LIFEWAY FOODS INC
Form 10-Q
August 11, 2014

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: June 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	36-3442829
(State or Other Jurisdiction of Incorporation or Organization)	(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 August 7, 2014, 16,346,017 shares of the registrant's common stock, no par value, were outstanding.

LIFEWAY FOODS, INC.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

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

	June 30, 2014	June 30, 2013	December 31, 2013
ASSETS			
Current assets			
Cash and cash equivalents	$ 2,869,638	$ 4,939,948	$ 3,306,608
Investments	2,986,329	2,483,673	2,516,380
Certificates of deposits in financial institutions	—	115,373	15,373
Inventories	6,810,541	7,807,150	6,899,008
Accounts receivable, net of allowance for doubtful accounts and discounts ($1,300,000 and $1,350,000 and $1,050,000)	9,538,188	9,911,305	10,444,839
Prepaid expenses and other current assets	13,612	31,797	128,323
Other receivables	56,680	5,400	103,272
Deposits	142,836	580,974	—
Deferred income taxes	293,445	391,139	322,071
Refundable income taxes	1,965,933	28,123	1,014,947
Total current assets	24,677,202	26,294,882	24,750,821
Property and equipment, net	21,494,127	14,718,760	20,824,448
Intangible assets			
Goodwill and other non amortizable brand assets	14,068,091	14,068,091	14,068,091
Other intangible assets, net of accumulated amortization of $4,913,397, $4,198,439 and $4,555,559 at June 30, 2014 and 2013 and at December 31, 2013, respectively	3,417,602	4,107,561	3,750,441
Total intangible assets	17,485,693	18,175,652	17,818,532
Other Assets			
Long-term accounts receivable, net of current portion	279,921	280,000	280,000
Total assets	$ 63,936,943	$ 59,469,294	$ 63,673,801

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities			
Current maturities of notes payable	$ 877,062	$ 545,494	$ 875,002
Accounts payable	6,471,442	7,166,377	6,723,179
Accrued expenses	899,803	1,094,820	1,284,060
Accrued income taxes	—	1,224,115	—
Total current liabilities	8,248,307	10,030,806	8,882,241
Notes payable	8,555,731	4,726,472	8,999,012
Deferred income taxes	2,395,143	3,018,629	2,843,426
Total liabilities	19,199,181	17,775,907	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 June 30, 2014; 17,273,776 shares issued; 16,346,017 shares outstanding at June 30, 2013 and 16,346,017 shares outstanding at 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	44,341,809	41,366,495	42,587,214
Accumulated other comprehensive income (loss), net of taxes	41,852	(27,209)	7,807
Total stockholders' equity	44,737,762	41,693,387	42,949,122
Total liabilities and stockholders' equity	$ 63,936,943	$ 59,469,294	$ 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 Six Months Ended June 30, 2014 and 2013 (Unaudited)

	(Unaudited) Three Months Ended June 30,				(Unaudited) Six Months Ended June 30,		
	2014		2013		2014		201
Sales	$32,594,048		$25,838,058		$64,655,195		$53,428,680
Less: discounts and allowances	(3,028,637)		(2,760,174)		(5,958,073)		(5,963,765)
Net sales	29,565,411	29,565,411	23,077,884	23,077,884	58,697,122	58,697,122	47,464,915
Cost of goods sold		21,432,624		15,058,461		43,114,535	
Depreciation expense		627,878		421,707		1,011,238	
Total cost of goods sold		22,060,502		15,480,168		44,125,773	
Gross profit		7,504,909		7,597,716		14,571,349	
Selling expenses		3,693,821		2,876,635		7,173,509	
General and administrative		2,107,197		2,057,581		4,487,827	
Amortization expense		178,919		177,842		357,839	
Total operating expenses		5,979,937		5,112,058		12,019,175	
Income from operations		1,524,972		2,485,658		2,552,174	
Other income (expense):							
Interest and dividend income		35,227		30,622		63,925	
Rental income		1,200		3,389		1,700	
Interest expense		(66,724)		(37,424)		(132,293)	
Gain on sale of investments, net reclassified from OCI		57,321		56,944		62,130	
Loss on sale of equipment		(76,484)		—		(76,484)	
Other Income		1,672		10,229		1,672	
Total other income (expense)		(47,788)		63,760		(79,350)	

