EDGAR Submission Header Summary

Submission Type	10-Q
Live File	on
Return Copy	on
Exchange	NASD
Confirming Copy	off
Filer CIK	0000814586
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Period of Report	09/30/14
Smaller Reporting Company	off
Notify via Filing website Only	off
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	email@exfile.com

Documents

10-Q	form10q_17723.htm
	FORM 10-Q
EX-31.1	exh31-1_17723.htm
	302 CERTIFICATION OF THE C.E.O.
EX-31.2	exh31-2_17723.htm
	302 CERTIFICATION OF THE C.F.O.
EX-32.1	exh32-1_17723.htm
	906 CERTIFICATION OF THE C.E.O.
EX-32.2	exh32-2_17723.htm
	906 CERTIFICATION OF THE C.F.O.
EX-101.INS	lway-20140930.xml
	INSTANCE DOCUMENT
EX-101.SCH	lway-20140930.xsd
	SCHEMA DOCUMENT
EX-101.CAL	lway-20140930_cal.xml
	CALCULATION LINKBASE DOCUMENT
EX-101.DEF	lway-20140930_def.xml
	DEFINITION LINKBASE DOCUMENT
EX-101.LAB	lway-20140930_lab.xml
	LABELS LINKBASE DOCUMENT
EX-101.PRE	lway-20140930_pre.xml
	PRESENTATION LINKBASE DOCUMENT

Module and Segment References

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2014

o 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 x No o

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 x No o

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 o Accelerated filer x Non-accelerated filer o Smaller reporting company o

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

As of November 10, 2014, 16,346,017 shares of the registrant's common stock, no par value, were outstanding.

LIFEWAY FOODS, INC.

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LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Financial Condition
September 30, 2014 and 2013 (Unaudited) and December 31, 2013

	September 30, 2014	September 30, 2013	December 31, 2013
ASSETS			
Current assets			
Cash and cash equivalents	$ 2,795,429	$ 1,240,730	$ 3,306,608
Investments	3,057,214	2,506,463	2,516,380
Certificates of deposits in financial institutions	—	115,373	15,373
Inventories	7,134,857	8,382,287	6,899,008
Accounts receivable, net of allowance for doubtful accounts and discounts ($1,300,000 and $1,350,000 and $1,050,000)	11,803,145	11,313,652	10,444,839
Prepaid expenses and other current assets	54,944	88,629	128,323
Other receivables	26,720	89,100	103,272
Deferred income taxes	360,765	394,277	322,071
Refundable income taxes	842,425	423,242	1,014,947
Total current assets	**26,075,499**	**24,553,753**	**24,750,821**
Property and equipment, net	**21,874,520**	**21,637,492**	**20,824,448**
Intangible assets			
Goodwill	14,068,091	14,068,091	14,068,091
Other intangible assets, net of accumulated amortization of $5,005,117, $4,376,640 and $4,468,359 at September 30, 2014 and 2013 and at December 31, 2013, respectively	3,238,683	3,929,360	3,750,441
Total intangible assets	**17,306,774**	**17,997,451**	**17,818,532**
Other Assets			
Long-term accounts receivable, net of current portion	270,599	280,000	280,000
Total assets	**$ 65,527,392**	**$ 64,468,696**	**$ 63,673,801**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Current maturities of notes payable	$ 877,038	$ 878,088	$ 875,002
Accounts payable	7,318,512	5,429,988	6,723,179
Accrued expenses	1,243,876	1,323,213	1,284,060
Accrued income taxes	—	1,292,762	—
Total current liabilities	**9,439,426**	**8,924,051**	**8,882,241**
Notes payable	**8,339,282**	**9,214,853**	**8,999,012**
Deferred income taxes	**2,065,221**	**2,917,213**	**2,843,426**
Total liabilities	**19,843,929**	**21,056,117**	**20,724,679**
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, 2014, September 30, 2013 and December 31, 2013	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)	(8,187,682)	(8,187,682)
Retained earnings	45,367,487	43,056,422	42,587,214
Accumulated other comprehensive income (loss), net of taxes	(38,125)	2,056	7,807
Total stockholders' equity	**45,683,463**	**43,412,579**	**42,949,122**
Total liabilities and stockholders' equity	**$ 65,527,392**	**$ 64,468,696**	**$ 63,673,801**

See accompanying notes to financial statements.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Income and Comprehensive Income
For the Three and Nine Months Ended September 30, 2014 and 2013 (Unaudited)

