

PACE UNIVERSITY *Student Research*

Food Processing

This report is published for educational purposes only by students competing in the New York Society of Security Analysts Investment Research Challenge.

March 25, 2003

Galaxy Nutritional Foods, Inc.

Analysts:

Adriana Kalova

E-mail: adriana_kalova@hotmail.com

Charles Yan

E-mail: charles-yan@usa.net

Priya Hariani

E-mail: priya_hariani@yahoo.com

Ronny Veith

E-mail: djynn_rv@yahoo.com

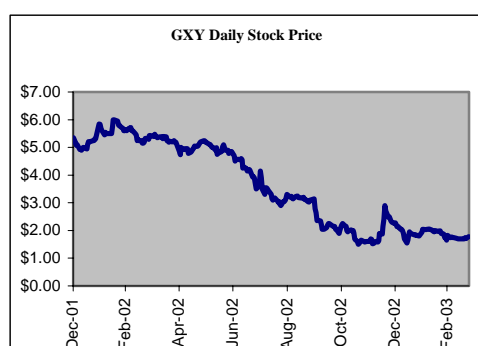
Ticker: GXY

Price: \$ 1.78

Recommendation: HOLD

12-month price target: \$ 1.84

Stock Data		Forecasts	2004E	2005E
52-week range	\$1.41-\$5.54	Revenue (\$ m)	45.136	52.805
Beta	1.8	EBITDA (\$ m)	5.168	6.712
Shares o/s (m)	12.8	EBITDA Margin (%)	11.45%	12.71%
Avg. Daily Volume (k)	28.1	Shares o/s (m)	15	15
Institutional Holdings	18%	Tax Rate (%)	0%	35%
Insider Holdings	22%	EPS (\$)	\$0.06	\$0.09
Market Cap. (\$ m)	22.7	FCF/Share (\$)	\$0.20	\$0.17
Book Value/share	\$0.58	Price /Sales (X)	0.65x	0.65x
Debt/Equity	2.65	Debt/Equity	1.47	1.24
Fiscal Year-end	Mar. 31			



Normalized Earnings/Share

	Jun.	Sep.	Dec.	Mar. E	Year E	P/E Ratio
2003A	(\$0.07)	(\$0.05)	(\$0.04)	(\$0.01)	(\$0.17)	NA
2004E	(\$0.01)	\$0.01	\$0.02	\$0.03	\$0.05	32.33

Highlights

- We are placing a HOLD recommendation on Galaxy Nutritional Foods (Galaxy) with a 12-month price target of \$1.84. Under new management, the Company has returned to operating profitability but still needs to complete its financial restructuring.
- We used a peer group median of the trailing 12-month Price/Sales ratio, EV/EBITDA ratio and P/E ratio to FY 2004 estimate of sales, EBITDA and EPS of Galaxy to arrive at our price target. Galaxy is currently trading at a discount to its peer group for Price/Sales and EV/EBITDA. We believe that Galaxy should reach the peer group median in the next twelve months.
- Galaxy is a market leader in the alternative cheese category, with 59% market share. The market for soy foods is expected to grow at 17% for the next 4 years. The Company has become more profitable by reducing the number of SKU's it produces and by focusing on its core Veggie and Soyco brands.
- Galaxy is faced with maturing debt of \$4.8 million and a \$4.2 million expiring line of credit. The biggest risk facing the Company is its ability to refinance or renegotiate this debt. Management is currently in discussions with lenders and is confident of finding a suitable solution. However, failure to do so could result in steep penalty fees and higher interest charges or possibly even bankruptcy.
- Galaxy also faces a potential dilution problem with 3.9 million of employee stock options outstanding and 57,384 shares of Convertible Preferred Stock. These options have an exercise price of \$2.05 and the preferred stock must be redeemed by April 2005 at \$48.18 plus accrued dividends.



The New York Society of Security Analysts
1601 Broadway, 11th Floor, NY, NY 10019
212-541-4530 www.nyssa.org

Important disclosures appear at the back of this report.

Investment Summary

We are placing a HOLD recommendation on the stock of Galaxy Nutritional Foods, Inc. with a 12-month price target of \$1.84. Galaxy is currently trading at \$1.78 implying a return of 3% over the next twelve months.

Galaxy is trading at a Price/Sales multiple of 0.57x vs. a peer group median multiple of 0.61x. We expect the Company to reach the peer group median in the next twelve months. Although Galaxy's sales growth and margins are better than the peer group, we don't expect it to trade at a premium to its peers due to the high leverage, low interest coverage and the uncertainty surrounding the Company's ability to refinance its debt maturing in July 2003.

Galaxy is a market leader in the alternative cheese category. It's two brands Veggie and Soyco, combined hold a 59% share of the market. Under the new CEO, Christopher New, the Company has shown improved results by focusing on its more profitable brands. For the nine months ended Dec 2002, the Company's gross margin improved to 29.7%, compared to 23.8% one-year ago, and EBITDA increased to 8.6% versus negative 3.5% one year ago.

Galaxy's negative performance in FY 2002 was due to the delay in the installation of new equipment. In FY 1999 and 2000 the Company experienced increasing demands for its products (revenues grew by 45% and 41% respectively). In FY 2001, management decided to purchase additional equipment. To finance this purchase, Galaxy raised funds from several sources, including FINOVA, South Trust Bank and several equity offerings.

The installation of the equipment was significantly delayed and was not completed until the middle of FY 2002. This delay had a devastating effect on Galaxy's operations, resulting in a drop in production, increased overhead costs, shortfalls in cash, a drop in order fulfillment, and reduced margins. As the working capital situation deteriorated, Galaxy violated several debt covenants, resulting in higher interest rates on the line of credit and other loans and paying penalty fees for waivers and extensions.

The Company needs to replace its \$4.2 million line of credit and repay \$4.8 million of maturing debt on July 2003. Management is confident they can replace this line of credit and raise \$3.5 million through an equity offering. They also feel confident they can raise an additional \$2 million in loans from South Trust bank. This will considerably lower the Company's interest expense and provide additional working capital. Given the poor capital market environment we are not as confident as management that they will be able to raise the required funds at the expected rate of prime +1%.

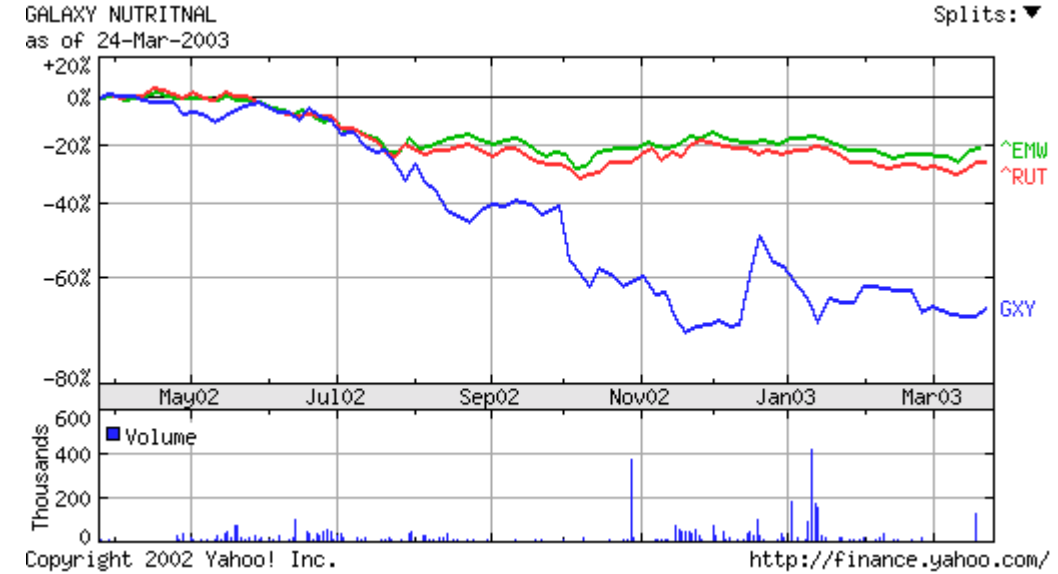
Under the new management structure and Board of Directors Galaxy exhibited strong sales growth potential and improved operating performance. However, if the Company fails to raise the required capital or renegotiate the existing debt they may not be able to continue as a going concern.

