

YOOREAM[®]

2003
Annual Report

ABOUT YOCREAM INTERNATIONAL, INC.

YoCream International has been producing frozen yogurt since 1977. Inspired by Mama Hanna, who originally created the recipe for our YoCream Frozen Yogurt in her kitchen back home, we take pride in preparing our wholesome foods from the best ingredients with the same attention to quality. We craft our frozen yogurt with one of the highest counts of beneficial live natural yogurt cultures, and our all natural smoothies are made from real fruit and fruit juices. All of this attention to quality makes for creamy delicious frozen desserts and beverages that are bursting with flavor!

Our product line features 43 soft serve frozen yogurt flavors including nonfat, premium, no-sugar-added, and new low-carb varieties; as well as sorbet; soy cultured frozen dessert; soft frozen custard; soft serve ice cream; and a novelty line of specially formulated single serve cups. Our smoothie category includes mixes for frozen beverage dispensers and blenders.

Our manufacturing facility in Portland, Oregon has three distinct packaging operations – gable-top filler, hard-pack, aseptic and fresh bag-in-box – all capable of operating simultaneously. A fully licensed dairy, we pasteurize under USDA certification and inspection and under organic certification. Food safety is always a primary focus at YoCream. Our Quality Assurance department ensures that the most stringent levels of regulatory compliance are maintained, meeting and exceeding all inspection standards including, but not limited to, USDA, FDA, Military Standards, food safety audits, export requirements, and kosher and organic certification. Additionally, we follow a comprehensive inspection program, modeled after the American Institute of Baking (AIB) standards for dairies.

As an established food service vendor and co-packer of high quality frozen desserts and smoothies, we continue to market our quality products by improving brand recognition and increasing customer loyalty.

Directors & Officers

Name	Age	Position held with Company and Principal Occupation During the Past Five Years	Director Since
John N. Hanna	63	Director; Chairman of Board of Directors; Chief Executive Officer	1977
James S. Hanna	70	Director; Secretary	1977
William J. Rush	69	Director; Partner in Rush, Hannula, Harkins, & Kyler, LLP Attorneys at Law	1987
Carl G. Behnke	58	Director; President R.E.B. Enterprises; Chairman of Sur La Table	1994
Joseph J. Hanna, Jr.	65	President of Hanna Strader PC Tax Attorney	2001
W. Douglas Caudell	60	Chief Financial Officer	NA

FORWARD LOOKING STATEMENTS

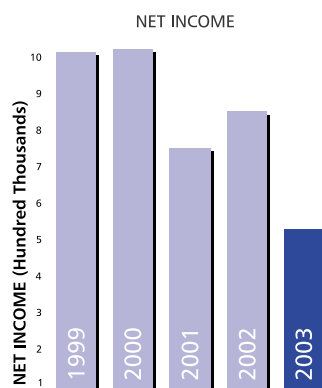
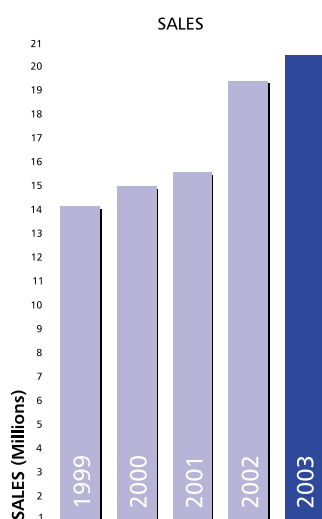
The information throughout this annual report includes certain forward-looking statements, including statements regarding the company's expectations, hopes, beliefs, intentions or strategies regarding the future. These statements are in locations such as that in the Letter to Shareholders, the Sales and Products sections, and the MD&A, and are based on assumptions that in the future may prove not to be accurate. Such forward-looking statements are based on the beliefs of the Company's management and on assumptions made by and information currently available to management. All statements other than statements of historical fact, regarding the Company's financial position, business strategy and plans and objectives of management for future operations of the Company are forward-looking statements. When used herein, the words "anticipate," "believe," "estimate," "expect," and "intend" and words or phrases of similar meaning, as they relate to the Company or management, are intended to identify forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable; it can give no assurance that such expectations will prove to have been

correct. Forward-looking statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those indicated by the forward-looking statements. These risks and uncertainties include the Company's ability to maintain or expand its distribution abilities, including the risk of disruptions in the transportation system and relationships with brokers and distributors. Further, actual results may be affected by the Company's ability to compete on price and other factors with other manufacturers and distributors of frozen dessert products; customer acceptance of new products; general trends in the food business as they relate to customer preferences for the Company's products; and the Company's ability to obtain raw materials and produce finished products in a timely manner, as well as its ability to develop and maintain its copacking relationships and strategic alliances. In addition, there are risks inherent in dependence on key customers, the loss of which could materially adversely affect the Company's operations. The reader is advised that this list of risks is not exhaustive and should not be construed as any prediction by the Company as to which risks would cause actual results to differ materially from those indicated by the forward-looking statements.

Selected Financial Data

For the years ended October 31, 2003, 2002, 2001, 2000, 1999

	2003	2002	2001	2000	1999
Balance Sheets					
Total current assets	\$6,125,215	\$5,430,073	\$4,992,797	\$4,372,804	\$4,637,304
Total assets	12,867,107	10,224,937	9,651,561	7,426,575	7,356,915
Long-term debt	2,279,667	858,167	1,037,024	125,073	201,238
Shareholders' equity	\$8,145,639	\$7,503,195	\$6,818,348	\$6,130,492	\$5,351,730
Statements of Income					
Sales	\$20,477,934	\$19,438,892	\$15,616,943	\$14,943,886	\$14,064,992
Income from operations	989,893	1,549,234	1,125,081	1,542,737	1,468,445
Income before taxes	803,144	1,368,070	1,021,193	1,572,918	1,424,066
Income tax provision	268,000	512,000	268,000	548,000	406,000
Net income	535,144	856,070	753,193	1,024,918	1,018,066
Earnings per common share-basic	0.24	0.38	0.33	0.45	0.44
Earnings per common share-diluted	\$0.23	\$0.38	\$0.33	\$0.45	\$0.43



COMPANY MISSION

YoCream International exists to delight people away from home with safe, nutritious, satisfying desserts and treats.

We are committed to

- product excellence
- extraordinary customer service
- notable ethical standards
- individual dignity, responsibility, and opportunity
- profit and growth to pursue our purpose

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To Our Shareholders,

Sales volume increased and we were profitable, but not to expectations.

We could blame the economy or market trends. Soaring product ingredient costs could be labeled the culprit. The time and resources to install a production line for aseptic shelf stable products could be the excuse. What is pertinent, however, is the course we are taking to continue our long term record of positive results.

The sizable investment to provide for shelf stable products is one of our responses to the sluggish economy. This new production capability enables us to reach additional markets with unique products. It also answers market trends favoring products that do not require refrigeration for distribution and storage. Our first customer for these timely products is Costco. We are in the process of nationally introducing an aseptically packaged smoothie to their hundreds of food courts. Another immediate application of the aseptic production line is a shelf stable coffee concentrate. This product can be conveniently utilized by customers to dispense frozen coffee latté.



The Company's new aseptic line enables production of shelf stable products.

Recognizing that the market for traditional frozen yogurt is in a mature stage, we have developed special additions to our product lines.

A cultured soft serve frozen soy was launched last year and we are now introducing a hard pack version to the marketplace. The Company has also developed a great tasting low-carb frozen yogurt in response to current trends. Samples of this premium product are being sent to existing customers and will be presented at trade shows throughout the year.

Our sales efforts in conjunction with The Dannon Company have been refined so that teams involving personnel from both companies will jointly coordinate activity with selected key accounts. We are convinced that the strength of the Dannon name along with our concentration on the away-from-home market place will enable us to continue to increase market share.

Quality products continue to be our hallmark. When key ingredient costs significantly increased, we resisted substituting low cost materials. We took the necessary time to develop high quality reformulations and issued a modest price increase to maintain appropriate margins. Our key customers have recognized and applauded this accomplishment.

Inventory levels have been significantly reduced by operating efficiencies. While the accounting effect of this reduction negatively impacted 2003 operating income, we are now benefiting from the increased inventory turns and reduced storage expenses.

Every successful company faces challenging times. The crucial factor is not the absence of adversity but the ability to tenaciously and confidently work through it, emerging stronger and better. While some companies have fabricated positive results prompting burdensome legislation, we are committed to perform with integrity. Our employees are determined and enthusiastic about Company prospects. Come visit our expanded facilities and you will sense for yourself the vigor and excitement.

We will keep growing responsibly, continuing a record of reliability and achieving results that merit your trust.

Sincerely,

John N. Hanna
Chairman and Chief Executive Officer

	YoCream	Industry*
Sales –		
5 Year Growth Rate	15.3%	5.4%
Return on Assets –		
5 Year Average	10.2%	7.6%
Capital Spending –		
5 Year Growth Rate	+36.5%	-28.5%

*Reuters

In the spring of 2004, the Company will introduce Dannon® YoCream® Premium Low-Carb Frozen Yogurt.

Meeting Consumer's Dietary & Lifestyle Needs



YoCream is committed to providing healthy products to a diverse and ever changing base of consumers. We address the changes in demographics, consumer desires and marketplace needs by creating new and innovative products, adjusting marketing strategies, and improving the methods by which products are delivered to the marketplace offering the optimum solution to the broadest possible customer base. Current YoCream product developments include...

