

LIFEWAY FOODS INC  
Form 10-Q  
August 15, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

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(Mark One)

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

For the quarterly period ended: June 30, 2011

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

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

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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) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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, or a non-accelerated filer or a smaller reporting company. See definition 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 June 30, 2011, the issuer had 16,430,809 shares of common stock, no par value, outstanding.

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## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS.

## LIFEWAY FOODS, INC. AND SUBSIDIARIES

## Consolidated Statements of Financial Condition

June 30, 2011 and 2010 (unaudited) and December 31, 2010

	(unaudited) June 30, 2011	2010	December 31, 2010
<b>ASSETS</b>			
Current assets			
Cash and cash equivalents	\$1,398,523	\$858,490	\$3,229,939
Investments	1,172,193	3,411,804	1,079,232
Certificates of deposits in financial institutions	300,000	550,000	250,000
Inventories	5,608,151	4,154,719	3,985,374
Accounts receivable, net of allowance for doubtful accounts and discounts	8,891,068	7,780,512	6,793,276
Prepaid expenses and other current assets	199,866	70,130	158,315
Other receivables	9,825	142,389	104,680
Deferred income taxes	394,376	389,249	328,470
Refundable income taxes		---	906,748
Total current assets	17,974,002	17,357,293	16,836,034
Property and equipment, net	15,237,279	14,890,327	15,152,713
Intangible assets			
Goodwill and other non amortizable brand assets	14,068,091	13,806,091	14,068,091
Other intangible assets, net of accumulated amortization of \$2,696,023 and \$1,931,091 at June 30, 2011 and 2010 and \$2,304,107 at December 31, 2010, respectively	5,609,977	5,907,909	6,001,893
Total intangible assets	19,678,068	19,714,000	20,069,984
Other assets	---	500,000	---
Total assets	\$52,889,349	\$52,461,620	\$52,058,731
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current liabilities			
Checks written in excess of bank balances	\$1,709,050	\$847,374	\$1,341,210
Current maturities of notes payable	1,892,042	4,431,873	2,851,610
Accounts payable	4,174,835	2,259,236	4,183,481
Accrued expenses	552,058	531,553	509,459
Accrued income taxes	378,482	604,323	---
Total current liabilities	8,706,467	8,674,359	8,885,760
Notes payable	5,957,795	6,397,780	6,122,225

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Deferred income taxes	3,329,537	3,262,795	3,401,728
Total liabilities	17,993,799	18,334,934	18,409,713
Stockholders' equity			
Common stock, no par value; 20,000,000 shares authorized; 17,273,776 shares issued; 16,430,809 shares outstanding at June 30, 2011; 17,273,776 shares issued; 16,657,478 shares outstanding at June 30, 2010; 17,273,776 shares issued; 16,536,657 shares outstanding at December 31, 2010	6,509,267	6,509,267	6,509,267
Paid-in-capital	2,032,516	2,018,727	2,032,516
Treasury stock, at cost	( 7,397,344 )	( 5,256,054 )	( 6,425,546 )
Retained earnings	33,767,188	30,906,602	31,575,875
Accumulated other comprehensive income (loss), net of taxes	( 16,077 )	( 51,856 )	( 43,094 )
Total stockholders' equity	34,895,550	34,126,686	33,649,018
Total liabilities and stockholders' equity	\$52,889,349	\$52,461,620	\$52,058,731

See accompanying notes to financial statements

## LIFEWAY FOODS, INC. AND SUBSIDIARIES

## Consolidated Statements of Income and Comprehensive Income

For the Three and Six Months Ended June 30, 2011 and 2010 (unaudited)

and for the Year Ended December 31, 2010

	(unaudited) Three Months Ended June 30,		(unaudited) Six Months Ended June 30,	
	2011	2010	2011	2010
Sales	\$19,913,003	15,546,556	38,960,269	\$31,510,715
Less: discounts and allowances	(1,715,085 )	(1,261,195 )	(3,458,448 )	(2,336,208 )
Net Sales	18,197,918	14,285,361	35,501,821	29,174,507
Cost of goods sold	12,535,368	8,454,095	22,186,640	18,111,100
Depreciation expense	390,694	281,220	767,207	600,000
Total cost of goods sold	12,926,062	8,735,315	22,953,847	18,711,100
Gross profit	5,271,856	5,550,046	12,547,974	10,463,407
Selling expenses	2,790,507	1,741,886	5,012,315	3,800,000
General and administrative	1,585,178	1,478,062	3,177,907	2,800,000
Amortization expense	195,957	175,761	391,916	300,000
Total Operating Expenses	4,571,642	3,395,709	8,582,138	6,900,000
Income from operations	700,214	2,154,337	3,965,836	3,563,407
Other income (expense):				
Interest and dividend income	17,094	53,176	34,687	100,000
Rental income	650	2,800	650	4,000
Interest expense	(72,298 )	(80,164 )	(134,428 )	(100,000 )
Gain (loss) on sale of investments, net	541	84,043	(2,056 )	500,000
Total other income (expense)	(54,013 )	59,855	(101,147 )	404,000
Income before provision for income taxes	646,201	2,214,192	3,864,689	4,007,407

