

LIFEWAY FOODS INC
Form 10-Q
August 16, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark
One)

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

For the quarterly period ended: June 30, 2010

- 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 36-3442829
(State or Other Jurisdiction of Incorporation (I.R.S. Employer Identification No.)
or Organization)

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, 2010, the issuer had 16,657,478 shares of common stock, no par value, outstanding.

LIFEWAY FOODS, INC.

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010 AND 2009
AND DECEMBER 31, 2009

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Consolidated Statements of Financial Condition

June 30, 2010 and 2009 (Unaudited) and December 31, 2009

		(Unaudited) June 30,	December 31,
	2010	2009	2009
ASSETS			
Current assets			
Cash and cash equivalents	\$858,490	\$582,766	\$630,407
Investments	3,411,804	4,659,161	4,392,125
Certificates of deposits in financial institutions	550,000	—	652,005
Inventories	4,154,719	3,817,195	3,296,976
Accounts receivable, net of allowance for doubtful accounts and discounts	7,780,512	6,064,801	5,999,738
Prepaid expenses and other current assets	70,130	55,669	40,697
Other receivables	142,389	65,730	49,758
Deferred income taxes	389,249	638,372	251,456
Refundable income taxes	—	778,125	1,308,978
Total current assets	17,357,293	16,661,819	16,622,140
Property and equipment, net	14,890,327	13,793,929	14,282,182
Intangible assets			
Goodwill and other non amortizable brand asset	13,806,091	13,806,091	13,806,091
Other intangible assets, net of accumulated amortization of \$1,949,729 and \$1,260,809 at June 30, 2010 and 2009 and \$1,598,208 at December 31, 2009	5,907,909	6,596,829	6,259,430
Total intangible assets	19,714,000	20,402,920	20,065,521
Other assets	500,000	500,000	500,000
Total assets	\$52,461,620	\$51,358,668	\$51,469,843
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Checks written in excess of bank balances	\$847,374	\$—	\$342,976
Current maturities of notes payable	4,431,873	6,219,788	4,842,315
Accounts payable	2,259,236	2,024,313	2,764,000
Accrued expenses	531,553	617,662	614,344
Accrued income tax	604,323	—	—
Total current liabilities	8,674,359	8,861,763	8,563,635
Notes payable	6,397,780	7,907,847	6,890,214

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Deferred income taxes	3,262,795	3,593,740	3,444,664
Total liabilities	18,334,934	20,363,350	18,898,513
Stockholders' equity			
Common stock, no par value; 20,000,000 shares authorized; 17,273,776 shares issued; 16,657,478 shares outstanding at June 30, 2010; 17,273,776 shares issued; 16,812,955 shares outstanding at June 30, 2009; 17,273,776 shares issued; 16,778,555 shares outstanding at December 31, 2009			
	6,509,267	6,509,267	6,509,267
Paid-in-capital	2,018,727	1,912,845	1,965,786
Treasury stock, at cost	(5,256,054)	(3,353,490)	(3,846,773)
Retained earnings	30,906,602	26,463,077	27,953,409
Accumulated other comprehensive loss, net of taxes	(51,856)	(536,381)	(10,359)
Total stockholders' equity	34,126,686	30,995,318	32,571,330
Total liabilities and stockholders' equity	\$52,461,620	\$51,358,668	\$51,469,843

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Consolidated Statements of Income and Comprehensive Income

For the Three and Six Months Ended June 30, 2010 and 2009 (Unaudited)