Low-Carb Frozen Yogurt: The low carbohydrate product category is one of the quickest emerging and fastest growing in recent times. This single food category has had an unprecedented impact in our marketplace. YoCream is proud to enter this emerging category with Dannon® YoCream® Low-Carb Premium Soft Serve Frozen Yogurt, with net carbohydrate counts ranging from 3 grams to 5 grams depending on flavor. Our gourmet product is the only nationally branded low-carb soft serve that includes live active yogurt cultures to promote a healthy digestive system. Superior taste and very pleasing product texture set Dannon YoCream apart from competitive products. Sweetened with Splenda brand sucralose, this product meets the dietary guidelines for low-carb as well as diabetic consumers. Previewed at selected spring 2004 food shows, this product is already generating excitement and interest from all of our market segments. To meet the snack-on-the-go needs of consumers, the Company anticipates introducing single serve novelty cups in the third quarter of 2004.

Soy Cultured Frozen Dessert: Lactose free, dairy free and dairy protein free, this great-tasting product was introduced through selected distribution and targeted at the vegetarian/vegan consumer in 2003. Sales were slow to respond given the narrower market and the education required for this new product category. The Company has repositioned its marketing strategy for 2004 to target a broader market now including the health-conscious and lactose intolerant consumer and specifically healthcare facilities and universities. In the second quarter of fiscal 2004, a line extension of single serve 4 oz cups will be introduced to address the needs of operators that do not have the volume or space to support soft serve equipment.

Fruit Smoothies: The Company is extending its all-natural smoothie product line to include a shelf stable bag-in-the box product, packaged on the Company's new aseptic packaging line. In the second quarter of 2004, the Company will introduce Fruitquake® aseptic, shelf stable, all natural dispenser smoothies. Packed in 1/2 gallon to 3 gallon bags with auto fill equipment fitments, this smoothie line extension meets the needs of operators that have limited refrigeration or, as in military, geographic locations without refrigeration. As with the Company's existing frozen smoothie line, the the addition of water or ingredients at the operation location is not required, promoting a consistent product and reduced labor for the customer. The smoothie "mobile meal" solution is targeted at students and military personnel.

Coffee Latté Frozen Beverage: The Company has developed an aseptically packaged coffee concentrate product designed to be mixed with milk at the foodservice customer's location. The new YoCaffé® Latté Coffee Concentrate will be introduced at food shows in the second quarter of 2004. Manufactured on the Company's new aseptic line, the half-gallon bag packaging size was chosen to appeal to a broader foodservice market, such as coffee shops and restaurants. The product can be delivered through dairy distribution with customers' regular milk deliveries or through national and regional broadband distribution.

Frozen Yogurt: Nonfat frozen yogurt is a healthy snack option for many Americans. With only 120 calories, 0 grams of fat and high counts of beneficial live active cultures, Dannon YoCream Frozen Yogurt meets the dietary guidelines for healthy heart dieters and the most popular low-fat weight loss programs. Consumers are becoming more aware of the importance of including dairy in their diets through National Dairy Council's education programs such as the Healthy Weight with Dairy and 3-a-Day dairy campaigns. The Company has focused its marketing efforts on educating existing customers and new markets, including healthcare, on how Dannon YoCream Frozen Yogurt fits the needs of their consumers.

The YoCream Dairy



All of the manufacturing and packaging of the Company's products for both domestic and international sales occurs at its plant in Portland, Oregon. The facility is a fully licensed dairy and pasteurizes its products under USDA certification and inspection.

Capable of producing a full range of dairy products and other fluid items, such as fruit based beverages, the manufacturing plant is primarily utilized to produce frozen yogurt, frozen custard, ice cream, sorbet and smoothies.

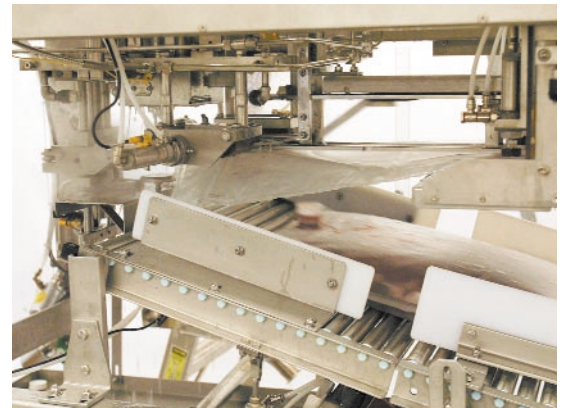
The manufacturing plant has three distinct packaging operations that can be operated simultaneously based on demand. The first line fills half-gallon gable top containers for soft serve mixes or liquid products. The second line is capable of packaging hard packed frozen desserts with or without inclusions in quarts, pints and 4 ounce cups. Within these two operations are a multitude of packaging sizes, styles, and finished casing capabilities. The third line is a new aseptic packaging line completed in October of 2003.

The Company's new aseptic processing system, costing over \$2 million, expands the production capabilities, and enables the Company to produce shelf stable products that do not require refrigeration for shipping or storage. The system will initially be used to satisfy customer demands for shelf stable fruit and coffee smoothie products in half-gallon, one-gallon, and three-gallon bags. The line will also be available for copacking juices, fruits, purees, and other beverages in sizes ranging from half-gallon to five-gallon bags.

This manufacturing expansion allows the Company to provide foodservice operators and military accounts with high-quality shelf stable beverage products. Installation of the new line opens capacity on existing production lines for potential custom manufacturing and copacking partners as well as for the Company's other products.

YoCream Aseptic Processing Line

*Above top to bottom:
Beginning the smoothie process...
Ingredients are pasteurized, the base is mixed with fruit, product is run through the sterilizer.
See caption right...*



and Manufacturing Plant

The YoCream dairy and manufacturing plant offers versatility and flexibility for our own production needs as well as custom manufacturing for other companies. One unique feature of the facility is its ability to provide product under Organic Certification, including organic ice creams, yogurts, and sorbets. Throughout the facility, both organic and non-organic products can be processed and packaged simultaneously while maintaining separation. The Company also has a cold-fill plastic bottling line available. The Company's research and development and logistics expertise can also be available to companies interested in utilizing our custom manufacturing capabilities.

A significant part of the Company's marketing strategy is to utilize its product development and manufacturing capabilities to gain new customers and strengthen existing business relationships by customizing products to meet individual needs.

Quality Assurance and Food Safety

Food safety is a primary focus for the Company. The Company's Quality Assurance Department ensures that the most stringent levels of regulatory compliance are maintained, meeting and exceeding all inspection standards including but not limited to USDA, FDA, military, customer food safety audits, aseptic processing standards, export requirements, kosher and organic certification. The Quality Assurance Department is staffed with two full time microbiologists, a degreed sanitarian and a degreed food scientist. The department maintains its proficiency on important food safety issues such as allergen and pathogen control through food safety training, GMP education, supplier audits, and laboratory analyses.

The Company is in compliance with the Bioterrorism and Preparedness Act with registration of the facility completed and a lot tracking system in place to comply with the stringent requirements for

trace back and trace forward of all ingredients, packaging, and finished products. The strength of the Company's quality assurance program has been validated by the high ratings achieved on several third-party safety audits performed during fiscal 2003.



Fruit smoothies and coffee latté concentrate are aseptically packed on the company's new production line.



Far left to right: Continuing the smoothie process... Product is run through triple tube heating and cooling process, bags are filled with product, filled bags are set into cases, pallets are shrink wrapped and ready for shipping.

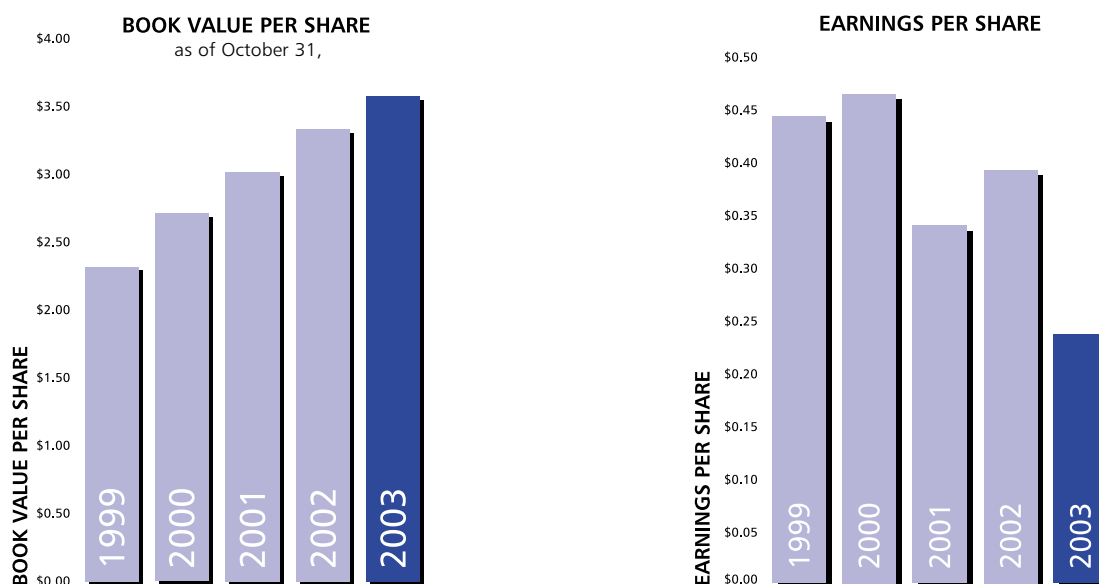
Market Information

The common stock of the Company is traded in the over-the-counter market and is quoted on the National Association of Securities Dealers Automated Quotation System ("NASDAQ") under the symbol YOCCM. As of January 15, 2004, there were 2,277,956 shares of the common stock outstanding and there were 139 shareholders of record estimated to represent approximately 1,000 beneficial holders based on the number of individual participants in security position listings. On January 15, 2004 the closing bid and asked prices were \$5.05 and \$5.10, respectively.

