

LIFEWAY FOODS INC
Form 10-Q
November 14, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark
One)

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

For the quarterly period ended: September 30, 2013

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

For the transition period from _____ to _____

Commission File Number: 000-17363

LIFEWAY FOODS, INC.
(Exact Name of Registrant as Specified in its Charter)

Illinois
(State or Other Jurisdiction of
Incorporation or Organization)

36-3442829
(I.R.S. Employer
Identification No.)

6431 West Oakton, Morton Grove, IL 60053
(Address of Principal Executive Offices, Zip Code)

(847) 967-1010
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 8, 2013, 16,346,017 shares of the registrant’s common stock, no par value, were outstanding.

LIFEWAY FOODS, INC.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Consolidated Statements of Financial Condition

September 30, 2013 and 2012 (Unaudited) and December 31, 2012

	(Unaudited) September 30, 2013	2012	December 31, 2012
ASSETS			
Current assets			
Cash and cash equivalents	\$ 1,240,730	\$ 2,379,565	\$ 2,286,226
Investments	2,506,463	2,032,598	1,869,888
Certificates of deposits in financial institutions	115,373	450,000	450,000
Inventories	8,382,287	5,569,887	5,939,186
Accounts receivable, net of allowance for doubtful accounts and discounts	11,313,652	10,002,065	8,723,737
Prepaid expenses and other current assets	88,629	45,350	97,138
Other receivables	89,100	3,946	8,825
Deferred income taxes	394,277	315,887	234,687
Refundable income taxes	423,242	84,828	84,828
Total current assets	\$ 24,553,753	\$ 20,884,126	\$ 19,694,515
Property and equipment, net	21,637,492	14,754,312	14,986,776
Intangible assets			
Goodwill and other non-amortizable brand assets	14,068,091	14,068,091	14,068,091
Other intangible assets, net of accumulated amortization of \$4,376,640 and \$3,662,477 at September 30, 2013 and 2012 and \$3,842,756 at December 31, 2012, respectively	3,929,360	4,643,523	4,463,242
Total intangible assets	17,997,451	18,711,614	18,531,333
Other Assets			
Long-term accounts receivable net of current portion	280,000	162,522	294,000
Total assets	\$ 64,468,696	\$ 54,512,574	\$ 53,506,624
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Current maturities of notes payable	\$ 878,088	\$ 580,781	\$ 542,981
Accounts payable	5,429,988	5,118,902	4,256,725
Accrued expenses	1,323,213	894,092	1,155,677
Accrued income taxes	1,292,762	1,341,652	254,311
Total current liabilities	8,924,051	7,935,427	6,209,694
Notes payable	9,214,853	5,096,675	4,955,945

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Deferred income taxes	2,917,213	3,112,529	3,028,518
Total liabilities	21,056,117	16,144,631	14,194,157
Stockholders' equity			
Common stock, no par value; 40,000,000 shares authorized; 17,273,776 shares issued; 16,346,017 shares outstanding at September 30, 2013; 17,273,776 shares issued; 16,359,017 shares outstanding at September 30, 2012; 17,273,776 shares issued; 16,346,017 shares outstanding at December 31, 2012	6,509,267	6,509,267	6,509,267
Paid-in-capital	2,032,516	2,032,516	2,032,516
Treasury stock, at cost	(8,187,682)	(8,077,239)	(8,187,682)
Retained earnings	43,056,422	37,831,275	38,904,777
Accumulated other comprehensive income (loss), net of taxes	2,056	72,124	53,591
Total stockholders' equity	43,412,579	38,367,943	39,312,469
Total liabilities and stockholders' equity	\$ 64,468,696	\$ 54,512,574	\$ 53,506,626

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Income and Comprehensive Income
September 30, 2013 and 2012 (Unaudited)

	(Unaudited) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2013	2012	2013	2012
Sales	\$ 26,601,341	\$ 22,617,132	\$ 80,030,021	\$ 66,876,986
Less: discounts and allowances	(2,808,811)	(1,997,399)	(8,772,576)	(6,306,675)
Net Sales	23,792,530	20,619,733	71,257,445	60,570,311
Cost of goods sold	16,513,357	13,342,566	47,217,179	
Depreciation expense	410,797	407,567	1,226,629	
Total cost of goods sold	16,924,154	13,750,133	48,443,808	
Gross profit	6,868,376	6,869,600	22,813,637	
Selling expenses	2,815,126	2,974,294	8,291,960	
General and administrative	1,671,080	1,620,967	5,567,649	
Amortization expense	178,201	197,129	533,884	
Total Operating Expenses	4,664,407	4,792,390	14,393,493	
Income from operations	2,203,969	2,077,210	8,420,144	
Other income (expense):				
Interest and dividend income	36,535	16,270	82,166	
Rental income	2,231	4,270	8,889	
Interest expense	(59,887)	(41,897)	(133,610)	
Gain (loss) on sale of investments, net, reclassified from OCI	161	4,024	121,441	
Other income	209,175	0	219,404	
Total other income (expense)	188,215	(17,333)	298,290	
Income before provision for income	2,392,184	2,059,877	8,718,434	

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taxes

Provision for income taxes	702,257	657,697	3,258,928
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Net income	\$ 1,689,927	\$ 1,402,180	5,459,506
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Basic and diluted earnings per common share	0.10	0.09	0.33
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Weighted average number of shares outstanding	16,346,017	16,366,974	16,346,017
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COMPREHENSIVE INCOME

Net income	\$ 1,689,927	\$ 1,402,180	5,459,506
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Other comprehensive income (loss), net of tax:

Unrealized gains (losses) on investments (net of tax)	29,356	62,266	17,079
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Less reclassification adjustment for (gains) losses included in net income (net of taxes)	(91)	(2,274)	(68,614)
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Comprehensive income	\$ 1,719,192	\$ 1,462,172	\$ 5,407,971
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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders' Equity