Valuation

Stock Performance

Galaxy has under-performed the Russell 2000 and the Wilshire 4500 by 38.8% in the last year. This was due to the operational and financial problems they faced in FY 2002.

Figure 1: Price Performance of GXY vs. Russell 200 (^RUT) and Wilshire 4500 (^EMW) Index



Source: Yahoo Finance

Relative Valuation

We arrived at a twelve-month price target of \$1.84 using an average of the Price/Sales, EV/EBITDA and P/E multiples. This price is also supported by our discounted cash flow model. Galaxy is currently trading at a discount to its peer group for Price/Sales and EV/EBITDA. We believe that Galaxy should reach the peer group median in the next twelve months as results improve, assuming they are able to refinance. While the Company will continue to be more leveraged, it has stronger projected sales growth and potential for improving margins. However, the uncertainty regarding the refinancing is too great for the stock to trade at premium.

In order to value Galaxy, we used the median trailing 12-month price to sales, EV/EBITDA and P/E multiples of Galaxy's peer group to estimated sales, EBITDA and earnings of Galaxy for FY2004.

The peer group consists of sixteen food-processing companies with a mean market capitalization of \$164 million. These companies are comparable to Galaxy in terms of revenues, market capitalization, financial leverage, and operating margins. Several of these companies are Galaxy's competitors in the organic, dairy alternative, or dairy categories (See Appendix 1 for Peer Group Index).

Galaxy is currently trading at a Price/Sales multiple of 0.57x vs. a peer group multiple of 0.61x. We feel that this discount to the peer group is due to the poor performance of Galaxy in FY 2002, the highly leveraged capital structure and the uncertainty concerning the Company's ability to raise sufficient capital to meet its maturing debt obligations.

Going forward we expect Galaxy to trade at its peer group level. For 3QFY2003, the Company reported a gross profit of 30.8% and an EBITDA margin of 8.93%, compared to the most recent quarter average peer group gross margin of 30.2% and EBITDA margin of 5.6%. For FY2004 we estimate sales growth of 12%, EBITDA margin of 11.45%, and net profit margin of 1.8%. While it appears the Company has turned around its operating performance the uncertainty of the refinancing will continue to place pressure on the stock price.

Applying the peer group Price/Sales ratio of 0.61x to Galaxy's expected FY2004 sales of \$45.3 million, we arrive at a 12-month price target of \$1.82.

Similarly, using the peer group median P/E of 18.6 to FY 2004 \$0.05 earnings per share estimate for Galaxy we arrive at the 12-month price target of \$0.93.

We also valued Galaxy using a trailing 12-month peer group EV/EBITDA of 11.4x to estimated FY2004 EBITDA of \$ 5.2million. Using our pro forma debt estimates of \$ 15.8 million and preferred shares of \$1.7 million we arrive at an estimated market value of \$ 41.2 million. Dividing by an estimated 15 million shares outstanding we arrive at a 12-month price target of \$2.76.

We arrive at our 12-month price target by taking the average of these three target prices (\$1.82, \$0.93 and \$2.76), or \$1.84.

Figure 2: Relative Valuation (Closing Market Prices as of March 24, 2003)

All figures in 000s

Company	Ticker	Shares	Market	Market	Enterprise	Sales	EBITDA	Price/	EV/	PE	FY 2003	FY 2004
		O/s	Value	Price	Value			Sales	EBITDA		EPS Est.	EPS Est.
Galaxy Nutritional Foods	GXY	12,800	\$22,700	\$1.77	\$42,867	\$40,074	-\$1,808	0.57 X	-23.7 X	-2.14 X		
<i>(Trailing Twelve Months)</i>												
Galaxy Nutritional Foods	GXY	12,800	\$21,900	\$1.77	\$42,067	\$40,300	\$4,466	0.56 X	9.6 X	14.26 X	(\$0.17)	\$0.05
<i>(FY 2003 E)</i>												
PEER GROUP INDEX												
Aurora Foods	AOR	77,100	\$29,300	\$0.38	\$1,122,915	\$849,397	\$88,254	0.03 X	12.72 X	NA	\$0.11	\$0.11
Brigford Foods Corp	BRID	10,400	\$77,800	\$7.48	\$67,495	\$139,202	\$6,479	0.56 X	10.42 X	65.18 X		
Cal-Maine Foods Incorp.	CALM	11,800	\$42,900	\$3.64	\$173,808	\$347,186	\$5,044	0.12 X	34.46 X	NA		
Golden Enterprises	GLDC	11,900	\$29,400	\$2.47	\$33,758	\$96,042	\$64	0.31 X	NA	NA		
Hain Celestial Group Inc.	HAIN	34,100	\$519,400	\$15.23	\$565,458	\$385,748	\$18,551	1.35 X	30.48 X	21.18 X	\$0.84	\$1.05
Horizon Organic Holding	HCOW	10,300	\$144,900	\$14.07	\$182,683	\$178,219	\$8,076	0.81 X	22.62 X	41.00 X	\$0.42	\$0.49
Lance Incorporated	LNCE	29,100	\$236,300	\$8.12	\$277,939	\$552,027	\$43,250	0.43 X	6.43 X	13.36 X	\$0.55	\$0.65
Lucille Farms Inc	LUCY	3,290	\$2,860	\$0.87	\$13,688	\$38,301	-\$1,939	0.07 X	NA	NA		
Lifeway Foods Inc	LWAY	4,270	\$28,200	\$6.60	\$21,975	\$11,602	\$2,285	2.43 X	9.62 X	17.41 X	\$0.38	\$0.48
NBTY Incorporated	NBTY	66,500	\$1,240,000	\$18.65	\$1,374,486	\$990,397	\$159,882	1.25 X	8.60 X	13.87 X	\$1.37	\$1.65
Northland Cranberries	NRCNA	9,150	\$64,100	\$7.01	\$131,590	\$92,899	\$3,272	0.69 X	40.22 X	21.67 X		
Reliv International Inc	RELV	11,300	\$48,000	\$4.25	\$49,539	\$58,208	\$3,304	0.82 X	14.99 X	27.89 X	\$0.19	\$0.26
Seneca Foods Corp	SENEB	6,590	\$118,600	\$18.10	\$210,162	\$647,141	\$28,407	0.18 X	7.40 X	19.80 X		
Spectrum Organic Products	SPOP	45,700	\$18,300	\$0.40	\$21,018	\$41,065	\$1,694	0.45 X	12.41 X	15.25 X		
Tofutti	TOF	6,120	\$15,900	\$2.60	\$13,160	\$17,186	\$1,582	0.93 X	8.32 X	15.88 X		
Yocream	YOCM	2,250	\$12,700	\$5.64	\$12,389	\$19,440	\$1,549	0.65 X	8.00 X	13.11 X	\$0.55	
Mean			\$164,291		\$267,004	\$279,004	\$23,110	0.69X	16.19 X	23.80 X		
Median			\$45,450		\$99,443	\$117,622	\$4,174	0.61 X	11.41 X	18.61 X		
High			\$1,240,000		\$1,374,486	\$990,397	\$159,882	2.43 X	40.22 X	65.18 X		
Low			\$2,860		\$12,389	\$11,602	-\$1,939	0.03 X	6.43 X	13.11 X		
FY 2004 E												
Galaxy Nutritional Foods	GXY	15,000	\$29,181			\$45,136	\$5,168					

Source: Yahoo Finance, Business Industry Data base, Student Estimates

Discounted Cash Flow

We arrive at a 12-month price target of \$2.01 for the stock of Galaxy using a discounted cash flow model. This supports the price target of \$1.84 using relative valuation.