The following table sets forth the high and low closing prices for quarterly periods in the two twelve month periods ended October 31, 2003 and 2002, as reported by Nasdaq Stock Market:

Twelve Months Ended October 31, 2003	High	Low
August 1, 2003 - October 31, 2003	\$5.73	\$4.55
May 1, 2003 - July 31, 2003	5.75	4.55
February 1, 2003 - April 30, 2003	6.89	5.01
November 1, 2002 - January 31, 2003	\$8.39	\$6.59
Twelve Months Ended October 31, 2002	High	Low
August 1, 2002 - October 31, 2002	\$8.76	\$6.37
May 1, 2002 - July 31, 2002	9.75	5.26
February 1, 2002 - April 30, 2002	6.20	3.45
November 1, 2001 - January 31, 2002	\$4.13	\$3.26

The Company has not paid dividends on its common stock since the stock began public trading on November 17, 1987. The Company does not expect to pay cash dividends on its common stock in the foreseeable future. The Company intends to invest funds otherwise available for dividends, if any, on improving the Company's capital assets.



Stock Quote

For a delayed price quote on YOCCM see the investor information page at www.yocream.com

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

General

YoCream International's primary focus is on manufacturing, marketing and sales of superior quality frozen yogurt, frozen custard, sorbet, smoothie, coffee latté and ice cream products in a variety of premium, low-fat, and nonfat flavors in either non-organic or organic formulations. The Company also copacks similar products for other companies. Due to the nature of these products, sales are subject to seasonal fluctuations, with the summer months normally being the busiest season. The introduction and roll out of new products has tended to level the seasonal fluctuations.

In fiscal 2003, the Company achieved a 5.3% increase in sales, primarily from new products, which included soft frozen custard, gourmet ice cream, and aseptic coffee latté freeze. The increase in sales, however, was not as high as expected due to the following:

Economic Conditions: The sluggish economy and high unemployment have had an impact on the rate of sales growth. As a result, management has focused on the development of new products that will enable the Company to reach new markets. For example, the Company invested over \$2 million in 2003 for a new aseptic production line to address the market for shelf-stable products. This processing system, completed in October 2003, will initially produce smoothies and coffee concentrate beverages. (See Sales Section p.8.) Other products conducive to this processing system are being evaluated to meet the high demand of the away-from-home marketplace for shelf stable products.

Market Trends: While traditional frozen yogurt remains entrenched in the marketplace, it is presently in its mature stage. In response, the Company has developed unique cultured items in the frozen dessert category. For example, the Company developed a Soft Serve Soy Cultured Frozen Dessert, to appeal to the health conscious consumer. This product is currently being marketed through a national broadline foodservice distributor under their private label. (See Sales Section p.8.) The Company has also developed a low-carb frozen yogurt to respond to strong consumer demand. This product will be introduced at food shows in February, 2004.

The Dannon Alliance: In January 2003, the Company initiated a program whereby the sales teams for both the Company and Dannon began representing their combined product lines to the away-from-home market. In unifying the broker sales network to represent both companies, broker changes were made which resulted in a loss of some customers. YoCream regional sales personnel aggressively pursued the program and attention was diverted from the sale of the Company's core products. By the third quarter the program was revised in cooperation with Dannon, and the Company's sales staff refocused its attention on the sales of the Company's core products.

The Company continues to value its relationship with The Dannon Company. The two Companies are now representing selected products to specific distribution market segments. Under this arrangement, sales teams are defined involving personnel from both Companies to jointly coordinate sales efforts. The Companies expect to find additional opportunities to develop their mutual business interests. The strength of the Dannon name along with YoCream's concentration on the food-service or away-from-home marketplace is expected to offer opportunities for increased sales and market share in the future. Management believes that the two Companies are similar in philosophy, and both Companies' yogurt products are known for their high live culture count, with an emphasis on product quality and appeal to consumers with concerns for health and nutrition.

Other Factors: In the first two quarters of 2003, the Company began selling a proprietary gourmet-softened ice cream in a 10% vanilla bean and a coffee variety to a major regional chain of specialty restaurants. In June 2003 the customer suspended purchasing the product due to pricing concerns. The Company has formulated a new product to meet the customer's needs and expects sales to begin again in the second quarter of fiscal 2004.

The Company expected a higher level of sales of its coffee latté beverage to its lead customer, which was not achieved in 2003 (See explanation below).

Military sales did not meet anticipated expectations due to troop deployment overseas.

Table 1: Sales by Category

Three years ended October 31, 2003, 2002, 2001

	2003	% Total	2002	% Total	2001	% Total
Yogurt	\$10,399,000	50.8%	\$10,108,000	52.0%	\$ 8,544,000	54.7%
Smoothies	8,631,000	42.2%	8,339,000	42.9%	6,804,000	43.6%
Custard and Ice Cream	1,256,000	6.1%	727,000	3.7%	83,000	0.5%
Copacking	192,000	.9%	265,000	1.4%	186,000	1.2%
	\$20,478,000	100.0%	\$19,439,000	100.0%	\$15,617,000	100.0%

Management believes that the sluggish economy, market trends, the temporary diversion of its sales staff, and the other factors listed above will impact sales growth through the first quarter of fiscal 2004, but expects that results will improve through the balance of the year.

While the Company achieved a modest sales increase in a tough economy, a 36.1% decrease in income from operations and a 37.4% decrease in net income were experienced as a result of the following:

Raw Materials: The industry experienced increases in raw materials costs including vanilla, cocoa, and sugar. The Company responded with high-quality product reformulations.

Inventory Levels: Inventory levels were significantly reduced as a result of operating efficiency initiatives. While the accounting effect of this reduction negatively impacts 2003 operating income, management expects future benefits of increased inventory turns, reduced storage expenses, as well as increased cash flow (See Liquidity Section p.12.).

Coffee Latté: In 2002 the Company developed a pre-mixed coffee latté product for its lead customer, which resulted in significant sales. The customer decided it wanted this product in a shelf-stable form. The Company responded by having the product copacked aseptically, which resulted in significantly reduced margins. The customer then accepted an aseptic concentrated form of the product from a competitor, which significantly impacted the Company's sales of coffee latté and related economies of scale. Upon completion of the Company's aseptic processing system in October 2003, a concentrated shelf-stable coffee product was developed, which duplicates the flavor profile of the original product. The concentrate will be presented to this customer for consideration in new markets.

Legal Fees: The Company incurred higher legal fees than expected due to the transition of its former president, to a consultant position.

Unusual Expenses: A freight reimbursement settlement of \$182,000 with its lead customer was incurred by the Company in 2003. The underlying circumstances of this charge have been remedied and management believes the matter to be fully resolved. (See details in Other Income (Expense) p.10.)

In the future, the Company may entertain potential acquisitions, where appropriate, to broaden its product lines or increase market share. The Company has retained the services of an investment banker to assist in analyzing such opportunities.

In August 2003 the Company's president, who was one of its founders, retired after 27 years of outstanding service. He continues to be a major shareholder and the Company has retained the benefit of his experience on a consulting basis.

Management believes that the Company's commitment to the industry, evidenced by its significant investment for expansion and its responsible plan for growth, effectively positions the Company to increase shareholder value. Additional details relative to results and managements plans are presented below.

Sales

The Company's sales were \$20,478,000, \$19,439,000, and \$15,617,000, for the years ended October 31, 2003, 2002, and 2001, respectively, and represented increases of 5.3% in 2003 and 24.5% in 2002.

The increase in fiscal 2003 and 2002 sales primarily related to increases in yogurt case sales to Costco Wholesale and the military/government sector, and from the sale of new products (coffee latté freeze, soft frozen custard and gourmet-softened ice cream).

Frozen Yogurt: The increase in frozen yogurt sales of 2.9% was primarily related to continued growth in its wholesale club business and sales to the military

and government sector, and the efforts of the Company's foodservice sales staff. Although domestic sales to the military are down as a result of troop movements outside of the continental United States, international sales have increased.

The Company continues to develop its business with the military and government sector. The sale of soft frozen yogurt to this segment began on a small scale following the Company's alliance with The Dannon Company in 2001, and has since been systematically growing. The Company recently initiated a worldwide comprehensive program with the US Air Force. This program provided an introduction to two of the country's largest air force bases, Lackland Air Force Base in Texas and Keesler Air Force Base in Mississippi, which will begin serving the Company's products in the second quarter of 2004. During 2003, the Company began sales to the Army, Navy, Air Force, and Coast Guard and obtained new product approvals (see smoothies section below) to facilitate future sales. Marketing plans for fiscal 2004 focus on building volume in each of these branches of the armed forces.

