

YOOREAM[®]



2004 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 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	64	Director; Chairman of Board of Directors; Chief Executive Officer	1977
James S. Hanna	71	Director; Secretary	1977
William J. Rush	70	Director; Partner in Rush, Hannula, Harkins, & Kyler, LLP Attorneys at Law	1987
Carl G. Behnke	59	Director; President R.E.B. Enterprises; Chairman of Sur La Table	1994
Joseph J. Hanna, Jr.	66	Director; President of Hanna Strader PC Tax Attorney	2001
Fred M. Kinyon	66	Director; Owner of Capital Values Northwest	2004
W. Douglas Caudell	61	Chief Financial Officer	NA

FORWARD LOOKING STATEMENTS

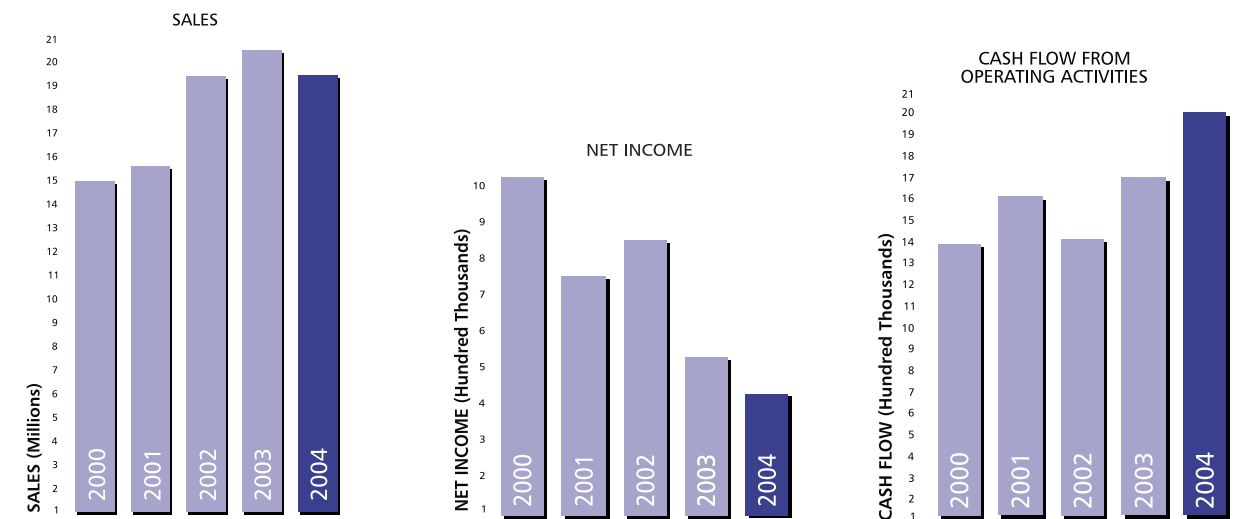
The information throughout this annual report includes certain forward-looking statements, including statements regarding the Company's expectations, hopes, beliefs, intentions or strategies regarding the future. These statements are in locations such as that in the Letter to Shareholders, the Sales 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

Balance Sheets	October 31,				
	2004	2003	2002	2001	2000
Total current assets	\$7,027,349	\$6,125,215	\$5,430,073	\$4,992,797	\$4,372,804
Total assets	13,755,896	12,867,107	10,224,937	9,651,561	7,426,575
Long-term debt	2,305,939	2,279,667	858,167	1,037,024	125,073
Shareholders' equity	\$8,572,578	\$8,145,639	\$7,503,195	\$6,818,348	\$6,130,492

Statements of Income	For the years ended October 31,				
	2004	2003	2002	2001	2000
Sales	\$19,272,376	\$20,477,934	\$19,438,892	\$15,616,943	\$14,943,886
Income from operations	693,544	989,893	1,549,234	1,125,081	1,542,737
Income before taxes	639,639	803,144	1,368,070	1,021,193	1,572,918
Income tax provision	219,000	268,000	512,000	268,000	548,000
Net income	420,639	535,144	856,070	753,193	1,024,918
Earnings per common share-basic	0.18	0.24	0.38	0.33	0.45
Earnings per common share-diluted	\$0.18	\$0.23	\$0.38	\$0.33	\$0.45



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

CONTENTS

To Our Shareholders	2
Our Products	4-5
Financial Review	
Market Information	6
Management's Discussion and Analysis	7-11
Financial Statements	12-16
Notes to Financial Statements	17-24
Shareholder Information	<i>Inside Back Cover</i>

To Our Shareholders,

Nearly seven million dollars were invested in capital assets for product capability within the preceding five years. That's a bold move for a company our size. To do it we had to resist the pressure for near term fiscal performance. Why did we assume the risks?

We did it because we have capable personnel committed to audacious achievement. Six of our senior managers have an average tenure of 17 years, indicative of their know-how and tenacity. Two senior managers add depth in marketing and operations. Professional field personnel are spearheading a unique business development attack that has opened a new vista of opportunity.

We did it because we have the product expertise to meet the needs of our dynamic marketplace. There is renewed interest by health proponents in probiotics and the food industry is sensitive to public awareness of its benefits. This has thrust us to the forefront of product development with a number of the nation's largest food purveyors.

We did it in response to industry demand for aseptic, shelf stable products. It was costly, but our established, proficient aseptic packaging line enhances our competitive position.

We did it because our exceptional logistics system enables us to deliver product throughout the nation. Few companies with similar products have evolved this ability. Although increased freight rates and fuel surcharges impacted us significantly during fiscal 2004 and the first quarter of 2005, the Company is now recovering from this unexpected hit. We stand ready with increased capacity and product lines to get our goods anywhere.