For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

and For the Year Ended December 31, 2012

	Common Stock, No Par Value 40,000,000 Shares Authorized		# of Shares Treasury Stock	# of Shares Common Stock	Paid In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	Total
	# of Shares Issued	# of Shares Outstanding							
Balances at December 31, 2011	17,273,776	16,409,317	864,459	\$ 6,509,267	\$ 2,032,516	\$ (7,606,974)	\$ 34,431,296	\$ (8,948)	\$
Redemption of stock	0	(63,300)	63,300	0	0	(580,708)	0	0	0
Other comprehensive income (loss): Unrealized gains on securities, net of taxes	0	0	0	0	0	0	0	0	62,539
Net income for the year ended December 31, 2012	0	0	0	0	0	0	5,619,798	0	0
Dividends (\$0.07) per share	0	0	0	0	0	0	(1,146,317)	0	0
Balances at December 31, 2012	17,273,776	16,346,017	927,759	\$ 6,509,267	\$ 2,032,516	\$ (8,187,682)	\$ 38,904,777	\$ 53,591	\$
Balances at January 1, 2012	17,273,776	16,409,317	864,459	\$ 6,509,267	\$ 2,032,516	\$ (7,606,974)	\$ 34,431,296	\$ (8,948)	\$
Redemption of stock	0	(50,300)	50,300	0	0	(470,265)	0	0	0
Other comprehensive income (loss):	0	0	0	0	0	0	0	0	81,072

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Unrealized
gains on
securities, net
of taxes

Net income for
the nine months
ended

September 30,
2012

0	0	0	0	0	0	0	4,546,296	0
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Dividends
(\$.07) per share

0	0	0	0	0	0	0	(1,146,317)	0
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Balances at
September 30,
2012

17,273,776	16,359,017	914,759	\$ 6,509,267	\$ 2,032,516	\$ (8,077,239)	\$ 37,831,275	\$ 72,124	\$
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Balances at
January 1, 2013

17,273,776	16,346,017	927,759	\$ 6,509,267	\$ 2,032,516	\$ (8,187,682)	\$ 38,904,777	\$ 53,591	\$
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Other
comprehensive
income (loss):
Unrealized
gains on
securities, net
of taxes

0	0	0	0	0	0	0	0	(51,535)
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Net income for
the nine months
ended

September 30,
2013

0	0	0	0	0	0	0	5,459,506	0
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Dividends
(\$.08) per share

0	0	0	0	0	0	0	(1,307,861)	0
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Balances at
September 30,
2013

17,273,776	16,346,017	927,759	\$ 6,509,267	\$ 2,032,516	\$ (8,187,682)	\$ 43,056,422	\$ 2,056	\$
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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the Nine Months Ended September 30, 2013 and 2012 (Unaudited)

	(Unaudited) September 30, 2013	2012
Cash flows from operating activities:		
Net income	\$ 5,459,506	\$ 4,546,296
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	1,760,513	1,794,259
Loss (gain) on sale of investments, net	(121,441)	(26,415)
Deferred income taxes	(231,218)	(458,424)
Bad Debt Expense	26,819	332,301
Loss (gain) on sale of equipment	(209,175))
(Increase) decrease in operating assets:		
Accounts receivable	(2,612,905)	(2,106,020)
Other receivables	(80,275)	220,258
Inventories	(2,443,101)	(615,412)
Refundable income taxes	(338,414)	(43,512)
Prepaid expenses and other current assets	33,509	34,280
Increase (decrease) in operating liabilities:		
Accounts payable	1,173,263	732,663
Accrued expenses	167,536	340,367
Income taxes payable	1,038,451	1,341,652
Net cash provided by operating activities	3,623,068	6,092,293
Cash flows from investing activities:		
Purchases of investments	(2,877,968)	(1,092,976)
Proceeds from sale of investments	2,281,792	802,026
Redemption of certificates of deposits	334,627	(150,000)
Purchases of property and equipment	(8,205,669)	(775,210)
Proceeds from sale of equipment	537,500	0
Net cash used in investing activities	(7,929,718)	(1,216,160)
Cash flows from financing activities:		
Checks written in excess of bank balances	—	(592,040)
Purchases of treasury stock	—	(470,265)
Dividends paid	(1,307,861)	(1,146,317)
Net proceeds from debt issuance	4,975,000	0
Repayment of notes payable	(405,985)	(1,403,096)
Net cash used in financing activities	3,261,154	(3,611,718)
Net (decrease) increase in cash and cash equivalents	(1,045,496)	1,264,415
Cash and cash equivalents at the beginning of the period	2,286,226	1,115,150
Cash and cash equivalents at the end of the period	\$ 1,240,730	\$ 2,379,565

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 1 – NATURE OF BUSINESS

Lifeway Foods, Inc. (the “Company” or “Lifeway”) commenced operations in February 1986 and incorporated under the laws of the state of Illinois on May 19, 1986. The Company’s principal business activity is the production of dairy products. Specifically, the Company produces Kefir, a drinkable product which is similar to but distinct from yogurt, in several flavors sold under the name “Lifeway’s Kefir;” a plain farmer’s cheese sold under the name “Lifeway’s Farmer’s Cheese;” a fruit sugar-flavored product similar in consistency to cream cheese sold under the name of “Sweet Kiss;” and a dairy beverage, similar to Kefir, with increased protein and calcium, sold under the name “Basics Plus.” The Company also produces a vegetable-based seasoning under the name “Golden Zesta.” The Company currently distributes its products throughout the Chicago Metropolitan area and various cities on the East Coast through local food stores. In addition, products are sold throughout the United States by distributors. The Company also distributes some of its products in London.