	(Unaudited) Three Months Ended September 30,				(Unaudited) Nine Months Ended September 30,			
	2014		2013		2014		2013	
Sales	$ 32,704,435		$ 26,601,341		$ 97,359,630		$ 80,030,021	
Less: discounts and allowances	(2,594,213)		(2,808,811)		(8,552,286)		(8,772,576)	
Net sales	30,110,222	30,110,222	23,792,530	23,792,530	88,807,344	88,807,344	71,257,445	71,257,445
Cost of goods sold		21,697,954		16,513,357		64,812,489		47,217,179
Depreciation expense		1,010,966		410,797		2,022,204		1,226,629
Total cost of goods sold		22,708,920		16,924,154		66,834,693		48,443,808
Gross profit		**7,401,302**		**6,868,376**		**21,972,651**		**22,813,637**
Selling expenses		2,804,127		2,815,126		9,977,636		8,291,960
General and administrative		2,627,566		1,671,080		7,115,393		5,567,649
Amortization expense		178,919		178,201		536,758		533,884
Total operating expenses		**5,610,612**		**4,664,407**		**17,629,787**		**14,393,493**
Income from operations		**1,790,690**		**2,203,969**		**4,342,864**		**8,420,144**
Other income (expense):								
Interest and dividend income		22,739		36,535		86,664		82,166
Rental income		1,201		2,231		2,900		8,889
Interest expense		(62,084)		(59,887)		(194,377)		(133,610)
Gain on sale of investments, net reclassified from OCI		(22,940)		161		39,190		121,441
Gain on sale of equipment		85,077		—		8,592		—
Other Income		—		209,175		1,674		219,404
Total other income (expense)		**23,993**		**188,215**		**(55,357)**		**298,290**
Income before provision for income taxes		**1,814,683**		**2,392,184**		**4,287,507**		**8,718,434**
Provision for income taxes		789,005		702,257		1,507,234		3,258,928
Net income		**$ 1,025,678**		**$ 1,689,927**		**$ 2,780,273**		**$ 5,459,506**
Basic and diluted earnings per common share		0.06		0.10		0.17		0.33
Weighted average number of shares outstanding		**16,346,017**		**16,346,017**		**16,346,017**		**16,346,017**
<u>COMPREHENSIVE INCOME</u>								
Net income		**$ 1,025,678**		**$ 1,689,927**		**$ 2,780,273**		**$ 5,459,506**
Other comprehensive income (loss), net of tax:								
Unrealized gains (losses) on investments (net of tax)		(93,679)		29,356		(22,524)		17,079
Less reclassification adjustment for (gains) losses included in net income (net of taxes)		13,702		(91)		**(23,408)**		(68,614)
Comprehensive income		**$ 945,701**		**$ 1,719,192**		**$ 2,734,341**		**$ 5,407,971**

See accompanying notes to financial statements.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
For the Nine Months Ended September 30, 2014 and 2013 (Unaudited) and For the Year Ended December 31, 2013

	Common Stock, No Par Value 40,000,000 Shares Authorized								
	# of Shares Issued	# of Shares Outstanding	# of Shares of Treasury Stock	Common Stock	Paid In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	Total
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**	**$ 39,312,469**
Other comprehensive income (loss): Unrealized gains on securities, net of taxes	—	—	—	—	—	—	—	(45,784)	**(45,784)**
Net income for the year ended December 31, 2013	—	—	—	—	—	—	4,990,298	—	**4,990,298**
Dividends ($.08) per share	—	—	—	—	—	—	(1,307,861)	—	**(1,307,861)**
Balances at December 31, 2013	**17,273,776**	**16,346,017**	**927,759**	**$ 6,509,267**	**$ 2,032,516**	**$ (8,187,682)**	**$ 42,587,214**	**$ 7,807**	**$ 42,949,122**
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**	**$ 39,312,469**
Other comprehensive income (loss): Unrealized gains on securities, net of taxes	—	—	—	—	—	—	—	(51,535)	**(51,535)**
Net income for the nine months ended September 30, 2013	—	—	—	—	—	—	5,459,506	—	**5,459,506**
Dividends ($.08) per share	—	—	—	—	—	—	(1,307,861)	—	(1,307,861)
Balances at September 30, 2013	**17,273,776**	**16,346,017**	**927,759**	**$ 6,509,267**	**$ 2,032,516**	**$ (8,187,682)**	**$ 43,056,422**	**$ 2,056**	**$ 43,412,579**
Balances at January 1, 2014	**17,273,776**	**16,346,017**	**927,759**	**$ 6,509,267**	**$ 2,032,516**	**$ (8,187,682)**	**$ 42,587,214**	**$ 7,807**	**$ 42,949,122**
Other comprehensive income (loss): Unrealized gains on securities, net of taxes	—	—	—	—	—	—	—	(45,932)	**(45,932)**
Net income for the nine months ended September 30, 2014	—	—	—	—	—	—	2,780,273	—	**2,780,273**
Balances at September 30, 2014	**17,273,776**	**16,346,017**	**927,759**	**$ 6,509,267**	**$ 2,032,516**	**$ (8,187,682)**	**$ 45,367,487**	**$ (38,125)**	**$ 45,683,463**

See accompanying notes to financial statements.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Nine Months Ended September 30, 2014 and 2013 (Unaudited)

	(Unaudited) September 30, 2014	(Unaudited) September 30, 2013
Cash flows from operating activities:		
Net income	**$ 2,780,273**	**$ 5,459,506**
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	2,558,962	1,760,513
Gain on sale of investments, net	(39,190)	(121,441)
Deferred income taxes	(783,607)	(231,218)
Bad debt expense	76,049	26,819
Gain on sale of equipment	(8,592)	(209,175)
(Increase) decrease in operating assets:		
Accounts receivable	(1,548,110)	(2,612,905)
Other receivables	76,552	(80,275)
Inventories	(235,849)	(2,443,101)
Refundable income taxes	172,522	(338,414)
Prepaid expenses and other current assets	73,379	33,509
Increase (decrease) in operating liabilities:		
Accounts payable	595,333	1,173,263
Accrued expenses	(40,184)	167,536
Income taxes payable	—	1,038,451
Net cash provided by operating activities	**3,677,538**	**3,623,068**
Cash flows from investing activities:		
Purchases of investments	(2,319,742)	(2,877,968)
Proceeds from sale of investments	1,736,946	2,281,792
Redemption of certificates of deposits	15,000	334,627
Purchases of property and equipment	(3,052,303)	(8,205,669)
Proceeds from sale of equipment	89,076	**537,500**
Net cash used in investing activities	**(3,531,023)**	**(7,929,718)**
Cash flows from financing activities:		
Dividends paid	—	(1,307,861)
Net proceeds from debt issuance	—	4,975,000
Repayment of notes payable	(657,694)	(405,985)
Net cash used in financing activities	(657,694)	**3,261,154**
Net decrease in cash and cash equivalents	**(511,179)**	**(1,045,496)**
Cash and cash equivalents at the beginning of the period	3,306,608	2,286,226
Cash and cash equivalents at the end of the period	**$ 2,795,429**	**$ 1,240,730**

See accompanying notes to financial statements.