The sizable capital expansion has not diverted us from our core products and existing customer base. Sale of our core products increased 7.1% in 2004. Overall sales decreased, however, due to previously reported events that took place last year.

One of the new products expected to fill the gap is Dannon Frozen Frusion – by YoCream, a unique, tasty frozen drink of yogurt and fruit. This beverage is an example of a probiotic product, defined to contain live microorganisms that improve health by modifying intestinal microflora. It will be presented to the foodservice marketplace in early spring of 2005.

For several years management has been cautiously observing the market for a retail reentry. We have decided upon another new probiotic product, Dannon-YoCream Frozen Yogurt premium pints. Six flavors will be offered through the Fred Meyer retail grocery chain in the Northwest this spring.

Frequent economic storms of recent years have moderated growth and profits. The financial statements tell of the struggle with real, unfabricated numbers. They also reflect commitment to profitable growth with responsible expenditures for operating capacity. Accompanying this commitment is management's determination to make it happen and assurance that it will happen.

My sincere thanks to each of you for the confidence you have expressed by your investment.



John N. Hanna
Chairman and Chief Executive Officer



In the spring of 2005, the Company will introduce Dannon® YoCream® Frozen Yogurt premium pints in the Northwest region.



Our Products

YoCream remains focused on its core business, moderating the maturity of the frozen yogurt market with introductions of innovative products, including drinkable yogurts and aseptically packaged smoothies. A realignment of our sales team in 2004 resulted in a structure that better balances resources against our key objectives and has already provided new growth opportunities for our branded products as well as custom manufacturing projects. Expanding distribution to the away-from-home market is key to our success and has been a primary focus in 2004, enabling us to secure new specialty and broadline points of distribution. We will grow by increasing the availability of our products, reaching consumers in more outlets.

Health and wellness are a major issue for today's consumer and have always been a focus at YoCream. Our product lines are well positioned to meet these needs with offerings ranging from nonfat and no-sugar-added to non-dairy. Some of our newest healthy products are introduced on these pages. Read more and for watch them in 2005.

Dannon YoCream Frozen Yogurt pints are the newest addition to the YoCream family of better-for-you desserts. This creamy, indulgent frozen yogurt compares to high-fat ice cream, yet only contains 5% butterfat. High counts of live active yogurt cultures provide the benefits of probiotics, while outstanding flavors with exciting inclusions create the tasty experience that consumers love. Frozen yogurt pints are available in select markets in spring 2005.



Our core product line of Dannon YoCream Frozen Yogurt performed well in 2004. With more than 35 flavors in Nonfat, No Sugar Added, Low-Carb and Premium varieties, this good-for-you probiotic product satisfies consumers with its rich and creamy texture. Two new flavors will be added in 2005.

Other soft serve products by the Company include Ice Cream, Frozen Custard, Sorbet and Soy Frozen Dessert.

Fruitquake dispenser smoothies are bold and intense fruit beverages with high concentrations of real fruit. This new ready-to-use line has been selectively introduced in the first quarter of 2005 and will roll out nationwide this spring. The product is packaged on the Company's aseptic packaging line providing for a shelf-stable product.

The Company will expand its smoothie line this spring with a new and improved concentrated smoothie and beverage mix. This frozen product is designed for blender smoothies and bar mixers.



Drinkable Yogurts are fast becoming a staple in many consumer diets. YoCream has teamed up with The Dannon Company to provide foodservice operators with a delicious frozen beverage version of the popular Dannon Frusion.



America loves coffee beverages, and YoCream provides a convenient solution for foodservice operators with YoCaffé Latte. This aseptically packaged coffee concentrate is designed to be mixed with milk and served through a frozen beverage machine for a delightful drink. In 2005, YoCream will introduce a new ready-to-use version of YoCaffé Latte that is pre-mixed with milk. Both shelf-stable products are designed to store at room temperature!



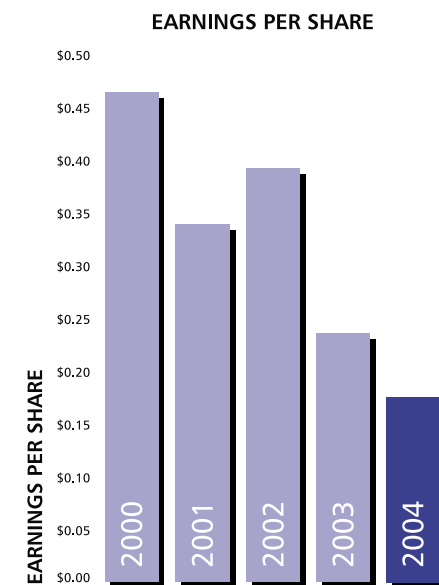
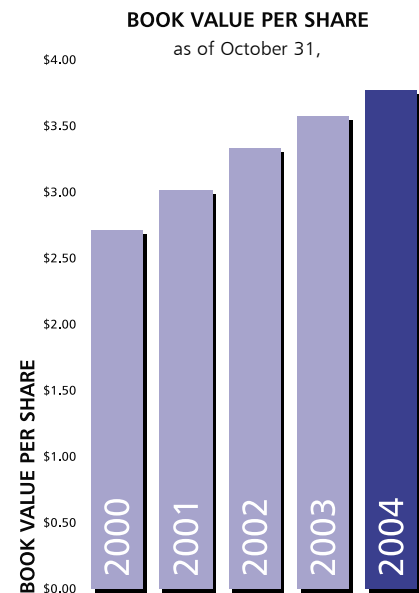
Market Information

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 14, 2005, there were 2,150,600 shares of the common stock outstanding and there were 142 shareholders of record estimated to represent approximately 1,000 beneficial holders based on the number of individual participants in security position listings. On January 14, 2005 the closing bid and asked prices were \$4.43 and \$4.45, respectively.