and for the Year Ended December 31, 2009

	(Unaudited)		(Unaudited)		Year Ended December 31, 2009
	Three Months Ended June 30,		Six Months Ended June 30,		
	2010	2009	2010	2009	
Sales	15,546,556	14,479,429	31,510,715	28,215,509	58,115,878
Cost of goods sold	9,273,872	7,978,110	17,892,871	16,102,691	36,083,553
Depreciation expense	281,220	353,654	684,595	570,428	1,134,404
Total cost of goods sold	9,555,092	8,331,764	18,577,466	16,673,119	37,217,957
Gross profit	5,991,464	6,147,665	12,933,249	11,542,390	20,897,921
Selling expenses	2,183,304	1,386,815	4,710,777	2,694,740	5,987,917
General and administrative	1,478,062	1,437,505	2,968,219	2,810,103	5,294,550
Amortization expense	175,761	168,698	351,521	339,388	676,786
Total Operating Expenses	3,837,127	2,993,018	8,030,517	5,844,231	11,959,253
Income from operations	2,154,337	3,154,647	4,902,732	5,698,159	8,938,668
Other income (expense):					
Interest and dividend income	53,176	48,506	107,684	110,717	199,047
Rental Income	2,800	11,947	4,035	21,294	35,240
Interest expense	(80,164)	(110,090)	(176,106)	(264,473)	(442,703)
Loss on Disposition of Equipment	—	(2,825)	—	(2,825)	(2,826)
Gain (loss) on sale of marketable securities, net	84,043	53,638	54,784	(96,152)	(278,474)
Total other income (expense)	59,855	1,176	(9,603)	(231,439)	(489,716)
Income before provision for income taxes	2,214,192	3,155,823	4,893,129	5,466,720	8,448,952
	1,029,688	623,918	1,939,936	1,387,350	2,879,250

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Provision for income taxes

Net income	\$1,184,504	\$2,531,905	\$2,953,193	\$4,079,370	\$5,569,702
Basic and diluted earnings per common share	0.07	0.15	0.18	0.24	0.33
Weighted average number of shares outstanding	16,701,539	16,823,691	16,731,549	16,823,691	16,798,164

COMPREHENSIVE INCOME

Net income	\$1,184,504	\$2,531,905	\$2,953,193	\$4,079,370	\$5,569,702
Other comprehensive income (loss), net of tax:					
Unrealized gains (losses) on investments (net of tax)	(55,842)	338,409	(9,339)	(93,913)	325,086
Less reclassification adjustment for (gains) losses included in net income (net of taxes)	(49,333)	(31,486)	(32,158)	56,441	163,464
Comprehensive income	\$1,079,329	\$2,838,828	\$2,911,696	\$4,041,898	\$6,058,252

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
For the Six Months Ended June 30, 2010 and 2009 (Unaudited)
and for the Year Ended December 31, 2009

	Common Stock, No Par Value 20,000,000 Shares Authorized		# of Shares of	Common Stock	Paid In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax
	# of Shares Issued	# of Shares Outstanding	Treasury Stock					
Balances at December 31, 2008	17,273,776	16,724,467	549,309	\$6,509,267	\$1,202,009	\$(3,302,025)	\$22,383,707	\$(498,909)
Redemption of stock	—	(87,991)	87,991	—	—	(905,607)	—	—
Issuance of treasury stock for compensation	—	13,132	(13,132)	—	119,039	25,597	—	—
Issuance of treasury stock for Fresh Made acquisition	—	128,947	(128,947)	—	644,738	335,262	—	—
Other comprehensive income (loss): Unrealized gains on securities, net of taxes and reclassification adjustment	—	—	—	—	—	—	—	488,550
Net income for the year ended December 31, 2009	—	—	—	—	—	—	5,569,702	—
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)

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Balances at January 1, 2009	17,273,776	16,724,467	549,309	\$6,509,267	\$1,202,009	\$(3,302,025)	\$22,383,707	\$(498,909)
Redemption of stock	—	(48,341)	48,341	—	—	(402,947)	—	—
Issuance of treasury stock for compensation	—	7,882	(7,882)	—	66,098	16,220	—	—
Issuance of treasury stock for Fresh Made acquisition	—	128,947	(128,947)	—	644,738	335,262	—	—
Other comprehensive income (loss): Unrealized gains on securities, net of taxes and reclassification adjustment	—	—	—	—	—	—	—	(37,472)
Net income for the six months ended June 30, 2009	—	—	—	—	—	—	4,079,370	—
Balances at June 30, 2009	17,273,776	16,812,955	460,821	\$6,509,267	\$1,912,845	\$(3,353,490)	\$26,463,077	\$(536,381)
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)
Redemption of stock	—	(129,841)	129,841	—	—	(1,418,657)	—	—
Issuance of treasury stock for compensation	—	8,764	(8,764)	—	52,941	9,376	—	—
Other comprehensive income (loss):	—	—	—	—	—	—	—	(41,497)