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the preparation of the accompanying financial statements follows:

Basis of presentation

The accompanying unaudited financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by general accepted accounting principles for complete financial statements. However, such information reflects all adjustments (consisting of normal recurring adjustments), which are, in the opinion of Management, necessary for fair statement of results for the interim periods. The unaudited consolidated financial statements contained in this Quarterly Report should be read in conjunction with the consolidated financial statements contained in our 2012 Annual Report on Form 10-K.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Helios Nutrition, Ltd., Pride of Main Street, L.L.C., Starfruit, L.L.C., Fresh Made, Inc. and Starfruit Franchisor, L.L.C., Lifeway First Juice, Inc., First Juice, Inc. and Lifeway Wisconsin, Inc. Lifeway Wisconsin, Inc. was created to facilitate the operation of a production facility in Wisconsin. All significant intercompany accounts and transactions have been eliminated.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates made in preparing the consolidated financial statements include the allowance for doubtful accounts, the valuation of investment securities, the valuation of goodwill, intangible assets, and deferred taxes.

Revenue Recognition

Sales of Company produced dairy products are recorded at the time of shipment and the following four criteria have been met: (i) The product has been shipped and the Company has no significant remaining obligations; (ii) Persuasive evidence of an agreement exists; (iii) The price to the buyer is fixed or determinable and (iv) Collection is probable. In addition, shipping costs invoiced to the customers are included in net sales and the related cost in cost of sales. Discounts and allowances are reported as a reduction of gross sales unless the allowance is attributable to an identifiable benefit separable from the purchase of the product, the value of which can be reasonably estimated, which would be charged to the appropriate expense account.

Customer Concentration

Sales are predominately to companies in the retail food industry, located within the United States of America. Two major customers accounted for approximately 35 percent and 36 percent of gross sales for the nine months ended September 30, 2013 and 2012, respectively. These customers accounted for approximately 25 percent, 30 percent, and 33 percent of accounts receivable as of September 30, 2013, September 30, 2012, and December 31, 2012, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Cash and cash equivalents

All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents.

The Company maintains cash deposits at several institutions located in the greater Chicago, Illinois and Philadelphia, Pennsylvania metropolitan areas.

Investments

All investment securities are classified as available-for-sale and are carried at fair value. Unrealized gains and losses on available-for-sale securities are reported as a separate component of stockholders' equity. Amortization, accretion, interest and dividends, realized gains and losses, and declines in value judged to be other-than-temporary on available-for-sale securities are recorded in other income. All of the Company's securities are subject to a periodic impairment evaluation. This evaluation depends on the specific facts and circumstances. Factors that we consider in determining whether an other-than-temporary decline in value has occurred include: the market value of the security in relation to its cost basis; the financial condition of the investee; and the intent and ability to retain the investment for a sufficient period of time to allow for possible recovery in the market value of the investment.

Accounts receivable

Credit terms are extended to customers in the normal course of business. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral. Balances expected to be paid beyond one year are classified as long-term.

Accounts receivable are recorded at invoice amounts, and reduced to their estimated net realizable value by recognition of an allowance for doubtful accounts and anticipated discounts. The Company's estimate of the allowances for doubtful accounts and anticipated discounts are based upon historical experience, its evaluation of the current status and contract terms of specific receivables, and unusual circumstances, if any. Accounts are considered past due if payment is not made on a timely basis in accordance with the Company's credit terms. Accounts considered uncollectible are charged against the allowance.

Inventories

Inventories are stated at the lower of cost or market, cost being determined by the first-in, first-out method.

Property and equipment

Purchased property and equipment are recorded at cost. Property and equipment is stated at depreciated cost or fair value where depreciated cost is not recoverable. Depreciation is computed using the straight-line method. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to income as incurred; significant renewals and betterments are capitalized.

Property and equipment is being depreciated over the following useful lives:

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Category	Years
Buildings and improvements	31 and 39
Machinery and equipment	5 – 12
Office equipment	5 – 7
Vehicles	5

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Intangible assets acquired in business combinations

The Company accounts for intangible assets at historical cost. Intangible assets acquired in a business combination are recorded under the purchase method of accounting at their estimated fair values at the date of acquisition. Goodwill represents the excess purchase price over the fair value of the net tangible and other identifiable intangible assets acquired. Goodwill is not amortized, but is reviewed for impairment at least annually. Brand assets represent the fair value of brands acquired. Brand assets have an indefinite life and therefore are not amortized, rather are reviewed periodically for impairment. The Company amortizes other intangible assets over their estimated useful lives, as disclosed in the table below.

The Company reviews intangible assets and their related useful lives at least once per year to determine if any adverse conditions exist that would indicate the carrying value of these assets may not be recoverable. The Company conducts more frequent impairment assessments if certain conditions exist, including: a change in the competitive landscape, any internal decisions to pursue new or different strategies, a loss of a significant customer, or a significant change in the market place including changes in the prices paid for the Company's products or changes in the size of the market for the Company's products.

If the estimate of an intangible asset's remaining useful life is changed, the remaining carrying amount of the intangible asset is amortized prospectively over the revised remaining useful life.

Intangible assets are being amortized over the following useful lives:

Category	Years
Recipes	4
Customer lists and other customer related intangibles	7-10
Lease agreement	7
Trade names	15
Formula	10
Customer relationships	12

Income taxes

Deferred income taxes are the result of temporary differences that arise from income and expense items reported for financial accounting and tax purposes in different periods. Deferred taxes are classified as current or non-current, depending on the classification of the assets and liabilities to which they relate. Deferred taxes arising from temporary differences that are not related to an asset or liability are classified as current or non-current depending on the periods in which the temporary differences are expected to reverse.

The principal sources of temporary differences are different depreciation and amortization methods for financial statement and tax purposes, unrealized gains or losses related to investments, capitalization of indirect costs for tax purposes, purchase price adjustments, and the recognition of an allowance for doubtful accounts for financial statement purposes.

The Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The only periods subject to examination for the Company's federal returns are the 2010 and 2011 tax years. The Company believes that its income tax filing positions and deductions would be sustained on audit and does not anticipate any adjustments that would result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded.

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Treasury stock

Treasury stock is recorded using the cost method.

Advertising and promotional costs

The Company expenses advertising costs as incurred. For the nine months ended September 30, 2013 and 2012 total advertising expenses were \$1,859,798 and \$1,977,611, respectively.