The following table sets forth the high and low closing prices for quarterly periods in the two twelve month periods ended October 31, 2004 and 2003, as reported by Nasdaq Stock Market:

Twelve Months Ended October 31, 2004	High	Low
August 1, 2004 - October 31, 2004	\$4.81	\$4.00
May 1, 2004 - July 31, 2004	4.99	4.31
February 1, 2004 - April 30, 2004	5.50	4.80
November 1, 2003 - January 31, 2004	\$5.75	\$4.80
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

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 latte 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.

The results for fiscal 2004 were impacted by an increase in freight rates, a decrease in sales and by increased fixed costs due to the plant expansion completed in the fourth quarter of fiscal 2003. Sales of the Company's core products increased 7.1% in 2004; however, overall sales decreased 5.9% primarily related to events that took place in the prior year. These included the Company's lead customer switching from the Company's premixed coffee latte freeze to a competitor's coffee concentrate product in late 2003, a regional chain of specialty restaurants suspending purchases of a proprietary gourmet ice cream in June 2003, and a copacking customer acquiring its own production facility early in 2003.

Sales in fiscal 2003 increased 5.3%, primarily from new products, which included soft frozen custard, gourmet ice cream, and aseptic latte freeze. The increase in sales was not as high as expected due to the factors described above, as well as the sluggish economy, high unemployment, and a joint sales program with the Company's strategic partner, which diverted attention from the sale of the Company's core products through the second quarter of fiscal 2003. Operating costs in fiscal 2003 increased due to raw material costs increases,

and by additional outside costs incurred related to providing its lead customer with the aseptic coffee latte product. Competitive conditions limit the Company's ability to pass on these costs. Increases in professional fees, and additional freight charge reimbursements also impacted earnings for the year.

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 management's plans are presented below.

Sales

The Company's sales were \$19,272,000, \$20,478,000, and \$19,439,000, for the years ended October 31, 2004, 2003, and 2002, respectively, and represented a decrease of 5.9% in 2004 and an increase of 5.3% in 2003.

For the years 2004, 2003, and 2002, the breakdown of sales by category is as follows:

Frozen Yogurt: The increase in frozen yogurt sales of 7.4% was primarily related to continued growth in three sectors: wholesale club, military/government, and healthcare/institutions.

The Company continues to develop and experience success in its core business of frozen yogurt. In 2004 concentrated sales activities were directed to the healthcare and military/government segments as well as national broadline distribution of the Company's core products. The Company has seen successive growth in its military/government business since 2001. Subsequent to previously engaged contracts, the Company has expanded its sales efforts in the healthcare and institution segment. This activity has resulted in successful sales conversions of competitor's products to the Company's products. This business also facilitated expanded distribution of the Company's

Sales by Category

Three years ended October 31, 2004, 2003, 2002

	2004	% Total	2003	% Total	2002	% Total
Frozen Yogurt	\$11,164,000	57.9%	\$10,399,000	50.8%	\$10,108,000	52.0%
Smoothies	7,426,000	38.5%	6,955,000	34.0%	6,921,000	35.6%
Coffee Latte Freeze	-	0.0%	1,676,000	8.2%	1,418,000	7.3%
Custard, Ice Cream and Soy	663,000	3.5%	1,256,000	6.1%	727,000	3.7%
Copacking	19,000	0.1%	192,000	0.9%	265,000	1.4%
	\$19,272,000	100.0%	\$20,478,000	100.0%	\$19,439,000	100.0%

products with broadline foodservice distributors. Sales focus on distribution has allowed the Company to secure 25 new national points of distribution in the last two years. The Company continues to service wholesale club sales by maintaining a high level of customer support.

Smoothie Sales: Smoothie sales, consisting of both aseptic and non-aseptic products, increased by 6.8% primarily as a result of the growth in the wholesale club business.

Research and development continued during 2004 on the new FruitQuake® aseptic, shelf-stable dispenser smoothies for the Company's foodservice product line. The shelf-stable dispenser smoothies were selectively tested in the fourth quarter of 2004 and will be available for introduction in the second quarter of 2005. Packed in one-gallon to three-gallon bags, this smoothie line extension meets the needs of operators who have limited refrigeration or, as in military, geographic locations without refrigeration. As with the Company's existing frozen smoothie line, the addition of water or ingredients at the operator's location is not required, promoting a consistent product and reduced labor for the customer. The Company has developed a concentrated fruit smoothie line for those customers desiring to mix the product with water at their dispensing location, as well as an aseptically packed coffee concentrate designed to be mixed with milk at the operator's location. This line extension is being selectively introduced to key accounts for test market and is scheduled for release in the second quarter of 2005.

Frozen Custard, Gourmet Ice Cream and Soy: Gourmet softened ice cream decreased when compared to the same period in the prior year primarily due to a major regional chain of specialty restaurants suspending purchases in June 2003 of this proprietary ice cream formulation due to pricing concerns. The Company formulated new products to meet the customer's needs; however sales of the new product have been insignificant. In the second quarter of 2004, a Nebraska based chain of 64 restaurants that had been purchasing the Company's soft serve frozen custard changed to the Company's reduced fat ice cream product with a lower price. This customer has recently elected not to renew the contract in favor of local supply effective December 31, 2004.

This category also includes sales of soft serve soy cultured dessert. The Company sees this as a niche product that helps set it apart from its competitors. Marketing strategies for this product line are directed at specialty operators and shops.

Copacking: The Company promotes its copacking capabilities, and the flexibility of its manufacturing facility through industry affiliations such as Northwest

Food Processors Association and the All Star Dairy Buying Group, as well as through the direct sales activities of business development managers and senior sales staff.

The decrease in copacking revenue in fiscal 2004 occurred as a result of a large copacking customer acquiring its own production facility. The Company is in the process of developing new proprietary products at the request of significant potential customers that could result in new, high volume accounts in the future.

