

Sep 03, 2024

Consumer

**LWAY**

NSD

Rating

**Outperform**

Unchanged

Current Price

**\$19.18**

Target Price

**\$25.00**

Market Capitalization

**283.69m**

Shares Outstanding

**14.79m**

Float

**4.09m**

Institutional Holdings

**19.36%**

12-Month Low/High

**\$9.06/\$28.61**

Average 90-Day Volume

**168850**

Fiscal Year End

**2024-12-31**

## Lifeway Foods

### Positive Momentum for Shares, Increasing Price Target

**Increasing Price Target.** Shares of LWAY have risen since the Company had record-breaking operating results in the second quarter. The increase in the share price, of around 15% from the announcement of second quarter results, along with the positive operating momentum of the Company pushes our target price from a previous \$20 to \$25.

**Rise in Price.** Since the second quarter results on August 13th, shares of LWAY have risen to \$19.18 as of Friday's close from \$16.66. The average volume per day over the course of this time (14 days) was approximately 255,571 shares as opposed to last quarter's 164,046. Although not all volume is positive, the positive trend indicates more investor interest in Lifeway's story and being encouraged with the Company's performance.

**Positive Operating Momentum.** The second quarter capped another quarter of record revenue, a continuation of year-over-year growth, and its fifth consecutive quarter of setting a record for revenue. Although the price of milk remains a headwind for the Company, Lifeway shows no signs of slowing down its revenue growth, and its operating efficiency will alleviate milk prices in our view. Management's marketing focus also brings a positive to the Company, putting more eyes on the Company's products and potentially expanding its revenue even more.

**Valuation.** With our \$25 price target, LWAY shares trade at an EV/Sales and EV/EBITDA multiple of 1.6x and 9.7x our 2025 revenue and EBITDA estimates. At the price target, LWAY shares trade below its peers with the group trading at 1.6x EV/Sales and 11.5x EV/EBITDA. We believe the multiples are more in-line with its peer group at our price target and represents the Company's recent operating results but takes into account its limited float and concentration in kefir.

**Maintaining Outperform.** We are maintaining our Outperform rating on LWAY shares but increasing our price target to \$25 from \$20. With its market leading position and ample white space to grow the brand, we believe the Company is in the early stages of a long-term growth period.

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#### Revenues (\$ MIL)

| Period | 2023A  | 2024E  | 2025E  |
|--------|--------|--------|--------|
| Q1     | 37.9A  | 44.6A  |        |
| Q2     | 39.2A  | 49.2A  |        |
| Q3     | 40.9A  | 51.5E  |        |
| Q4     | 42.1A  | 54.5E  |        |
|        | 160.1A | 199.8E | 230.0E |

#### EPS (\$)

| Period | 2023A | 2024E | 2025E |
|--------|-------|-------|-------|
| Q1     | 0.06A | 0.16A |       |
| Q2     | 0.21A | 0.25A |       |
| Q3     | 0.23A | 0.27E |       |
| Q4     | 0.26A | 0.30E |       |
|        | 0.75A | 0.99E | 1.53E |

## Company Profile

Founded in 1986 by Michael Smolyansky shortly after he and his family's emigration from Eastern Europe to the United States. Mr. Smolyansky was 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. 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. The Company'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 an 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. In addition to kefir, Lifeway has expanded into adjacent markets including farmer cheese and, most recently, probiotic cultured oat beverages and a line of adaptogenic functional mushroom beverages. In August 2021, Lifeway acquired GlenOaks Farms, adding drinkable yogurt to the product line.

For the year ended December 31, 2023, Lifeway generated revenue of \$160.1 million and net income of \$11.4 million, or \$0.75 per share.