This price is based on the sales growth estimate of 12% for FY 2004, 17% for FY 2005 and FY 2006, 15% for FY 2007-2012 and a terminal growth of 4% beyond FY 2012. Sales are expected to grow at only 12% for FY 2004 as the Company's financial restructuring is still not completed.

We used the operating income from our earnings model and then subtracted changes in working capital and net capital expenditures (CAPEX-depreciation) to calculate free cash flow. These cash flows are discounted using WACC of the firm. (See Appendix 2 for Earnings Model)

Weighted average cost of capital (WACC) is based on the following assumptions:

- Cost of equity is computed using the CAPM. According to Yahoo Finance, the company's beta was - 0.19, which we feel is not appropriate for the level of risk inherent in Galaxy's common stock. We then calculated an alternative beta using the published betas of the peer group. We unlevered each of the peer company's betas; arriving at an unlevered beta for the industry; and then used this beta along with the current Debt to Equity ratio and tax rate of Galaxy to get a final beta of 1.8. Using this beta, we calculated the cost of equity as 13.5% (See Appendix 3 for Beta calculation).
- We calculated the cost of preferred stock at 12.9%, using the schedule for preferred dividends and the book value of preferred equity (See Appendix 4 for Cost of Preferred Stock).
- The company has three different loans outstanding. We calculated cost of debt of 9.6% as the weighted average cost of their current debt outstanding (See Appendix 4 for Debt calculation).
- Effective FY2005, we adjusted the weights of debt, equity, and preferred stock to reflect anticipated changes in the capital structure. We also raised our tax rate to 35% from zero.

This gives us a WACC of 11.81% for FY2003/2004 and a WACC of 10.38% effective FY2005.

Figure 3: Discounted Cash Flow Calculation

In 000's	FY 2002	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E
Operating Income (EBIT)	(\$9,009)	\$1,498	\$2,892	\$4,436	\$5,808	\$6,679	\$7,681	\$8,833	\$10,158	\$11,682	\$13,434
Tax Rate	0%	0%	0%	35%	35%	35%	35%	35%	35%	35%	35%
EBIT * (1-t)	(\$9,009)	\$1,498	\$2,892	\$2,883	\$3,775	\$4,341	\$4,993	\$5,742	\$6,603	\$7,593	\$8,732
Changes in Inventories	\$5,026	\$549	(\$520)	(\$972)	(\$1,205)	(\$1,385)	(\$1,593)	(\$1,832)	(\$2,107)	(\$2,423)	(\$2,786)
Changes in Payables	(\$3,556)	(\$649)	(\$350)	(\$400)	(\$800)	\$465	\$535	\$615	\$707	\$813	\$935
Changes in Receivables	\$2,364	\$920	(\$540)	(\$857)	(\$1,061)	(\$1,221)	(\$1,404)	(\$1,614)	(\$1,856)	(\$2,135)	(\$2,455)
Prepaid Expenses	\$1,071	\$256	(\$603)	(\$153)	(\$180)	(\$206)	(\$237)	(\$273)	(\$314)	(\$361)	(\$415)
Total Changes in Working Capital	\$4,905	\$1,076	(\$2,013)	(\$2,383)	(\$3,246)	(\$2,347)	(\$2,700)	(\$3,105)	(\$3,570)	(\$4,106)	(\$4,722)
CAPEX		\$195	\$218	\$256	\$299	\$344	\$395	\$455	\$523	\$601	\$0
Dep. & Amortization		\$2,968	\$2,276	\$2,276	\$2,276	\$2,276	\$2,276	\$2,276	\$2,276	\$2,276	\$0
No. of shares o/s		12,800	15,000								
FCFF		5,347	2,936	2,521	2,507	3,926	4,174	4,458	4,786	5,162	4,011
WACC			11.81%	10.38%	10.38%	10.38%	10.38%	10.38%	10.38%	10.38%	10.38%
PV of FCFE			\$2,626	\$2,069	\$1,864	\$2,645	\$2,548	\$2,465	\$2,398	\$2,343	\$1,649
Long Term Growth Rate											4%
Implied Terminal Value											\$65,406
Gross Present Value of Firm	\$ 47,505										
	\$/Share \$2.01										
Weighted Average Cost of Capital	Cost of Equity										
Type	Rate	2003	2004E	= Risk Free Rate + (Beta* Market Risk Premium)							
Debt	9.6%	\$17,877	\$15832	Risk Free Rate (3/11/03)		3.6%					
Preferred Stock	12.9%	\$1,713	\$1,713	Beta		1.8					
Common Equity (Mkt. Cap.)	13.5%	\$22,300	\$25,300	Market Risk Premium		5.5%					
WACC		11.81%	10.38%	Cost of Equity		13.5%					

Source: Company Documents, Student Estimates

Financial Restructuring

What went wrong?

In FY 1999 and 2000 the company experienced increasing demand for its products, with revenues growing by 45% and 41% respectively. In FY 2001, management decided to purchase additional equipment. The installation of the equipment was significantly delayed and was not completed until the middle of FY 2002.

The purchase of the equipment was principally financed by a term loan from South Trust Bank N.A. However, due to the delays in the installation, Galaxy experienced excess overhead costs and significant down time. As a result, the Company used its available working capital to speed installation of the new equipment and begin production. This resulted in:

- Inability of Galaxy to purchase sufficient amount of casein, the main ingredient in most of their products.
- Reduced production of only 200lbs/week, vs. a demand for nearly 800lbs/week.
- Drop in Case Fill to 40% and Order Fill to 17%.
- Increased selling expenses as the Company paid retailers to retain shelf space.
- Violation of debt covenants, resulting in a rise in interest rates to 15.5%, from 11.5% on \$4 million loan from FINOVA and high penalty fees.

In the beginning of FY 2002 the Company also issued \$3.1 million of convertible preferred to fund working capital needs. The preferred equity carries the right to a 10% preferred stock dividend for FY 2002 and 8% for subsequent three years.

FY 2002 was disastrous for the Company. They were faced with rising costs, an inability to purchase raw materials, falling sales and increasing interest expense. To make matters worse, FINOVA, the primary asset based lender, filed to reorganize under Chapter 11. Since then, FINOVA has steadily reduced Galaxy's line of credit and eventually called for it to be repaid in full by July 1, 2003. The \$ 4 million subordinated loan from FINOVA is also due on July 1, 2003.