Cost of Sales

Cost of sales, as a percentage of revenues, were 73.8%, 72.6%, and 71.7%, in 2004, 2003, and 2002 respectively. Costs increased in 2004 primarily as a result of the conversion of sales from a fresh smoothie to an aseptic shelf-stable smoothie, as well as by higher dairy and other ingredient costs, expanded research and development activities, and current fuel surcharges for both incoming and outgoing freight. Depreciation and lease payments also increased due to the aseptic processing system completed in October 2003 (see General Section) and the lease of additional warehouse space in November 2003. In some cases, competitive conditions have limited the Company's ability to pass on the additional costs.

Costs increased in 2003 primarily due to the manufacture of the low margin coffee latte freeze and a planned reduction of finished goods inventory levels. Other significant factors effecting cost of sales in 2004 and 2003 included increased costs of raw materials (see General Section for details).

Ingredients used in the Company's products are agricultural products subject to price risk. The Company minimizes this risk by entering into contracts to cover its annual production requirements. In 2004 and 2003 the Company responded to significant increases in raw material costs by developing high-quality reformulations of key products, which limited the effect of the cost increases.

Gross Profit

Gross profit margins were 26.2%, 27.4%, and 28.3%, in 2004, 2003, and 2002, as a result of the factors discussed above and the lower sales level in 2004.

Selling and Marketing Expenses

Selling and marketing expenses, as a percentage of revenues, for the years ended October 31, 2004, 2003, and 2002 were 12.0%, 11.1%, and 10.4%, respectively. Such expenses are generally related to the level of revenues and marketing activities. Sales and marketing expenses in total have increased in 2004, 2003 and 2002 due to promotional expenses, Dannon

royalty payments, an increase in field staff, and travel expenses related to supporting the sales expansion. The sales department was reorganized late in 2004, which resulted in the addition of senior level sales and marketing personnel to support projected growth. This is expected to increase expenditures in 2005; however, 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, 2004, 2003, and 2002, as a percentage of revenues, were 10.7%, 11.5%, and 9.9%, respectively. The decrease of general and administrative expenses in 2004 is primarily the result of a reduction of personnel related expenses, and professional fees as expected. Expenses in 2003 were higher than normal due to increases in personnel costs and professional fees.

Income from Operations

Income from operations for the years ended October 31, 2004, 2003, and 2002 was \$694,000, \$990,000, and \$1,549,000, respectively. The factors affecting the reduced income from operations in 2004 are explained in the General Section above.

The results for 2004 and 2003 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 2004 as a result of the master finance lease facility used to fund the aseptic processing system, which was completed in October 2003. Over the last three years construction interest capitalized amounted to \$0 in 2004, \$9,200 in 2003 and \$0 in 2002.

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. The parties have resolved the underlying circumstances related to the freight issue and Management does not expect a recurrence of this charge in future periods. The Company incurred no unusual expenses in fiscal 2004.

Income before Income Taxes

Income before taxes for the years ended October 31, 2004, 2003, and 2002 was \$640,000, \$803,000, and \$1,368,000, respectively. The change in income from operations in 2004 is explained in the General Section. The large income from operations of 2002 was primarily the result of a 24.5% increase in sales.

Provision for Income Taxes

The effective tax rate was 34.2%, 33.4%, and 37.4% in 2004, 2003, and 2002, respectively. The effective rates are less than the expected rate of 38.4% primarily due to the realization of federal tax credits in 2004, 2003, and 2002. In the future, the Company expects that its provision for income taxes will be at or near the applicable federal and state statutory rates.

Net Income

Net income for the years ended October 31, 2004, 2003, and 2002 was \$421,000, \$535,000, and \$856,000, respectively. Net income, as a percentage of sales, was 2.2%, 2.6%, and 4.4% in each of the three years. See General Section for management's analysis for declining year 2004 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 2005.

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 01-9, "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Products" certain promotional payments paid to wholesalers or retailers by a vendor for the sale of its products must be shown as a reduction of the revenues in the period they are provided.

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. In December 2004, the FASB issued SFAS No. 123(R) (revised 2004), "Share-Based Payment", which amends FASB Statement Nos. 123 and will be effective for public companies for interim or annual periods beginning after June 15, 2005. The new standard

will require the Company to expense employee stock options and other share-based payments. The new standard may be adopted in one of three ways - the modified prospective transition method, a variation of the modified prospective transition method or the modified retrospective transition method. The Company is currently evaluating the effect that the adoption of SFAS 123(R) will have on its financial position and results of operations.

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, 2004 is summarized below.

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 to approximately 7.7 and 6.6 times per year in 2004 and 2003, respectively, compared with 5.4 times in 2002. Through improvements in logistics planning, the related storage costs were also reduced in fiscal 2004 and 2003. Management plans to continue the current inventory management and logistics programs in fiscal 2005.

The Company's capital expenditures for the years ended October 31, 2004, 2003, and 2002 were approximately \$934,000, \$2,069,000, and \$642,000, respectively. During 2003 the Company completed the installation of an aseptic processing system. The construction cost 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. In 2004 the Company

added \$363,000 in ancillary outlays related to the aseptic processing system.

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. This financing arrangement provides for payments over seven years with interest at 30-day LIBOR plus 175 basis points (3.74% at October 31, 2004), with the option to convert to a fixed rate by using an interest rate swap at the Company's discretion.

In November 2004, the Company entered into an interest rate swap agreement with the objective to take advantage of the current low interest rate environment. This swap agreement has been designated as a fair-value hedge of the Company's floating rate debt, effectively converting this debt to a fixed rate of 5.88%. It is the Company's policy to enter in to interest rate swap agreements when management deems them useful in reducing risks to the Company. The Company will account for this interest rate swap as a fair value hedge, which it has determined to be highly effective. The fair value of the interest rate swap will be recorded on the balance sheet and changes in fair value of this instrument will be shown, net of tax, in accumulated other comprehensive income.