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Provision for income taxes	380,659	1,029,688	1,673,376	1
Net income	\$265,542	\$1,184,504	\$2,191,313	\$2
Basic and diluted earnings per common share	0.02	0.07	0.13	0
Weighted average number of shares outstanding	16,434,314	16,701,539	16,461,981	1
<b>COMPREHENSIVE INCOME</b>				
Net income	\$265,542	\$1,184,504	\$2,191,313	\$2
Other comprehensive income (loss), net of tax:				
Unrealized gains on investments (net of tax)	10,404	(55,842 )	25,855	(
Less reclassification adjustment for (gains) losses included in net income (net of taxes)	(305 )	(49,333 )	1,162	(
Comprehensive income	\$275,641	\$1,079,329	\$2,218,330	\$2

See accompanying notes to financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES  
 Consolidated Statements of Changes in Stockholders' Equity  
 For the Six Months Ended June 30, 2011 and 2010 (unaudited)  
 and for the Year Ended December 31, 2010

	Common Stock, No Par Value		# of Shares of	Treasury Stock	Common Stock	Paid In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	
	20,000,000 Shares Authorized	# of Shares								
	Issued	Outstanding								
	# of Shares	# of Shares								
Balances at December 31, 2009	17,273,776	16,778,555	495,221	\$6,509,267	\$1,965,786	\$(3,846,773)	\$27,953,409	\$(10,359)	32	
Redemption of stock	---	(252,398 )	252,398	---	---	(2,666,288)	---	---	(2)	
Issuance of treasury stock for compensation	---	10,500	(10,500 )	---	66,730	87,515	---	---	15	
Issuance of treasury stock for Fresh Made acquisition	---			---			---	---	---	
Other comprehensive income (loss): Unrealized gains on securities, net of taxes and reclassification adjustment	---	---	---	---	---	---	---	(32,735)	(3)	
Net income for the year ended December 31, 2010	---	---	---	---	---	---	3,622,466	---	3,	
Balances at December 31,	17,273,776	16,536,657	737,119	\$6,509,267	\$2,032,516	\$(6,425,546)	\$31,575,875	\$(43,094)	\$33	



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2010

Balances at January 1, 2010	17,273,776	16,778,555	495,221	\$6,509,267	\$1,965,786	\$(3,846,773)	\$27,953,409	\$(10,359)	32
Redemption of stock	---	(129,841 )	129,841	---	---	(1,418,657)	---	---	(1
Issuance of treasury stock for compensation	---	8,764	(8,764 )	---	52,941	9,376	---	---	62
Other comprehensive income (loss): Unrealized gains on securities, net of taxes and reclassification adjustment	---	---	---	---	---	---	---	(41,497)	(4
Net income for the six months ended June 30, 2010	---	---	---	---	---	---	2,953,193	---	2,
Balances at June 30, 2010	17,273,776	16,657,478	616,298	\$6,509,267	\$2,018,727	\$(5,256,054)	\$30,906,602	\$(51,856)	\$34
Balances at January 1, 2011	17,273,776	16,536,657	737,119	\$6,509,267	\$2,032,516	\$(6,425,546)	\$31,575,875	\$(43,094)	\$33
Redemption of stock	---	(105,848 )	105,848	---	---	(971,798 )	---	---	(9
Other comprehensive income (loss): Unrealized gains on securities, net of taxes and reclassification adjustment	---	---	---	---	---	---	---	27,017	27
Net income for the six months ended June 30, 2011	---	---	---	---	---	---	2,191,313	---	2,

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Balances at

June 30, 2011 17,273,776 16,430,809 842,967 \$6,509,267 \$2,032,516 \$(7,397,344) \$33,767,188 \$(16,077) \$34,783,261

See accompanying notes to financial statements

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## LIFEWAY FOODS, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