Income before provision for income taxes	1,477,184	2,549,418	2,472,824	
Provision for income taxes	382,768	1,145,478	718,229	
Net income	$1,094,416	$1,403,940	$1,754,595	$
Basic and diluted earnings per common share	0.07	0.09	0.11	
Weighted average number of shares outstanding	16,346,017	16,346,017	16,346,017	
COMPREHENSIVE INCOME				
Net income	$1,094,416	$1,403,940	$1,754,595	$
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on investments (net of tax)	63,111	(63,811)	71,155	
Less reclassification adjustment for (gains) losses included in net income (net of taxes)	(34,393)	(32,174)	(37,110)	
Comprehensive income	$1,123,134	$1,307,955	$1,788,640	$

See accompanying notes to financial statements.

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

	Common Stock, No Par Value 40,000,000 Shares Authorized							Accumulated	
	# of Shares Issued	# of Shares Outstanding	# of Shares of Treasury Stock	Common Stock	Paid In Capital	Treasury Stock	Retained Earnings	Other Comprehensive Income (Loss), Net of Tax	
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	$39
Redemption of stock	—	—	—	—	—	—	—	—	—
Other comprehensive income (loss): Unrealized gains on securities, net of taxes	—	—	—	—	—	—	—	(45,784)	(4
Net income for the year ended December 31, 2013	—	—	—	—	—	—	4,990,298	—	4,
Dividends ($.08) per share	—	—	—	—	—	—	(1,307,861)	—	(1
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
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
Redemption of stock	—	—	—	—	—	—	—	—	—
Other comprehensive									

income (loss): Unrealized gains on securities, net of taxes	—	—	—	—	—	—	—	(80,800)	(8
Net income for the six months ended June 30, 2013	—	—	—	—	—	—	3,769,579	—	3,
Dividends ($.08) per share	—	—	—	—	—	—	(1,307,861)	—	(1
Balances at June 30, 2013	17,273,776	16,346,017	927,759	$6,509,267	$2,032,516	$(8,187,682)	$41,366,495	$(27,209)	$41
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	$42
Redemption of stock	—	—	—	—	—	—	—	—	—
Other comprehensive income (loss): Unrealized gains on securities, net of taxes	—	—	—	—	—	—	—	34,045	34
Net income for the six months ended June 30, 2014	—	—	—	—	—	—	1,754,595	—	1,
Dividends ($.08) per share	—	—	—	—	—	—	—	—	—
Balances at June 30, 2014	17,273,776	16,346,017	927,759	$6,509,267	$2,032,516	$(8,187,682)	$44,341,809	$41,852	$44

See accompanying notes to financial statements.

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

	(Unaudited) June 30, 2014	2013
Cash flows from operating activities:		
Net income	$ 1,754,595	$ 3,769,579
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	1,369,077	1,171,515
Gain on sale of investments, net	(62,130)	(121,280)
Deferred income taxes	(440,285)	(104,133)
Bad Debt Expense	156,049	26,819
Loss on sale of equipment	76,484	—
(Increase) decrease in operating assets:		
Accounts receivable	728,281	(1,211,015)
Other receivables	46,591	3,425
Inventories	88,467	(1,867,964)
Refundable income taxes	(950,986)	56,705
Prepaid expenses and other current assets	(28,125)	(515,633)
Increase (decrease) in operating liabilities:		
Accounts payable	(1,972,157)	2,909,652
Accrued expenses	1,336,163	(60,857)
Income taxes payable	—	969,804
Net cash provided by operating activities	2,102,024	5,026,617
Cash flows from investing activities:		
Purchases of investments	(1,774,734)	(2,573,721)
Proceeds from sale of investments	1,419,362	1,948,839
Redemption of certificates of deposits	15,000	334,627
Purchases of property and equipment	(1,761,401)	(547,819)
Proceeds from sale of equipment	4,000	—
Net cash used in investing activities	(2,097,773)	(838,074)
Cash flows from financing activities:		
Dividends paid	—	(1,307,861)
Repayment of notes payable	(441,221)	(226,960)
Net cash used in financing activities	(441,221)	(1,534,821)
Net (decrease) increase in cash and cash equivalents	(436,970)	2,653,722
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	$ 2,869,638	$ 4,939,948