The Company has an unutilized bank line of credit of \$2,000,000, which matures in July 2007, 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, 2004, 2003, and 2002 the Company repurchased zero, 26,822, and 71,713 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.

On November 8, 2004, the Company's Board of Directors authorized the repurchase of up to \$1,250,000 of the Company's common stock. Under terms of the Plan, the Company may make purchases over time through open market transactions, block purchases, or through privately negotiated transactions. Based on the recent market price, the Company could acquire in excess of 10% of the outstanding common stock of the Company. To assist the Company in executing the stock repurchases, the Company has entered into a 10b5-1 trading plan that will be administered and executed by a designated broker that may purchase shares on behalf of the Company beginning November 8, 2004 and ending on April 30, 2005, unless terminated earlier by the Company. (See Note O of Notes to the Financial Statements for additional information.)

At October 31, 2004 and 2003, working capital includes income tax receivables of approximately \$51,000 and \$378,000, respectively. 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 K 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 Note M of Notes to Financial Statements for a description of the terms).

	2004	% Change	2003	% Change	2002
Net cash provided by operating activities	\$ 2,051,000	20.5%	\$ 1,702,000	20.0%	\$ 1,418,000
Capital expenditures	(934,000)	(54.9%)	(2,069,000)	222.3%	(642,000)
Net cash provided by (used in) financing activities	45,000	(97.0%)	1,483,000	463.5%	(408,000)
Net increase in cash and cash equivalents	1,163,000	4.2%	1,116,000	204.1%	367,000
Cash and cash equivalents at end of year	3,807,000	44.0%	2,644,000	72.9%	1,529,000
Working capital	\$ 5,267,000	16.9%	\$ 4,505,000	18.1%	\$ 3,815,000



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
YoCream International, Inc.
Portland, Oregon

We have audited the balance sheets of YoCream International, Inc. as of October 31, 2004 and 2003, and the related statements of income, shareholders' equity and cash flows for each of the three years in the period ended October 31, 2004. 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 the standards of the Public Company Accounting Oversight Board (United States). 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, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended October 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Portland, Oregon
December 23, 2004

Balance Sheets

October 31, 2004 and October 31, 2003

	2004	2003
ASSETS		
Current assets		
Cash and cash equivalents	\$ 3,806,993	\$ 2,644,436
Trade accounts receivable, net of allowance for doubtful accounts of \$41,500 in 2004 and \$37,500 in 2003	910,010	934,259
Inventories	1,866,051	1,846,989
Other current assets	198,622	247,012
Income tax receivable	51,154	378,269
Deferred tax assets	194,519	74,250
Total current assets	7,027,349	6,125,215
Fixed assets, net.	6,328,875	6,241,922
Intangible and other long-term assets, net.	399,672	499,970
Total assets	\$13,755,896	\$12,867,107
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt	\$ 403,319	\$ 336,333
Accounts payable	1,208,074	1,144,045
Other accrued liabilities	149,206	140,146
Total current liabilities	1,760,599	1,620,524
Long-term debt, less current portion	2,305,939	2,279,667
Deferred tax liabilities	1,070,720	795,451
Other liabilities	46,060	25,826
Total liabilities	5,183,318	4,721,468
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	4,739,581	4,733,281
Retained earnings	3,832,997	3,412,358
Total shareholders' equity	8,572,578	8,145,639
Total liabilities and shareholders' equity	\$13,755,896	\$12,867,107

The accompanying notes are an integral part of these statements.

Statements of Income

For the years ended October 31, 2004, 2003, 2002

	2004	2003	2002
Sales	\$19,272,376	\$20,477,934	\$19,438,892
Cost of goods sold	14,214,810	14,868,324	13,947,245
Gross profit	5,057,566	5,609,610	5,491,647
Selling and marketing expenses	2,308,045	2,267,137	2,023,469
General and administrative expenses	2,055,977	2,352,580	1,918,944
Income from operations	693,544	989,893	1,549,234
Other income (expense)			
Interest income	7,563	6,144	14,743
Interest expense	(89,910)	(28,335)	(48,420)
Unusual expenses	-	(157,163)	(147,487)
Other, net	28,442	(7,395)	-
Income before income taxes	639,639	803,144	1,368,070
Income tax provision	219,000	268,000	512,000
Net income	\$ 420,639	\$ 535,144	\$ 856,070
Earnings per common share - basic	\$0.18	\$0.24	\$0.38
Earnings per common share - diluted	\$0.18	\$0.23	\$0.38
Shares used in basic earnings per share	2,278,284	2,257,998	2,253,248
Shares used in diluted earnings per share	2,294,474	2,280,233	2,272,986

The accompanying notes are an integral part of these statements.

Statement of Shareholders' Equity

Fiscal years ended October 31, 2004, 2003, 2002

	Common Stock		Retained Earnings	Total Shareholders' Equity
	Shares	Amounts		
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
Net income	-	-	420,639	420,639
Stock held exchanged for stock option exercise cost	4,544	-	-	-
Tax benefit of options exercised	-	6,300	-	6,300
Balance, October 31, 2004	2,282,500	\$4,739,581	\$3,832,997	\$8,572,578

The accompanying notes are an integral part of these statements.