## Fundamental Analysis — 3.0/5.0 checks

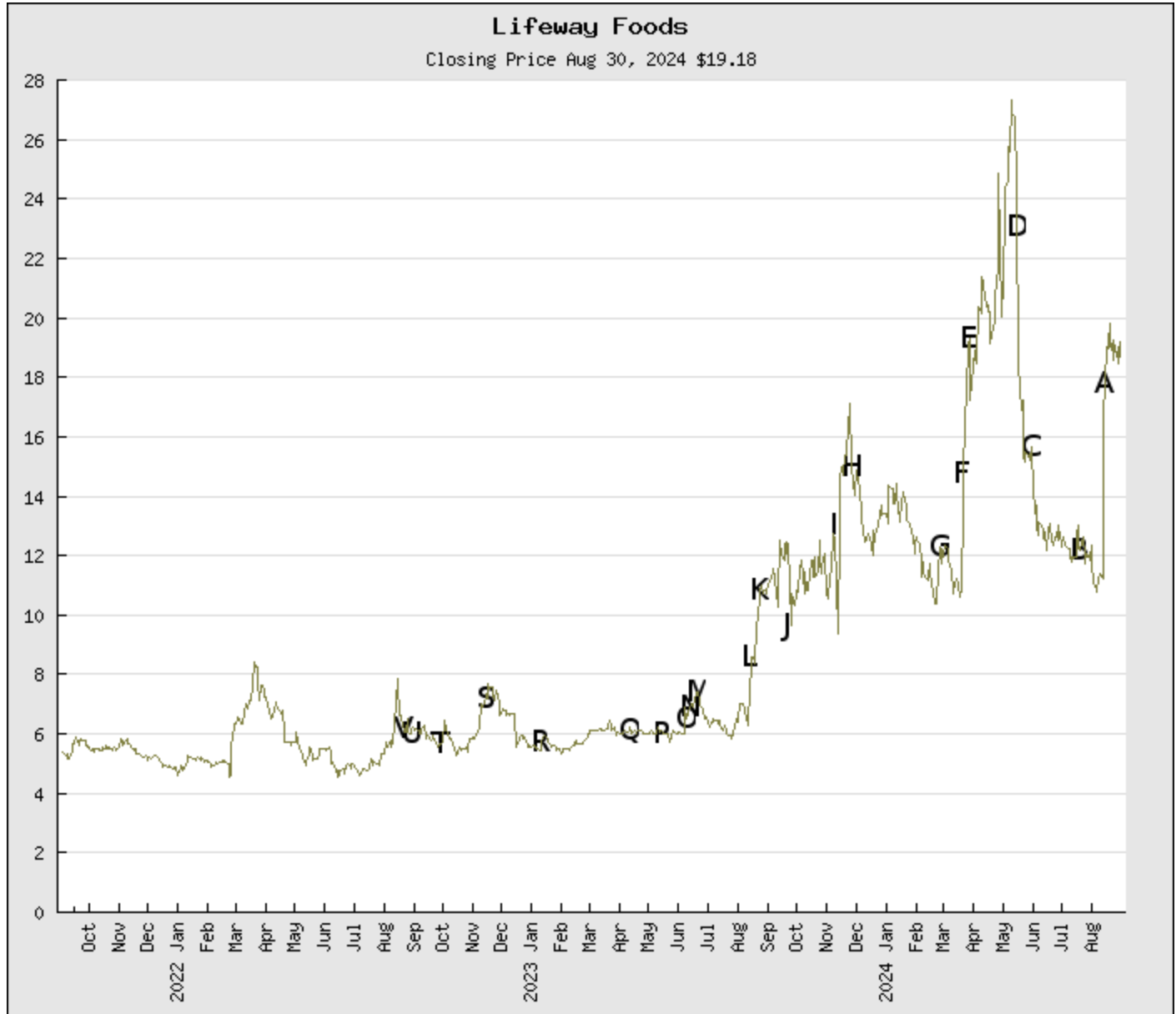
We give Lifeway Foods 3.0 checks out of 5.0, which falls within our "Average" range of 2.5 to 3.0 checks. We give the Company average marks for its Corporate Governance and Management. The Company has eight directors, six of whom are independent. The CEO and Chairperson roles are separated. Directors are elected annually. Management and the Board of Directors owned a reported 32.6% of the outstanding shares as of April 2023. There is a clawback policy to recover payments of incentive-based compensation from executives and management and Board members have stock ownership guidelines. This is offset by the concentration in family ownership and the 13 year average tenure of the Board members. We view Lifeway's overall market opportunity favorably, although this is a highly competitive industry with a number of competitors that are significantly larger than Lifeway. We believe there is additional operating leverage as the Company scales revenue. Lifeway's balance sheet is strong, although the Company may need to raise additional capital if it continues to acquire additional firms.

## Valuation Summary

We are maintaining our Outperform rating on Lifeway shares but increasing our price target to \$25 from a prior \$20. Our price target represents 1.6x and 9.7x our 2025 revenue and EBITDA estimates, respectively. These multiples compare to a peer group which trades at an average 1.6x on 2025 consensus revenue and 11.5x on consensus 2025 EBITDA basis. At our price target, the Company is more in line with its peers but takes into account its limited float and concentration on kefir. We believe the limited float has resulted in significant volatility in the share price and any change in sentiment towards the sale of the Company could result in additional volatility in the shares, either higher or lower, in our view. We continue to look favorably on the Company's operations, its recent record financial results, and its place in the "better for you" space.