Turnaround

In FY 2003, Galaxy's new management instituted a business and financial turnaround. Galaxy reduced its product line from 400SKU's to 200SKU's. These constitute 95% of the Company's total revenues. This eliminated their low margin, low volume goods, improving profitability. Christopher New, as COO and later CEO, introduced a number of other initiatives:

- Introduced a profit sharing plan among the production staff to increase output.
- Signed contracts with three key vendors to avoid casein shortages in the future.
- Reduced selling expenses and has reorganized the sales force with focus on key account level.
- Formed strategic alliances with Pizza Hut, Sbarro and Subway to offer the Company's Veggie Mozzarella as a healthier option to customers.
- Introduced Ultra Smoothie, as smoothies are getting popular ready-to-eat soy food.
- Improved the Company's management structure and board of directors.

This resulted in improving performance for nine months ended Dec 31, 2002. Gross margin and EBITDA expanded to 29.7% and 8.6% respectively. Order fill and case fill rates improved to 95% and 99% respectively.

During the company presentation on Feb. 26, 2003, Christopher New, CEO, outlined the Company's financial plan. He said they were close to replacing FINOVA as the primary asset based lender and would be able to increase their current line of credit to \$7.5 million from \$4.2 million. In addition Galaxy is in discussions with investors to raise \$ 2 million in debt and \$3.5 million in equity financing to retire the \$4.8 million in loans maturing in July 2003. Management believes that the new loans will carry an interest rate of prime +1%. However, if they do not succeed in replacing or renegotiating these loans, they will either be subject to further penalties and fees from FINOVA or possibly even be forced into bankruptcy.

Given the poor capital market environment we are not as confident as management that they will be able to raise the required funds at the expected rate. If they are not able to raise the capital at favorable rates interest expense could increase. A 100 bps increase in interest rate will increase interest expenses by \$144,000 annually.

Business Description

Galaxy Nutritional Foods is engaged in developing, manufacturing and selling healthy soy-based dairy alternative products to the retail, food service and industrial marketplace. Alternative cheese products constitute a majority of the Company's business. The Company's products contain low or no fat; low or no cholesterol; no saturated fat; and are lactose (milk sugar) free. Furthermore, these products are vitamin, calcium and mineral enriched and contain one-third fewer calories than conventional cheese. The main brands of the Company are:

Veggie

The Veggie brand is Galaxy's flagship brand. The brand generated approximately 62% of the Company's sales in FY 2002. Veggie provides a complete line of healthy dairy alternatives made with soy. The alternative cheese line includes slices, chunks and shreds in varying flavors. Apart from cheeses the Company also sells butter, milk, yogurt, ice cream and smoothies under the Veggie brand.

We personally sampled some of the Veggie cheese products and found that they taste superior to Yves's soy cheeses. Most of the vegetarians we spoke to prefer the taste and texture of Galaxy's cheeses to their competitors. They liked the fact that Veggie slices melt like traditional cheese.

Soyco Foods

Soyco Foods is a separate line sold exclusively in health and specialty food stores. These products are 100% natural and contain no artificial flavoring or coloring and are cholesterol free and lactose free. The Soyco product line consists of: **Soymage**, vegan products made from soy completely free of animal by-products, including casein; **Soy Free**, products are made from rice, oats and almonds; and **Soy Nutritious Veggie**, dairy alternatives are made with health benefiting soy, but are not completely dairy free.

Lite Bakery

The company's sells its soy based baking powder under the Lite Bakery brand that can be used to develop finished products or can be sold as an ingredient to be used in other foods. It also sells some baking mixes that are fat, cholesterol and lactose free. The popular Atkins Diet¹ promotes the use of baking powder containing soy protein.

Veggie Café

Veggie Café is a concept promoted by the Company as branded kiosk, counters or carts in schools, universities, colleges, cafeterias, or student unions serving a full line of healthy offerings including pizzas, sandwiches, wraps, salads, baked goods, and ready to eat products, created from Galaxy's cheeses and other ingredients.

In FY 2003, Galaxy formed strategic alliances with **Pizza Hut, Subway and Sbarro** to offer a selection of healthy menu items made from the Company's cheeses. Galaxy's cheeses are currently offered in 44 Pizza Hut franchises in Indiana and Ohio. According to management, the healthy menu accounts for 10% of the franchisee's revenues.

The Company sells directly to the retail, food services and industrial marketplace from its facilities in Orlando, Florida.

The company expanded its production capacity in FY 2002 and is capable of supporting annual sales of \$600 million. Currently Galaxy utilizes only about 7% of its total production capacity.

¹ The Atkins Baking mix contains Supro™ Brand Isolated Soy Protein, Soy Flour, Glucono Delta Lactone, Potassium Bicarbonate, Sodium Phosphate, Oat Fiber, Polydextrose (Lytesse™), Potassium Chloride. <http://www.n101.com>

Competitive Positioning

Galaxy's market consists of health conscious consumers. Its prime competitors are Dean Foods (White Wave), Wessanen (Tree of Life), Hain Celestial (Yves Veggie Cuisine), Tofutti Brands, Inc. (Tofutti) and Kraft (low fat or fat free cheeses).

Hain Celestial's **Yves Veggies Cuisine** manufactures mostly soy based meat alternative products. They also have soy-based cheese slices and shreds which compete directly with Galaxy's Veggie brand.

Dean Food's **White Wave** is the leading manufacturer for soymilk. They also sell tofu, yogurt and tempeh.

Wessanen's **Tree of Life** is a distributor of soy and health based products sold in health stores.

Kraft offers low fat and reduced fat cheeses. Its brand Polly-O manufactures natural cheeses like ricotta and mozzarella.

Galaxy products also compete with private labels of established retail and health foods stores such as Whole foods, Pathmark etc.

Figure 4: Alternative Cheese Category – Growth by Brand

Company	1998	1999	2000	2001
Galaxy (Veggie and Soyco)	10,423,636	19,333,456	28,874,020	33,945,983
Growth		85.5%	49.3%	17.6%
Soya Kaas	790,844	1,001,889	1,132,063	1,100,172
Growth		26.7%	13.0%	-2.8%
Yves				724,082
Lisanatti	256,475	375,657	560,500	605,884
Growth		46.5%	49.2%	8.1%
Rella Good Cheese	788,059	797,923	712,165	572,629
Growth		1.3%	-10.7%	-19.6%
Tofutti			59,253	285,417
Melissa's			5,474	78,529
Others	448,252	136,991	290,858	158,912
Total	12,707,266	21,645,918	31,634,334	37,471,608
Growth		70.3%	46.1%	18.5%

Source: IRI InfoScan Review, 52-week period ending Jan 3,

Soy food cheeses are generally located in special section or near the produce section of the grocery stores. Hence, they avoid competing for visibility with Kraft and other dairy based low fat cheeses.

We surveyed stores like Stop & Shop, Shop Rite, Pathmark, and A&P in NY, NJ and CT and found that Galaxy's products are well displayed and have more shelf space than Yves Veggie Cuisine, and other non-dairy alternative products.

Pricing

Galaxy's positions itself as a high quality soy based cheese manufacturer. Most of Veggie's cheeses cost \$2.99 / 8 oz. We compared prices of cheeses in Stop & Shop and Pathmark in NJ and found Galaxy's price is on average 11% lower than Kraft's low fat and healthy cheeses and 24% higher than Yves Veggie Cuisine. Its price is also higher than Polly-O and Americas Choice. The higher prices could limit Galaxy's increase in market share.