For the Six Months Ended June 30, 2011 and 2010 (unaudited)

and for the Year Ended December 31, 2010

	(unaudited) June 30, 2011	2010	December 31, 2010
Cash flows from operating activities:			
Net income	\$2,191,313	\$2,953,193	\$3,622,466
Adjustments to reconcile net income to net cash flows from operating activities, net of acquisition:			
Depreciation and amortization	1,159,123	1,036,116	2,118,282
Loss (Gain) on sale of investments, net	2,056	( 54,784 )	( 250,480 )
Deferred income taxes	( 156,040 )	( 290,465 )	( 96,918 )
Treasury stock issued for compensation	---	62,317	154,245
Increase in allowance for doubtful accounts	20,000	---	17,754
(Increase) decrease in operating assets:			
Accounts receivable	( 2,117,792 )	( 1,780,774 )	( 811,292 )
Other receivables	94,855	( 92,631 )	( 54,922 )
Inventories	( 1,622,777 )	( 857,743 )	( 682,398 )
Refundable income taxes	906,748	1,308,978	402,230
Prepaid expenses and other current assets	(41,551 )	( 29,433 )	( 117,618 )
Increase (decrease) in operating liabilities:			
Accounts payable	( 8,646 )	( 504,764 )	1,419,479
Accrued expenses	42,599	( 82,791 )	( 104,885 )
Income taxes payable	378,482	604,323	---
Net cash provided by operating activities	848,370	2,271,542	5,615,943
Cash flows from investing activities:			
Purchases of investments	( 582,697 )	( 538,852 )	( 2,161,552 )
Proceeds from sale of investments	532,640	1,502,724	5,669,158
Investments in certificates of deposits	( 50,000 )		
Proceeds from redemption of certificates of deposit	---	102,545	402,005
Purchases of property and equipment	( 747,250 )	( 1,292,741 )	( 2,229,274 )
Acquisition of the assets of First Juice	---	---	( 270,000 )
Net cash provided by (used in) investing activities	( 847,307 )	( 226,324 )	1,410,337
Cash flows from financing activities:			
Proceeds of note payable	250,000	250,000	250,000
Checks written in excess of bank balances	367,840	504,398	998,234
Purchases of treasury stock	( 971,798 )	( 1,418,657 )	( 2,666,288 )
Repayment of notes payable	( 1,478,521 )	( 1,152,876 )	( 3,008,694 )
Net cash used in financing activities	( 1,832,479 )	( 1,817,135 )	( 4,426,748 )
Net (decrease) increase in cash and cash equivalents	( 1,831,416 )	228,083	2,599,532
Cash and cash equivalents at the beginning of the period	3,229,939	630,407	630,407

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Cash and cash equivalents at the end of the period	\$1,398,523	\$858,490	\$3,229,939
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See accompanying notes to financial statements

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2011 and 2010

and December 31, 2010

Note 1 – NATURE OF BUSINESS

Lifeway Foods, Inc. (The “Company”) 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 in the East Coast through local food stores. In addition, the products are sold throughout the United States and Ontario, Canada by distributors. The Company also distributes some of its products to Eastern Europe.

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 consolidated 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 generally 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.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, LFI Enterprises, Inc., Helios Nutrition, Ltd., Pride of Main Street, L.L.C., Starfruit, L.L.C., Fresh Made, Inc. and Starfruit Franchisor, L.L.C. In 2010, the Company acquired the assets of First Juice, Inc. (“First Juice”) and consolidated the operations into the operations of the Company. All significant intercompany accounts and transactions have been eliminated. The financial statements include the results of operations from the acquisition of the assets of First Juice from October 14, 2010 through the end of the period (see Note 3).

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 and discounts, 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.

LIFEWAY FOODS, INC. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements  
June 30, 2011 and 2010  
and December 31, 2010

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.

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

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:

Category	Years
Buildings and improvements	31 and 39

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Machinery and equipment	5 – 12
Office equipment	5 – 7
Vehicles	5



LIFEWAY FOODS, INC. AND SUBSIDIARIES  
 Notes to Consolidated Financial Statements  
 June 30, 2011 and 2010  
 and December 31, 2010

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
L e a s e agreement	7
Trade names	15
Formula	10
C u s t o m e r 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.

LIFEWAY FOODS, INC. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements  
June 30, 2011 and 2010  
and December 31, 2010

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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 return are the 2009 and 2010 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.

During the year ended December 31, 2010, the IRS completed a review of the Company's 2007 and 2008 federal tax return filings, resulting in a liability of approximately \$220,000 being recognized and paid during 2010. The Company's policy for recording interest and penalties associated with audits is to record such items as a component of income before taxes. There were no such items during the periods covered in this report.

Treasury stock

Treasury stock is recorded using the cost method.

Advertising and promotional costs

The Company expenses advertising costs as incurred. For the year ended December 31, 2010 and for the six months ended June 30, 2011 and 2010 total advertising costs and promotional discounts and allowances were \$7,433,554, \$5,363,466 and \$3,634,684, respectively. Of these totals, \$2,390,002, \$1,905,018, and \$1,298,476 were classified as advertising expenses and \$5,043,552, \$3,458,448, and \$2,336,208 were considered to be promotional discounts and allowances and were classified as reductions of sales for the year ended December 31, 2010 and the six months ended June 30, 2011 and 2010, 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 six months ended June 30, 2011 and 2010 and for the year ended December 31, 2010, diluted and basic earnings per share were the same, as the effect of dilutive securities options outstanding was not significant.