See accompanying notes to financial statements.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2014 and 2013 (Unaudited) and December 31, 2013

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 32 percent and 34 percent of gross sales for the six months ended June 30, 2014 and 2013, respectively. These customers accounted for approximately 25 percent, 24 percent and 22 percent of accounts receivable as of June 30, 2014, June 30, 2013 and December 31, 2013, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2014 and 2013 (Unaudited) and December 31, 2013

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

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2014 and 2013 (Unaudited) and December 31, 2013

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

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

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

The Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The only periods subject to examination for the Company's federal returns are the 2010, 2011 and 2012 tax years. The Company believes that its income tax filing positions and deductions would be sustained on audit and does not anticipate any adjustments that would result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2014 and 2013 (Unaudited) and December 31, 2013

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 six months ended June 30, 2014 and 2013 total advertising expenses were $1,818,938 and $1,308,306, respectively.

Earnings per common share
Earnings per common share were computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. For the six months ended June 30, 2014 and 2013, diluted and basic earnings per share were the same.

Note 3 – INTANGIBLE ASSETS

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

	June 30, 2014		June 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	2,700,754	4,504,200	2,249,544	4,504,200	2,474,790
Customer relationship	985,000	631,827	985,000	561,743	985,000	596,785
Trade names	2,248,000	1,103,266	2,248,000	953,402	2,248,000	1,028,334
Formula	438,000	346,750	438,000	302,950	438,000	324,850
	$ 8,218,800	$ 4,826,197	$ 8,218,800	$ 4,111,239	$ 8,218,800	$ 4,468,359

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

2015	$ 715,677
2016	715,677
2017	675,527
2018	671,877
2019	408,261
Thereafter	205,584
	$ 3,392,603

Amortization expense during the six months ended June 30, 2014 and 2013 was $357,839 and $355,683, respectively.

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LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2014 and 2013 (Unaudited) and December 31, 2013

Note 4 – INVESTMENTS

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

June 30, 2014	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	$ 986,709	$ 90,872	$ (28,176)	$ 1,049,405
Mutual Funds	15,070	895	(795)	15,170
Preferred Securities	394,015	28,088	0	422,103
Corporate Bonds	1,520,466	4,356	(25,171)	1,499,651
Total	$ 2,916,260	$ 124,211	$ (54,142)	$ 2,986,329

June 30, 2013	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	$ 893,998	$ 83,082	$ (39,910)	$ 937,170
Mutual Funds	17,803	0	(209)	17,594
Preferred Securities	403,300	40	(26,030)	377,310
Corporate Bonds	1,216,728	5,100	(70,229)	1,151,599
Total	$ 2,531,829	$ 88,222	$ (136,378)	$ 2,483,673

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 $1,419,362 and $1,948,839 for the six months ended June 30, 2014 and 2013, respectively.