Earnings per common share

Earnings per common share were computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. For the nine months ended September 30, 2013 and 2012, diluted and basic earnings per share were the same, as the effect of dilutive securities options outstanding was not significant.

Correction of Prior Year Amounts

Management has restated the unaudited statements of income and comprehensive income for interim period ending September 30, 2012. During the period ending September 30, 2012, amounts related to costs of production of inventory were not presented as part of cost of goods sold and were erroneously included as general and administrative operation expenses in our previously issued financial statements (see Note 14). There was no impact on previously reported income, consolidated balance sheets or consolidated statement of cash flows.

Note 3 – INTANGIBLE ASSETS

Intangible assets, and the related accumulated amortization, consist of the following:

	September 30, 2013		September 30, 2012		December 31, 2012	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Recipes	\$ 43,600	\$ 43,600	\$ 43,600	\$ 43,600	\$ 43,600	\$ 43,600
Customer lists and other customer related intangibles	4,504,200	2,361,808	4,504,200	1,914,395	4,504,200	2,025,736
Lease acquisition	87,200	87,200	87,200	87,200	87,200	87,200
Customer relationship	985,000	579,264	985,000	506,180	985,000	526,701
Trade names	2,248,000	990,868	2,248,000	841,002	2,248,000	878,469
Formula	438,000	313,900	438,000	270,100	438,000	281,050
	\$ 8,306,000	\$ 4,376,640	\$ 8,306,000	\$ 3,662,477	\$ 8,306,000	\$ 3,842,756

Amortization expense is expected to be approximately the following for the 12 months ending September 30:

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2014	\$	716,258
2015		716,258
2016		708,958
2017		680,509
2018		600,405
Thereafter		506,972
	\$	3,929,360

Amortization expense during the nine months ended September 30, 2013 and 2012 was \$533,884 and \$574,538, respectively.

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 4 – INVESTMENTS

The cost and fair value of investments classified as available for sale are as follows:

September 30, 2013	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	\$ 887,418	\$ 115,298	\$ (29,256)	\$ 973,460
Mutual Funds	69,849	0	(1,965)	67,884
Preferred Securities	528,306	3,684	(26,363)	505,627
Corporate Bonds	1,017,252	1	(57,761)	959,492
Total	\$ 2,502,825	\$ 118,983	\$ (115,345)	\$ 2,506,463

September 30, 2012	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	\$ 698,444	\$ 128,530	\$ (11,971)	\$ 815,003
Mutual Funds	0	0	0	0
Preferred Securities	0	0	0	0
Corporate Bonds	1,178,762	41,825	(2,991)	1,217,596
Total	\$ 1,877,206	\$ 170,355	\$ (14,962)	\$ 2,032,599

December 31, 2012	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	\$ 639,974	\$ 90,875	\$ (5,190)	\$ 725,659
Corporate Bonds	1,135,064	16,212	(7,047)	1,144,229
Total	\$ 1,775,038	\$ 107,087	\$ (12,237)	\$ 1,869,888

Proceeds from the sale of investments were \$2,281,792 and \$802,026 for the nine months ended September 30, 2013 and 2012, respectively.

Gross gains of \$ 161,421 and \$43,367 and gross losses of \$39,980 and \$16,952 were realized on these sales during the nine months ended September 30, 2013 and 2012, respectively.

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2013 and 2012 and at December 31, 2012:

Less Than 12 Months	12 Months or Greater	Total
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September 30, 2013	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	\$ 292,456	\$ (28,896)	\$ 21,409	\$ (359)	\$ 313,865	\$ (29,255)
Mutual Funds	50,080	(1,965)	0	0	50,080	(1,965)
Preferred						
Securities	276,933	(26,363)	0	0	276,933	(26,363)
Corporate Bonds	868,294	(54,667)	80,994	(3,094)	949,288	(57,761)
	\$ 1,487,763	\$ (111,891)	\$ 102,403	\$ (3,453)	\$ 1,590,166	\$ (115,344)

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 4 – INVESTMENTS - Continued

September 30, 2012	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	\$ 19,437	\$ (10,998)	\$ 22,669	\$ (973)	\$ 42,106	\$ (11,971)
Mutual Funds	0	0	0	0	0	0
Preferred Securities	0	0	0	0	0	0
Corporate Bonds	81,472	(490)	149,626	(2,501)	231,098	(2,991)
	\$ 100,909	\$ (11,488)	\$ 172,295	\$ (3,474)	\$ 273,204	\$ (14,962)

December 31, 2012	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	\$ 63,620	\$ (3,745)	\$ 21,910	\$ (1,445)	\$ 85,530	\$ (5,190)
Corporate Bonds	301,229	(2,721)	193,930	(4,326)	495,159	(7,047)
	\$ 364,849	\$ (6,466)	\$ 215,840	\$ (5,771)	\$ 580,689	\$ (12,237)

Equities, Mutual Funds, Preferred Securities, and Corporate Bonds - The Company's investments in equity securities, mutual funds, preferred securities, and corporate bonds consist of investments in common stock, preferred stock and debt securities of companies in various industries. As of September 30, 2013, there were three corporate bond securities that had unrealized losses. The Company evaluated the near-term prospects of the issuer in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company did not consider any material investments to be other-than-temporarily impaired at September 30, 2013.

Note 5 – INVENTORIES

Inventories consist of the following:

	September 30,		December 31,	
	2013	2012	2012	
Finished goods	\$ 3,106,557	\$ 2,162,292	\$ 2,462,548	
Production supplies	3,469,239	2,188,111	2,599,668	
Raw materials	1,806,491	1,219,484	876,970	
Total inventories	\$ 8,382,287	\$ 5,569,887	\$ 5,939,186	

Note 6 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	September 30, 2013	2012	December 31, 2012
Land	\$ 1,856,370	\$ 1,178,160	\$ 1,178,160
Buildings and improvements	14,921,016	11,713,436	11,904,919
Machinery and equipment	19,921,064	15,099,413	15,185,204
Vehicles	1,350,608	1,379,591	1,346,078
Office equipment	433,346	413,113	411,773
Construction in process	33,542	234,895	612,468
	38,515,946	30,018,608	30,638,602
Less accumulated depreciation	16,878,454	15,264,296	15,651,826
Total property and equipment	\$ 21,637,492	\$ 14,754,312	\$ 14,986,776

Lifeway completed the sale of Golden Guernsey's assets on July 2, 2013. The cost was approximately \$7.4 million and none of the purchased assets have been placed in service.