Reclassification

Certain 2010 balance sheet amounts have been reclassified to conform to the 2011 presentation.

Note 3 – ACQUISITIONS

On October 14, 2010, Lifeway purchased certain assets of First Juice, Inc., a producer of organic fruit and vegetable juice beverages designed for children. The consideration for substantially all of the assets was an aggregate of \$770,000, consisting of a \$500,000 previous investment in preferred stock and an additional \$270,000 cash paid in 2010. Production was moved to Lifeway facilities upon closing of the acquisition. The acquisition was consummated to expand the Company's presence in the children's market, increase distribution channels for existing Lifeway products, and increase diversification of the Company's products. There were no significant liabilities assumed. Acquisition costs for legal and professional fees have been included in General and Administrative costs and were not significant. The entire amount of goodwill resulting from the acquisition is tax deductible.



LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2011 and 2010

and December 31, 2010

The estimated fair value of assets acquired, including the real property, and liabilities assumed consisted of the following:

Trade names	\$ 268,000
Other current assets	6,000
Customer lists	199,000
Fixed assets	35,000
Non amortizable goodwill and brand asset	262,000
Total fair value of assets acquired and liabilities assumed	\$ 770,000

Had the acquisition occurred on January 1, 2010, the impact on the gross revenue and net income of the Company would not have been significant and would have had no impact on earnings per share for the full year ended December 31, 2010.

Note 4 – INTANGIBLE ASSETS

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

	June 30, 2011		June 30, 2010		December 31, 2010	
	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	1,292,997	4,305,200	803,744	4,504,200	1,039,323
Lease acquisition	87,200	83,559	87,200	73,707	87,200	79,941
C u s t o m e r relationship	985,000	403,586	985,000	321,490	985,000	362,526
Trade names	2,248,000	656,931	1,980,000	517,000	2,248,000	585,267
Formula	438,000	215,350	438,000	171,550	438,000	193,450
	\$ 8,306,000	\$ 2,696,023	\$ 7,839,000	\$ 1,931,091	\$ 8,306,000	\$ 2,304,107

Amortization expense is expected to be as follows for the 12 months ending June 30:

2012	\$ 780,200
2013	722,217
2014	711,367
2015	711,367
2016	711,367
Thereafter	1,973,459
	\$ 5,609,977

Amortization expense during the six months ended June 30, 2011 and 2010 and the year ended December 31, 2010 was \$391,916, \$351,521 and \$724,537, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES  
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## Note 5 – INVESTMENTS

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

June 30, 2011	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	\$211,831	\$3,034	\$( 35,930 )	\$178,934
Mutual Funds	114,362	2,022	( 798 )	115,586
Preferred Securities	203,514	---	( 5,719 )	197,795
Corporate Bonds	670,941	12,251	( 3,315 )	679,877
<b>Total</b>	<b>\$1,200,648</b>	<b>\$17,307</b>	<b>\$( 45,762 )</b>	<b>\$1,172,193</b>
June 30, 2010	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	\$653,068	\$26,400	\$( 117,892 )	\$561,576
Mutual Funds	206,961	3,056	( 7,853 )	202,164
Preferred Securities	272,629	6,650	( 64,789 )	214,490
Corporate Bonds	1,751,719	89,355	( 30,140 )	1,810,934
Government Agency Obligations	615,767	8,625	( 1,752 )	622,640
<b>Total</b>	<b>\$3,500,144</b>	<b>\$134,086</b>	<b>\$( 222,426 )</b>	<b>\$3,411,804</b>
December 31, 2010	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	\$ 225,573	\$ 16,173	\$ ( 68,974)	\$ 172,772
Mutual Funds	202,108	4,661	( 2,017)	204,752
Preferred Securities	228,514	—	( 18,329)	210,185
Corporate Bonds	496,451	843	( 5,771)	491,523
<b>Total</b>	<b>\$ 1,152,646</b>	<b>\$ 21,677</b>	<b>\$ ( 95,091)</b>	<b>\$ 1,079,232</b>

Proceeds from the sale of investments were \$5,669,158, \$532,640 and \$1,502,724 during the year ended December 31, 2010 and for the six months ended June 30, 2011 and 2010, respectively.

Gross gains of \$451,420, \$27,622 and \$120,850 and gross losses of \$200,940, \$29,678 and \$66,066 were realized on these sales during the year ended December 31, 2010 and for the six months ended June 30, 2011 and 2010, respectively.