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 consolidated 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 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 presentation 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 2013 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. (IL), First Juice, Inc. (DE) 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, 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 __ percent and 35 percent of gross sales for the nine months ended September 30, 2014 and 2013, respectively. These customers accounted for approximately __ percent, 30 percent and 22 percent of accounts receivable as of September 30, 2014, September 30, 2013 and December 31, 2013, respectively.

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. Our products are valued using the first in, first out method. The costs of inventories include raw materials, direct labor and indirect production and overhead costs.

Property and equipment
Property and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the related assets. 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 expense 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
Machinery and equipment	5 – 12
Office equipment	5 – 7
Vehicles	5
Leasehold improvements	Shorter of expected useful life or lease term

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. 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
Lease agreement	7
Trade names	8-15
Formula	10
Customer relationships	8-12

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 2011, 2012 and 2013 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.

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 three and nine months ended September 30, 2014 and 2013 total advertising expenses were $643,127 and $2,462,313, $551,492 and $1,859,798, 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 three and nine months ended September 30, 2014 and 2013, the weighted average number of shares outstanding used in the calculation of diluted and basic earnings per share were the same.

Segments
Currently, the Company has one segment with multiple dairy products. All such dairy products are produced using the same process and materials, sold to consumers retail food sellers through direct delivery and distributors in the United States of America. The reportable segment has been determined based on how the Company's chief operating decision maker manages the business and in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Financial Officer and the board of directors that makes strategic decisions. The Company's sales in foreign markets are considered not to be material and accordingly the Company has not presented financial information by geography.

Note 3 – INTANGIBLE ASSETS

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

	September 30, 2014		September 30, 2013		December 31, 2013	
	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	2,813,737	4,504,200	2,361,808	4,504,200	2,474,790
Customer relationship	985,000	649,348	985,000	579,264	985,000	596,785
Trade names	2,248,000	1,140,732	2,248,000	990,868	2,248,000	1,028,334
Formula	438,000	357,700	438,000	313,900	438,000	324,850
	$ 8,218,800	$ 5,005,117	$ 8,218,800	$ 4,289,440	$ 8,218,800	$ 4,468,359

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

2015	$ 715,677
2016	708,377
2017	671,877
2018	658,197
2019	293,156
Thereafter	166,399
	$ 3,213,683

Amortization expense during the three and nine months ended September 30, 2014 and 2013 was $178,919 and $536,758, $178,201 and $533,884, respectively.

Note 4 – INVESTMENTS

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

September 30, 2014	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	$ 1,023,998	$ 82,968	$ (53,441)	$ 1,053,525
Mutual Funds	7,040	0	(633)	6,407
Preferred Securities	416,415	24,959	(4,330)	437,044
Corporate Bonds	1,673,591	2,397	(115,750)	1,560,238
Total	$ 3,121,044	$ 110,324	$ (174,154)	$ 3,057,214

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

December 31, 2013	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	$ 1,006,169	$ 98,213	$ (32,181)	$ 1,072,201
Mutual Funds	54,847	1,994	0	56,841
Preferred Securities	464,585	12,960	(15,449)	462,096
Corporate Bonds	973,333	1,329	(49,420)	925,242
Total	$ 2,498,934	$ 114,496	$ (97,050)	$ 2,516,380

Proceeds from the sale of investments were $317,584, $1,736,946 and $332,953, $2,281,792 for the three and nine months ended September 30, 2014 and 2013, respectively.

Gross gains of $2,988, $83,810 and $161,421 and gross losses of $25,928, $44,620 and $39,980 were realized on these sales during the three months ended September 30, 2014, nine months ended September 30, 2014 and 2013, 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, 2014 and 2013 and at December 31, 2013:

	Less Than 12 Months		12 Months or Greater		Total	
September 30, 2014	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	$ 326,673	$ (40,115)	$ 83,996	$ (13,326)	$ 410,669	$ (53,441)
Mutual Funds	6,407	(633)	0	0	6,407	(633)
Preferred Securities	175,790	(4,330)	0	0	175,790	(4,330)
Corporate Bonds	910,520	(65,250)	522,316	(50,500)	1,432,836	(115,750)
	$ 1,419,390	$ (110,328)	$ 606,312	$ (63,826)	$ 2,025,702	$ (174,154)

	Less Than 12 Months		12 Months or Greater		Total	
September 30, 2013	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	$ 292,456	$ (28,897)	$ 21,409	$ (359)	$ 313,865	$ (29,256)
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	$ (111,892)	$ 102,403	$ (3,453)	$ 1,590,166	$ (115,345)

Note 4 – INVESTMENTS - Continued

	Less Than 12 Months		12 Months or Greater		Total	
December 31, 2013	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	$ 213,222	$ (32,181)	$ 0	$ 0	$ 213,222	$ (32,181)
Mutual Funds	0	0	0	0	0	0
Preferred Securities	224,125	(15,449)	0	0	224,125	(15,449)
Corporate Bonds	615,986	(42,827)	96,726	(6,593)	712,712	(49,420)
	$ 1,053,333	$ (90,457)	$ 96,726	$ (6,593)	$ 1,150,059	$ (97,050)

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, 2014, there were three corporate bond securities that had unrealized losses greater than twelve months. 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, 2014.