Depreciation expense during the nine months ended September 30, 2013 and 2012 was \$1,226,629 and \$1,219,721, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 7 – ACCRUED EXPENSES

Accrued expenses consist of the following:

	September 30, 2013	2012	December 31, 2012
Accrued payroll and payroll taxes	\$ 562,491	\$ 493,872	\$ 356,280
Accrued property tax	244,028	226,930	302,573
Other	516,694	173,290	496,824
	\$ 1,323,213	\$ 894,092	\$ 1,155,677

Note 8 – NOTES PAYABLE

Notes payable consist of the following:

	September 30, 2013	2012	December 31 2012
Note payable to Private Bank in monthly installments of \$42,222, plus variable interest rate, currently at 2.67905%, with a balloon payment for the remaining balance. Collateralized by substantially all assets of the Company. In May 2013, the Company refinanced this note under similar terms which extended the maturity date to May 31, 2018.	\$ 4,985,556	\$ 5,534,445	\$ 5,365,556
Line of credit with Private Bank at variable interest rate, currently at 3.25%. The agreement has been extended with terms allowing borrowings up to \$50.0 million. Collateralized by substantially all assets of the Company and matures on May 31, 2014.	0	0	0
Note payable to Private Bank in monthly installments of \$27,778, plus variable interest rate, currently at 2.67905% with a balloon payment for the remaining balance, maturing on May 31, 2019, collateralized by substantially all assets of the Company	5,000,000	0	0
Notes payable to Ford Credit Corp. payable in monthly installments of \$1,778.23 at 5.99%, due July 2015, secured by transportation equipment.	36,919	55,382	50,871
	70,466	87,629	82,499

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Note payable to Fletcher Jones of Chicago, Ltd LLC
in monthly installments of \$1,768.57 at 6.653%, due
May 24, 2017, secured by transportation equipment.

Total notes payable	10,092,941	5,677,456	5,498,926
Less current maturities	878,088	580,781	542,981
Total long-term portion	\$ 9,214,853	\$ 5,096,675	\$ 4,955,945

In accordance with the Private Bank agreements referenced above, the Company is subject to minimum fixed charged ratio and tangible net worth thresholds.

Maturities of notes payables are as follows:

For the Period Ended September 30,

2014	\$	878,088
2015		875,575
2016		859,545
2017		854,180
2018		3,292,233
Thereafter		3,333,320
Total	\$	10,092,941

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 9 – COMMITMENTS AND CONTINGENCIES

The Company leases four stores for its Starfruit subsidiary. Total expense for these leases was approximately \$165,849, \$191,915 and \$379,348 for the nine months ended September 30, 2013 and 2012 and for the year ended December 31, 2012, respectively. The Company is also responsible for additional rent equal to real estate taxes and other operating expenses. Future annual minimum base rental payments for the leases as of September 30, 2013 are approximately as follows:

2014	\$	43,818
2015		45,130
2016		46,484
2017		47,878
2018		49,314
Thereafter		12,419
Total	\$	245,043

Note 10 – PROVISION FOR INCOME TAXES

The provision for income taxes consists of the following:

	For the Nine Months Ended September 30,	
	2013	2012
Current:		
Federal	\$ 2,892,620	\$ 2,318,292
State and local	597,526	623,348
Total current	3,490,146	2,941,640
Deferred	(231,218)	(458,424)
Provision for income taxes	\$ 3,258,928	\$ 2,483,216

A reconciliation of the provision for income taxes and the income tax computed at the statutory rate is as follows:

	For the Nine Months Ended September 30,		2012	
	2013		2012	
	Amount	Percentage	Amount	Percentage
Federal income tax expense computed at the statutory rate	\$ 2,964,268	34.0%	\$ 2,390,034	34.0%
State and local tax expense, net	828,251	9.5%	667,804	9.5%
U.S. domestic manufacturers' deduction & other permanent	(444,711)	(5.1)%	(368,403)	(5.2)%

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differences

Change in tax estimate		(88,880)	(1.0)%		(206,219)	(2.9)%
Provision for income taxes	\$	3,258,928	37.4%	\$	2,483,216	35.4%

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 10 – PROVISION FOR INCOME TAXES - Continued

Amounts for deferred tax assets and liabilities are as follows:

	September 30, 2013	2012	December 31, 2012
Non-current deferred tax assets (liabilities) arising from:			
Temporary differences -			
Accumulated depreciation and amortization from purchase accounting adjustments	\$ (3,002,058)	\$ (3,279,737)	\$ (3,164,716)
Capital loss carry-forwards	84,845	167,208	136,198
Total non-current net deferred tax liabilities	(2,917,213)	(3,112,529)	(3,028,518)
Current deferred tax assets arising from:			
Unrealized losses (gain) on investments	(1,583)	(67,596)	(41,260)
Inventory	374,110	248,633	265,072
Allowance for doubtful accounts and discounts	21,750	134,850	10,875
Total current deferred tax assets	394,277	315,887	234,687
Net deferred tax liability	\$ (2,522,936)	\$ (2,796,642)	\$ (2,793,831)

Note 11 – SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest and income taxes are as follows:

	For the Nine Months Ended September 30,	
	2013	2012
Interest	\$ 140,068	\$ 136,540
Income taxes	\$ 2,862,991	\$ 1,643,619

Note 12 – STOCK AWARD AND STOCK OPTION PLANS

The Company has a registration statement filed with the Securities and Exchange Commission in connection with a Consulting Service Compensation Plan covering up to 1,200,000 of the Company's common stock shares. Pursuant to such Plan, the Company may issue common stock or options to purchase common stock to certain consultants, service providers, and employees of the Company. The option price, number of shares, grant date, and vesting terms are determined at the discretion of the Company's Board of Directors.