## Key Risks Include, but are not limited to:

1. *Competitive Market* — Lifeway operates in a highly competitive overall market, with some competitors possessing substantially greater financial and marketing resources.
2. *Business Strategy* — Any inability to implement the Company business strategy of leveraging existing brands and new products may result in adverse impacts to operating results.
3. *Acquisitions* — Additional acquisitions bear all the risks-integration, overpayment, etc. — of any acquisition.
4. *International Growth* — Lifeway's international operations bring their own risk, such as currency fluctuations and heightened management oversight.
5. *Customer Consolidation* — The consolidation of customer or loss of a major customer— two customers accounted for approximately 24% of sales in 2023—could negatively impact sales and results of operations.



|                |                |                 |                 |                |                |                 |                 |
|----------------|----------------|-----------------|-----------------|----------------|----------------|-----------------|-----------------|
| A - 08/14/2024 | Outperform     | Target \$20.00  | Current \$17.80 | B - 07/19/2024 | Outperform     | Target \$20.00  | Current \$12.15 |
| C - 05/30/2024 | Outperform     | Target \$20.00  | Current \$15.68 | D - 05/15/2024 | Market Perform | Current \$23.06 |                 |
| E - 03/27/2024 | Market Perform | Current \$19.33 |                 | F - 03/21/2024 | Outperform     | Target \$16.00  | Current \$14.76 |
| G - 02/26/2024 | Outperform     | Target \$14.00  | Current \$12.31 | H - 11/27/2023 | Market Perform | Current \$14.97 |                 |
| I - 11/14/2023 | Outperform     | Target \$13.00  | Current \$13.00 | J - 09/25/2023 | Market Perform | Current \$9.65  |                 |
| K - 08/24/2023 | Outperform     | Target \$12.00  | Current \$10.83 | L - 08/16/2023 | Outperform     | Target \$10.00  | Current \$8.56  |
| M - 06/20/2023 | Outperform     | Target \$10.00  | Current \$7.41  | N - 06/12/2023 | Outperform     | Target \$10.00  | Current \$6.90  |
| O - 06/09/2023 | Outperform     | Target \$10.00  | Current \$6.50  | P - 05/16/2023 | Outperform     | Target \$10.00  | Current \$6.00  |
| Q - 04/11/2023 | Outperform     | Target \$10.00  | Current \$6.11  | R - 01/11/2023 | Outperform     | Target \$10.00  | Current \$5.71  |
| S - 11/16/2022 | Outperform     | Target \$10.00  | Current \$7.21  | T - 09/29/2022 | Market Perform | Current \$5.68  |                 |
| U - 08/29/2022 | Market Perform | Current \$6.02  |                 | V - 08/23/2022 | Market Perform | Current \$6.20  |                 |

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The fundamental assessment rating system is designed to provide insights on the company's fundamentals both on a macro level, which incorporates a company's market opportunity and competitive position, and on a micro/company specific level. The micro/company specific attributes include operating & financial leverage, and corporate governance/management. The number of check marks that a company receives is designed to provide a quick reference and easy determination of the company's fundamentals based upon the following five attributes of the company (weighting reflects the importance of each attribute in the overall scoring of company's fundamental analysis):

| Attribute                       | Weighting |
|---------------------------------|-----------|
| Corporate Governance/Management | 20%       |
| Market Opportunity Analysis     | 20%       |
| Competitive Position            | 20%       |
| Operating Leverage              | 20%       |
| Financial Leverage              | 20%       |

For each attribute, the analysts score the company from a low of zero to a high of ten based upon the analysis described below. The final rating and resulting check marks is a result of dividing the overall score (out of 100%) by ten.

| Rating        | Score     | Checks                |
|---------------|-----------|-----------------------|
| Superior      | 9.1 to 10 | Five Checks           |
| Superior      | 8.1 to 9  | Four & A Half Checks  |
| Above Average | 7.1 to 8  | Four Checks           |
| Above Average | 6.1 to 7  | Three & A Half Checks |
| Average       | 5.1 to 6  | Three Checks          |
| Average       | 4 to 5    | Two & A Half Checks   |
| Below Average | 3 to 3.9  | Two Checks            |
| Below Average | 2 to 2.9  | One & A Half Checks   |
| Low Quality   | 0 to 1.9  | One Check             |

While these are the attributes currently used for the analyst's fundamental analysis, the attributes and weighting may be reviewed, updated with additional attributes, and/or changed in the future based on discussions with the analysts and recommendations from the Director of Research.

Following is the description of each attribute in the fundamental analysis.