Note 5 – INVENTORIES

Inventories consist of the following:

	September 30,		December 31,
	2014	2013	2013
Finished goods	$ 3,177,603	$ 3,106,557	$ 3,027,900
Production supplies	1,669,984	3,469,239	2,690,097
Raw materials	2,287,270	1,806,491	1,181,011
Total inventories	$ 7,134,857	$ 8,382,287	$ 6,899,008

Note 6 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	September 30,		December 31,
	2014	2013	2013
Land	$ 1,856,370	$ 1,856,370	$ 1,856,370
Buildings and improvements	15,496,906	14,921,016	14,587,022
Machinery and equipment	20,999,223	19,921,064	19,633,164
Vehicles	1,244,560	1,350,608	1,244,560
Office equipment	433,679	433,346	433,679
Construction in process	973,852	33,542	177,519
	41,004,590	38,515,946	37,932,314
Less accumulated depreciation	19,130,070	16,878,454	17,107,866
Total property and equipment	$ 21,874,520	$ 21,637,492	$ 20,824,448

Lifeway completed the purchase of Golden Guernsey’s assets on July 2, 2013. The cost was approximately $7.4 million.

Depreciation expense during the three and nine months ended September 30, 2014 and 2013 was $1,010,966 and $2,022,204, $410,797 and $1,226,629 respectively. Included in the depreciation expense for the three months ended September 30, 2014 is an adjustment of approximately $470,000 related to the useful life of the Company’s Starfruit leasehold improvements.

Note 7 – ACCRUED EXPENSES

Accrued expenses consist of the following:

	September 30, 2014	September 30, 2013	December 31, 2013
Accrued payroll and payroll taxes	$ 231,612	$ 562,491	$ 477,312
Accrued property tax	251,228	244,028	306,608
Other	761,036	516,694	500,140
	$ 1,243,876	$ 1,323,213	$ 1,284,060

Note 8 – NOTES PAYABLE

Notes payable consist of the following:

	September 30, 2014	September 30, 2013	December 31, 2013
Note payable to Private Bank in monthly installments of $42,222, plus variable interest rate, currently at 2.6677%, 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.	$ 4,478,889	$ 4,985,556	$ 4,858,889
Note payable to Private Bank in monthly installments of $27,778, plus variable interest rate, currently at 2.6677% with a balloon payment for the remaining balance, maturing on May 31, 2019, collateralized by substantially all assets of the Company.	4,666,667	5,000,000	4,916,667
Notes payable to Ford Credit Corp. payable in monthly installments of $1,778 at 5.99%, due July 2015, secured by transportation equipment.	17,294	36,919	32,124
Note payable to Fletcher Jones of Chicago, Ltd LLC in monthly installments of $1,769 at 6.653%, due May 24, 2017, secured by transportation equipment.	53,470	70,466	66,334
Total notes payable	9,216,320	10,092,941	9,874,014
Less current maturities	877,038	878,088	875,002
Total long-term portion	$ 8,339,282	$ 9,214,853	$ 8,999,012

In accordance with the Private Bank agreements referenced above, the Company is subject to minimum fixed charged ratio and tangible net worth thresholds. The Company was in compliance with the debt covenants at September 30, 2014.

Maturities of notes payables are as follows:

For the 12 months ending September 30,	
2015	$ 877,038
2016	859,546
2017	854,180
2018	3,292,233
2019	3,333,323
Total	$ 9,216,320

Note 9 – COMMITMENTS AND CONTINGENCIES

The Company leases three stores for its Starfruit subsidiary. Total expense for these leases was approximately $27,402 and $226,279, $46,441 and $165,849 for the three and nine months ended September 30, 2014 and 2013, 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, 2014 are as follows:

For the 12 months ending September 30,		
2015	$	45,130
2016		46,484
2017		47,878
2018		49,314
2019		12,419
Total	$	201,225

Note 10 – PROVISION FOR INCOME TAXES

The provision for income taxes consists of the following:

	For the Nine Months Ended September 30, 2014		2013	
Current:				
Federal	$	1,697,412	$	2,892,620
State and local		593,429		597,526
Total current		2,290,841		3,490,146
Deferred		(783,607)		(231,218)
Provision for income taxes	$	1,507,234	$	3,258,928

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, 2014			2013		
	Amount		Percentage	Amount		Percentage
Federal income tax expense computed at the statutory rate	$	1,457,752	34.0%	$	2,964,268	34.0%
State and local tax expense, net		268,827	6.3%		828,251	9.5%
U.S. domestic manufacturers' deduction & other permanent differences		(311,715)	(7.3)%		(444,711)	(5.1)%
Change in tax estimate		92,370	2.2%		(88,880)	(1.0)%
Provision for income taxes	$	1,507,234	35.2%	$	3,258,928	37.4%

Note 10 – PROVISION FOR INCOME TAXES - Continued

Amounts for deferred tax assets and liabilities are as follows:

	September 30, 2014	September 30, 2013	December 31, 2013
Non-current deferred tax assets (liabilities) arising from:			
Temporary differences -			
Accumulated depreciation and amortization			
from purchase accounting adjustments	$ (2,098,017)	$ (3,002,058)	$ (2,896,058)
Capital loss carry-forwards	32,796	84,845	52,632
Total non-current net deferred tax liabilities	(2,065,221)	(2,917,213)	(2,843,426)
Current deferred tax assets arising from:			
Unrealized losses (gain) on investments	25,704	(1,583)	(7,589)
Inventory	294,791	374,110	307,910
Allowance for doubtful accounts and discounts	40,270	21,750	21,750
Total current deferred tax assets	360,765	394,277	322,071
Net deferred tax liability	$ (1,704,456)	$ (2,522,936)	$ (2,521,355)

Note 11 – SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest and income taxes are as follows:

	For the Nine Months Ended September 30, 2014	2013
Interest	$ 195,275	$ 140,068
Income taxes	$ 2,131,658	$ 2,862,991

Note 12 – 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.