Additionally, other cheese brands offer different size packages for their products. Galaxy's slices come only in an 8 oz package while Kraft's slices come in 8 oz, 12 oz, 16oz and 24 oz. Galaxy also offers its cheeses in chunks and shredded for cooking purposes.

Industry Overview

Galaxy’s soy-based products are associated with healthier lifestyles adapted due to personal preferences or recommended by medical experts. Some of the major trends affecting the soy food and the health food industry are:

Healthy eating trends

Soy Food is considered a good dairy and meat alternative for people suffering from diabetes, heart diseases and for those who are lactose intolerant. Some medical associations have promoted the benefits of soy in diet for preventing certain medial conditions.

- **Heart Diseases:** In October 1999, the U.S Food and Drug Administration approved the use of the health claim that, “25 grams of soy protein in a daily diet low in saturated fat and cholesterol may reduce the risk of heart disease”, in food labeling². American Heart Association has also endorsed the above claim. Cardio vascular diseases, kills about 40% of Americans.
- **Diabetes:** Soy foods have a very low glycemic index. According to the American Diabetes Association post-menopausal woman with Type 2 diabetes may benefit from a daily dose of soy.
- **Lactose Intolerance:** Soymilk, soy cheese and other dairy alternatives are ideal for people suffering from lactose intolerance. Approximately, 50 million Americans have some level of lactose intolerance.

Rising average age of the US population

30% of the US population is between the ages of 37 and 55³. Aging population is more knowledgeable and concerned about eating healthy. According to a study by the United Soybean Board⁴ 88% of consumers in 2002 consider nutrition to be an important factor while purchasing groceries.

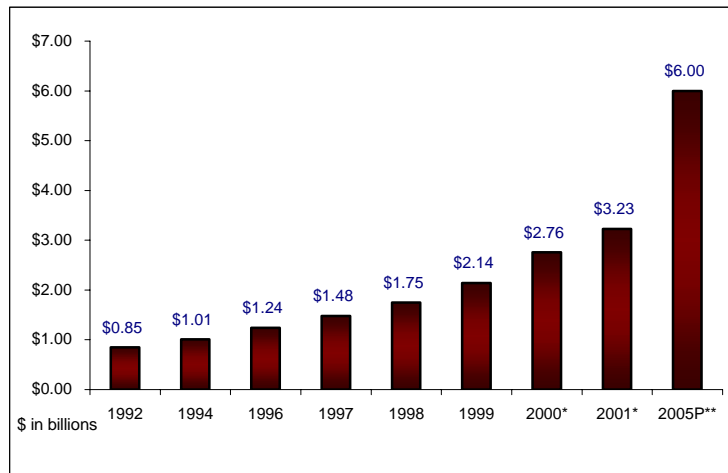
Growing vegetarian population

According to data provided by management, about 17 million Americans are vegetarians.

Value Driven market with increased consumer awareness

When it comes to eating healthier, 71% of US consumers planned to do so in October 2002 compared to 64% in March 2002. These consumers were also less price sensitive when making healthier purchases⁵. Thus, focusing on high quality and brand equity marketing rather than price comparisons could provide long term positioning advantage for companies within the sector of health and functional foods.

Figure 5: Retail Sales of Soy Foods (1992-2005P)



Source: *FDA Consumer*, U.S. FDA, May – June 2000, * Soyfoods Association of North America: www.soyfoods.org/press/FAQ
 ** U.S. Markets for Soyfoods 2001, Soyatech Inc.

2 *FDA Talk Paper*, U. S. Food and Drug Administration, October 20,1999

3 Industry Survey, Foods & Nonalcoholic Beverages, December 5, 2002, p.7

4 *National Report 2002-2003: Consumer Attitudes about Nutrition*, United Soybean Board, www.talksoy.com

5 Food Marketing Institute. *Facts, Figures & the Future: March- October 2002.*

Market

The market for retail soy foods has grown at an average of 14% for the last ten years, and is projected to be around \$6 billion by 2005⁶. Soymilk is the biggest selling category in soy foods, roughly 10% of the total market in 2002. It is also the fastest growing segment of soy foods. Cheese alternatives make up roughly 2% of this market⁷.

Galaxy hasn't been able to capture market share in the soymilk segment. It operates mainly in the alternative cheese segment, which is a small portion of the total soy food market. In this segment Galaxy is the leader with 59% market share.

Figure 6: Cheese Alternatives and Galaxy's Market Share in Retail Soy Foods Sales
\$ In millions

	2000	2001	Growth (%)	2005P
Total Soy Foods*	\$2,760	\$3,234	17.2%	\$6,000
Non Dairy Beverages **	\$241.6	\$324.0	34.1%	\$1,000
% Of Total	8.7%	10%		16.7%
Cheese Alternatives *	\$51.60	\$57.60	11.6%	\$108
% Of Total	1.87%	1.78%		1.8%
Galaxy Foods (Veggie & Soyco)***	\$28.80	\$33.90	17.7%	\$63.56
Market Share (%)	56%	59%		59%

Source: *Soyfoods Association of North America: www.soyfoods.org/press/FAQ, ** What's in Store 2003, 2002 International Dairy, Deli, Bakery Association, Table 39 Top Soy Categories, p. 55, *** IRI InfoScan Review, 52 -week period ending Jan 3, 2002

The projection for Cheese alternatives market in 2005 is extrapolated from the total soy foods sales, using the cheese alternatives current share of the total soy food market.

However, increasing unemployment claims, weak economic recovery and an ongoing war with Iraq could cause the market for soy foods not to grow as fast as projected. Since soy foods are priced at a premium to dairy and deli products, under the current environment, fewer consumers may be inclined to shift to these foods.

⁶ FDA Consumer, U.S. FDA, May – June 2000, and Soyfoods Association of North America: www.soyfoods.org/press/FAQ

⁷ What's in Store 2003, 2002 International Dairy, Deli, Bakery Association, Table 39 Top Soy Categories, p. 55

Earnings Analysis

Galaxy's management expects double-digit sales growth in FY 2004. We believe that Galaxy will achieve 12% sales growth in FY 2004 and then grow at 17% for FY 2005 and 2006, assuming they are able to refinance. The Company is still reducing the total number of SKU's and has not yet completed its financial restructuring. Effective FY 2005, the company will have overcome its current problems and will be able to increase sales to the level of the fast growing alternative cheese market. Since the alternative cheese market is still in the growth stage, Galaxy should be able to grow at a high rate (15%) for several years before tapering off to a long-term sustainable growth rate.

Gross margins should continue to improve as Galaxy concentrates more on their core brands, has improved terms from suppliers, and maintains an order fill and case fill rate above 95%. Management believes that gross margins will be 35+% in FY 2004. We do not expect an immediate jump in margins but instead expect a gradual improvement with margins reaching 35% in FY 2006. We are expecting SGA expense to fall to 25% as the Company has better account management and reduced selling expenses. We expect EBITDA margins to gradually increase from 11% to 13% by FY 2006. Management indicated that they expect EBITDA of +14% in FY 2004, which we consider overly optimistic.

Interest expense is expected to fall to \$1.1 million from \$2.8 million, largely due to a reduced debt structure, effective FY 2004, assuming a successful refinancing. Additionally, in 1HFY2003, the Company amortized debt discounts arising from an original issue discount and a difference in exercise price and actual price received by Galaxy for warrants exercised by FINOVA in connection to the \$4 million subordinated loan. These discounts were fully amortized by 2QFY2003.