Gross gains of $80,822 and $151,472 and gross losses of $18,319 and $30,192 were realized on these sales during the six months ended June 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 June 30, 2014 and 2013 and at December 31, 2013:

	Less Than 12 Months		12 Months or Greater		Total	
June 30, 2014	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

Equities	$	202,239	$	(17,150)	$	121,033	$	(11,026)	$	323,272	$	(28,176)
Mutual Funds		7,235		(795)		0		0		7,235		(795)
Corporate Bonds		669,480		(6,285)		442,924		(18,886)		1,112,404		(25,171)
	$	878,954	$	(24,230)	$	563,957	$	(29,912)	$	1,442,911	$	(54,142)

	Less Than 12 Months				12 Months or Greater				Total			
June 30, 2013	Fair Value		Unrealized Losses		Fair Value		Unrealized Losses		Fair Value		Unrealized Losses	
Equities	$	455,403	$	(39,910)	$	0	$	0	$	455,403	$	(39,910)
Mutual Funds		17,594		(209)		0		0		17,594		(209)
Preferred Securities		302,265		(26,030)		0		0		302,265		(26,030)
Corporate Bonds		876,607		(60,701)		115,691		(9,529)		992,298		(70,230)
	$	1,651,869	$	(126,850)	$	115,691	$	(9,529)	$	1,767,560	$	(136,379)

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Note 4 – INVESTMENTS - Continued

December 31, 2013	Less Than 12 Months Fair Value	Less Than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
Equities	$ 213,222	$ (32,180)	$ 0	$ 0	$ 213,222	$ (32,180)
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	$ (90,456)	$ 96,726	$ (6,593)	$ 1,150,059	$ (97,049)

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 June 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 June 30, 2014.

Note 5 – INVENTORIES

Inventories consist of the following:

	June 30, 2014	June 30, 2013	December 31, 2013
Finished goods	$ 3,005,972	$ 2,977,298	$ 3,027,900
Production supplies	2,323,139	3,321,484	2,690,097
Raw materials	1,481,430	1,508,368	1,181,011
Total inventories	$ 6,810,541	$ 7,807,150	$ 6,899,008

Note 6 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	June 30, 2014	June 30, 2013	December 31, 2013
Land	$ 1,856,370	$ 1,178,160	$ 1,856,370
Buildings and improvements	15,305,616	12,220,693	14,587,022
Machinery and equipment	20,773,006	16,007,943	19,633,164
Vehicles	1,244,560	1,350,608	1,244,560
Office equipment	433,679	429,013	433,679
Construction in process	0	0	177,519

		39,613,231		31,186,417		37,932,314
Less accumulated depreciation		18,119,104		16,467,657		17,107,866
Total property and equipment	$	21,494,127	$	14,718,760	$	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 six months ended June 30, 2014 and 2013 was $1,011,238 and $815,832 respectively.

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Note 7 – ACCRUED EXPENSES

Accrued expenses consist of the following:

	June 30, 2014	June 30, 2013	December 31, 2013
Accrued payroll and payroll taxes	$ 423,483	$ 235,918	$ 477,312
Accrued property tax	325,392	311,376	306,608
Other	150,928	547,526	500,140
	$ 899,803	$ 1,094,820	$ 1,284,060

Note 8 – NOTES PAYABLE

Notes payable consist of the following:

	June 30, 2014	June 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.	$ 4,605,555	$ 5,154,445	$ 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.	4,750,000	0	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.	22,313	41,641	32,124
Note payable to Fletcher Jones of Chicago, Ltd LLC in monthly installments of $1,769 at 6.653%, due	54,925	75,880	66,334

May 24, 2017, secured by transportation equipment.						
Total notes payable		9,432,793		5,271,966		9,874,014
Less current maturities		877,062		545,494		875,002
Total long-term portion	$	8,555,731	$	4,726,472	$	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 not in compliance with one of the ratios at June 30, 2014 but has subsequently obtained a waiver from the bank.