Note 12 – FAIR VALUE MEASUREMENTS - Continued

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, 2014 and 2013.

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.

The following table sets forth by level, within the fair value hierarchy, the Company’s financial assets at fair value as of September 30, 2014 and 2013 and for the year ended December 31, 2013. 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, 2014			
	Level 1	Level 2	Level 3	Total
Cash	$ 2,795,429	$ 0	$ 0	$ 2,795,429
Mutual Funds	6,407	0	0	6,407
Stocks	1,053,525	0	0	1,053,525
Preferred Securities	0	437,044	0	437,044
Corporate Bonds	0	1,560,238	0	1,560,238
Notes Payable	0	9,216,320	0	9,216,320

	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 December 31, 2013			
	Level 1	Level 2	Level 3	Total
Cash	$ 3,306,608	$ 0	$ 0	$ 3,306,608
Certificate of Deposits	0	15,378	0	15,378
Mutual Funds	56,841	0	0	56,841
Stocks	1,072,201	0	0	1,072,201
Preferred Securities	0	462,096	0	462,096
Corporate Bonds	0	925,242	0	925,242
Notes Payable	0	9,874,014	0	9,874,014

Note 12 – FAIR VALUE MEASUREMENTS – Continued

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 13 – 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 14 – RECENT ACCOUNTING PRONOUNCEMENTS

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 consolidated financial statements.

In July 2013, the FASB issued an Accounting Standards Update ("ASU") related to the presentation of unrecognized tax benefits. The update requires presentation of an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward in the statement of financial position. The guidance does not apply to the extent that a net operating loss carryforward or tax credit carryforward at the reporting date is not available under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position. The guidance is effective for fiscal years (and interim periods within those years) beginning after December 15, 2013. This standard did not have a material impact on the consolidated financial statements.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"), which supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific requirements. ASU 2014-09 establishes a five-step revenue recognition process in which an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers. ASU 2014-09 will be effective for the Company in the first quarter of 2017. Management is currently evaluating the impact the adoption of ASU 2014-09 will have on the Company's condensed consolidated financial position, results of operations or cash flows and the method of retrospective application, either full or modified.

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

The following discussion of the financial condition and results of operations of Lifeway Foods, Inc. for the three months and nine months ended September 30, 2014 and 2013 should be read in conjunction with the unaudited consolidated financial statements and the notes to those statements that are included elsewhere in this report on Form 10-Q and the audited financial statements and Management's Discussion and Analysis contained in our Form 10-K. In addition to historical information, the following discussion contains certain forward-looking statements within the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These statements relate to our future plans, objectives, expectations and intentions. These statements may be identified by the use of words such as "may", "will", "could", "expect", "anticipate", "intend", "believe", "estimate", "plan", "predict", and similar terms or terminology, or the negative of such terms or other comparable terminology. Although we believe the expectations expressed in these forward-looking statements are based on reasonable assumptions within the bound of our knowledge of our business, our actual results could differ materially from those discussed in these statements. Factors that could contribute to such differences include, but are not limited to, those discussed in the "Risk Factors" section. We undertake no obligation to update publicly any forward-looking statements for any reason even if new information becomes available or other events occur in the future.

Results of Operations

Comparison of Quarter Ended September 30, 2014 to Quarter Ended September 30, 2013

Total consolidated net sales increased by $6,317,692 (approximately 27%) to $30,110,222 during the three-month period ended September 30, 2014 from $23,792,530 during the same three-month period in 2013, primarily as a result of a $6,103,094 (approximately 23%) increase in total consolidated gross sales to $32,704,435 during the three-month period ended September 30, 2014 from $26,601,341 during the same three-month period in 2013, and to a lesser extent, fewer discounts and allowances. The increase in total consolidated gross sales included approximately $5,121,961 from an increase in volume of products sold and approximately $981,133 from an increase in prices of products sold.

The following table summarizes our cost of goods sold, excluding depreciation expense:

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013
Purchases	$ 14,514,267	$ 11,255,629
Testing	7,841	7,080
Supplies	330,409	196,059
Salaries production	2,350,648	1,838,909
Contract work	31,565	15,981
Freight	3,203,229	2,463,506
Delivery expense	131,495	74,008
Outside services	8,560	12,400
Uniform	13,906	23,297
Sales and use tax	2,613	35,505
Labor and overhead	1,103,421	590,983
Cost of goods sold	$ 21,697,954	$ 16,513,357

Cost of goods sold, excluding depreciation expense, increased by $5,184,597 (approximately 31%) to $21,697,954 during the three-month period ended September 30, 2014 from $16,513,357 during the same three-month period in 2013. This increase is primarily a result of a $3,258,638 (approximately 29%) increase in purchases primarily resulting from an increase in purchases of raw materials of $2,741,216 (approximately 26%) to $13,295,087 during the three-month period ended September 30, 2014 from $10,553,871 during the same three-month period in 2013. The increase in purchases included $2,731,109 from an increase in volume of purchases (which included $2,302,621 resulting from an increase in the volume of raw material purchased) and $520,211 from increases in prices of products purchased (which included $438,595 from increases in prices of raw materials purchased).