As of December 31, 2012 and at September 30, 2013 and 2012, there were no stock options outstanding or exercisable. There were approximately 940,000 shares available for issuance under the Plan at September 30, 2013.

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 13 – FAIR VALUE MEASUREMENTS

Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 820, Fair Value Measurements and Disclosures, provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

Level 1. Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2. Inputs to the valuation methodology include the following:

- Quoted prices for similar assets or liabilities in active markets;

- Quoted prices for identical or similar assets or liabilities in inactive markets;

- Inputs other than quoted prices that are observable for the asset or liability;

- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3. Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used as of September 30, 2013 and 2012, and December 31, 2012.

The majority of the Company's short-term investments are classified within Level 1 or Level 2 of the fair value hierarchy. The Company's valuation of its Level 1 investments, which include mutual funds, is based on quoted market prices in active markets for identical securities. The Company's valuation of its Level 2 investments, which include certificates of deposits, is based on other observable inputs, specifically a valuation model which utilized vendor pricing for similar securities.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes the valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 13 – FAIR VALUE MEASUREMENTS – Continued

The following table sets forth by level, within the fair value hierarchy, the Company's financial assets at fair value as of September 30, 2013 and 2012 and for the year ended December 31, 2012. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

	Assets and Liabilities at Fair Value as of September 30, 2013			
	Level 1	Level 2	Level 3	Total
Cash	\$ 1,240,730	\$ 0	\$ 0	\$ 1,240,730
Certificate of Deposits	0	115,159	0	115,159
Mutual Funds	67,884	0	0	67,884
Stocks	973,460	0	0	973,460
Preferred Securities	0	505,627	0	505,627
Corporate Bonds	0	959,492	0	959,492
Notes Payable	0	10,092,941	0	10,092,941

	Assets and Liabilities at Fair Value as of September 30, 2012			
	Level 1	Level 2	Level 3	Total
Cash	\$ 2,379,565	\$ 0	\$ 0	\$ 2,379,565
Mutual Funds:				
Money Market	59,282	0	0	59,282
Equity Income	0	0	0	0
Bonds	0	0	0	0
Certificate of Deposits	0	438,062	0	438,062
Stocks	815,003	0	0	815,003
Preferred Stock	0	0	0	0
Corporate Bonds	0	1,217,596	0	1,217,596
Notes Payable	0	5,677,456	0	5,677,456

	Assets and Liabilities as Fair Value as of December 31, 2012			
	Level 1	Level 2	Level 3	Total
Cash	\$ 2,286,226	\$ 0	\$ 0	\$ 2,286,226
Certificate of Deposits	0	439,982	0	439,982
Stocks	725,670	0	0	725,670
Corporate Bonds	0	1,144,229	0	1,144,229
Notes Payable	0	5,498,926	0	5,498,926

The Company's financial assets and liabilities also include accounts receivable, other receivables and, accounts payable for which carrying value approximates fair value. All such assets are valued using level 2 inputs.

Note 14 – RESTATEMENT OF 2012 QUARTERLY CONSOLIDATED FINANCIAL STATEMENT

The consolidated statements of income for the year-to-date period ended September 30, 2012, that were previously included in our Quarterly Reports on Forms 10-Q filed in 2012, were restated as a result of erroneous presentation of production activity within general and administrative operating expenses.

These restatements result in increases in cost of goods sold and corresponding decreases in general and administrative operating expenses. These restatements had no impact on our previously reported net income, condensed consolidated balance sheets or consolidated statements of cash flows.

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

and December 31, 2012

Note 14 – RESTATEMENT OF 2012 QUARTERLY CONSOLIDATED FINANCIAL STATEMENT - Continued

As detailed in the table below, these restatements impact the following consolidated statement of income line items:

	(Unaudited) Nine Months Ended September, 2012		
	As Previously Reported	Adjustment	As Restated
Income Statement			
Net Sales	\$ 60,570,311	\$ 0	\$ 60,570,311
COGS	\$ 38,299,212	\$ 1,692,406	\$ 39,991,618
Gross Profit	\$ 22,271,099	\$ (1,692,406)	\$ 20,578,693
Operating Expenses	\$ 15,194,607	\$ (1,692,406)	\$ 13,502,201
Income from Operations	\$ 7,076,492	\$ 0	\$ 7,076,492

	(Unaudited) Three Months Ended September, 2012		
	As Previously Reported	Adjustment	As Restated
Income Statement			
Net Sales	\$ 20,619,733	\$ 0	\$ 20,619,733
COGS	\$ 13,145,876	\$ 604,257	\$ 13,750,133
Gross Profit	\$ 7,473,857	\$ (604,257)	\$ 6,869,600
Operating Expenses	\$ 5,396,648	\$ (604,257)	\$ 4,792,390
Income from Operations	\$ 2,077,209	\$ 0	\$ 2,077,210

Note 15 – LITIGATION

The Company is named a party to lawsuits in the normal course of business. In the opinion of management, the resolution of these lawsuits will not have a material adverse effect on the Company's consolidated financial position or results of operations.

Note 16 – RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the FASB issued ASU No. 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS." This pronouncement was issued to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards ("IFRS"). ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. ASU 2011-04

became effective for the Company on January 1, 2012. Management adopted this statement effective January 1, 2012.

In February 2013, the Financial Accounting Standards Board (“FASB”) amended the disclosure requirements regarding the reporting of amounts reclassified out of accumulated other comprehensive income. The amendment does not change the current requirement for reporting net income or other comprehensive income, but requires additional disclosures about items reclassified out of accumulated other comprehensive income, and the income statement line items impacted by the reclassifications. We adopted this standard effective January 1, 2013. Other than the additional disclosure requirements, the adoption of this standard did not have a material impact on our unaudited Consolidated Financial Statements.