Maturities of notes payables are as follows:

For the 12 Months Ending June 30,		
2015	$	877,062
2016		860,987
2017		859,189
2018		3,418,899
2019		3,416,656
Total	$	9,432,793

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Note 9 – COMMITMENTS AND CONTINGENCIES

The Company leases three stores for its Starfruit subsidiary. Total expense for these leases was approximately $150,566, $175,209 and $347,164 for the six months ended June 30, 2014, 2013 and for the year ended December 31, 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 June 30, 2014 are as follows:

For the 12 Months Ending June 30,		
2015	$	44,799
2016		46,143
2017		47,527
2018		48,953
2019		24,838
Total	$	212,260

Note 10 – PROVISION FOR INCOME TAXES

The provision for income taxes consists of the following:

	For the Six Months Ended June 30,			
	2014		2013	
Current:				
Federal	$	850,032	$	1,937,370
State and local		308,482		723,434
Total current		1,158,514		2,660,804
Deferred		(440,285)		(104,133)
Provision for income taxes	$	718,229	$	2,556,671

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

	For the Six Months Ended June 30,					
	2014			2013		
	Amount		Percentage	Amount		Percentage
Federal income tax expense computed at the statutory rate	$	840,760	34.0%	$	2,150,925	34.0%
State and local tax expense, net		330,586	13.4%		766,896	12.1%
U.S. domestic manufacturers’		(453,117)	(18.3)%		(361,150)	(5.7)%

deduction & other permanent differences						
Provision for income taxes	$	718,229	29.1%	$	2,556,671	40.4%

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Note 10 – PROVISION FOR INCOME TAXES - Continued

Amounts for deferred tax assets and liabilities are as follows:

	June 30, 2014	June 30, 2013	December 31, 2013
Non-current deferred tax assets (liabilities) arising from:			
Temporary differences - Accumulated depreciation and amortization from purchase accounting adjustments	$ (2,418,845)	$ (3,102,071)	$ (2,896,058)
Capital loss carry-forwards	23,702	83,442	52,632
Total non-current net deferred tax liabilities	2,395,143	(3,018,629)	(2,843,426)
Current deferred tax assets arising from:			
Unrealized losses (gain) on investments	(28,216)	20,948	(7,589)
Inventory	281,391	348,441	307,910
Allowance for doubtful accounts and discounts	40,270	21,750	21,750
Total current deferred tax assets	293,445	391,139	322,071
Net deferred tax liability	$ (2,101,698)	$ (2,627,490)	$ (2,521,355)

Note 11 – SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest and income taxes are as follows:

	For the Six Months Ended June 30, 2014	For the Six Months Ended June 30, 2013
Interest	$ 132,415	$ 61,333
Income taxes	$ 2,109,500	$ 1,691,093

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.

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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 June 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 June 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 June 30, 2014			
	Level 1	Level 2	Level 3	Total
Cash	$ 2,869,638	$ 0	$ 0	$ 2,869,638
Mutual Funds	15,170	0	0	15,170
Stocks	1,049,405	0	0	1,049,405
Preferred Securities	0	422,103	0	422,103
Corporate Bonds	0	1,499,650	0	1,499,650
Notes Payable		9,432,793	0	9,432,793

	Assets and Liabilities at Fair Value as of June 30, 2013			
	Level 1	Level 2	Level 3	Total
Cash	$ 4,939,948	$ 0	$ 0	$ 4,939,948
Certificate of Deposits	0	115,373	0	115,373
Stocks	954,765	0	0	954,765
Preferred Securities	377,310	0	0	377,310
Corporate Bonds	0	1,151,598	0	1,151,598
Notes Payable	0	4,726,472	0	4,726,472

	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

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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. We do not expect the adoption of this standard to have a material impact on our 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 six months ended June 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 neg 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 June 30, 2014 to Quarter Ended June 30, 2013

Total consolidated gross sales increased by $6,755,990 (approximately 26%) to $32,594,048 during the three-month period ended June 30, 2014 from $25,838,058 during the same three-month period in 2013. This increase is primarily attributable to increased sales and awareness of the Company's flagship line, Kefir, as well as ProBugs® Organic Kefir for kids and BioKefir™.