Depreciation expense increased by $600,169 (approximately 146%) to $1,010,966 during the three-month period ended September 30, 2014 from $410,797 during the same three-month period in 2013. The increase is primarily attributable to the increase in depreciation expense of $470,000 related to an adjustment of the useful life of the Starfruit leasehold improvements and the depreciation expense of $120,000 associated with assets placed in service at the Lifeway Wisconsin location during July 2013.

The following table summarizes our general and administrative expenses.

	Three Months Ended September 30,	
	2014	2013
Employee expenses	$ 968,616	$ 765,820
Rent	75,713	86,645
Equipment lease	2,576	1,168
Auto expense	25,430	19,920
Office supplies	100,577	130,057
Professional fees	1,009,070	395,415
Permits and licenses	21,905	65,702
Telephone expense	21,001	23,307
Facilities	320,029	132,303
Tax	21,948	21,421
Miscellaneous	60,701	29,322
General and administrative expense	2,627,566	1,671,080

General and administrative expense increased $956,486 (approximately 57.2%) to $2,627,566 during the three-month period ended September 30, 2014 from $1,671,080 during the same period in 2013. The increase is primarily a result of increases in professional fees and expenses related to facilities. Professional fees, including accounting and legal expenses and various other professional fees and expenses incurred in our business, increased by $613,655 (approximately 155%) to $1,009,070 during the three-month period ended September 30, 2014 from $395,415 during the same period in 2013. Expenses related to our facilities, mainly attributed to repairs and maintenance performed at the Wisconsin facility purchased in July 2013, increased by $187,726 (approximately 142%) to $320,029 during the three-month period ended September 30, 2014 from $132,303 during the same period in 2013.

Total operating expenses increased by $946,205 (approximately 20%) to $5,610,612 during the three-month period ended September 30, 2014 from $4,664,407 during the same three-month period in 2013. Total operating expenses as a percentage of net sales were approximately 19% during the three-month period ended September 30, 2014 compared to approximately 20% during the same period in 2013. The increase was primarily attributable to increased general and administrative expenses.

Income from operations decreased by $413,279 (approximately 19%) to $1,790,689 during the third quarter of 2014, from $2,203,969 during the same period in 2013 primarily as a result of an increase in total operating expenses, which included aforementioned one-time adjustment of the Starfruit leasehold improvements, offset by an increase in gross profits.

Total other income (expense) decreased by $164,222 (87%) to $23,993 during the three-month period ended September 30, 2014 from $188,215 in the same three-month period in 2013 primarily as a result of non-recurring other income earned during the three-month period ended September 30, 2013 and a decrease in interest and dividend income, partially offset by a non-recurring gain on sale of equipment of approximately $85,076 during the three-month period ended September 30, 2014.

Income tax expense was $789,005, or a 43% effective tax rate for the third quarter of 2014 compared to an income tax expense of $702,257, or a 29% effective tax rate during the same period in 2013. A portion of the increase in the effective tax rate resulted from a provision reconciliation adjustment of $85,777 in the third quarter of 2014. The provision reconciliation adjustment is the difference between the prior-year income tax expense recorded on the books (which is estimated) and the actual income tax as shown on the Federal and State tax returns prepared and filed with the appropriate taxing authorities in the third quarter.

Total net income was $1,025,678 or $0.06 per diluted share for the three-month period ended September 30, 2014 compared to $1,689,927 or $0.10 per diluted share in the same period in 2013.

Comparison of Nine-Month Period Ended September 30, 2014 to Nine-Month Period Ended September 30, 2013

Total consolidated net sales increased by $17,549,899 (approximately 25%) to $88,807,344 during the nine-month period ended September 30, 2014 from $71,257,445 during the same nine-month period in 2013, primarily as a result of a $17,329,609 (approximately 22%) increase in total consolidated gross sales to $97,259,630 during the nine-month period ended September 30, 2014 from $80,030,021 during the same nine-month period in 2013, and to a lesser extent, fewer discounts and allowances. The increase in total consolidated gross sales included approximately $15,280,655 from an increase in volume of products sold and approximately $2,048,954 from an increase in prices of products sold.

The following table summarizes our cost of goods sold, excluding depreciation expense:

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Purchases	$ 44,629,835	$ 32,507,830
Testing	29,299	28,073
Supplies	990,254	525,969
Salaries	6,719,070	5,169,502
Contract work	122,121	100,887
Freight	8,984,409	6,785,868
Delivery expense	292,948	222,283
Outside services	43,873	9,387
Uniform	38,624	38,994
Sales and use tax	7,755	36,111
COS	73,289	—
Vendor payment discounts	—	(113)
Labor and overhead	2,881,012	1,792,388
Cost of goods sold	64,812,489	47,217,179

Cost of goods sold, excluding depreciation expense, increased by $17,595,310 (approximately 37%) to $64,812,489 during the nine-month period ended September 30, 2014 from $47,217,179 during the same nine-month period in 2013. This increase is primarily a result of a $12,122,005 (approximately 37%) increase in purchases primarily resulting from an increase in purchases of raw materials of $9,535,709 (approximately 30%) to $41,784,980 during the nine-month period ended September 30, 2014 from $32,249,271 during the same nine-month period in 2013. The increase in purchases included $10,182,484 from an increase in volume of purchases (which included $8,009,995 resulting from an increase in the volume of raw material purchased) and $1,939,521 from increases in prices of products purchased (which included $1,525,714 from increases in prices of raw materials purchased).