Operating margin is expected to rise from the current 3.5% to 6.4% in FY 2004, to 8.4% in FY 2005 and to 9.4% in FY 2006 as Galaxy improves its gross margin and reduces its interest expense.

In 1Q FY 2002, Galaxy issued 72,646 shares of Series A convertible preferred stock. In 3Q FY 2002, 15,262 of these shares with accrued dividends were converted into equity. The Company records a dividend expense and records a charge to income statement for excess of the initial redemption value over the initial carrying value. All of the remaining shares are redeemable on 1Q FY2006. Assuming no further conversion till the redemption date, we estimate a non-cash charge of \$1.016 million for FY 2004 and FY 2005.

Based on pro forma projections we expect the Company to issue an additional 2.2 million shares, raising \$3.5 million in equity. This will increase shares outstanding to 15 million in FY 2004. We are not considering the dilution from stock options in forecasting FY 2004 and FY 2005 EPS, as the options have an exercise price that is higher than our 12-month price target.

In FY 2000, 2001, 2002 and 3 quarters of FY 2003, Galaxy recorded a non-cash compensation expense related to stock options due to adoption of FASB rule FIN 44. The company recorded an expense of \$0.025 million, \$1.16 million and \$2.85 million in FY 2000, 2001 and 2002 respectively and an income of \$2.79 million for 3 quarters of FY 2003. Based on the 31st Dec 2002 closing stock price of Galaxy of \$2.28, exercise price of \$2.05 and the current price of \$1.72 we expect the Company to record a non-cash compensation income of \$0.89million. Fluctuations in the market price will affect this expense. For comparability we have normalized earnings for FY 2000, 2001, 2002 and 3 quarters of 2003. The normalized EPS is \$0.12, \$0.19, (\$1.45) and (\$0.16) respectively.

We estimate EPS of \$0.05 for FY 2004 and \$0.11 for FY 2005.

In the discounted cash flow model, we project changes in working for FY 2004, 2005 and 2006 based on pro forma estimates for inventory, accounts receivable and accounts payable. For FY 2007-2012 we expect changes in working capital at the same rate as growth in sales of 15%. We expect capital expenditure to grow at the same rate as sales and don't foresee any significant CAPEX till FY 2007, as the company has enough productive capacity to accommodate projected sales.

Investment Risks

Galaxy may fail to raise adequate amounts of financing.

On July 1, 2003, Galaxy must repay a \$4.2 million line of credit and a \$4 million subordinated loan to FINOVA. In the past, Galaxy violated covenants on both of these loans. As a result, the Company is paying interest rates of prime +4% and 15.5%, respectively. Management believes that they will be able to replace this financing with a combination of debt (at prime +1%) and equity.

Presently, Galaxy does not have the cash to repay this debt. If management fails to secure the required financing, the Company may be forced into bankruptcy. Even if management can convince FINOVA to restructure the debt without resorting to bankruptcy, it will result in steep penalty fees and possibly even higher interest charges. This will reduce future earnings and limit the working capital available to finance future growth.

Charges to net earnings for increase in stock price beyond \$2.05.

Galaxy has re-priced several million shares of employee stock options and warrants at various prices. The strike price on 3.9 million of these options is set at \$2.05. As the price of Galaxy's stock moves above this price, holders of vested options may exercise and sell their shares, putting downward pressure on the stock's price. Additionally, due to variable accounting rules, Galaxy is required to show a compensation expense of approximately \$39,000 for each one-cent increase in the Company's stock price beyond \$2.05. This will create earnings volatility and actually cause net earnings to fall as the stock price increases.

Shareholders may experience further dilution due to convertible preferred shares.

In 2001, Galaxy issued 72,646 shares of Series A Convertible Preferred Stock. This stock is convertible at a rate of \$48.18 plus all accrued dividends divided by the lesser of \$4.08 or 95% of the average of the two lowest bid prices on the AMEX within the last fifteen days prior to conversion. On December 26, 2002, 15,262 shares plus accrued dividends were converted at a conversion rate of \$1.3633. This resulted in the issuance of 624,936 shares of common stock. Additional conversions will further dilute Galaxy's earnings, especially if the stock price remains low.

We assumed that sales will grow at a high rate.

We have assumed a double-digit sales growth rate until FY 2012. While we believe that there is plenty of demand for Galaxy's product, there is no guarantee that Galaxy will be able raise the working capital necessary to support this level of growth. Further, the main strength of Galaxy's Veggie brand is its taste. It is possible that another company will develop a better taking cheese alternative and significantly cut into Galaxy's market share.

Galaxy is being sued for patent infringement.

A lawsuit has been filed against Galaxy and several other companies by Schreiber Foods alleging various acts of patent infringement. The machines in question are used to produce and wrap individually wrapped pieces of cheese, which are required to fill a majority of customer orders. Galaxy's management seem confident that the slicing and wrapping machines have been altered sufficiently so as to not infringe on any patents and this lawsuit is currently on hold. However, if Galaxy were unable to use these machines they would not be able to produce or wrap their most important products.

Galaxy relies heavily on a single ingredient and sources much of it from Europe.

Most of Galaxy's products are produced using casein, a milk protein, which they import from Europe. This makes them vulnerable to fluctuations in the price of casein, such as those that occurred when "Mad-Cow Disease" struck European dairy producers.

An increase in interest rates will significantly raise interest expenses.

Much of Galaxy debt financing is tied to the prime rate. If management follows through with their restructuring plans, all of their debt will be floating. A 100 bps increase in interest rate will increase their interest expense by \$144,000 annually. Galaxy does not hedge interest rate risk and an increase in rates would result in a higher interest expense

