Herewith			
31.2	Rule 13a-14(a)/15d-14(a) Certification of Eric Hanson	Filed Herewith			
32.1	Section 1350 Certification of Julie Smolyansky*	Furnished Herewith			
32.2	Section 1350 Certification of Eric Hanson*	Furnished Herewith			
99.1	Press release dated August 26, 2022 reporting Lifeway's financial results for the three months ended March 31, 2022.*	Furnished Herewith			
101.INS	Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document)				
101.SCH	Inline XBRL Taxonomy Extension Schema Document				
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document				
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document				
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document				
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document				
104	Cover Page Interactive Data File (formatted in IXBRL, and included in exhibit 101).				

* The exhibits deemed furnished with this Form 10-Q and are not deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, nor shall they be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act., whether made before or after the date of the filing of this Form 10-Q and irrespective of any general incorporation language contained in such filing.

SIGNATURES

Pursuant to the requirements 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: August 26, 2022

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

Date: August 26, 2022

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

EXHIBIT 31.1

SECTION 302 CERTIFICATION OF C.E.O.
CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Julie Smolyansky, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lifeway Foods, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 26, 2022

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

EXHIBIT 31.2

SECTION 302 CERTIFICATION OF C.F.O.
CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Eric Hanson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lifeway Foods, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 26, 2022

By: /s/ Eric Hanson
Eric Hanson
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT 32.1

SECTION 906 CERTIFICATION OF C.E.O.
CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT
TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Lifeway Foods, Inc. (the "Company") for the period ended March 31, 2022 as filed with the SEC (the "Report"), the undersigned, in the capacity and on the date indicated below, hereby certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to her knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 26, 2022

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

EXHIBIT 32.2

SECTION 906 CERTIFICATION OF C.F.O.
CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT
TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Lifeway Foods, Inc. (the “Company”) for the period ended March 31, 2022 as filed with the SEC (the “Report”), the undersigned, in the capacity and on the date indicated below, hereby certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 26, 2022

By: /s/ Eric Hanson
Eric Hanson
Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit 99.1

Lifeway®

Lifeway Foods, Inc. Announces Results for the First Quarter Ended March 31, 2022

Net sales increase 16.1% year-over-year to $34.1 million; up 34.3% compared to 2020

Delivers 10th straight quarter of year-over-year net sales growth

Morton Grove, IL — August 26, 2022— Lifeway Foods, Inc. (Nasdaq: LWAY) (“Lifeway” or “the Company”), a leading U.S. supplier of kefir and fermented probiotic products to support the microbiome, today reported financial results for the first quarter ended March 31, 2022.

“I am pleased to announce that the first quarter marked yet another consecutive quarter of growth for Lifeway, highlighted by 16.1% year-over-year net sales growth,” commented Julie Smolyansky, Lifeway’s President and Chief Executive Officer. “Like others in the industry, we have faced inflationary challenges throughout 2022, but our team has worked tirelessly to respond swiftly to the dynamic operating environment and take decisive action in an effort to preserve our margin. We remain very encouraged by the demand of our drinkable Kefir product, which is the core driver of our results. We were recently awarded another rotation of Lifeway Kefir distribution at a large retailer in the club channel and have expanded our efforts to increase our presence in high visibility away-from-home locations, such as universities, small format convenience stores and healthcare settings. We are crafting strategy to build upon the amazing momentum we have amassed over the past two years and will work to maximize our gains by expanding product assortment with key retailers and reaching new customers with targeted marketing tactics. Consumers remain focused on immunity and gut health, and our probiotic Lifeway Kefir is well-positioned for continued growth as our addressable market expands.”

First Quarter 2022 Results

Net sales were $34.1 million for the first quarter ended March 31, 2022, an increase of $4.7 million or 16.1% from the same period in 2021. The net sales increase was primarily driven by higher volumes of our branded drinkable kefir and the impact of price increases implemented during the quarter, and to a lesser extent the favorable impact of our acquisition of GlenOaks Farms during the third quarter of 2021.

Gross profit as a percentage of net sales was 16.4% for the first quarter ended March 31, 2022.

Delayed Reporting of Financial Results

As previously announced, the Company experienced delays in reporting its financial results and filing its 10-K for the year ended December 31, 2021, which was subsequently filed on July 21, 2022. As a result, the reporting of financial results and filing of its 10-Q for the first quarter ended March 31, 2022 was also delayed.

About Lifeway Foods, Inc.

Lifeway Foods, Inc., which has been recognized as one of Forbes' Best Small Companies, is America's leading supplier of the probiotic, fermented beverage known as kefir. In addition to its line of drinkable kefir, the company also produces cheese, probiotic oat milk, and a ProBugs line for kids. Lifeway's tart and tangy fermented dairy products are now sold across the United States, Mexico, Ireland and France. Learn how Lifeway is good for more than just you at lifewayfoods.com.

Forward-Looking Statements

This release (and oral statements made regarding the subjects of this release) contains "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995 regarding, among other things, future operating and financial performance, product development, market position, business strategy and objectives. These statements use words, and variations of words, such as "continue," "build," "future," "increase," "drive," "believe," "look," "ahead," "confident," "deliver," "outlook," "expect," and "predict." Other examples of forward looking statements may include, but are not limited to, (i) statements of Company plans and objectives, including the introduction of new products, or estimates or predictions of actions by customers or suppliers, (ii) statements of future economic performance, and (III) statements of assumptions underlying other statements and statements about Lifeway or its business. You are cautioned not to rely on these forward-looking statements. These statements are based on current expectations of future events and thus are inherently subject to uncertainty. If underlying assumptions prove inaccurate or known or unknown risks or uncertainties materialize, actual results could vary materially from Lifeway's expectations and projections. These risks, uncertainties, and other factors include: price competition; the decisions of customers or consumers; the actions of competitors; changes in the pricing of commodities; the effects of government regulation; possible delays in the introduction of new products; and customer acceptance of products and services. A further list and description of these risks, uncertainties, and other factors can be found in Lifeway's Annual Report on Form 10-K for the fiscal year ended December 31, 2020, and the Company's subsequent filings with the SEC. Copies of these filings are available online at https://www.sec.gov, http://lifewaykefir.com/investor-relations/, or on request from Lifeway. Information in this release is as of the dates and time periods indicated herein, and Lifeway does not undertake to update any of the information contained in these materials, except as required by law. Accordingly, YOU SHOULD NOT RELY ON THE ACCURACY OF ANY OF THE STATEMENTS OR OTHER INFORMATION CONTAINED IN ANY ARCHIVED PRESS RELEASE.