Depreciation expense increased by $795,575 (approximately 65%) to $2,022,204 during the nine-month period ended September 30, 2014 from $1,226,629 during the same nine-month period in 2013. The increase is primarily attributable to the increase in depreciation expense of approximately $470,000 related to an adjustment of the useful life of the Starfruit leasehold improvements and the depreciation expense of $320,000 associated with assets placed in service at the Lifeway Wisconsin location during July 2013.

The following table summarizes our selling expenses:

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Salesperson commissions	$ 1,692,421	$ 1,299,932
Advertising	2,462,313	1,859,798
Salaries	4,301,159	3,844,410
Promotions payable	248,486	217,664
Travel	1,266,329	1,070,087
Freight out	508	—
Demos	6,420	—
Sponsorship	—	69
Selling expense	$ 9,977,636	8,291,960

Selling expenses increased by $1,685,676 (approximately 20%) to $9,977,636 during the nine-month period ended September 30, 2014 from $8,291,960 during the same period in 2013. This increase resulted primarily from increases in salesperson commissions, advertising expenses and salaries. Selling expenses as a percentage of sales were 11 % for the nine-month periods ended September 30, 2014 and September 30, 2013. Advertising expenses increased by $602,515 (approximately 32%) to $2,462,313 during the nine-month period ended September 30, 2014 from $1,859,798 during the same nine-month period in 2013 as a result of an increase in volume of advertising. Salaries increased by $456,749 (approximately 12%) to $4,301,159 during the nine-month period ended September 30, 2014 from $3,844,410 during the same nine-month period in 2013 as a result of the employees hired after September 30, 2013 to staff the Lifeway Wisconsin facility purchased in July 2013.

The following table summarizes our general and administrative expenses.

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Employee expenses	$ 2,781,703	$ 2,338,144
Rent	226,279	261,854
Equipment lease	5,770	3,505
Auto expense	74,707	40,796
Office supplies	242,049	198,415
Professional fees	2,389,099	1,843,045
Permits and licenses	153,567	214,229
Telephone expense	77,893	62,642
Facilities	768,256	407,746
Tax	93,397	80,176
Miscellaneous	302,673	117,097
General and administrative expense	7,115,393	5,567,649

General and administrative expenses increased $1,547,744 (approximately 28%) to $7,115,393 during the nine-month period ended September 30, 2014 from $5,567,649 during the same period in 2013. The increase is primarily a result of increases in professional fees and expenses related to facilities. Professional fees, including accountants and legal expenses and various other professional fees and expenses increased by $546,054 (approximately 29.6%) to $2,389,099 in the nine-month period ended September 30, 2014 from $1,843,045 during the same period in 2013. Expenses related to our facilities, mainly attributed to repairs and maintenance performed at the Wisconsin facility purchased in July 2013 increased $360,510 to $768,256 during the nine-month period ended September 30, 2014 from $407,746 during the same period in 2013.

Total operating expenses increased by $3,236,294 (approximately 22%) to $17,629,787 during the nine-month period ended September 30, 2014, from $14,393,493 during the same period in 2013. Operating expenses as a percentage of net sales were approximately 20% during each of the nine-month periods ended September 30, 2014 and September 30, 2013. The increase was primarily attributable to an increase in selling expenses and general and administrative expenses.

Income from operations decreased by $4,077,280 (approximately 48%) to $4,342,864 during the nine-month period ended September 30, 2014 from $8,420,144 during the same period in 2013 primarily as a result of an increase in total operating expenses.

Total other income (expense) decreased $353,647 (approximately 119%) to an expense of $55,357 during the nine-month period ended September 30, 2014 from income of $298,290 during the same nine-month period in 2013 primarily as a result of interest expense on the loans entered into by the Company in connection with the acquisition of the Lifeway Wisconsin facility in July 2013.

The provision for income taxes was $1,507,233 or a 35% effective tax rate, for the nine-month period ended September 30, 2014 compared with $3,258,928, or a 37% tax rate, during the same period in 2013. The amount of taxes increased as a result of increased income to which the effective tax rate was applied.

Total net income was $2,780,273 or $0.17 per share for the nine-month period ended September 30, 2014 compared to $5,459,506 or $0.33 per share in the same period in 2013.

Liquidity and Capital Resources

Sources and Uses of Cash

Net cash provided by operating activities was $3,677,538 during the nine-months ended September 30, 2014 compared to $3,623,068 during the same period in 2013.

Net cash used in investing activities of $3,531,023 during the nine-months ended September 30, 2014 was primarily attributable to the Company’s purchase of equipment for use at the Lifeway Wisconsin facility for approximately $3,000,000. Net cash used in investing activities of $7,929,718 during the nine-months ended September 30, 2013 was primarily attributable to the Company’s purchase of the Lifeway Wisconsin facility for approximately $7,400,000.

The Company had a net decrease in cash and cash equivalents of $511,179 during the nine month period ended September 30, 2014 compared to a net decrease in cash and cash equivalents of $1,045,496 during the same period in 2013. The Company had cash and cash equivalents of $2,795,429 as of September 30, 2014 compared to cash and cash equivalents of $1,240,730 as of September 30, 2013.

Assets and Liabilities

Total current assets were $26,075,499 as of September 30, 2014, which is an increase of $1,521,746 when compared to September 30, 2013. This is primarily due to an increase in cash and cash equivalents of $1,554,699 as of September 30, 2014 when compared to September 30, 2013.