Appendix 1: Peer Group Index (Trailing Twelve Months), March 24, 2003

Company	Ticker	Cost of Debt/ Debt	Debt/ Equity	Interest Coverage	Current Ratio (MRQ)	Tax Rate	Gross Margin	SGA to Sales	EBITDA Margin	Net Profit Margin	ROA	Sales Growth	FCFF/ Share
Galaxy Nutritional Foods (Trailing Twelve Months)	GXY	15.9%	2.59	-0.38	0.62	0%	23.1%	35.7%	-4.4%	-21.5%			
Galaxy Nutritional Foods (Trailing Nine Months)	GXY	12.63%	2.65	1.33	0.62	0%	29.7%	26%	11.1%	4.2%	NA	NA	\$0.42
PEER GROUP INDEX													
Aurora Foods	AOR	8.27%	2.82	-0.81	0.96	12.3%	26.9%	25.5%	10.2%	-17.9%	-3.0%	-13.4%	\$0.01
Brigford Foods Corp	BRID				3.93	19.0%	36.1%	31.9%	4.2%	0.5%	1.5%	-11.0%	\$0.01
Cal-Maine Foods Incorp.	CALM	6.6%	2.39	0.65	1.20	8.9%	13.7%	12.4%	1.3%	-0.7%	-0.9%	0.2%	(\$0.75)
Golden Enterprises	GLDC	4.1%	0.18	15.14	2.77	33.2%	42.1%	42.6%	-0.5%	1.0%	1.6%	-17.1%	\$0.05
Hain Celestial Group Inc.	HAIN	6.2%	0.06	15.68	2.28	28.3%	14.5%	12.4%	2.1%	-1.2%	0.9%	-10.9%	(\$0.36)
Horizon Organic Holding	HCOW	2.0%	0.73	2.23	1.48	29.5%	31.5%	27.0%	4.6%	-0.1%	2.9%	16.5%	\$0.50
Lance Incorporated	LNCE	8.2%	0.30	9.99	1.76	36.3%	49.7%	41.9%	7.8%	4.1%	7.2%	-6.9%	\$1.18
Lucille Farms Inc	LUCY	8.0%	14.49	-2.23	0.98	0.0%	-2.5%	2.5%	-5.0%	-7.2%	-14.8%	-17.0%	(\$0.40)
Lifeway Foods Inc	LWAY	8.8%	0.07	31.39	8.01	27.4%	43.7%	24.2%	19.5%	15.1%	12.5%	11.8%	(\$0.03)
NBTY Incorporated	NBTY	8.4%	0.52	9.71	2.53	28.0%	55.2%	39.0%	16.1%	10.2%	13.4%	15.8%	\$1.06
Northland Cranberries	NRCNA	6.0%	1.95	1.63	1.17	0.0%	30.9%	27.5%	3.4%	3.3%	2.4%	-16.6%	\$0.29
Reliv International Inc	RELV	8.3%	0.73	10.06	1.29	44.6%	82.0%	76.6%	5.4%	3.0%	10.1%	5.9%	\$0.17
Seneca Foods Corp	SENEB	8.5%	1.11	1.90	3.41	39.9%	8.2%	3.5%	4.7%	1.1%	1.9%	-3.0%	\$8.37
Spectrum Organic Products	SPOP	12.9%	2.01	2.35	1.09	0.6%	26.1%	21.9%	4.1%	0.8%	3.1%	-0.9%	\$0.03
Tofutti	TOF				10.58	37.0%	34.6%	23.2%	9.0%	6.5%	19.9%	12.7%	\$0.09
Yocream	YOCM	3.6%	0.18	29.36	3.35	36.2%	28.4%	20.9%	7.5%	4.1%	8.4%	22.4%	\$0.31
Mean		7.1%	1.97	9.07	2.92	23.8%	32.6%	27.1%	5.9%	1.4%	4.2%	-0.7%	0.66
Median		8.1%	0.73	6.03	2.02	28.1%	31.2%	24.8%	4.6%	1.1%	2.7%	-1.9%	0.07
High		12.9%	14.49	31.39	10.58	44.6%	82.0%	76.6%	19.5%	15.1%	19.9%	22.4%	8.37
Low		2.0%	0.06	-2.23	0.96	0.0%	-2.5%	2.5%	-5.0%	-17.9%	-14.8%	-17.1%	(0.75)
FY 2004 Estimated													
Galaxy Nutritional Foods	GXY	9.26%	1.47	1.756	0.95	0.00%	32%	25.00%	11.45%	1.80%	2.5%	12.0%	\$0.20

Source: Company Documents, Student Estimates

Appendix 2: Galaxy Nutritional Foods, Inc. Earnings Model

Figures in 000's	2002						2004						FY 2004	FY 2005	FY 2006
	1 Q	2 Q	3 Q	4 Q	E	FY	1 Q	2 Q	3 Q	4 Q	FY				
Sales	43,581	10,046	10,118	9,829	10,307	40,300	11,252	11,332	11,009	11,543	45,136	52,809	61,787		
% Growth						-7.53%	12.00%	12.00%	12.00%	12.00%	12.00%	17.00%	17.00%		
COGS	35,276	7,237	7,047	6,806	7,112	28,201	7,764	7,706	7,486	7,734	30,690	34,854	40,161		
Gross Income	8,305	2,809	3,071	3,024	3,195	12,099	3,488	3,626	3,523	3,809	14,446	17,955	21,625		
Gross Margin	19.06%	27.96%	30.35%	30.76%	31.00%	30.02%	31.00%	32.00%	32.00%	33.00%	32.01%	34.00%	35.00%		
SG&A	17,052	2,471	2,661	2,657	2,577	10,365	2,813	2,833	2,752	2,886	11,284	13,202	15,447		
% Of sales	39.13%	24.60%	26.30%	27.03%	25.00%	25.72%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%		
Research & Development	262	58	56	61	60	235	68	68	66	69	271	317	371		
% Of Sales	0.60%	0.58%	0.55%	0.62%	0.58%	0.58%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%		
EBITDA	-5,413	1,209	1,253	877	1,127	4,466	1,177	1,294	1,274	1,423	5,168	6,712	8,084		
EBITDA Margin	-12.42%	12.03%	12.38%	8.92%	10.94%	11.08%	10.46%	11.42%	11.57%	12.33%	11.45%	12.71%	13.08%		
Depreciation	2,363	569	570	569	569	2,277	569	569	569	569	2,276	2,276	2,276		
Amortization	1,233	360	329	2	0	691	0	0	0	0	0	0	0		
Total Dep./Amort.	3,596	929	899	571	569	2,968	569	569	569	569	2,276	2,276	2,276		
Operating Income	-9,009	280	354	306	558	1,498	608	725	705	854	2,892	4,436	5,808		
Operating Margin	-20.67%	2.79%	3.50%	3.11%	5.42%	3.72%	5.40%	6.40%	6.40%	7.40%	6.41%	8.40%	9.40%		
Interest Expense	3,594	898	970	537	430	2,835	424	222	213	209	1,068	798	739		
Other, net	-2,895	1,637	1,348	-246	897	3,636	0	0	0	0	0	0	0		
Pretax Earnings	-15,498	1,019	732	-477	1,025	2,300	184	503	492	645	1,824	3,638	5,069		
Pretax Margin	-35.56%	10.14%	7.23%	-4.85%	9.95%	5.71%	1.63%	4.44%	4.47%	5.59%	4.04%	6.89%	8.20%		
Taxes	1560	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	1,273.3	1,774.1		
Effective Tax Rate							0%	0%	0%	0%	0%	35%	35%		
Net Income	-17,058	1,019	732	-477	1,025	2,300	183.6	503.3	491.6	645.2	1,823.6	2,364.7	3,294.8		
Net Margin							1.63%	4.44%	4.47%	5.59%	4.04%	4.48%	5.33%		
Preferred Dividends	2089	248	-33	268	255	738	254	254	254	254	1016	1016			
Net Income to Common Shares	-19,147	771	765	-745	770	1,562	-70.4	249.3	237.6	391.2	807.6	1,348.7	3,294.8		
Yearend Shares Outstanding	11,540	11,921	12,131	12,755	12,800	12,800	15,000	15,000	15,000	15,000	15,000	15,000	15,000		
Average Shares Outstanding	10,556					12,170									
Earnings per share/C. Shares	(1.81)	0.06	0.06	(0.06)	0.06	0.12	(0.005)	0.017	0.016	0.0261	0.05	0.11	0.21		