Unrealized
gains on
securities, net
of taxes and
reclassification
adjustment

Net income for
the six months
ended June 30,
2010

— — — — — — 2,953,193 —

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)

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the Six Months Ended June 30, 2010 and 2009 (Unaudited)

and for the Year Ended December 31, 2009

	(Unaudited)		December 31,
	2010	June 30, 2009	2009
Cash flows from operating activities:			
Net income	\$2,953,193	\$4,079,370	\$5,569,702
Adjustments to reconcile net income to net cash flows from operating activities, net of acquisition:			
Depreciation and amortization	1,036,116	909,816	1,811,190
(Gain) Loss on sale of investments, net	(54,784)	96,152	278,474
Loss on disposition of assets	—	2,825	2,826
Deferred income taxes	(290,465)	179,796	389,754
Treasury stock issued for compensation	62,317	82,318	144,636
Decrease in allowance for doubtful accounts	—	—	(75,000)
(Increase) decrease in operating assets:			
Accounts receivable	(1,780,774)	(752,978)	(612,915)
Other receivables	(92,631)	(25,416)	(7,758)
Inventories	(857,743)	(346,800)	173,419
Refundable income taxes	1,308,978	(435,205)	(475,635)
Prepaid expenses and other current assets	(29,433)	5,029	9,506
Increase (decrease) in operating liabilities:			
Accounts payable	(504,764)	(440,911)	298,800
Accrued expenses	(82,791)	36,719	96,062
Accrued income taxes	604,323	—	—
Net cash provided by operating activities	2,271,542	3,390,715	7,603,061
Cash flows from investing activities:			
Purchases of investments	(538,852)	(3,342,662)	(6,156,682)
Proceeds from sale of investments	1,502,724	4,127,666	6,928,321
Proceeds from redemption of certificates of deposit	102,545	—	—
Purchases of property and equipment	(1,292,741)	(714,052)	(1,766,280)
Acquisition of Fresh Made, net of cash acquired	—	(10,498,224)	(11,042,546)
Net cash used in investing activities	(226,324)	(10,427,272)	(12,037,187)
Cash flows from financing activities:			
Proceeds of note payable	250,000	9,342,085	9,353,504
Checks written in excess of bank balances	504,398	—	342,976
Purchases of treasury stock	(1,418,657)	(402,947)	(905,607)
Repayment of notes payable	(1,152,876)	(1,597,063)	(4,003,588)
Net cash (used in) provided by in financing activities	(1,817,135)	7,342,075	4,787,285
Net increase in cash and cash equivalents	228,083	305,518	353,159
Cash and cash equivalents at the beginning of the period	630,407	277,248	277,248

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Cash and cash equivalents at the end of the period	\$858,490	\$582,766	\$630,407
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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2010 and 2009

and December 31, 2009

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 several soy-based products under the name “Soy Treat” and 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. All significant intercompany accounts and transactions have been eliminated. The financial statements include the results of operations from Fresh Made, Inc from February 6, 2009 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.

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2010 and 2009

and December 31, 2009

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 net of anticipated discounts. The Company's estimate of the allowance for doubtful accounts is based upon historical experience, its evaluation of the current status 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, 2010 and 2009

and December 31, 2009

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Intangible assets

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

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

Intangible assets are being amortized over the following useful lives:

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

Income taxes

Deferred income taxes arise from temporary differences resulting 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, 2010 and 2009
and December 31, 2009

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 2006 through 2009 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.

Subsequent to June 30, 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 as of June 30, 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 costs

The Company expenses advertising costs as incurred. During the year ended December 31, 2009 and for the six months ended June 30, 2010 and 2009, approximately \$1,689,540, \$2,272,520 and \$780,116 of such costs respectively, were expensed.