### Corporate Governance/Management

We believe that a review of corporate governance and assessment of the senior management are important tools to determine investment merit. Good corporate governance aligns management with the interests of stakeholders. As such, analysts are to rank the company on the basis of good corporate governance principles that may include rules and procedures, board composition and staggered term limits, rights and responsibilities, corporate objectives, monitoring of actions and policies, and accountability. In addition, analysts will assess issues with controlling shareholders and whether decisions have been made in the past that were in the interests of all shareholders. In addition, management will be assessed based on industry experience, expertise, and/or track record.

High ranking example: Board and management that is aligned with the interests of shareholders with incentives based on stock price appreciation and with an experienced management team known for exceptional shareholder returns.

Low ranking example: Concentrated ownership without independent directors that do not necessarily align with all shareholders' interests.

### The Market Opportunity Analysis

In this review, the analyst assesses the company's macro environment as a measure of understanding the industry. Factors considered include the size and growth potential of the industry under various economic conditions, the emerging demands in the market, technological benefits/disruptions, competition, geographical opportunities, and customer demands/needs, and an assessment of supply and distribution channels. In addition, the analyst will review legal and regulatory trends, as well as potential shifts in consumer or social behavior and natural environment changes.

High rank example: A company in an industry that is growing revenues well above GDP rates (which are on average 2% plus) and/or may have unmet or underserved needs in a rapidly growing market opportunity.

Low rank example: A mature industry that is in secular decline and likely to grow below GDP rates.

### Competitive Position

The evaluation of the company's competitive position is another macro environment attribute designed to measure the relevance, market share, position and value proposition, and sustainable differentiations of the company and its products/services within its industry. Ease of entry into the industry and the ability of other well-funded players to potentially enter the market would be determined. As such, the assessment would consider the company's strengths and advantages of its products/services against weaknesses and limitations. This may include the company's current brand awareness, pricing and cost structure, current market strategies and geographic penetration that may affect demand for its products/services. In addition, the company's competitors would be evaluated.

High rank example: An analyst would consider the company's product to be superior to its competitors and that should allow the company to gain market share.

Low rank example: A company with a "me-too" product that does not have any significant technology advantages in an industry that has low barriers to entry.

### Operating Leverage

Simplistically, operating leverage is determined by the operating income relative to changes in revenue. The analyst will calculate the impact on sensitivity on gross margins and variable costs to determine operating leverage. The analyst will take into account the ability of the company to cut fixed and variable costs in a challenged revenue environment and technological changes that may impact operating expenses. In addition, the analyst is to assess corporate strategies that include capital investment, which may be required for sustainable revenue growth, marketing expenses, and the company's ability to attract and retain talent and/or employees. The analyst should focus on the revenue opportunity and determine the price elasticity of demand for the company's products or services. In other words, the analyst is to rank the company based on improved operating margins going forward on an absolute and relative basis.

High rank example: A company that has improving margins for the foreseeable future, with significant price elasticity.

Low rank example: A company that is in a challenged revenue environment with a fixed cost structure and limited ability to cut costs, indicating an outlook for declining margins.

### Financial Leverage

A strict definition of financial leverage is total debt divided by total shareholder's equity. Financial leverage analysis is to determine the company's ability to improve shareholder value by means of utilizing its balance sheet to grow organically or to acquire assets. Analysts may look at the company's debt to cash flow leverage ratio, interest coverage ratios, or debt to equity ratios. In addition, the interest rate environment and the outlook for interest rates are a factor in determining the company's ability to manage financial leverage. Finally, the analyst is expected to determine the ability to service the debt given the industry and/or company profile, such as cyclical, barriers to entry, history of bankruptcy, consistency in revenue and profit growth, or predictability in sales and profits and large cash reserves. The analyst is expected to take into account capital intensity of the company and the anticipated of capital allocation decisions.

High rank example: A company with predictable and growing revenue and cash flow with modest debt levels. This may indicate that the company could improve shareholder value through growth investments, including acquisitions, using debt financing.

Low rank example: A company in a cyclical industry in a late stage economic cycle that has above average debt leverage and is in an industry that has a history of financial challenges, including bankruptcies.

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| NOBLE RATINGS DEFINITIONS  | % OF SECURITIES COVERED | % IB CLIENTS |
|--|-------------------------|--------------|
| Outperform: potential return is >15% above the current price         | 91%                     | 23%          |
| Market Perform: potential return is -15% to 15% of the current price | 9%                      | 3%           |
| Underperform: potential return is >15% below the current price       | 0%                      | 0%           |

**NOTE:** On August 20, 2018, Noble Capital Markets, Inc. changed the terminology of its ratings (as shown above) from "Buy" to "Outperform", from "Hold" to "Market Perform" and from "Sell" to "Underperform." The percentage relationships, as compared to current price (definitions), have remained the same.

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Report ID: 26963