In October 2003, Premier Inc., a leading health-care alliance, awarded the Company a 36-month Committed Agreement to supply Dannon YoCream Frozen Yogurt to Premier healthcare members. Introduction to members began at shows in October and sales are rapidly increasing. Through the first quarter of 2004, the Company opened 7 new national points of distribution to facilitate Premier sales, with 5 additional distributors targeted in the second quarter of 2004. Sales to Premier members have also increased sales volume with 3 existing distributors. The Company's sales plans for this account ensure securing the business of additional members as well as building volume at the points of distribution. The Dannon YoCream alliance was instrumental in introducing the Company to this account.

In December 2003, the Company became an approved supplier for the Amerinet manufacturer allowance program. Amerinet is a health care group purchasing organization in the United States with more than 1,800 hospitals and other health care member facilities. The 24-month agreement covers all YoCream products and certain other private label frozen dessert products that the Company manufactures, with sales expected to begin in the second quarter fiscal 2004.

Consistent product quality resulting from the Company's on-site manufacturing is a major factor in the achievement of the above awards. Other factors include: high counts of beneficial live active yogurt cultures, unique flavor selection, and an extensive branded merchandising program.

Management believes that the above contracts launching national expansion into the healthcare sector are significant in broadening the Company's market base and increasing market share. This business facilitates expanded distribution of the Company's products into the nation's two largest broadline food-service distributors and other independent distributors. Furthermore, it provides opportunity to offer the Company's products to non-healthcare customers serviced by these distributors.

Smoothie Sales: Smoothie sales, consisting of both fruit and coffee products, increased by 3.5% primarily as a result of the growth in coffee latté sales.

Coffee latté sales were initiated with the Company's lead customer as stated in the General Section above. The Company has since installed an aseptic processing system to facilitate the production of this coffee latté in a concentrated form.

A coffee latté concentrate has also been developed for the general market place utilizing the Company's newly installed aseptic line. This product is designed to be mixed with milk at the foodservice customer's location. It is a shelf stable product packed in half-gallon bags and replaces the premix coffee beverage that was copacked in three-gallon bags. The new packaging size appeals to a broader foodservice market, such as coffee shops and restaurants, for which the larger size is not compatible. The new YoCaffé® Latté Coffee Concentrate will be introduced at food shows in the second quarter of 2004. Marketing strategies in 2004 include teaming with a new category of distribution partners that market directly to the optimal customers for this product line.

In the fourth quarter of 2003, the Company initiated a worldwide comprehensive program for aseptic smoothies with the US Air Force. This program provided an introduction to the country's largest air force training installation, Lackland Air Force Base in Texas, which will begin serving smoothies as well as Dannon YoCream frozen yogurt in the second quarter of 2004. In the first quarter of 2004, Keesler Air Force Base, one of the country's three largest air force bases, approved the smoothie program and will begin serving smoothies as well as Dannon YoCream frozen yogurt in the second quarter of 2004. The shelf-stable attributes of the new smoothie products effectively address the product storage needs of many military installations, both domestic and international. In 2004, the new Fruitquake® Smoothies and YoCaffé® Latté products will be promoted at food shows, presented at menu board planning meetings, and advertised in military and government foodservice publications.

Frozen Custard, Gourmet Ice Cream and Soy:

These products are the latest in a line of classic products that have contributed to the historical growth in YoCream sales. Soft frozen custard and gourmet-softened ice cream represent the indulgent line of products that the Company introduced last year.

In June 2002, the Company entered into a 30-month contract to supply its soft serve frozen custard to a Nebraska based chain of restaurants. This contract is being serviced successfully and has resulted in increased sales.

The outstanding quality of the YoCream Frozen Custard, along with the teamwork of the Company's sales personnel and broker have resulted in this product currently being placed in test markets with two large chain accounts in the fourth quarter. Should the testing prove satisfactory, these accounts are expected to significantly increase the Company's sales volume.

In the third quarter of 2002, the Company began selling a proprietary gourmet-softened ice cream in a 10% butterfat vanilla bean and a coffee variety to a major regional chain of specialty restaurants. In June 2003, the customer suspended purchasing the product due to pricing concerns. The Company has formulated a new product to meet the customer's needs and expects sales to resume in the second quarter of fiscal 2004. (See General Section p.7.)

Following the Company's historical trend of developing innovative, high quality products, the Company began distribution in June 2003 of its newest product line of soy based cultured frozen desserts. These unique products are dairy free, all natural, vegan and cultured. This product has been stocked at the central warehouse for one of the Nation's largest distributors facilitating the opening of 7 new major distribution points. In the second quarter, management plans to offer a 4oz hard pack version of the product, which is expected to be more convenient for the customer base.

Cost of Sales

Cost of sales, as a percentage of revenues, were 72.6%, 71.7%, and 70.6%, in 2003, 2002, and 2001, respectively. Costs increased in 2003 and 2002 primarily as a result of the manufacture of coffee latté freeze. Other significant factors effecting cost of sales in 2003 and 2002 included increased costs of raw materials and planned reduction of inventory levels. (See General Section for details p.7.)

In fiscal 2001, cost increases were experienced in ingredients, transportation, and utility costs. Ingredients used in the Company's products are agricultural products subject to price risk. The Company attempts to minimize this risk by entering into contracts to cover its annual production requirements.

During 2001, when certain contracts matured, the Company experienced significant increases in the costs of vanilla, cocoa, and sugar. Competitive conditions limited the Company's ability to pass on these costs. Depreciation and lease payments also increased due to the plant upgrade project completed in January 2001.

Gross Profit

Gross profit margins were 27.4%, 28.3%, and 29.4%, in 2003, 2002, and 2001, as a result of the factors discussed above. Margins decreased in 2003, 2002 and 2001 primarily as a result of the change in sales mix, including the introduction of the new coffee latté product, and other cost of sales factors described above.

Selling and Marketing Expenses

Selling and marketing expenses, as a percentage of revenues, for the years ended October 31, 2003, 2002, and 2001 were 11.1%, 10.4%, and 11.0%, respectively. Such expenses are generally related to the level of revenues and marketing activities. Sales and marketing expenses in total have increased in 2003, 2002 and 2001 due to promotional expenses, Dannon royalty payments, an increase in field staff, and travel expenses related to supporting the sales expansion. Management believes that the opportunities merit the intensified sales and marketing activities.

General and Administrative Expenses

General and administrative expenses for the years ended October 31, 2003, 2002, and 2001, as a percentage of revenues, were 11.5%, 9.9%, and 11.2%, respectively. Overall general and administrative expenses have increased over the three-year period, primarily due to increases in personnel costs and professional fees. Management believes that personnel cost increases are consistent with the Company's growth. Professional fees are expected to decline in 2004. (See General Section p.7.)

Income from Operations

Income from operations for the years ended October 31, 2003, 2002, and 2001 was \$990,000, \$1,549,000, and \$1,125,000, respectively. The factors affecting the reduced income from operations in 2003 are explained in the General Section above.

The significant increase of 37.7% in income from operations in 2002 resulted primarily from the 24.5% increase in sales.

The results for 2001 were impacted by the Company's commitment to expand its sales organization and intensify its marketing programs. The results were also affected by the increase in cost of sales described above.

Other Income (Expense)

Interest expense increased in 2001 as a result of the term loan in June 2001 associated with the plant upgrade project. Over the last three years construction interest capitalized amounted to \$9,200 in 2003, \$0 in 2002 and \$5,300 in 2001.

In August 2002, the Company received notification from a third party freight auditor representing a customer of the Company. The notification implied that the customer might be entitled to freight charge reimbursements for shipments that occurred in 1999 and 2000. As a result of a subsequent investigation of this matter, the Company agreed to a settlement of approximately \$147,000, which was provided for in the fourth quarter 2002. At that time the Company believed that the issues that gave rise to this claim were settled.

During the third quarter 2003, the Company received notification from the same customer regarding a claim for additional freight charge reimbursements for shipments that occurred primarily in 2001 and 2002, with a portion in 2003. The financial results for the third quarter 2003 include a provision of approximately \$182,000 for the settlement of these additional freight costs. Management now believes that this matter has been fully resolved, with the underlying circumstances remedied, and that there will not be any additional charge to the income statement related to this matter.

Other expense of \$71,000 in fiscal 2001, primarily represents a provision for loss on disposition of surplus equipment.

Income before Income Taxes

Income before taxes for the years ended October 31, 2003, 2002, and 2001 was \$803,000, \$1,368,000, and \$1,021,000, respectively. The change in income from operations in 2003 is explained in the General Section. The increase in 2002 is primarily the result of the 24.5% increase in sales.

Provision for Income Taxes

The effective tax rate was 33.4%, 37.4% and 26.3% in 2003, 2002 and 2001, respectively. The effective rates are less than the expected rate of 38.4% primarily due to the realization of federal tax credits in 2003, 2002 and 2001. In the future, the Company expects that its provision for income taxes will be at or near the applicable federal and state statutory rates.

In 2001, the tax provision was reduced by research and development tax credits of approximately \$145,000 relating to several years.