LIFEWAY FOODS, INC. AND SUBSIDIARIES  
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## Note 5 – INVESTMENTS - Continued

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 June 30, 2011 and 2010 and at December 31, 2010:

June 30, 2011	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	\$ 103,939	\$ (4,791 )	\$ 41,845	\$ (31,139 )	\$ 145,784	\$ (35,930 )
Mutual Funds	30,350	(541 )	22,165	(257 )	52,515	(798 )
Preferred Securities	—	—	197,795	(5,719 )	197,795	(5,719 )
Corporate Bonds	148,812	(3,315 )	—	—	148,812	(3,315 )
	\$ 283,101	\$ (8,647 )	\$ 261,805	\$ (37,115 )	\$ 544,906	\$ (45,762 )

June 30, 2010	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	\$ 58,222	\$ (10,953 )	\$ 154,154	\$ (106,939 )	\$ 212,376	\$ (117,892 )
Mutual Funds	278	(4 )	99,486	(7,849 )	99,764	(7,853 )
Preferred Securities	—	—	193,090	(64,789 )	193,090	(64,789 )
Corporate Bonds	499,285	(26,989 )	181,076	(3,151 )	680,361	(30,140 )
Government Agency Obligations	—	—	84,775	(1,752 )	84,775	(1,752 )
	\$ 557,785	\$ (37,946 )	\$ 712,581	\$ (184,480 )	\$ 1,270,366	\$ (222,426 )

December 31, 2010	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	\$ 48,202	\$ (11,675 )	\$ 101,467	\$ (57,299 )	\$ 149,669	\$ (68,974 )
Mutual Funds	—	—	85,061	(2,017 )	85,061	(2,017 )
Preferred Securities	—	—	210,185	(18,329 )	210,185	(18,329 )
Corporate Bonds	146,710	(2,296 )	122,532	(3,475 )	269,242	(5,771 )
	\$ 194,912	\$ (13,971 )	\$ 519,245	\$ (81,120 )	\$ 714,157	\$ (95,091 )

Equities, Mutual Funds, Preferred Securities, Corporate Bonds and Government Agency Obligations - The Company's investments in equity securities, mutual funds, corporate bonds and government agency obligations consist of investments in common stock, preferred stock and debt securities of companies in various industries. As of June 30, 2011, there were eleven equity securities, fifteen mutual fund securities, two preferred securities, and two 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 does not consider any material investments to be other-than-temporarily impaired at June 30, 2011.

## LIFEWAY FOODS, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

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## Note 6 – INVENTORIES

Inventories consist of the following:

	June 30,		December 31,
	2011	2010	2010
Finished goods	\$2,320,692	\$1,405,538	\$1,636,988
Production supplies	1,944,159	1,657,546	1,527,064
Raw materials	1,343,300	1,091,635	821,322
Total inventories	\$5,608,151	\$4,154,719	\$3,985,374

## Note 7 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	June 30,		December 31,
	2011	2010	2010
Land	\$1,178,160	\$1,178,160	\$1,178,160
Buildings and improvements	11,477,053	11,051,821	11,328,860
Machinery and equipment	14,112,020	13,182,669	13,713,649
Vehicles	1,211,760	963,245	976,745
Office equipment	366,064	299,110	352,135
Construction in process	153,255	---	96,990
	28,498,312	26,675,005	27,646,539
Less accumulated depreciation	13,261,033	11,784,678	12,493,826
Total property and equipment	\$15,237,279	\$14,890,327	\$15,152,713

Depreciation expense during the six months ended June 30, 2011 and 2010 and for the year ended December 31, 2010 was \$767,207, \$684,595 and \$1,393,745, respectively.

## Note 8 – ACCRUED EXPENSES

Accrued expenses consist of the following:

	June 30,		December 31,
	2011	2010	2010
Accrued payroll and payroll taxes	\$252,592	\$161,175	\$181,274
Accrued property tax	274,374	299,254	273,876
Other	25,092	71,124	54,309
	\$552,058	\$531,553	\$509,459



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## Note 9 – NOTES PAYABLE

Notes payable consist of the following:

	2011	June 30, 2010	December 31, 2010
Note payable to Private Bank in monthly installments of \$42,222, plus variable interest rate, currently at 2.761%, with a balloon payment of \$5,066,667 due February 6, 2014. Collateralized by substantially all assets of the Company.	\$6,375,556	\$6,904,444	6,628,889
Line of credit with Private Bank at variable interest rate, currently at 2.761%. The agreement has been extended with terms allowing borrowings up to \$2.0 million, maturing on May 31, 2012. Collateralized by substantially all assets of the Company.	---	750,000	—
Line of credit with Morgan Stanley for borrowings up to \$2.8 million at variable interest rate, currently at 2.94% due on demand. Collateralized by investments with a fair value of \$877,623, and cash and CD's totaling \$1,253,446 at June 30, 2011.	1,370,695	2,303,090	2,344,946
Notes payable to Ilya Mandel & Michael Edelson, subordinated to Private Bank, payable in quarterly installments of \$341,875, plus interest at the floating rate per annum (3.25% at June 30, 2010). This balance was paid in full during August, 2010.		872,119	—
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	103,586	---	---
Total notes payable	7,849,837	10,829,653	8,973,835
Less current maturities	1,892,042	4,431,873	2,851,610
Total long-term portion	\$5,957,795	\$6,397,780	6,122,225

In accordance with the Private Bank agreements referenced above, the Company is subject to minimum fixed charged ratio and tangible net worth thresholds. At June 30, 2011, the Company was in compliance with these covenants.