Statements of Cash Flows

For the years ended October 31, 2004, 2003, 2002

	2004	2003	2002
Cash flows from operating activities			
Net income	\$ 420,639	\$ 535,144	\$ 856,070
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	612,700	516,028	612,376
(Gain) loss on disposal of equipment	(28,442)	7,395	-
Deferred income taxes	155,000	512,001	214,200
Tax benefit related to exercise of stock options	6,300	22,200	73,800
Change in assets and liabilities			
Accounts receivable	24,249	(33,263)	138,007
Inventories	(19,062)	807,443	(180,894)
Other assets	148,688	(26,791)	(150,759)
Accounts payable	374,649	(250,529)	(58,444)
Income taxes receivable and payable	327,115	(409,978)	(90,466)
Other accrued liabilities	29,294	22,218	3,614
Net cash provided by operating activities	<u>2,051,130</u>	<u>1,701,868</u>	<u>1,417,504</u>
Cash flows from investing activities			
Expenditures for fixed assets	<u>(933,868)</u>	<u>(2,068,825)</u>	<u>(642,149)</u>
Net cash used in investing activities	<u>(933,868)</u>	<u>(2,068,825)</u>	<u>(642,149)</u>
Cash flows from financing activities			
Proceeds from issuance of long-term debt	394,886	1,767,500	181,500
Principal payments on long-term debt	(349,591)	(370,025)	(344,675)
Repurchase of common stock	-	(125,400)	(461,403)
Proceeds from exercise of stock options	-	210,500	216,380
Net cash provided by (used in) financing activities	<u>45,295</u>	<u>1,482,575</u>	<u>(408,198)</u>
Net increase in cash and cash equivalents	<u>1,162,557</u>	<u>1,115,618</u>	<u>367,157</u>
Cash and cash equivalents, beginning of year	<u>2,644,436</u>	<u>1,528,818</u>	<u>1,161,661</u>
Cash and cash equivalents, end of year	<u>\$3,806,993</u>	<u>\$2,644,436</u>	<u>\$1,528,818</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 and novelties, in addition to fruit and coffee smoothie beverages, under its brand names "YOCCREAM" or "DANNON YOCCREAM", 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, supermarkets, grocery stores, convenience stores, restaurants, hospitals, schools, military installations, yogurt shops and fast food chains.

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, which approximates cost based on the first-in, first-out method.

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 01-9, "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Products" certain promotional payments paid to wholesalers or retailers by a vendor for the sale of its products must be shown as a reduction of the revenues in the period they are provided. For the three years ended October 31, 2004, 2003 and 2002 the total of rebates and promotional costs charged against sales were approximately \$696,000, \$610,000, and \$599,000, respectively.

8. Shipping and Handling Costs

Pursuant to EITF 00-10, "Accounting for Shipping and Handling Fees and Costs" such 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, 2004, 2003 and 2002 such costs aggregated approximately \$464,000, \$555,000 and \$446,000, respectively, and are classified in the financial statements as part of cost of sales, selling, general and administrative expenses, as appropriate.

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. 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 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 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:

	2004	2003	2002
Net income, as reported	\$421,000	\$535,000	\$856,000
Deduct: stock based compensation expense determined under the fair value method, net of tax	(20,000)	(234,000)	-
Net income, pro forma	\$401,000	\$301,000	\$856,000
Net income per share, as reported			
Basic	\$.18	\$.24	\$.38
Diluted	\$.18	\$.23	\$.38
Net income per share, pro forma			
Basic	\$.18	\$.13	\$.38
Diluted	\$.17	\$.13	\$.38
Weighted average assumptions:			
Risk-free interest rate	3.24%	3.15%	-
Expected dividend yield	-	-	-
Expected lives (years)	5	5	-
Expected volatility	42.4%	37.0%	-

12. Supplemental Cash Flow Information

Supplemental cash flow information for the years ended October 31, are as follows:

	2004	2003	2002
Cash paid during the period for income taxes	\$32,000	\$144,000	\$315,000
Cash paid during the period for interest	\$82,000	\$37,000	\$48,000
Acquisition of capital assets with debt	\$48,000	-	-
Payment (acquisition) of vendor payables used to acquire capital assets	\$310,000	\$(310,000)	-

The statements of cash flows also excludes non-cash transactions for the year ended October 31, 2004 whereby certain options were exercised by exchange of previously issued shares, as defined in the stock option plan, which resulted in a net increase in shares outstanding of 4,544.

13. Concentrations of Credit Risk and Major Customer

One customer accounted for 60% and 60% of accounts receivable at October 31, 2004 and 2003. This same customer accounted for 72%, 70% and 68% of total revenues in the years ended October 31, 2004, 2003 and 2002.

14. Reclassifications

Certain amounts from prior years' financial statements have been reclassified to conform to the current year presentation.

Note B - Adoption of Accounting Pronouncements

SFAS Interpretation No. 46 (Revised)

In January 2003, the Financial Accounting Standards Board issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities". FIN 46 clarifies certain issues related to Accounting Research Bulletin No. 51, "Consolidated Financial Statements" and addresses consolidation by business enterprises of the assets, liabilities, and results of the activities of a variable interest entity. This interpretation is not applicable since the Company determined that there are no variable interest entities.

SFAS No. 123 (Revised)

In December 2004, the FASB issued SFAS No. 123(R) (revised 2004), "Share-Based Payment", which amends FASB Statement Nos. 123 and will be effective for public companies for interim or annual periods beginning after June 15, 2005. The new standard will require the Company to expense employee stock options and other share-based payments. The new standard may be adopted in one of three ways - the modified prospective transition method, a variation of the modified prospective transition method or the modified retrospective transition method. The Company is currently evaluating the effect that the adoption of SFAS 123(R) will have on its financial position and results of operations.

SFAS No. 151

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 151, "Inventory Costs". SFAS No. 151 requires abnormal amounts of inventory costs related to idle facility, freight handling and wasted material expenses to be recognized as current period charges. Additionally, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The standard is effective for fiscal years beginning after June 15, 2005. The Company believes the adoption of SFAS No. 151

will not have a material impact on its financial statements.