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, 2010 and 2009 and for the year ended December 31, 2009, diluted and basic earnings per share were the same, as the effect of dilutive securities options outstanding was not significant.

Reclassification

Certain 2009 balance sheet amounts have been reclassified to conform to the 2010 presentation.

Note 3 – ACQUISITION

On February 6, 2009, we completed a Stock Purchase Agreement (the "Stock Agreement") under which Lifeway purchased all of the issued and outstanding stock (the "Shares") of Fresh Made, Inc., a Pennsylvania corporation ("Fresh"). The consideration for the Shares was an aggregate of \$8,048,000 in cash, a note in the principal amount of \$2,735,000, due on August 1, 2010 as amended and restated, 128,948 shares of common stock of Lifeway valued at a total of \$980,000 ("Lifeway's Common Stock"), the cancellation of a loan in the principal amount of \$265,000. The issuance of Lifeway's Common Stock was exempted from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended.

Also on February 6, 2009, we entered into and consummated a Real Property Purchase Agreement (the "Real Property Agreement") under which we acquired 1.1355 acres of land in Philadelphia, PA (the "Property"). The consideration for the Property was approximately \$2,000,000.

The acquisition was consummated to expand the geographic footprint of Lifeway as well as grow market share. The acquisition was accounted for using the purchase accounting method of accounting, and accordingly, the purchase price was allocated to assets acquired and the liabilities assumed based on the

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2010 and 2009

and December 31, 2009

Note 3 – ACQUISITION - Continued

fair value as of the merger date. Acquisition costs for legal and professional fees have been included in General and Administrative costs. None of the goodwill resulting from the acquisition is tax deductible.

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

Cash and cash equivalents	\$226,000
Accounts receivable (contractual amounts totaling \$545,958)	546,000
Other current assets	361,000
Building and other fixed assets	2,617,000
Customer list	4,000,000
Non amortizable goodwill and brand asset	8,391,000
Current liabilities	(461,000)
Deferred tax liability associated with purchase adjustments	(1,652,000)
Total fair value of assets acquired and liabilities assumed	\$14,028,000

The following pro forma disclosures, including the effect of purchase accounting adjustments, depict the results of operations for the six months ended June 30, 2009 and the year ended December 31, 2009 as though the merger with Fresh had taken place as of January 1, 2009:

	For the Six Months Ended June 30, 2009	For the Year Ended December 31, 2009
Gross revenue	\$ 29,331,092	\$59,231,461
Net income	\$ 4,128,139	\$5,618,471
Earnings per share	\$ 0.25	\$0.33

Note 4 – INTANGIBLE ASSETS

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

	June 30, 2010		June 30, 2009		December 31, 2009	
	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	4,305,200	803,744	4,305,200	385,166	4,305,200	587,393

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Lease acquisition	87,200	73,707	87,200	61,245	87,200	67,473
Other	6,638	6,638	6,638	6,638	6,638	6,638
C u s t o m e r relationship	985,000	321,490	985,000	239,410	985,000	280,454
Contractual backlog	12,000	12,000	12,000	12,000	12,000	12,000
Trade names	1,980,000	517,000	1,980,000	385,000	1,980,000	451,000
Formula	438,000	171,550	438,000	127,750	438,000	149,650
	\$ 7,857,638	\$ 1,949,729	\$ 7,857,638	\$ 1,260,809	\$ 7,857,638	\$ 1,598,208

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LIFEWAY FOODS, INC. AND SUBSIDIARIES
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June 30, 2010 and 2009
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Note 4 – INTANGIBLE ASSETS - Continued

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

2011	\$	703,040
2012		690,583
2013		690,583
2014		676,958
2015		657,883
Thereafter		2,488,862
	\$	5,907,909

Amortization expense during the six months ended June 30, 2010 and 2009 and for the year ended December 31, 2009 was \$351,521, \$339,388 and \$676,786, respectively.