Maturities of notes payables are as follows:

For the Period Ended June 30,

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2012	\$	1,892,042
2013		522,384
2014		5,379,031
Thereafter		56,380
Total	\$	7,849,837

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## Note 10 – PROVISION FOR INCOME TAXES

The provision for income taxes consists of the following:

	For the Six Months Ended June 30,		For the Year Ended December 31,
	2011	2010	2010
Current:			
Federal	\$1,173,349	\$1,759,484	2,269,819
State and local	656,067	470,917	651,085
Total current	1,829,416	2,230,401	2,920,904
Deferred	( 156,040 )	( 290,465 )	( 96,918 )
Provision for income taxes	\$1,673,376	\$1,939,936	2,823,986

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

	For the Six Months Ended June 30,		For the Year Ended December 31,
	2011	2010	2010
Federal income tax expense computed at the statutory rate	\$1,313,994	\$1,663,664	\$2,180,228
State and local tax expense, net	367,146	234,870	651,085
Permanent differences	(73,711 )	( 92,868 )	( 117,247 )
Tax credits and other	65,947	134,270	109,920
Provision for income taxes	\$1,673,376	\$1,939,936	\$2,823,986

Amounts for deferred tax assets and liabilities are as follows:

	2011	June 30, 2010	December 31, 2010
Non-current deferred tax assets (liabilities) arising from:			
Temporary differences -			
Accumulated depreciation and amortization from purchase accounting adjustments	\$(3,601,105 )	\$(3,599,811 )	\$(3,673,296 )
Capital loss carry-forwards	271,568	337,016	271,568
Total non-current net deferred tax liabilities	(3,329,537 )	(3,262,795 )	(3,401,728 )
Current deferred tax assets arising from:			
Unrealized losses on investments	12,377	95,488	30,320
Impairment of investments	---	---	4,232
Inventory	250,297	176,051	168,875
Allowance for doubtful accounts and discounts	131,702	117,710	125,043

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Total current deferred tax assets	394,376	389,249	328,470
Net deferred tax liability	\$(2,935,161 )	\$(2,873,546 )	\$(3,073,258 )

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Note 11 – SUPPLEMENTAL CASH FLOW INFORMATION

The Company applied a previous investment in First Juice, Inc. of \$500,000 toward the acquisition during 2010. The impact on the acquisition and intangible assets has been omitted from the investing section of the cash flow statement.

Cash paid for interest and income taxes are as follows:

	For the Six Months Ended June 30,		For the Year Ended December 31,
	2011	2010	2010
Interest	\$131,172	\$211,836	\$375,347
Income taxes	\$669,334	\$317,346	\$2,824,824

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, 2010 and at June 30, 2011 and 2010, there were no stock options outstanding or exercisable. There were approximately 940,000 shares available for issuance under the Plan at June 30, 2011.

On May 28, 2009, Lifeway's Board of Directors approved awards of an aggregate amount of 18,000 shares to be awarded under its Employee and Consulting Services and Compensation Plan to certain key employees and consultants for services rendered to the Company. The stock awards were made on May 28, 2009 and have vesting periods of one year. The expense for the awards is measured as of July 14, 2009 at \$14.69 per share for 18,000 shares, or a total stock award expense of \$264,420. This expense was recognized as the stock awards vested in 12 equal portions of \$22,035, or 1,500 shares per month for one year.

Note 13 – FAIR VALUE MEASUREMENTS

Generally accepted accounting principles define fair value as the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The standards emphasize that fair value is a market-based measurement, not an entity-specific measurement and establish the following fair value hierarchy used in fair value measurements:

LIFEWAY FOODS, INC. AND SUBSIDIARIES

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Note 13 – FAIR VALUE MEASUREMENTS - Continued

Level 1 – Inputs use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

Level 2 – Inputs use other inputs that are observable, either directly or indirectly. These inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 – Inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company's assessment of the significance of particular inputs to these fair measurements requires judgment and considers factors specific to each asset or liability.

The Company has available for sale investment securities measured at fair value on a recurring basis. All categories of investment securities noted in Note 5 were valued using Level 1 inputs as described above, in 2011 and 2010. There were no other assets or liabilities measured at fair value on a recurring or non-recurring basis as of June 30, 2011, June 30, 2010 or December 31, 2010.

Note 14 – RECENT ACCOUNTING PRONOUNCEMENTS

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures. FASB ASU 2010-06 amends the fair value disclosure guidance to include new disclosures and changes to clarify existing disclosure requirements. ASU 2010-06 was effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements of Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The impact of ASU 2010-06 on the Company's disclosures was not significant to the consolidated financial statements.