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

Results of Operations

Comparison of Quarter Ended September 30, 2013 to Quarter Ended September 30, 2012

The following analysis should be read in conjunction with the unaudited financial statements of the Company and related notes included elsewhere in this quarterly report and the audited financial statements and Management's Discussion and Analysis contained in our Form 10-K, for the fiscal year ended December 31, 2012.

Total consolidated gross sales increased by \$3,984,209 (approximately 18%) to \$26,601,341 during the three-month period ended September 30, 2013 from \$22,617,132 during the same three-month period in 2012. This increase is primarily attributable to increased sales and awareness of the Company's flagship line, Kefir, as well as ProBugs® Organic Kefir for kids and BioKefir™.

Total consolidated net sales increased by \$3,172,797 (approximately 15%) to \$23,792,530 during the three-month period ended September 30, 2013 from \$20,619,733 during the same three-month period in 2012.

Cost of goods sold as a percentage of net sales, excluding depreciation expense, were approximately 69% during the third quarter of 2013, compared to 65% during the same period in 2012. This was primarily attributable to a 35% increase in the cost of milk, the Company's largest raw material.

Total operating expenses decreased \$127,983 (approximately 3%) to \$4,664,407 during the third quarter of 2013, from \$4,792,390 during the same period in 2012. This decrease was primarily attributable to decreased selling expenses.

Total operating income increased by \$126,759 (approximately 6%) to \$2,203,969 during the third quarter of 2013, from \$2,077,210 during the same period in 2012.

During the three-month period ended September 30, 2013, the company sold certain assets that were acquired in the Golden Guernsey Wisconsin production facility in July 2013 for net sale proceeds of \$537,500. In connection with the sale of those assets, the company recognized a gain of approximately \$209,000 which is included in other income.

Income tax expense was \$702,257 or a 29% effective tax rate for the third quarter of 2013 compared to an income tax expense of \$657,697, or a 32% effective tax rate during the same period in 2012.

Total net income was \$1,689,927 or \$0.10 per diluted share for the three-month period ended September 30, 2013 compared to \$1,402,180 or \$0.09 per diluted share in the same period in 2012.

Comparison of Nine-Month Period Ended September 30, 2013 to Nine-Month Period Ended September 30, 2012

Total consolidated gross sales increased by \$13,153,035, (approximately 20%) to \$80,030,021 during the nine-month period ended September 30, 2013 from \$66,876,986 during the same nine-month period in 2012. This increase is primarily attributable to increased sales and awareness of flagship line, Kefir, as well as ProBugs® Organic Kefir for kids and BioKefir™.

Total consolidated net sales increased by \$10,687,134 (approximately 18%) to \$71,257,445 during the nine-month period ended September 30, 2013 from \$60,570,311 during the same nine-month period in 2012.

Cost of goods sold as a percentage of net sales, excluding depreciation expense, were approximately 66% during the nine-month period ended September 30, 2013, compared to approximately 64% during the same period in 2012. The cost of milk was approximately 25% higher during the nine month period ended September 30, 2013 when compared to the same period in 2012.

Total operating expenses as a percentage of net sales were approximately 20% during the nine-month period ended September 30, 2013 compared to approximately 22% during the same period in 2012. General and administrative expenses increased by \$940,796 (approximately 20%) to \$5,567,649 during the nine-month period ended September 30, 2013, from \$4,626,853 during the same period in 2012.

Total operating income increased by \$1,343,652 (approximately 19%) to \$8,420,144 during the nine-month period ended September 30, 2013, from \$7,076,492 during the same period in 2012.

During the nine-month period ended September 30, 2013, the company sold certain assets that were acquired in the Golden Guernsey Wisconsin production facility in July 2013 for net sale proceeds of \$537,500. In connection with the sale of those assets, the company recognized a gain of approximately \$209,000 which is included in other income.

Provision for income taxes was \$3,258,928 or a 37% effective tax rate, for the nine-month period ended September 30, 2013 compared with \$2,483,216 or a 35% tax rate, during the same period in 2012.

Total net income was \$5,459,506 or \$0.33 per share for the nine-month period ended September 30, 2013 compared to \$4,546,296 or \$0.28 per share in the same period in 2012.

Liquidity and Capital Resources

Sources and Uses of Cash

Net cash provided by operating activities was \$3,598,069 during the nine-months ended September 30, 2013 compared to \$6,092,293 during the same period in 2012. This decrease is primarily attributable to an increase in inventories of \$1,827,689.

Net cash used in investing activities was \$7,929,718 during the nine-months ended September 30, 2013 compared to net cash used in investing activities of \$1,216,160 during the same period in 2012. This decrease is primarily attributable to the increase in purchases of property and equipment of \$7,430,459.

The Company had a net decrease in cash and cash equivalents of \$1,164,834 during the nine month period ended September 30, 2013 compared to the same period in 2012. The Company had cash and cash equivalents of \$1,215,731 as of September 30, 2013 compared to cash and cash equivalents of \$2,379,565 as of September 30, 2012.

Assets and Liabilities

Total assets were \$64,468,696 as of September 30, 2013, which is an increase of \$9,956,122 when compared to September 30, 2012. This is primarily due to an increase in property and equipment, net of \$6,883,180 as of September 30, 2013 when compared to September 30, 2012. The increase is related to the purchase of the Golden Guernsey Dairy facility.

Total current liabilities were \$8,924,051 as of September 30, 2013, which is an increase of \$988,624 when compared to September 30, 2012. This is primarily due to a \$429,121 increase in accrued expenses.

Notes payable increased by \$4,118,178 as of September 30, 2013, when compared to September 30, 2012. The balance of the notes payable as of September 30, 2013 was \$9,214,853.

Total stockholder's equity was \$43,412,579 as of September 30, 2013, which is an increase of \$5,044,636 when compared to September 30, 2012. This is primarily due to an increase in retained earnings of \$5,225,147 when compared to September 30, 2012.

All of our marketable securities are classified as available-for-sale on our balance sheet. All of these securities are stated thereon at market value as of the end of the applicable period. Gains and losses on the portfolio are determined by the specific identification method.