Net Income

Net income for the years ended October 31, 2003, 2002, and 2001 was \$535,000, \$856,000, and \$753,000, respectively. Net income, as a percentage of sales, was 2.6%, 4.4%, and 4.8% in each of the three years. See General Section for management's analysis for declining year 2003 net income. The Company believes that the marketing strategies described in this document as well as cost control measures will enable it to improve financial results by the second and third quarters of 2004.

New Accounting Pronouncements

See Note B of Notes to Financial Statements for a discussion of the adoption of new accounting pronouncements.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the appropriate application of certain accounting policies, many of which require management to make estimates and assumptions about future events and their impact on amounts reported in the Company's financial statements and related notes. On an ongoing basis, management evaluates these estimates, including those related to inventory reserves and allowance for doubtful accounts. Management bases these estimates on historical experience and on various other assumptions. Actual results may differ from these estimates if conditions turn out differently from the assumptions.

The Company's accounting policies are more fully described in Note A of Notes to Financial Statements. The critical accounting policies are as follows:

Inventories are stated at the lower of cost or market. The Company determines cost based on the first-in, first-out (FIFO) method for raw materials, packaging materials and supplies, and based on standard costs for finished goods. The realizability of raw material and finished goods inventories is regularly evaluated based on a combination of factors including the following: historical usage rates, forecasted sales or usage, historical spoilage rates and other factors, and reserves established as necessary.

Revenue from the sale of products is generally recognized at the time of shipment to the customer. Pursuant to EITF 00-14 "Accounting for Certain Sales Incentives," certain coupons, rebate offers and free products offered concurrently with a single exchange transaction are recognized at the later of when revenue is recognized or when the sales incentive is offered, and reported as a

reduction in revenue. In addition, pursuant to EITF 00-25 "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products," certain promotional costs paid to a retailer or wholesaler by a vendor in connection with the sale of the vendor's or promotion of sales of the vendor's products by the retailer or wholesaler are recognized when incurred and reported as a reduction of revenue.

The Company has adopted the disclosure only provisions of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" (SFAS 123). It applies APB Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for its stock-based compensation plans.

Liquidity and Capital Resources

In recent years, the Company has financed its operations and expansion from internally generated funds, bank loans, operating leases, capital leases and stock sales. The cash flow for the three years ended October 31, 2003 is summarized as follows:

Cash provided by operations in fiscal 2003 improved primarily due to the decrease in inventories of approximately \$807,000. This resulted from management's plan to reduce inventories during the year and the Company continues to effectively service its marketplace at reduced inventory levels.

During fiscal 2003, management identified certain logistics elements and inventory turns as key performance indicators. As a result of management's focus on this area, inventory levels were reduced and inventory turns increased from approximately 5.4 to 6.6 times per year. Through improvements in logistics planning, the related storage costs were reduced by 35% in fiscal 2003. Management plans to continue the current inventory management and logistics programs in fiscal 2004.

The Company's capital expenditures for the years ended October 31, 2003, 2002, and 2001 were approximately \$2,379,000, \$642,000, and \$2,245,000, respectively. During 2003 the Company completed the installation of an aseptic processing system. The construction costs to the point of bringing the system on line in October 2003 was approximately \$2,153,000, including \$141,000 in capitalized internal labor costs associated with the project.

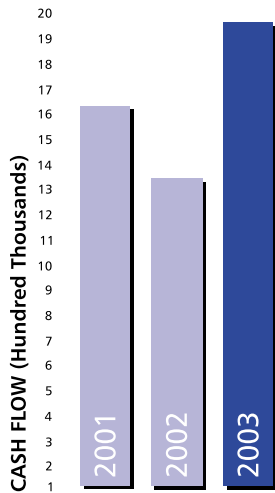
The Company is in the process of evaluating its capital expenditure plans for fiscal 2004, which will include approximately \$488,000 related to the aseptic packaging system. The Company has arranged adequate financing as explained below.

Expenditures in 2001 include approximately \$1,922,000 relating to the \$2.8 million plant upgrade project started in 2000. Cash provided by financing in 2001 includes \$1,400,000 of term loan borrowing to finance 50% of the project. The balance of the project cost was financed with cash generated from operations.

During fiscal 2003 the Company arranged a master finance lease facility to fund the new aseptic processing system. The project was funded by this facility in December 2003. At that time the amounts previously drawn on the line of credit and the existing term loans were refinanced under the master lease facility. The Company also received approximately \$395,000, resulting in a long-term obligation totaling approximately \$2,953,000. The remaining amount that can be borrowed under this facility is approximately \$539,000. This financing arrangement provides for payments over seven years with interest at 30-day LIBOR plus 175 basis points (2.87% at October 31, 2003), with the option to convert to a fixed rate by using an interest rate swap at the Company's discretion. The facility is collateralized by the aseptic system project assets and by the

	2003	% Change	2002	% Change	2001
Net cash provided by operating activities	\$ 1,990,000	48.1%	\$ 1,344,000	-16.1%	\$ 1,602,000
Capital expenditures	(2,379,000)	270.5%	(642,000)	-71.4%	(2,245,000)
Net cash provided by (used in) financing activities	1,505,000	-550.0%	(334,000)	-130.8%	1,085,000
Net increase in cash and cash equivalents	1,116,000	203.9%	367,000	-17.0%	443,000
Cash and cash equivalents at end of year	2,644,000	73.0%	1,529,000	31.6%	1,162,000
Working capital	\$ 4,505,000	18.1%	\$ 3,815,000	17.6%	\$ 3,243,000

CASH FLOW FROM
FROM OPERATING ACTIVITIES



other equipment and fixtures related to the existing term loans, and is subject to the same financial covenants as the revolving line of credit. Under this arrangement, the bank also agreed to release its blanket security interest in the other equipment and fixtures owned by the Company.

The Company has a bank line of credit of \$2,000,000, which matures in July 2005, and provides for an interest rate at prime, with the option to lock in sub-prime rates on blocks of funds up to 90 days. The bank has also offered an additional \$500,000 term loan line for equipment purchases.

During the three years ended October 31, 2003, 2002, and 2001 the Company repurchased 26,822, 71,713, and 45,592 shares, respectively of its common stock. It has been the Company's practice to purchase shares of its stock from time to time, pursuant to board approved plans. The Company also purchases stock for its required contributions to the Company's 401(k) Employee Savings Plan and Trust. At October 31, 2003 the Company does not have any plans to purchase additional shares of its stock at this time, other than for its required 401(k) contributions. (See Note H of Notes to Financial Statements for a further explanation).

At October 31, 2003, working capital includes an income tax receivable of approximately \$378,000. This primarily resulted from the benefit of accelerated tax depreciation of the aseptic processing system, which was completed and placed in service in October 2003.

The Company believes its existing assets, bank lines, and cash flow from operations will be sufficient to fund the Company's operations for at least the next twelve months.

Off Balance Sheet Arrangements

Prior to fiscal year 2001, the Company entered into operating leases relating to certain assets utilized in its production process. (See Note L of the Notes to Financial Statements for a description of these off-balance sheet lease commitments.) The Company also leases its offices, production facility and warehouse with terms of 9 to 15 years. (See Notes L and M of Notes to Financial Statements for a description of the terms).

Accountants and Business Advisors



Report of Independent Certified Public Accountants

Board of Directors and Shareholders
YOCREAM International, Inc.

We have audited the balance sheets of YOCREAM International, Inc. as of October 31, 2003 and 2002, and the related statements of income, shareholders' equity and cash flows for each of the three years in the period ended October 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of YOCREAM International, Inc. as of October 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended October 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton & P

Portland, Oregon
January 12, 2004

Balance Sheets

October 31, 2003 and October 31, 2002

	2003	2002
ASSETS		
Current assets		
Cash and cash equivalents	\$ 2,644,436	\$ 1,528,818
Trade accounts receivable, net of allowance for doubtful accounts of \$37,500 in 2003 and \$18,000 in 2002	934,259	900,996
Inventories	1,846,989	2,654,432
Other current assets	247,012	311,227
Income tax receivable	378,269	-
Deferred tax assets	74,250	34,600
Total current assets	6,125,215	5,430,073
Fixed assets, net	6,241,922	4,385,900
Intangible and other long-term assets, net	499,970	408,964
Total assets	\$12,867,107	\$10,224,937
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt	\$ 336,333	\$ 360,358
Accounts payable	1,144,045	1,083,954
Income taxes payable	-	31,709
Other accrued liabilities	140,146	139,196
Total current liabilities	1,620,524	1,615,217
Long-term debt, less current portion	2,279,667	858,167
Deferred tax liabilities	795,451	243,800
Other liabilities	25,826	4,558
Total liabilities	4,721,468	2,721,742
Shareholders' equity		
Preferred stock, no par value, 5,000,000 shares authorized, none issued or outstanding	-	-
Common stock, no par value, 30,000,000 shares authorized	4,733,281	4,625,981
Retained earnings	3,412,358	2,877,214
Total shareholders' equity	8,145,639	7,503,195
Total liabilities and shareholders' equity	\$12,867,107	\$10,224,937

The accompanying notes are an integral part of these statements.