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

Comparison of Quarter Ended June 30, 2011 to Quarter Ended June 30, 2010

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, 2010, and in the Management's Discussion and Analysis contained in our Form 10-Q, for the fiscal quarter ended March 31, 2011.

Results of Operations

Total consolidated gross sales increased by \$4,366,447 (approximately 28%) to \$19,913,003 during the three-month period ended June 30, 2011 from \$15,546,556 during the same three-month period in 2010. This increase is primarily attributable to increased sales and awareness of flagship line, Kefir, as well as ProBugs® Organic Kefir for kids and BioKefir™. In addition, Lifeway Frozen Kefir line, which was launched in April 2011, contributed to approximately \$250,000 to revenue during the second quarter 2011.

Total consolidated net sales increased by \$3,912,557 (approximately 27%) to \$18,197,918 during the three-month period ended June 30, 2011 from \$14,285,361 during the same three-month period in 2010. Net sales are recorded as gross sales less promotional activities such as slotting fees paid, couponing, spoilage and promotional allowances as well as early payment terms given to customers.

Cost of goods sold as a percentage of net sales, excluding depreciation expense, were approximately 69% during the second quarter of 2011, compared to approximately 59% during the same period in 2010. The increase was primarily attributable to the cost of transportation and other petroleum based production supplies, as well as the increased cost of conventional milk, our largest raw material. The cost of milk was approximately 35%-45% higher during the second quarter 2011 when compared to the same period in 2010.

Operating expenses as a percentage of net sales were approximately 25% during the second quarter of 2011 compared to approximately 24% during the same period in 2010. This increase was primarily attributable to increased selling expenses as compared to the same period in 2010. Selling related expenses increased by \$1,048,621, (approximately 60%) to \$2,790,507 during the second quarter of 2011, from \$1,741,886 during the same period in 2010. This increase is directly attributable to the company recording an approximate \$700,000 expense related its 25th Anniversary Cross Country Mobile tour, which occurred in the second quarter and was expensed during the second quarter. The Company views this as a non-recurring advertising expense.

Total operating income decreased by \$1,454,123 (approximately 67%) to \$700,214 during the second quarter of 2011, from \$2,154,337 during the same period in 2010.

Provision for income taxes was \$380,659, or a 59% effective tax rate, for the 2011 second quarter compared with \$1,029,688, or a 47% tax rate, during the same period in 2010. In addition to the higher rate, the Company's tax expense was higher due to a Minnesota State Department of Revenue audit from tax years 2006-2009, which resulted in approximately \$89,000 in additional taxes being paid in the 2011 second quarter. Income taxes are discussed in Note 10 of the Notes to Consolidated Financial Statements. The difference in rates was due to a lower level of permanent tax differences in relation to pre-tax net income.

Total net income was \$265,542 or \$0.02 per share for the three-month period ended June 30, 2011 compared to \$1,184,504 or \$0.07 per share in the same period in 2010.

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Comparison of Six- Month Period Ended June 30, 2011 to Quarter Ended June 30, 2010

Total consolidated gross sales increased by \$7,449,554 (approximately 24%) to \$38,960,269 during the six- month period ended June 30, 2011 from \$31,510,715 during the same six-month period in 2010. This increase is primarily attributable to increased sales and awareness of flagship line, Kefir, as well as ProBugs® Organic Kefir for kids and BioKefir™. In addition, Lifeway Frozen Kefir line, which was launched in April 2011, contributed to approximately \$250,000 to revenue during the second quarter 2011.

Total consolidated net sales increased by \$6,327,314 (approximately 22%) to \$35,501,821 during the six -month period ended June 30, 2011 from \$29,174,507 during the same six- month period in 2010. Net sales are recorded as gross sales less promotional activities such as slotting fees paid, couponing, spoilage and promotional allowances as well as early payment terms given to customers.

Cost of goods sold as a percentage of net sales, excluding depreciation expense, were approximately 62% during the six- month period ended June 30, 2011, compared to approximately 57% during the same period in 2010. The increase was primarily attributable to the cost of transportation and other petroleum based production supplies, as well as the increased cost of conventional milk, our largest raw material. The cost of milk was approximately 20%-25% higher during the six month period ended June 30, 2011 when compared to the same period in 2010.

Operating expenses as a percentage of net sales were approximately 24% during the six -month period ended June 30, 2011 compared to approximately 24% during the same period in 2010. Selling related expenses increased by \$1,275,582, (approximately 34%) to \$5,012,315 during the six-month period ended June 30, 2011, from \$3,736,733 during the same period in 2010. This increase is directly attributable to the company recording an approximate \$700,000 expense related its 25th Anniversary Cross Country Mobile tour, which occurred in the second quarter of 2011 and was expensed during the second quarter of 2011. The Company views this as a non-recurring advertising expense.