Note 5 – INVESTMENTS

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

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
Total	\$3,500,144	\$134,086	\$(222,426)	\$3,411,804

June 30, 2009	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	\$1,536,976	\$57,665	\$(178,926)	\$1,415,715
Mutual Funds	617,082	842	(267,818)	350,106
Preferred Securities	680,527	14,361	(207,218)	487,670
Corporate Bonds	506,165	5,836	(7,781)	504,220
Government Agency Obligations	1,889,963	15,201	(3,714)	1,901,450
Total	\$5,230,713	\$93,905	\$(665,457)	\$4,659,161

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
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Note 5 – INVESTMENTS - Continued

December 31, 2009	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	\$1,385,524	\$177,024	\$(128,547)	\$1,434,001
Mutual Funds	172,543	7,453	(22,833)	157,163
Preferred Securities	388,705	6,700	(95,753)	299,652
Corporate Bonds	1,569,245	65,226	(6,772)	1,627,699
Government Agency Obligations	893,755	2,989	(23,134)	873,610
Total	\$4,409,772	\$259,392	\$(277,039)	\$4,392,125

Proceeds from the sale of investments were \$6,928,321, \$1,605,269 and \$4,127,666 during the year ended December 31, 2009 and for the six months ended June 30, 2010 and 2009, respectively.

Gross gains of \$351,419, \$120,850 and \$235,408 and gross losses of \$629,893, \$66,066 and \$331,562 were realized on these sales during the year ended December 31, 2009 and for the six months ended June 30, 2010 and 2009, 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 June 30, 2010 and 2009 and at December 31, 2009:

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)

LIFEWAY FOODS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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Note 5 – INVESTMENTS - Continued

June 30, 2009	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	\$ 537,047	\$ (113,772)	\$ 270,700	\$ (65,154)	\$ 807,747	\$ (178,926)
Mutual Funds	95,391	(33,238)	248,327	(234,580)	343,718	(267,818)
Preferred Securities	21,527	(3,368)	365,740	(203,850)	387,267	(207,218)
Corporate Bonds	—	—	212,531	(7,781)	212,531	(7,781)
Government Agency Obligations	—	—	202,046	(3,714)	202,046	(3,714)
	\$ 653,965	\$ (150,378)	\$ 1,299,344	\$ (515,079)	\$ 1,953,309	\$ (665,457)

December 31, 2009	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	\$ 128,959	\$ (27,142)	\$ 230,502	\$ 101,405)	\$ 359,461	\$ (128,547)
Mutual Funds	1,694	(321)	131,870	(22,512)	133,564	(22,833)
Preferred Securities	—	—	278,202	(95,753)	278,202	(95,753)
Corporate Bonds	178,874	(3,176)	124,395	(3,596)	303,269	(6,772)
Government Agency Obligations	564,941	(20,096)	161,466	(3,038)	726,407	(23,134)
	\$ 874,468	\$ (50,735)	\$ 926,435	\$ 226,304)	\$ 1,800,903	\$ (277,039)

Equities, Mutual Funds, 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. 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, 2010.

Preferred Securities - The Company's investments in preferred securities consist of investments in preferred stock of companies in various industries. The Company evaluated the continuing performance of the securities, the credit worthiness of the issuers as well as the near-term prospects of the security 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, 2010.

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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,
	2010	2009	2009
Finished goods	\$1,405,538	\$1,500,090	\$1,101,885
Production supplies	1,657,546	1,704,240	1,367,457
Raw materials	1,091,635	612,865	827,634
Total inventories	\$4,154,719	\$3,817,195	\$3,296,976

Note 7 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	June 30,		December 31
	2010	2009	2009
Land	\$1,178,160	\$1,178,160	\$1,178,160
Buildings and improvements	11,051,821	9,769,348	10,380,393
Machinery and equipment	13,182,669	12,213,069	12,525,241
Vehicles	963,245	961,245	961,245
Office equipment	299,110	208,213	255,616
Construction in process	—	—	81,608
	26,675,005	24,330,035	25,382,263
Less accumulated depreciation	11,784,676	10,536,106	11,100,081
Total property and equipment	\$14,890,327	\$13,793,929	\$14,282,182