We anticipate being able to fund the Company's foreseeable liquidity requirements internally.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure material information required to be disclosed in our reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial and accounting officer, as appropriate, to allow timely decisions regarding required financial disclosure. In designing and evaluating the disclosure controls and procedures, we recognized that a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934 (the "Exchange Act")). Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of September 30, 2013 in ensuring that information required to be disclosed by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified under the Exchange Act rules and forms due to the material weakness described below. As a result, we performed additional analysis and other post-closing procedures to ensure our consolidated financial statements were prepared in accordance with generally accepted accounting principles. Accordingly, management believes the consolidated financial statements included in this Form 10-Q fairly present, in all material respects, our financial condition, results of operations and cash flows for the periods presented.

Material Weaknesses

Management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2012. In making the assessment, management used the framework in "Internal Control –Integrated Framework" promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria. Based on that assessment, our principal executive officer and principal financial and accounting officer concluded that our internal control over financial reporting was not effective as of December 31, 2012 because a material weakness existed in our internal control over financial reporting related to the classification of certain costs and expenses.

As a result, we performed additional analysis and other post-closing procedures to ensure our consolidated financial statements were prepared in accordance with generally accepted accounting principles. Accordingly, management believes the consolidated financial statements included in this Form 10-Q fairly present, in all material respects, our financial condition, results of operations and cash flows for the periods presented. This quarterly report on Form 10-Q does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting.

Description of Material Weaknesses at December 31, 2012

In 2012 the Company did not maintain effective monitoring controls over financial reporting relating to the classification of certain costs and expenses. Specifically, the Company and its auditors determined during the audit of our financial statements that, in connection with the preparation of the Company's Annual Report on Form 10-K for fiscal year ended December 31, 2012, certain post-closing adjustments were required with respect to our classification of certain direct manufacturing costs from general and administrative to cost of goods sold, primarily consisting of utilities, wage related expenses and overhead.

Remediation of Material Weakness

In light of the material weakness described above, we took steps to remediate our material weakness. Management enhanced the review process by improving real time general ledger monitoring and wage detail in the financial statement functionality of our accounting software, allowing for improved internal review of the source information which goes in to the completion of the financial statements. More specifically, management has focused on improving specific coding of direct expenses as compared to general and administrative expenses.

Management is committed to continuous improvement of the Company's internal control processes. Under the direction of the Audit Committee, management will continue to review and make changes it deems necessary to the overall design of the Company's internal control over financial reporting, including implementing further improvements in policies and procedures and taking additional measures to address any control deficiencies.

Conclusion

We believe the measures described above will remediate the material weaknesses we have identified and will continue to strengthen our internal controls over financial reporting. We are committed to continually improving our internal control processes and will diligently and vigorously review our financial reporting controls and procedures. As we continue to evaluate and work to improve our internal controls over financial reporting, we may determine that additional measures are necessary to address control deficiencies. Moreover, we may decide to modify certain of the remediation measures described above.

Changes in Internal Control over Financial Reporting

Except as discussed above there were no changes in our internal control over financial reporting that occurred during the third quarter of 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Lifeway is not party to any material pending legal proceedings. Lifeway is from time to time engaged in litigation matters arising in the ordinary course of business none of which presently is expected to have a material adverse effect on its business results or operations.

ITEM 1A. RISK FACTORS.

Not applicable.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURE.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

4.1 Note made on September 4, 2013 by Lifeway Foods, Inc., and its wholly-owned subsidiaries, Fresh Made Inc., Helios Nutrition Limited, Pride of Main Street Dairy, LLC, Starfruit, LLC and Lifeway Wisconsin, Inc. for the benefit of The Private Bank and Trust Company (incorporated by reference to Exhibit 4.1 on Lifeway's Current Report on Form 8-K filed on September 20, 2013 (File No. 000-17363)).

10.1 Mortgage, dated as of September 4, 2013 executed by Lifeway Wisconsin, Inc. to and for the benefit of The Private Bank and Trust Company (incorporated by reference to Exhibit 10.1 on Lifeway's Current Report on Form 8-K filed on September 20, 2013 (File No. 000-17363)).

10.2 Assignment of Rents and Leases dated September 4, 2013 executed by Lifeway Wisconsin, Inc. for the benefit of The Private Bank and Trust Company (incorporated by reference to Exhibit 10.2 on Lifeway's Current Report on Form 8-K filed on September 20, 2013 (File No. 000-17363)).

10.3

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Environmental Indemnity Agreement dated September 4, 2013, jointly and severally executed by Lifeway Foods, Inc., and its wholly-owned subsidiaries, Fresh Made Inc., Helios Nutrition Limited, Pride of Main Street Dairy, LLC, Starfruit, LLC and Lifeway Wisconsin, Inc. for the benefit of The Private Bank and Trust Company (incorporated by reference to Exhibit 10.3 on Lifeway's Current Report on Form 8-K filed on September 20, 2013 (File No. 000-17363)).

10.4 Eighth Modification to Loan and Security Agreement dated September 4, 2013 by and among The Private Bank and Trust Company, Lifeway Foods, Inc., Fresh Made, Inc., Helios Nutrition Limited, Pride of Main Street Dairy, LLC, Starfruit, LLC and Lifeway Wisconsin, Inc.

10.5 Second Amendment to Mortgage, Security Agreement, Assignment of Rents and Leases and Fixture Filing dated September 4, 2013 by and between Lifeway Foods, Inc. and The Private Bank and Trust Company.

31.1 Officer's Certificate Pursuant to 15 U.S.C. 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Officer's Certificate Pursuant to 15 U.S.C. 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.1 Press Release dated November 14, 2013.

101 Interactive Data Files.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LIFEWAY FOODS, INC.

Date: November 14, 2013

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

Date: November 14, 2013

By: /s/ Edward P. Smolyansky
Edward P. Smolyansky
Chief Financial and Accounting Officer,
Treasurer, Chief Operating Officer and
Secretary

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