SFAS No. 153

The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 153, "Exchanges of Nonmonetary Assets" - an amendment of APB Opinion No. 29 in December 2004. The guidance in APB Opinion No. 29, "Accounting for Nonmonetary Transactions", is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The Company does not expect this pronouncement to have a material impact on its financial statements.

On October 22, 2004, the President signed into law the American Jobs Creation Act of 2004. The Company is currently in the process of evaluating the Bill.

Note C - Inventories

Inventories consist of the following at October 31,:

	2004	2003
Finished goods	\$ 1,467,790	\$ 1,246,700
Raw materials	249,068	368,441
Packaging material and supplies	149,193	231,848
	<u>\$ 1,866,051</u>	<u>\$ 1,846,989</u>

Note D - Fixed Assets

Fixed assets consist of the following at October 31,:

	2004	2003
Machinery and equipment	\$ 8,139,046	\$ 8,466,836
Office equipment and furnishings	336,801	253,896
Leasehold improvements	1,374,401	1,186,646
Construction in process	108,484	159,475
	<u>9,958,732</u>	<u>10,066,853</u>
Less accumulated depreciation and amortization	(3,629,857)	(3,824,931)
	<u>\$ 6,328,875</u>	<u>\$ 6,241,922</u>

During the years ended October 31, 2004 and 2003, the Company expended \$310,000 and \$1,874,000, respectively 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, 2004 and 2003. In accordance with the provisions of SFAS No. 142, the amortization of trademarks ceased beginning in the first quarter 2003.

As of October 31, 2004 and 2003, the Company had made deposits totaling \$82,000 and \$209,000 related to the leases of various equipment and its production and office facility, and had insurance policy premium advances of \$217,000 and \$190,000, respectively (see Note M). As of October 31, 2004 and 2003, the Company also had other long-term assets of \$5,000. 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, 4.75% at October 31, 2004. The line is subject to renewal by July 2007. There were no amounts drawn on this line at October 31, 2004. 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.

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 refinanced term loans. In December 2003 the Company borrowed an additional \$394,886 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 master finance lease facility 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, 2004, the Company believes that it was in compliance with all of these ratios and covenants.

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

	2004	2003
Note payable to a bank in monthly installments of \$5,833 through January 2004, plus interest at 30-day LIBOR plus 1.75% collateralized by certain equipment.	\$ -	\$ 303,333
Note payable to a bank in monthly installments of \$23,333 through January 2004, plus interest at 30-day LIBOR plus 1.75% collateralized by certain equipment.	-	746,667
Capitalized lease obligation to a bank in monthly installments of \$38,880 through January 2011, plus interest at 30-day LIBOR plus 1.75% (3.74% October 31, 2004) collateralized by certain equipment.	2,664,074	1,566,000
Note payable in monthly installments of \$913 through June 2009, including interest at 5.25%, collateralized by certain equipment	45,184	-
	<u>2,709,258</u>	2,616,000
Less portion due within one year	(403,319)	(336,333)
	<u>\$ 2,305,939</u>	<u>\$ 2,279,667</u>
Year ending October 31,		
2005	\$ 403,319	
2006	415,391	
2007	427,808	
2008	440,619	
2009	450,042	
Thereafter	<u>572,079</u>	
	<u>\$2,709,258</u>	

In November 2004, the Company entered in to an interest rate swap agreement which will convert the variable interest rate paid on its debt to a fixed rate of 5.88%. It is the Company's policy to enter in to interest rate swap agreements when management deems them useful in reducing risks to the Company. The Company will account for this interest rate swap as a fair value hedge, which it has determined to be highly effective. The fair value of the interest rate swap will be recorded on the balance sheet and changes in fair value of this instrument will be shown, net of tax, in accumulated other comprehensive income.

Note G - Advertising Costs

Advertising costs are charged to operations in the year incurred. For the years ended October 31, 2004, 2003 and 2002 advertising costs aggregated approximately \$391,000, \$378,000 and \$372,000, 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 \$60,000, \$85,000 and \$56,000 during the years ended October 31, 2004, 2003 and 2002, 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, 2004, all of these options under this plan have been exercised or have expired.

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, 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	30,500	4.00
Granted	-	
Exercised	(30,500)	4.00
Expired	-	-
Balance, October 31, 2004	-	-

During the year ended October 31, 2004, certain participants in the plan, who are also shareholders, exercised options held under the 1994 stock option plan. Under the terms of the plan, shareholders are allowed to exchange stock held at the current fair market value in lieu of cash to satisfy the exercise price commitments. This exchange results in shares being issued for the difference between the fair value of the stock on the date of the transaction and the exercise price of the options.

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, 2001	65,000	\$3.21
Granted	65,000	5.26
Exercised	(30,000)	3.21
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	255,000	4.70
Granted	15,000	4.59
Exercised	-	-
Balance, October 31, 2004	270,000	\$4.70

	Number of Shares	Weighted Average Exercise Price
Options exercisable October 31, 2003	257,166	\$4.60
October 31, 2004	243,332	4.68

The following table summarizes information about stock options outstanding for both plans at October 31, 2004:

Exercise Prices	Options Outstanding	Weighted Average Remaining Contractual Life (Years)	Options Exercisable
\$3.21	20,000	1.73	20,000
5.26	55,000	2.57	43,332
7.17	5,000	3.04	5,000
4.63	175,000	3.87	175,000
4.59	15,000	4.80	-
	270,000		243,332

At October 31, 2004, there were 355,000 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:

	2004	2003	2002
Current	\$ 64,000	\$(244,000)	\$ 297,800
Deferred	155,000	512,000	214,200
	\$219,000	\$ 268,000	\$ 512,000