Source: Company Documents, Student Estimates

Appendix 3: Galaxy Nutritional Foods, Inc. Beta Estimate

Ticker	Company Name	Total Rev	Debt/Equity	Debt/Assets	Beta	Tax Rate	Unlevered
		Aug-02	Aug-02	Aug-02			Beta
AOR	AURORA FOODS INCORPORATED	907	2.05	0.605	0.86	9.48%	0.84437
BRID	BRIDGFORD FOODS CORPORATION	143	0.21	0.138	0.15	63.80%	0.14989
CALM	CAL-MAINE FOODS INCORPORATED	336	2.30	0.546	-0.11	60.31%	-0.10900
GBUR	GARDENBURGER INCORPORATED	53	30.48	0.864	0.76	0.00%	0.58244
HAIN	HAIN CELESTIAL GROUP INCORPORATED	396	0.03	0.024	1.04	38.17%	1.03981
HCOW	HORIZON ORGANIC HOLDING	170	0.78	0.367	0.25	22.98%	0.24850
LUCY	LUCILLE FARMS INCORPORATED	42	43.92	0.569	0.59	0.00%	0.40996
MLP	MAUI LAND & PINEAPPLE CO INC	164	0.59	0.246	0.15	42.47%	0.14949
NBTY	NBTY INCORPORATED	930	0.65	0.384	1.04	20.78%	1.03468
NRCNA	NORTHLAND CRANBERRIES CL A	102	1.80	0.557	0.59	11.30%	0.58074
SENEB	SENECA FOODS CORP CL A	642	1.18	0.443	0.14	11.15%	0.13854
YOXM	YOXCREAM INTERNATIONAL INC	19	0.18	0.143	0.68	16.75%	0.67896
Average		279.64	8.85	0.40	0.58	0.18	0.54
St dev.		316.34	16.43	0.25	0.35	0.15	0.34
						Median	0.4953

	Industrial Unlevered Beta	D/E of GXY	Tax Rate	Levered Beta
Median	0.4953	2.63	0%	1.7969

Galaxy Sources of Financing - Dec 31, 2002

Type	Book Value
Preferred Stock	\$1,712,969
Debt	\$17,877,731
Common Equity	\$7,455,910

D/E of Galaxy 2.63

Source: Reuters Stock Val, Student Estimates

Appendix 4: Galaxy Nutritional Foods, Inc. Preferred Dividend and Cost of Preferred Stock Estimate

Date	Event	No. of Shares	Redemption	Dividend	No. of Div.	Value of	Total Shares
			Price	Rate	Shares	Div (\$)	Outstanding
Apr-01	Issued	72,646	\$48.18	10%	7,265	\$350,008	79,911
Apr-02		72,646	\$48.18	8%	5,506	\$265,300	85,417
Dec-02	Converted	15,262			2,442		67,713
Dec-02	Balance	57,384			10,329		
Apr-03	Balance	57,384	\$48.18	8%	4,591	\$221,181	
Apr-04	Balance	57,384	\$48.18	8%	4,591	\$221,181	76,895

Book Value of Preferred Stock \$1,712,969
Cost of Preferred Stock 12.9%

Charges to Income Statement for Preferred Dividends and Accretion to Redemption Value

	Q4 FY2003	Q1	Q2	Q3	Q4	FY 2004	FY 2005
Preferred Dividends	\$56,283	\$55,295	\$55,295	\$55,295	\$55,295	\$221,181	\$221,181
Accretion to Redemption Value	\$198,852	\$198,852	\$198,852	\$198,852	\$198,852	\$795,408	\$795,408
TOTAL	\$255,135	\$254,147	\$254,147	\$254,147	\$254,147	\$1,016,589	\$1,016,589

Calculation for Value of Div (\$) for FY 2003 due to conversion of shares in Dec-02.

	No. of shares	No. of Div Shares	Value of Div (\$)
Converted	15,262	916	\$44,119
Remaining	57,384	4591	\$221,181

Source: Company Documents, Student Estimates

Appendix 5: Galaxy Nutritional Foods, Inc. Debt Balance, Interest Expense and Cost of Debt Estimate

Lender	Maturity	Balance	Interest	Interest	Principal	Interest	Principal
		Outstanding	Rate	Payments	Payments	Payments	Payments
		12/31/2002		Q4FY2003	Q4FY2003	Q1FY2004	Q1FY2004
FINOVA Capital Corp. <i>Line of Credit</i>	July 1 2003	4,166,084	8.25%	85,925		85,925	4,166,084
FINOVA Mezzanine Capital	July 1 2003	4,000,000	15.50%	155,000		155,000	4,000,000
Penalty for breaking covenants				86,250		86,250	
South Trust Bank N.A. <i>Term Loan</i>	March 2005	8,397,313	4.25%	88,233	279,000	85,269	279,000
South Trust Bank N.A. <i>Short term bridge loan</i>	October 2003	750,000	4.25%	7,438	150,000	5,844	150,000
Angelo S. Morini	June 15 2006	330,000	4.25%	3,506		3,506	
Target Containers	August 15 2003	234,334	7.00%	3,598	86,600	2,073	88,125
TOTAL		17,877,731		429,950	515,600	423,868	8,683,209

Annualized Interest Cost 9.62%

New debt structure effective July 1, 2003 (Q2FY2004)

Type of Loan	Maturity	Balance	Interest	Interest	Principal	Interest	Principal	Interest	Principal
		Outstanding	Rate	Payments	Payment	Payment	Payment	Payment	Payment
		Q2 FY 2004		Q2-4 FY2004	Q2-4 FY 2004	FY 2005	FY 2005	FY 2006	FY 2006
Asset Based Lender	Revolving	6,500,000	5.25%	255,938		341,250		341,250	
South Trust Bank <i>Term Loan</i>		9,839,313	5.25%	372,775	837,000	445,768	1,116,000	387,178	1,116,000
South Trust Bank N.A. <i>Short term bridge loan</i>	October 2003'	450,000	4.25%	4,250	450,000	MATURES			
Angelo S. Morini	June 15 2006	330,000	4.25%	10,519		10,519		10,519	
Target Containers	August 15 2003	59,609	7.00%	522	59,610	MATURES			
TOTAL Q2-4 FY 2004		17,178,922		644,004	1,346,610				
Debt Financing in Q2FY2004					8,500,000				
Total Payments in Q1FY2004 and Q2-4FY2004				1,067,871	1,529,819	797,536	1,116,000	738,946	1,116,000
Balance Outstanding at end of FY 2004				15,832,312			14,716,312		13,600,312

Increase in Interest Expense for a 100bps increase in interest rate 141,006

Source: Company Documents, Student Estimate

Disclosures:**Ownership and material conflicts of interest:**

The author(s), or a member of their household, of this report does not hold a financial interest in the securities of this company.

The author(s), or a member of their household, of this report does not know of the existence of any conflicts of interest that might bias the content or publication of this report.

Receipt of compensation:

The author(s) receive no compensation. This report is published for educational purposes as part of the NYSSA Investment Research Challenge.

Position as an officer or director:

The author(s), or a member of their household, does not serve as an officer, director or advisory board member of the subject company.

Market making:

The author(s) does not act as a market maker in the subject company's securities.

Ratings key:

Banks rate companies as a BUY, HOLD or SELL. A BUY rating is given when the security is expected to deliver absolute returns of 15% or greater over the next twelve month period, and recommends that investors take a position above the security's weight in the S&P 500, or any other relevant index. A SELL rating is given when the security is expected to deliver negative returns over the next twelve months, while a HOLD rating implies flat returns over the next twelve months.

Disclaimer:

The information set forth herein has been obtained or derived from sources generally available to the public and believed by the author(s) to be reliable, but the author(s) does not make any representation or warranty, express or implied, as to its accuracy or completeness. The information is not intended to be used as the basis of any investment decisions by any person or entity. This information does not constitute investment advice, nor is it an offer or a solicitation of an offer to buy or sell any security. This report should not be considered to be a recommendation by any individual affiliated with NYSSA or the NYSSA Investment Research Challenge with regard to this company's stock.