Statements of Income

For the years ended October 31, 2003, 2002, 2001

	2003	2002	2001
Sales	\$20,477,934	\$19,438,892	\$15,616,943
Cost of goods sold	14,868,324	13,947,245	11,024,318
Gross profit	5,609,610	5,491,647	4,592,625
Selling, general and administrative expenses			
Selling and marketing	2,267,137	2,023,469	1,723,884
General and administrative	2,352,580	1,918,944	1,743,660
Income from operations	989,893	1,549,234	1,125,081
Other income (expense)			
Interest income	6,144	14,743	22,806
Interest expense	(28,335)	(48,420)	(55,224)
Unusual expenses	(157,163)	(147,487)	-
Other, net	(7,395)	-	(71,470)
Income before income taxes	803,144	1,368,070	1,021,193
Income tax provision	268,000	512,000	268,000
Net income	\$ 535,144	\$ 856,070	\$ 753,193
Earnings per common share - basic	\$0.24	\$0.38	\$0.33
Earnings per common share - diluted	\$0.23	\$0.38	\$0.33
Shares used in basic earnings per share	2,257,988	2,253,248	2,262,657
Shares used in diluted earnings per share	2,280,233	2,272,986	2,271,186

The accompanying notes are an integral part of these statements.

Statement of Shareholders' Equity

Fiscal years ended October 31, 2003, 2002, 2001

	Common Stock		Retained Earnings	Total Shareholders' Equity
	Shares	Amounts		
Balance, October 31, 2000	2,262,583	\$4,862,541	\$1,267,951	\$6,130,492
Net income	-	-	753,193	753,193
Stock options exercised	43,000	84,350	-	84,350
Repurchase of common stock	(45,592)	(173,092)	-	(173,092)
Tax benefit of options exercised	-	23,405	-	23,405
Balance, October 31, 2001	2,259,991	\$4,797,204	\$2,021,144	\$6,818,348
Net income	-	-	856,070	856,070
Stock options exercised	61,900	216,380	-	216,380
Repurchase of common stock	(71,713)	(461,403)	-	(461,403)
Tax benefit of options exercised	-	73,800	-	73,800
Balance, October 31, 2002	2,250,178	\$4,625,981	\$2,877,214	\$7,503,195
Net income	-	-	535,144	535,144
Stock options exercised	54,600	210,500	-	210,500
Repurchase of common stock	(26,822)	(125,400)	-	(125,400)
Tax benefit of options exercised	-	22,200	-	22,200
Balance, October 31, 2003	2,277,956	\$4,733,281	\$3,412,358	\$8,145,639

The accompanying notes are an integral part of these statements.

Statements of Cash Flows

For the years ended October 31, 2003, 2002, 2001

	2003	2002	2001
Cash flows from operating activities			
Net income	\$ 535,144	\$ 856,070	\$ 753,193
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	516,028	612,376	588,996
Loss on disposal of equipment	7,395	-	72,302
Deferred income taxes	512,001	214,200	49,000
Change in assets and liabilities			
Accounts receivable	(33,263)	138,007	(41,927)
Inventories	807,443	(180,894)	23,875
Other assets	(26,791)	(150,759)	(150,379)
Accounts payable	60,091	(58,444)	228,518
Income taxes payable	(409,978)	(90,466)	53,179
Other accrued liabilities	22,218	3,614	25,681
Net cash provided by operating activities	<u>1,990,288</u>	<u>1,343,704</u>	<u>1,602,438</u>
Cash flows from investing activities			
Expenditures for fixed assets	<u>(2,379,445)</u>	<u>(642,149)</u>	<u>(2,244,531)</u>
Net cash used in investing activities	<u>(2,379,445)</u>	<u>(642,149)</u>	<u>(2,244,531)</u>
Cash flows from financing activities			
Proceeds from issuance of long-term debt	1,767,500	181,500	1,400,000
Principal payments on long-term debt	(370,025)	(344,675)	(250,048)
Repurchase of common stock	(125,400)	(461,403)	(173,092)
Proceeds from exercise of stock options	<u>232,700</u>	<u>290,180</u>	<u>107,755</u>
Net cash provided by (used in) financing activities	<u>1,504,775</u>	<u>(334,398)</u>	<u>1,084,615</u>
Net increase in cash and cash equivalents	1,115,618	367,157	442,522
Cash and cash equivalents, beginning of year	<u>1,528,818</u>	<u>1,161,661</u>	<u>719,139</u>
Cash and cash equivalents, end of year	<u>\$2,644,436</u>	<u>\$1,528,818</u>	<u>\$1,161,661</u>

The accompanying notes are an integral part of these statements.

Notes To Financial Statements

Note A - Operations and Summary of Significant Accounting Policies

YOCREAM International, Inc. (the Company) was incorporated on January 14, 1977 in the state of Oregon. The Company manufactures and wholesales frozen yogurt, custard, ice cream, fruit and coffee smoothie beverages, under its brand names "YOCREAM" or "DANNON YOCREAM", and also under private labels. Sales are made primarily throughout the United States to and through a variety of outlets, including distributors, discount club warehouses, convenience stores, restaurants, hospitals, schools, military installations, quick serve restaurants and specialty shops.

1. Significant Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Cash and Cash Equivalents

Cash and cash equivalents include money market and other short-term investments with a remaining maturity of three months or less when purchased.

3. Accounts Receivable

The majority of the Company's accounts receivable are due from companies in the retail and wholesale food service industries. Credit is extended based on evaluation of a customer's financial condition and, the Company periodically performs credit evaluations of its customers. Credit insurance is obtained on selected accounts. Accounts receivable are generally due within 15 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. Historically the Company's credit

losses have been insignificant.

4. Inventories

Inventories are stated at the lower of cost or market. The Company determines cost based on the first-in, first-out (FIFO) method for raw materials, packaging materials and supplies, and based on standard costs for finished goods.

5. Fixed Assets

Fixed assets are stated at cost. Expenditures for replacements and improvements are capitalized, and expenditures for repairs and maintenance and routine replacements are charged to operating expense as incurred. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation are eliminated from the accounts and any resulting gain or loss is included in operations. Depreciation is provided for on a straight-line basis in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives. Leasehold improvements are amortized over the life of the lease or the service life of the improvement, whichever is shorter. Property, plant and equipment are reviewed for impairment whenever events or circumstances indicate that the carrying amount of assets may not be recoverable in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." The recoverability of property, plant and equipment to be held and used is evaluated by comparing the carrying amount of an asset to the estimated future net undiscounted cash flows to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. The estimated lives used in calculating depreciation and amortization are as follows:

Plant equipment	10-25 years
Office equipment and furnishings	3-10 years
Leasehold improvements	5-14 years

6. Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable and payable, approximate fair value because of the relatively short maturity of these instruments. The carrying value of notes payable and long-term debt approximate fair values based upon the interest rates available to the Company for similar instruments.

7. Revenue Recognition and Sales Incentives

Revenue from the sale of products is generally recognized at the time of shipment to the customer. Pursuant to EITF 00-14 "Accounting for Certain Sales Incentives," certain coupons, rebate offers and free products offered concurrently with a single exchange transaction are recognized at the later of when revenue is recognized or when the sales incentive is offered, and reported as a reduction in revenue. In addition, pursuant to EITF 00-25 "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products," certain promotional costs paid to a retailer or wholesaler by a vendor in connection with the sale of the vendor's products, or promotion of sales of the vendor's products, by the retailer or wholesaler are recognized when incurred and reported as a reduction of revenue. For the three years ended October 31, 2003, 2002 and 2001 the total of rebates and promotional costs charged against sales were approximately \$610,000, \$599,000, and \$569,000, respectively.

8. Shipping and Handling Costs

Shipping and handling costs are classified as part of cost of sales. Payments received from customers for shipping and handling costs are classified as part of net sales upon recognition of the related sale.

9. Research and Development Costs

Research and development costs are expensed as incurred. For the years ended October 31, 2003, 2002 and 2001 such costs aggregated approximately \$555,000, \$446,000 and \$269,000, respectively.

10. Earnings Per Share (EPS)

Basic EPS is computed using the weighted average number of shares of common stock outstanding for the period. Diluted EPS is computed using the weighted average number of shares of common stock and dilutive common stock equivalents outstanding during the period. Common equivalent shares from stock options are excluded from the computation when their effect is antidilutive.

11. Supplemental Cash Flow Information

The Company made cash interest payments of approximately \$37,000, \$48,000 and \$61,000 for the years ended October 31, 2003, 2002 and 2001, respectively. Income taxes paid for the years ended October 31, 2003, 2002, and 2001 totaled approximately \$144,000, \$315,000 and \$142,000, respectively.

12. Stock Based Compensation Plans

The Company has stock-based employee compensation plans which are more fully described in Note I. The Company has adopted the disclosure only provi-

sions of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" (SFAS 123). It applies APB Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for its Plans.

Had the Company used the fair value methodology of SFAS 123 for determining compensation expense, the Company's net income and net income per share would approximate the pro forma amounts below:

	2003	2002	2001
Net income, as reported	\$535,144	\$856,070	\$753,193
Net income, pro forma	301,779	856,070	671,743
Diluted net income per common share, as reported	0.23	0.38	0.33
Diluted net income per common share, pro forma	\$ 0.13	\$ 0.38	\$ 0.30

The weighted-average fair value of options granted during the years ended October 31, 2003, 2002, and 2001 were \$1.73, \$2.17, \$1.35, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions in 2003, 2002, and 2001, respectively: no dividends; expected volatility of 36%, 43%, and 42%; risk-free interest rate of 3.19%, 2.95%, and 3.91%, and an expected life of 5 years.