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

	Year ended October 31,		
	2004	2003	2002
Statutory federal tax rate (graduated)	34.0%	34.0%	34.0%
State taxes, net of federal benefit	3.9	3.7	4.1
Tax credits	(4.1)	(4.5)	(2.1)
Other	0.4	0.2	1.4
	34.2%	33.4%	37.4%

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

	2004	2003
Deferred tax assets		
Accrued expenses	\$ 5,000	\$ 5,800
Allowance for doubtful accounts	15,900	14,400
State NOL carryforward	25,600	24,300
Federal Credits carryforward	118,500	-
Other	29,519	29,750
Deferred tax assets	\$ 194,519	\$ 74,250
Deferred tax liabilities		
Fixed assets	\$(1,070,720)	\$(795,451)

Management evaluates on a quarterly basis the recoverability of the deferred tax assets and the level of the valuation allowance. As of October 31, 2004 and 2003, the Company has not recorded an allowance against deferred tax assets as management believes it is more likely than not that such assets are fully realizable.

Note K - 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,	
2005	\$ 543,000
2006	497,000
2007	445,000
2008	406,000
2009	404,000
Thereafter	2,458,000
	\$ 4,753,000

Operating lease expense for the years ended October 31, 2004, 2003, and 2002 approximated \$681,000, \$547,000, and \$505,000. Operating lease expenses are allocated between manufacturing costs and general and administrative expenses in the accompanying statements of income.

NOTE L - 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
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	\$856,070	2,272,986	\$0.38
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	(0.01)
Diluted earnings per share income available to common shareholders	\$535,144	2,280,233	\$0.23
2004			
Basic earnings per share income available to common shareholders	\$420,639	2,278,284	\$0.18
Effect of dilutive securities stock options	-	16,190	-

Diluted earnings per share income available to common shareholders	2004	2003	2002
	\$420,639	2,294,474	\$0.18

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 8 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.

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.

Payments under the leases for the years ended October 31, 2004, 2003 and 2002 were approximately \$358,000, \$199,000 and \$187,000, respectively.

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, 2004, 2003 and 2002 billed the Company fees of approximately \$28,000, \$339,000, and \$217,000, 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. Payments under the consulting agreement for the years ended October 31, 2004 and 2003, amounted to approximately \$136,700 and \$34,200, respectively. 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. 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 \$98,000 and \$85,000 at October 31, 2004 and 2003, 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 \$119,000 and \$105,000 at October 31, 2004 and 2003, 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 – STOCK REPURCHASE PLAN

On November 8, 2004, the Company's Board of Directors authorized the repurchase of up to \$1,250,000 of the Company's common stock. Under the terms of Plan, the Company may make purchases over time through open market transactions, block purchases, or through privately negotiated transactions. Based on the recent market price, the Company could acquire in excess of 10% of the outstanding common stock of the Company. To assist the Company in executing the stock repurchases, the Company has entered into a 10b5-1 trading plan that will be administered and executed by a designated broker that may purchase shares on behalf of the Company beginning November 8, 2004 and ending on April 30, 2005, unless terminated earlier by the Company. Through December 22, 2004, the Company has paid approximately \$536,000 to repurchase 124,700 shares for an average per share price of \$4.30. In December, the Bank modified the covenants of the Business Loan Agreement to permit the Company to purchase or retire up to \$1,250,000 of its common stock during the fiscal year ended October 31, 2005, and the Company may purchase or retire up to \$500,000 of its common stock in each fiscal year thereafter.

NOTE P – QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly financial data for the two years ending October 31, 2004 is as follows:

	Sales	Gross Profit	Net Income (Loss)	Basic Earnings Per Share	Diluted Earnings Per Share
2004					
1st quarter	\$ 3,449,984	\$ 959,172	\$ (8,467)	\$ 0.00	\$ 0.00
2nd quarter	4,855,752	1,361,987	168,186	0.07	0.07
3rd quarter	5,906,991	1,467,814	189,351	0.08	0.08
4th quarter	5,059,649	1,268,593	71,569	0.03	0.03
	<u>\$19,272,376</u>	<u>\$ 5,057,566</u>	<u>\$ 420,639</u>	<u>\$ 0.18</u>	<u>\$ 0.18</u>
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)	<u>\$ 20,477,934</u>	<u>\$ 5,609,610</u>	<u>\$ 535,144</u>	<u>\$ 0.24</u>	<u>\$ 0.23</u>

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

Shareholder Information

Terry Lusetti, Director of Investor Relations
YoCream International, Inc.
5858 NE 87th Avenue
Portland, Oregon 97220-1312
(503) 256-3754

SEC Counsel
Foster Pepper Tooze LLP
601 SW Second Avenue, Suite 1800
Portland, Oregon 97204

Transfer Agent and Registrar
Computershare Trust Company, Inc.
350 Indiana Street Suite 800
Golden CO 80401
303-262-0714

Annual Meeting
The annual meeting of shareholders will be held on Wednesday, April 20, 2005, 10:00 a.m. in the "Rose Room" (located on the "Preferred Level").
Rose Garden Arena
One Center Court
Portland, Oregon 97227

Independent Certified Public Accountants
Grant Thornton LLP
111 SW Columbia, Suite 800
Portland, Oregon 97201

Form 10-KSB
This report is available to shareholders of record upon written request to:
Terry Lusetti, Director of Investor Relations
YoCream International, Inc.
5858 NE 87th Avenue
Portland, Oregon 97220-1312
(503) 256-3754

General Counsel
Hanna Strader PC
1300 SW Sixth Avenue, Suite 300
Portland, Oregon 97201

YoCream International, Inc. stock is publicly traded on NASDAQ: YOCCM • www.yocream.com



YOCREAM[®]
INTERNATIONAL

5858 NE 87th
Portland, Oregon 97220

1-800-YOCREAM
www.yocream.com
NASDAQ: YOCM