Total operating income decreased by \$936,896 (approximately 19%) to \$3,965,836 during the six -month period ended June 30, 2011, from \$4,902,732 during the same period in 2010.

Provision for income taxes was \$1,673,376, or a 43% effective tax rate, for the six -month period ended June 30, 2011 compared with \$1,939,936, or a 40% tax rate, during the same period in 2010. In addition to the higher rate, the Company's tax expense was higher due to a Minnesota State Department of Revenue audit from tax years 2006-2009, which resulted in approximately \$89,000 in additional taxes being paid in the six -month period ended June 30, 2011. Income taxes are discussed in Note 10 of the Notes to Consolidated Financial Statements. The difference in rates was due to a lower level of permanent tax differences in relation to pre-tax net income.

Total net income was \$2,191,313 or \$0.13 per share for the six -month period ended June 30, 2011 compared to \$2,953,193 or \$0.18 per share in the same period in 2010.

#### Liquidity and Capital Resources

##### Sources and Uses of Cash

Net cash provided by operating activities was \$848,370 during the six months ended June 30, 2011 which is a decrease of \$1,423,172 when compared to the same period in 2010. This decrease is primarily attributable to the decrease in net income of \$761,880.

Net cash used in investing activities was \$847,307 during the six months ended June 30, 2011 which is an increase of \$620,983 compared to the same period in 2010. This increase is primarily due to a decrease in proceeds from sale of investments of \$970,084 compared to 2010. The Company also repurchased 105,848 shares of its common stock at a cost of \$971,798 during the six-month period ending June 30, 2011.

The Company had a net increase in cash and cash equivalents of \$540,033 during the second quarter of 2011 compared to the same period in 2010. The Company had cash and cash equivalents of \$1,398,523 as of June 30, 2011 compared with cash and cash equivalents of \$858,490 as of June 30, 2010.

##### Assets and Liabilities

Total assets were \$52,889,349 as of June 30, 2011, which is an increase of \$830,618 when compared to December 31, 2010, and an increase of \$427,729 when compared to June 30, 2010. This is primarily due to an increase in cash and cash equivalents of \$540,033 as of June 30, 2011, when compared with June 30, 2010.

Total current liabilities were \$8,706,467 as of June 30, 2011, which is a decrease of \$179,293 when compared to December 31, 2010. Total current liabilities increased by \$32,108 when compared to June 30, 2010. This is primarily due a \$2,539,831 decrease in current maturities of notes payable partially offset by a \$1,915,599 increase in accounts payable as of June 30, 2011, when compared to June 30, 2010.

Long term notes payables decreased by \$164,430 as of June 30, 2011, when compared to December 31, 2010 and decreased by \$439,985 when compared to June 30, 2010. The balance of the long term notes payable as of June 30, 2011 was \$5,957,795.

Total stockholder's equity was \$34,895,550 as of June 30, 2011, which is an increase of \$1,246,532 when compared to December 31, 2010. This is primarily due the increase in retained earnings of \$2,191,313 when compared to December 31, 2010. Total stockholder's equity increased by \$768,864 when compared to June 30, 2010. This is primarily due the increase in retained earnings by \$2,860,586 as of June 30, 2011, when compared to June 30, 2010.

We previously held significant portions of our assets in marketable securities. During the fourth quarter of 2010, we converted certain securities to cash and cash equivalents in order to ensure we had easy access to capital to capitalize on the opportunities we see ahead for our business. 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. We continue to explore potential acquisition opportunities in our industry in order to boost sales while leveraging our distribution system to consolidate and lower costs.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

As of June 30, 2011, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial and Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial and Accounting Officer concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of June 30, 2011 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 weaknesses described in our Form 10-K filed on March 31, 2011. 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.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

None.

ITEM 1A. RISK FACTORS.

Not applicable.

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

## (c) PURCHASES OF THE COMPANY'S SECURITIES

Period	(a) Total Numbers of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs*	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs*
April 1, 2011 to April 30, 2011	6,000	9.82	6,000	198,754
May 1, 2011 to May 31, 2011	7,000	9.37	7,000	191,754
June 1, 2011 to June 30, 2011	0	—	0	191,754
Total	13,000	9.60	13,000	191,754

\*On January 1, 2011, the Company approved a new share repurchase program for up to 250,000 shares with a plan expiration date of one year from the date of the first purchase.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

## ITEM 4. REMOVED AND RESERVED.

## ITEM 5. OTHER INFORMATION.

None.

## ITEM 6. EXHIBITS.

Exhibit Number	Description of Document
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	



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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.

101 Interactive Data Files.

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SIGNATURES

In accordance with 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.  
(Registrant)

Date: August 15, 2011

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

Date: August 15, 2011

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

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