13. Concentrations of Credit Risk and Major Customer

One customer accounted for 60% and 63% of accounts receivable at October 31, 2003 and 2002. This same customer accounted for 70%, 68% and 67% of total revenues in the years ended October 31, 2003, 2002 and 2001.

14. Reclassifications

Certain balance sheet items at October 31, 2002 have been reclassified to conform to the current year's presentation.

Note B - Adoption of Accounting Pronouncements

SFAS No. 142

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142

Note B – Adoption of Accounting Pronouncements – Continued

changes the accounting for goodwill and other identifiable intangibles with indefinite lives from an amortization method to an impairment-only approach. The Company adopted SFAS No. 142 and, as a result, amortization of intangibles determined to have indefinite lives ceased in the first quarter of fiscal 2003. Had SFAS No. 142 been adopted at the beginning of fiscal 2002, depreciation and amortization of approximately \$9,900 would not have been recorded, and net income would have been approximately \$862,600 for the year ended October 31, 2002, respectively, with no effect on earnings per share.

SFAS No. 143

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations." This statement addresses the financial accounting and reporting for the retirement of tangible long-lived assets and the associated asset retirement costs. The Company believes the adoption of SFAS 143 will have no significant impact on its financial statements.

SFAS No. 144

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions for the Disposal of a Segment of a Business." SFAS No. 144 became effective for fiscal years beginning after December 15, 2001. The adoption of SFAS No. 144 in the first quarter of fiscal 2003 had no effect on financial position, cash flows or results of operations.

SFAS No. 150

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 establishes standards for how to classify and measure financial instruments with characteristics of both liabilities and equity. It requires financial instruments that fall within its scope to be classified as liabilities. SFAS No. 150 is effective as of June 1, 2003 for financial instruments entered into or modified on or after that date and, for pre-existing financial instruments, as of

July 1, 2003. However, in October 2003, the FASB deferred indefinitely the provisions of SFAS No. 150 that relate to mandatorily redeemable, non-controlling interests. The provisions of SFAS No. 150 have been reviewed and it has been determined that the Company does not currently have any financial instruments that have characteristics of both debt and equity.

Note C - Inventories

Inventories consist of the following at October 31,:

	2003	2002
Finished goods	\$ 1,246,700	\$ 1,996,415
Raw materials	368,441	412,345
Packaging material and supplies	231,848	245,672
	<u>\$ 1,846,989</u>	<u>\$ 2,654,432</u>

Note D - Fixed Assets

Fixed assets consist of the following at October 31,:

	2003	2002
Machinery and equipment	\$ 8,466,836	\$ 6,256,922
Office equipment and furnishings	253,896	245,305
Leasehold improvements	1,186,646	1,182,210
Construction in process	159,475	95,361
	<u>10,066,853</u>	<u>7,779,798</u>
Less accumulated depreciation and amortization	(3,824,931)	(3,393,898)
	<u>\$ 6,241,922</u>	<u>\$ 4,385,900</u>

During the year ended October 31, 2003, the Company expended \$2,184,000 related to the installation of an aseptic processing system, which was placed in service in October 2003.

Note E - Intangible and Other Long-Term Assets

Intangible assets consist of trademarks, principally "YoCream" with a cost basis of \$257,000. Accumulated amortization associated with intangible assets totaled \$161,000 at October 31, 2003 and 2002. In accordance with the provisions of SFAS No. 142, the amortization of trademarks ceased beginning in the first quarter 2003.

As of October 31, 2003 and 2002, the Company had made deposits totaling \$209,000 and \$101,000 related to the leases of various equipment and its production and office facility, and had insurance policy premium advances of \$190,000 and \$163,000, respectively (see Note M). As of October 31, 2003 and 2002, the Company also had other long-term

assets of \$5,000 and \$49,000, respectively. These items are included in intangible and other long-term assets in the accompanying balance sheet.

Note F - Current and Long-Term Debt

The Company has an uncollateralized bank line of credit, which permits borrowing of up to \$2,000,000. The line bears interest at the bank's commercial lending rate, 4.00% at October 31, 2003. The line is subject to renewal by July 2005. At October 31, 2003, the Company borrowed \$1,566,000 under the line of credit in anticipation of completing the long-term financing arrangement described below. In December 2003, the amount borrowed under the line was transferred into the long-term facility described below leaving no amount drawn on the line. There were no amounts drawn on this line at October 31, 2002.

The line of credit contains certain financial covenants including covenants related to the ratio of senior liabilities (as defined) to adjusted tangible capital, current ratio and operating cash flow to fixed charge as well as limits the amount of common stock which can be repurchased by the Company. At October 31, 2003, the Company was in compliance with all of these ratios and covenants.

In December 2003, the Company finalized the terms of the master finance lease facility, which refinances the existing bank term loans of \$991,667 and provides additional monies of up to \$2,500,000 (including the amount borrowed in October) to fund food manufacturing equipment expenditures. The facility, which reduced the interest rate by 25 basis points beginning in July 2003 and extended the maturity date on the existing term loans, provides for payments over seven years with interest at 30-day LIBOR plus 175 basis points, with the option to convert to a fixed rate by using an interest rate swap at the Company's discretion. The facility is subject to the same financial covenants as the revolving line of credit, and is collateralized by the aseptic system project assets, and by the other equipment and fixtures related to the existing term loans. In December 2003 the Company borrowed an additional \$394,887 under the terms of the master lease agreement. In conjunction with the payoff of the existing term loans, the lender agreed to release its blanket security interest in the other equipment and fixtures owned by the Company.

The debt maturity schedule as shown is based on the terms of the new financing facility, which provides for 84 monthly payments of \$33,680 at the initial 30-day LIBOR rate of 1.15% plus 175 basis points. The actual monthly payment will fluctuate with changes in the 30-day LIBOR rate.

Long-term debt consists of the following at October 31,:

	2003	2002
Note payable to a bank in monthly installments of \$5,833 through December 2007, plus interest at 30-day LIBOR plus 1.75% (2.87% at October 31,2003) collateralized by certain equipment.	\$ 303,333	\$ 181,500
Note payable to a bank in monthly installments of \$23,333 through June 2006, plus interest at 30-day LIBOR plus 1.75% (2.87% at October 31,2003) collateralized by certain equipment.	746,667	1,026,667
Capitalized lease obligation to a bank in monthly installments of \$20,622 through December 2010, plus interest at 30-day LIBOR plus 1.75% (2.87% at October 31,2003) collateralized by certain equipment.	1,566,000	-
Note payable in monthly installments of \$943 through October 2003, including interest at 6.6%, without collateral	-	10,358
	<u>2,616,000</u>	<u>1,218,525</u>
Less portion due within one year	<u>(336,333)</u>	<u>(360,358)</u>
	<u>\$ 2,279,667</u>	<u>\$ 858,167</u>

The principal portion of long-term debt is payable as follows:

Year ending	
October 31,	
2004	\$ 336,333
2005	342,580
2006	352,648
2007	363,012
2008	373,680
Thereafter	<u>847,747</u>
	<u>\$2,616,000</u>

Note G - Advertising Costs

Advertising costs are charged to operations in the year incurred. For the years ended October 31, 2003, 2002 and 2001 advertising costs aggregated approximately \$378,000, \$372,000 and \$327,000, respectively.

Note H - Employee Benefit Plans

The Company has a 401(k) Employee Savings Plan and Trust (the Plan) which requires the Company to make contributions to the Plan in the amount of 3% of eligible employee compensation. The Plan allows that the required contributions may be invested in common stock of the Company. The Company made contributions to the Plan of approximately \$85,000, \$56,000 and \$51,000 during the years ended October 31, 2003, 2002 and 2001, respectively. All such contributions have been made in the form of common stock of the Company, which has been purchased on the open market.

Additionally, the Company has a profit-sharing plan for eligible employees. Under the provisions of the plan, the Company may, at its discretion, make contributions of a sum not in excess of the amount permitted under the Internal Revenue Code as a deductible expense. The Company has not made any contributions to this plan.

Note I - Stock Option Plans

In January 1994, the Company's Board of Directors adopted a Combined Incentive and Nonqualified Stock Option Plan and reserved 200,000 shares of common stock for issuance pursuant to this plan. Options are exercisable in such amounts and at such times as authorized by a Stock Option Agreement applicable to each option. At October 31, 2003, these options had an exercise price of \$4.00 and a weighted average remaining contractual life of approximately 1 year.

A summary of option transactions relating to the Combined Incentive and Nonqualified Stock Option Plan is as follows:

	Shares under option	Weighted Average Exercise Price
Balance, October 31, 2000	130,000	\$3.54
Granted	-	-
Exercised	(23,000)	1.75
Expired	-	-
Balance, October 31, 2001	107,000	3.93
Granted	-	-
Exercised	(31,900)	3.76
Expired	-	-
Balance, October 31, 2002	75,100	4.00
Granted	-	-
Exercised	(44,600)	4.00
Expired	-	-
Balance, October 31, 2003	<u>30,500</u>	<u>\$4.00</u>

In March 2000, the shareholders approved the 2000 Stock Option Plan. The plan provides for the grant of options to directors, key employees including employees who are directors and other persons who provide services to the Company. Initially the plan authorized the issuance of 100,000 shares of common stock upon exercise of options granted under the plan. In April 2002 and 2003, the shareholders approved amendments to the plan to increase the number of shares authorized for grants under the plan to 400,000. Options granted under the plan are exercisable at a per share price not less than 100% of the fair market value of the underlying common stock on the date of the grant. Incentive stock options granted to any person with beneficial ownership of 10% or more of the outstanding shares of common stock must be exercisable at a per share price not less than 110% of the fair market value of the stock on the date of the grant. The plan will terminate January 25, 2010.