Contact:

Lifeway Foods, Inc.
Phone: 847-967-1010
Email: info@lifeway.net

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
March 31, 2022 and 2021
(In thousands)

	March 31, 2022 Unaudited	December 31, 2021
Current assets		
Cash and cash equivalents	$ 7,987	$ 9,233
Accounts receivable, net of allowance for doubtful accounts and discounts & allowances of $1,320 and $1,170 at March 31, 2022 and December 31, 2021 respectively	11,389	9,930
Inventories, net	8,649	8,285
Prepaid expenses and other current assets	1,066	1,254
Refundable income taxes	503	344
Total current assets	**29,594**	**29,046**
Property, plant and equipment, net	**19,822**	**20,130**
Operating lease right-of-use asset	**216**	**216**
Intangible assets		
Goodwill	11,704	11,704
Intangible assets, net	7,843	7,978
Total intangible assets	**19,547**	**19,682**
Other assets	1,800	1,800
Total assets	**$ 70,979**	**$ 70,874**
Current liabilities		
Current portion of note payable	$ 1,000	$ 1,000
Accounts payable	8,723	6,614
Accrued expenses	3,190	3,724
Accrued income taxes	199	725
Total current liabilities	**13,112**	**12,063**
Line of credit	**2,777**	**2,777**
Note payable	**3,222**	**3,470**
Operating lease liabilities	**98**	**85**
Deferred income taxes, net	**3,201**	**3,201**
Other long-term liabilities	**224**	**147**
Total liabilities	**22,634**	**21,743**
Commitments and contingencies	–	–
Stockholders' equity		
Preferred stock, no par value; 2,500 shares authorized; no shares issued or outstanding at March 31, 2022 and December 31, 2021	–	–
Common stock, no par value; 40,000 shares authorized; 17,274 shares issued; 15,435 outstanding at March 31, 2022 and December 31, 2021, respectively	6,509	6,509
Paid-in capital	2,661	2,552
Treasury stock, at cost	(13,436)	(13,436)
Retained earnings	52,611	53,506
Total stockholders' equity	**48,345**	**49,131**
Total liabilities and stockholders' equity	**$ 70,979**	**$ 70,874**

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
For the three months ended March 31, 2022 and 2021
(In thousands, except per share data)

	2022	2021
Net Sales	**$ 34,099**	**$ 29,376**
Cost of goods sold	27,863	20,512
Depreciation expense	656	815
Total cost of goods sold	28,519	21,327
Gross profit	**5,580**	**8,049**
Selling expense	3,202	3,222
General and administrative expense	3,292	2,891
Amortization expense	135	–
Total operating expenses	**6,629**	**6,113**
(Loss) income from operations	(1,049)	1,936
Other (expense) income:		
Interest expense	(42)	(22)
Loss on sale of property and equipment	–	(7)
Other (expense) income, net	(1)	(8)
Total other (expense) income	(43)	(37)
(Loss) income before provision for income taxes	**(1,092)**	**1,899**
(Benefit) provision for income taxes	(197)	593
Net (loss) income	**$ (895)**	**$ 1,306**
Earnings (loss) per common share:		
Basic	$ (0.06)	$ 0.08
Diluted	$ (0.06)	$ 0.08
Weighted average common shares:		
Basic	15,435	15,604
Diluted	15,435	15,814

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the three months ended March 31, 2022 and 2021
(In thousands)

	Three months ended March 31,	
	2022	**2021**
Cash flows from operating activities:		
Net (loss) income	**$ (895)**	**$ 1,306**
Adjustments to reconcile net (loss) income to operating cash flow:		
Depreciation and amortization	791	815
Non-cash interest expense	2	6
Deferred revenue	(8)	(8)
Stock-based compensation	315	153
Loss on sale of property and equipment	–	7
(Increase) decrease in operating assets:		
Accounts receivable	(1,458)	(1,959)
Inventories	(364)	193
Refundable income taxes	(159)	(15)
Prepaid expenses and other current assets	188	54
Increase (decrease) in operating liabilities:		
Accounts payable	2,109	(301)
Accrued expenses	(643)	398
Accrued income taxes	(526)	561
Net cash (used in) provided by operating activities	**(648)**	**1,210**
Cash flows from investing activities:		
Purchases of property and equipment	(348)	(518)
Net cash used in investing activities	**(348)**	**(518)**
Cash flows from financing activities:		
Repayment of note payable	(250)	–
Net cash used in financing activities	**(250)**	–
Net (decrease) increase in cash and cash equivalents	**(1,246)**	**692**
Cash and cash equivalents at the beginning of the period	9,233	7,926
Cash and cash equivalents at the end of the period	**$ 7,987**	**$ 8,618**
Supplemental cash flow information:		
Cash paid for income taxes, net	$ 95	$ 47
Cash paid for interest	$ 40	$ 16
Non-cash investing activities		
Increase (decrease) in right-of-use assets and operating lease obligations	$ 36	$ 21