Total current liabilities were $9,439,426 as of September 30, 2014, which is a decrease of $515,375 when compared to September 30, 2013.

Long-term portion of notes payable decreased by $875,571 as of September 30, 2014, when compared to September 30, 2013. The balance of the notes payable as of September 30, 2014 was $8,339,282. This is primarily due to the purchase of the Golden Guernsey facility in Wisconsin in July 2013, and the related financing.

Total stockholder's equity was $45,683,463 as of September 30, 2014, which is an increase of $2,270,884 when compared to September 30, 2013. This is primarily due to an increase in retained earnings of $2,311,065 when compared to September 30, 2013.

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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We do not undertake any specific actions to diminish our exposure to interest rate risk and we are not a party to any interest rate risk management transactions. We do not purchase or hold any derivative financial instruments. Our foreign sales are not material. Accordingly, our currency rate risk is not currently material.

As of September 30, 2014, we had an outstanding balance under our term loans of approximately $9.15 million, and we have the option to borrow an additional $5.0 million from our line of credit. The term loans bear interest at variable rates. Based on the outstanding amount under such loan at September 30, 2014 of approximately $9.15 million (which remains outstanding as of the time of this filing) a 1.0 percent increase in interest rates would result in additional annualized interest expense of approximately $92,725. For a detailed discussion of our loans, including a discussion of the applicable interest rate, please refer to Note 8, Notes payable under Part I, Item 1 in this Quarterly Report on Form 10-Q.

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, 2014 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 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, 2013. In making the assessment, management used the framework in "1992 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, 2013 because pervasive material weaknesses existed in our internal control over financial reporting. Specifically, we had material weaknesses arising from a lack of segregation of duties in financial reporting, a fragmented financial statement preparation process with various levels of input and control resulting from the use of external consultants for the processing and preparation of our financial statements, inadequate systems used to identify, record and review period end activity and calculations of inventory and inadequate entity level controls.

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.

Remediation of Material Weaknesses

As previously reported, the Company has (1) reviewed the accessibility for the accounting and finance department and updated the security clearance to provide for more robust segregation of duties, (2) updated its policies to require and formalize a more robust and frequent review by the chief financial officer of the entire external financial statement preparation process in order to minimize any fragmentation and ensure accuracy of financial statements, and (3) updated its policies to include a formal checklist to be adhered to by the controller and accounting department which the chief financial officer will review as well as undertake a post period closing internal audit which is used to identify, record and review period end activity.

Additionally, in the beginning of the fiscal quarter ended September 30, 2014, we completed an update to our systems information flow to automate the material pricing component of inventory to replace the manual input and calculation of such information.

In conjunction with our automation of the material pricing component of inventory, we strengthened our segregation of duties relating to inventory ensuring that no individual employee handles more than one of the custody of assets, record keeping, authorization and reconciliation functions. Additionally, having removed the Chief Financial Officer from the process relating to inventory by automating the input and calculation of the material pricing information, the Company also established a monitoring control related to inventory fulfilled by the Chief Financial Officer.

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

The Company believes that these measures are addressing the internal control weaknesses over financial reporting as the Company continues the process of remediation of the material weaknesses. However, until these remediation measures have been tested, we cannot assure or report that the remediation was successful. Due to high level of involvement in the remediation process by upper management, hiring a consultant to assist with remediation process has been postponed. 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 we implement as we continue to evaluate and work to improve our internal controls over financial reporting.

Changes in Internal Control over Financial Reporting

Except as discussed in this Item 4 there were no changes in our internal control over financial reporting that occurred during the third quarter of 2014 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.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, which could materially affect our business, financial condition or future results. The risks described in this report and in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

Of the risk factors disclosed in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, we delete the risk factor captioned "*We are a "controlled company" within the meaning of the NASDAQ Marketplace rules and, as a result, qualify for and rely on certain exemptions from certain corporate governance requirements"* because the Company has determined that it is no longer eligible to rely on the Nasdaq controlled company exemption. The Company is currently establishing its compensation committee and nominating committee, after which time the Company will have completed its transition from the limited corporate governance requirements required under the controlled company exemption to compliance with the full NASDAQ Marketplace rules governing companies that do not rely on that exemption.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURE.

Not applicable.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

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.

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 17, 2014	By:	/s/ Julie Smolyansky Julie Smolyansky Chief Executive Officer, President, and Director (Principal Executive Officer)
Date: November 17, 2014	By:	/s/ Edward P. Smolyansky Edward P. Smolyansky Chief Financial and Accounting Officer, Treasurer, Chief Operating Officer and Secretary (Principal Financial and Accounting Officer)

INDEX OF EXHIBITS

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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.

EXHIBIT 31.1

SECTION 302 CERTIFICATION OF C.E.O.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Julie Smolyansky, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lifeway Foods, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 17, 2014

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

EXHIBIT 31.2

SECTION 302 CERTIFICATION OF C.F.O.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Edward P. Smolyansky, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lifeway Foods, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 17, 2014

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

EXHIBIT 32.1

SECTION 906 CERTIFICATION OF C.E.O.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT
TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Lifeway Foods, Inc. (the "Company") for the period ended September 30, 2014 as filed with the SEC (the "Report"), the undersigned, in the capacity and on the date indicated below, hereby certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to her knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Date: November 17, 2014

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

EXHIBIT 32.2

SECTION 906 CERTIFICATION OF C.F.O.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Lifeway Foods, Inc. (the "Company") for the period ended September 30, 2014 as filed with the SEC (the "Report"), the undersigned, in the capacity and on the date indicated below, hereby certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Date: November 17, 2014

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