A summary of option transactions relating to the 2000 Stock Option Plan is as follows:

	Shares under option	Weighted Average Exercise Price
Balance, October 31, 2000	-	-
Granted	70,000	\$3.21
Exercised	(5,000)	3.21
Balance, October 31, 2001	65,000	3.21
Granted	65,000	5.26
Exercised	(30,000)	3.21
Expired	-	-
Balance, October 31, 2002	100,000	4.54
Granted	180,000	4.70
Exercised	(10,000)	3.21
Expired	(15,000)	4.58
Balance, October 31, 2003	<u>255,000</u>	<u>\$4.70</u>

At October 31, 2003, there were 385,500 shares of common stock reserved for issuance under the Company's stock option plans.

Note J - Income Taxes

The provision for income taxes for the years ended October 31, consists of the following:

	2003	2002	2001
Current	<u>\$(244,000)</u>	\$297,800	\$219,000
Deferred	<u>512,000</u>	214,200	49,000
	<u>\$ 268,000</u>	<u>\$512,000</u>	<u>\$268,000</u>

The effective tax rate differed from the statutory federal tax rate due to the following:

	Year ended October 31,		
	2003	2002	2001
Statutory federal tax rate (graduated)	34.0%	34.0%	34.0%
State taxes, net of federal benefit	3.7	4.1	3.8
Tax credits	(4.5)	(2.1)	(10.5)
Other	.2	1.4	(1.0)
	<u>33.4%</u>	<u>37.4%</u>	<u>26.3%</u>

Deferred tax assets (liabilities) consist of the following at October 31,:

	2003	2002
Deferred tax assets		
Accrued expenses	\$ 5,800	\$ 9,600
Allowance for doubtful accounts	14,400	6,900
State NOL carryforward	24,300	-
Other	29,750	18,100
Deferred tax assets	<u>\$ 74,250</u>	<u>\$ 34,600</u>
Deferred tax liabilities		
Fixed assets	<u>\$ (795,451)</u>	<u>\$ (243,800)</u>

Management evaluates on a quarterly basis the recoverability of the deferred tax assets and the level of the valuation allowance. As of October 31, 2003 and 2002, the Company has not recorded an allowance against deferred tax assets.

NOTE K - EARNINGS PER SHARE

The following table is a reconciliation of the numerators and denominators of the basic and diluted per share computations for each of the three years ended October 31,:

	Income (Numerator)	Weighted Average Shares (Denominator)	Per-Share Amount
2001			
Basic earnings per share			
Income available to common shareholders	\$ 753,193	2,262,657	\$ 0.33
Effect of dilutive securities			
Stock options	-	8,529	-
Diluted earnings per share			
Income available to common shareholders	<u>\$ 753,193</u>	<u>2,271,186</u>	<u>\$ 0.33</u>
2002			
Basic earnings per share			
Income available to common shareholders	\$ 856,070	2,253,248	\$ 0.38
Effect of dilutive securities			
Stock options	-	19,738	-
Diluted earnings per share			
Income available to common shareholders	<u>\$ 856,070</u>	<u>2,272,986</u>	<u>\$ 0.38</u>
2003			
Basic earnings per share			
Income available to common shareholders	\$ 535,144	2,257,998	\$ 0.24
Effect of dilutive securities			
Stock options	-	22,235	-
Diluted earnings per share			
Income available to common shareholders	<u>\$ 535,144</u>	<u>2,280,233</u>	<u>\$ 0.23</u>

Note L - Operating Lease Commitments

The Company leases its production, warehouse and office facilities under operating lease agreements with related parties, as described below. In addition, the Company leases equipment under non-cancelable operating leases with unrelated third parties.

Minimum lease payments required under these operating leases are as follows:

Year ending	
October 31,	
2004	\$ 596,000
2005	543,000
2006	497,000
2007	445,000
2008	407,000
Thereafter	<u>2,853,000</u>
	<u>\$ 5,341,000</u>

Operating lease expense for the years ended October 31, 2003, 2002 and 2001 approximated \$547,000, \$505,000, and \$508,000. Operating lease expenses are allocated between manufacturing costs and general and administrative expenses in the accompanying statements of income.

Note M - Related Party Transactions

The Company leases its production and office facilities from a company that is owned by the Company's chief executive officer, its former president, a director and secretary, and certain other shareholders of the Company. The lease has a remaining term of approximately 9 years with renewal provisions and currently provides for a base rent of \$17,000 per month for the period from July 2003 to July 2006. Thereafter the lease increases approximately 8% every three years. Payments under the lease for the years ended October 31, 2003, 2002 and 2001 were approximately \$199,000, \$187,000 and \$187,000, respectively.

In October 2003, the Company entered into an agreement to lease an adjoining warehouse facility from the same company described above. The lease has a term of 15 years and provides for a base rent of approximately \$12,800 per month for the period from November 2003 to 2006. Thereafter the lease payment increases approximately 9% every three years.

The Company has retained the services of a law firm in which a director of the Company is a shareholder. The law firm has served as the Company's general counsel and for the years ended October 31, 2003, 2002 and 2001 billed the Company fees of approximately \$339,000, \$217,000, and \$145,000, respectively.

In August 2003, the Company entered into a three-year consulting agreement with its former president, upon his retirement after 27 years of service, and

resignation from his positions as president and a director of the Company. Under the terms of the consulting agreement, he will be paid an annual fee of approximately \$136,700. Additionally, the Company will continue to provide health insurance benefits during the term of the agreement, and fund a \$500,000 split dollar life insurance policy until the policy is paid up, or the event of death. Payments under the agreement for the year ended October 31, 2003 were approximately \$38,000. The policy has been assigned to the Company as collateral for the repayment of the premiums. In the event of the death of the former employee, the Company would be paid the amount of its premium advances. The Company's premium advances since the inception of this policy are approximately \$85,000 and \$73,000 at October 31, 2003 and 2002, respectively, and are classified as part of Other Long-Term Assets (See Note E).

The Company also maintains a \$500,000 split dollar life insurance policy on its chief executive officer under which the Company pays the premiums. The policy is assigned to the Company as collateral for the repayment of the premiums. In the event of the death of the employee, the Company would be paid the amount of its premium advances. Since the inception of this policy such advances are approximately \$105,000 and \$90,000 at October 31, 2003 and 2002, respectively, and are classified as part of Other Long-Term Assets (See Note E).

Note N- Unusual Expenses

In August 2002, the Company received notification from a third party freight auditor representing a customer of the Company. The notification implied that the customer might be entitled to up to \$140,000 for additional freight charge reimbursements for shipments that occurred in 1999 and 2000. As a result of a subsequent investigation of this matter, the Company agreed to a settlement of approximately \$147,000, which was provided for in the fourth quarter 2002. At that time the Company believed that the issues that gave rise to this claim were settled.

During the third quarter 2003, the Company received notification from the same customer regarding a claim for additional freight charge reimbursements for shipments that occurred primarily in 2001 and 2002, with a portion in 2003. The financial results for the third quarter 2003 include a provision of approximately \$182,000 for the settlement of these additional freight costs. Management now believes that this matter has been fully resolved, with the underlying circumstances remedied, and that there will not be any additional charge to the income statement related to this matter.

Note O - Quarterly Financial Data (Unaudited)

Quarterly financial data for the two years ending October 31, 2003 is as follows:

	Sales	Gross Profit	Net Income	Basic Earnings Per Share	Diluted Earnings Per Share
2003					
1st quarter	\$ 3,869,008	\$ 971,909	\$ 10,647	\$0.00	\$0.00
2nd quarter	4,995,274	1,386,505	138,733	0.06	0.06
3rd quarter	6,635,915	1,986,737	335,998	0.15	0.15
4th quarter	4,977,737	1,264,459	49,766	0.02	0.02
(1)	\$20,477,934	\$5,609,610	\$535,144	\$0.24	\$0.23
2002					
1st quarter	\$ 3,361,716	\$1,017,012	\$103,501	\$0.05	\$0.05
2nd quarter	4,593,568	1,327,212	224,242	0.10	0.10
3rd quarter	6,289,553	1,811,877	469,976	0.21	0.21
4th quarter	5,194,055	1,335,546	58,351	0.03	0.03
(1)	\$19,438,892	\$5,491,647	\$856,070	\$0.38	\$0.38

(1) See NOTE N (left) regarding the impact of unusual expenses.

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Annual Meeting
The annual meeting of shareholders will be held on Wednesday, April 21, 2004, 10:00 a.m. in the "Rose Room" (located on the "Preferred Level").
Rose Garden Arena
One Center Court
Portland, Oregon 97227

Form 10-K
This report is available to shareholders of record upon written request to:
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