Total consolidated net sales increased by $6,487,527 (approximately 28%) to $29,565,411 during the three-month period ended June 30, 2014 from $23,077,884 during the same three-month period in 2013. Net sales are recorded as gross sales less promotional activities such as slotting fees paid, couponing, spoilage and promotional allowances as well as early payment terms given to customers.

Cost of goods sold as a percentage of net sales, excluding depreciation expense, were approximately 72% during the second quarter of 2014, compared to approximately 65% during the same period in 2013. The increase was primarily attributable to a 30% increase in the cost of milk, the Company's largest raw material, compared to the same period last year.

Total operating expenses increased $867,879 (approximately 17%) to $5,979,937 during the second quarter of 2014, from $5,112,058 during the same period in 2013. This increase was primarily attributable to an increase in selling expenses.

Total operating income decreased by $960,686 (approximately 39%) to $1,524,972 during the second quarter of 2014, from $2,485,658 during the same period in 2013.

Income tax expense was $382,768, or a 26% effective tax rate for the second quarter of 2014 compared to an income tax expense of $1,145,478, or a 45% effective tax rate during the same period in 2013.

Total net income was $1,094,416 or $0.07 per diluted share for the three-month period ended June 30, 2014 compared to $1,403,940 or $0.09 per diluted share in the same period in 2013.

Comparison of Six-Month Period Ended June 30, 2014 to Six-Month Period Ended June 30, 2013

Total consolidated gross sales increased by $11,226,515 (approximately 21%) to $64,655,195 during the six-month period ended June 30, 2014 from $53,428,680 during the same six-month period in 2013. This increase is primarily attributable to increased sales and awareness of flagship line, Kefir, as well as ProBugs® Organic Kefir for kids and BioKefir™.

Total consolidated net sales increased by $11,232,207 (approximately 24%) to $58,697,122 during the six-month period ended June 30, 2014 from $47,464,915 during the same six-month period in 2013. Net sales are recorded as gross sales less promotional activities such as slotting fees paid, couponing, spoilage and promotional allowances as well as early payment terms given to customers.

Cost of goods sold increased by $12,507,089 (approximately 41%) to $43,114,535 during the six-month period ended June 30, 2014, from $30,607,446 during the same period in 2013. Cost of goods sold as a percentage of net sales, excluding depreciation expense, were approximately 73% during the six- month period ended June 30, 2014, compared to approximately 64% during the same period in 2013. The increases were primarily attributable to a 30% increase in the cost of milk, the Company's largest raw material, compared to the same period last year.

Operating expenses increased by $2,193,713 (approximately 22%) to $12,019,175 during the six-month period ended June 30, 2014, from $9,825,462 during the same period in 2013. Operating expenses as a percentage of net sales were approximately 20% during the six-month period ended June 30, 2014 compared to approximately 21% during the same period in 2013.

Selling related expenses increased by $1,659,155 (approximately 30%) to $7,173,509 during the six-month period ended June 30, 2014, from $5,514,354 during the same period in 2013.

Total operating income decreased by $3,664,001 (approximately 59%) to $2,552,174 during the six-month period ended June 30, 2014, from $6,216,175 during the same period in 2013.

Provision for income taxes was $718,229 or a 29% effective tax rate, for the six-month period ended June 30, 2014 compared with $2,556,671, or a 40% tax rate, during the same period in 2013.

Total net income was $1,754,595 or $0.11 per share for the six-month period ended June 30, 2014 compared to $3,769,579 or $0.23 per share in the same period in 2013.

Liquidity and Capital Resources

Sources and Uses of Cash

Net cash provided by operating activities was $2,102,024 during the six-months ended June 30, 2014 compared to $5,026,617 during the same period in 2013. This decrease is primarily attributable to the decrease in accounts payable of $1,972,157 in the first six months of 2014 as compared to the same period in 2013.

Net cash used in investing activities was $2,097,773 during the six-months ended June 30, 2014 compared to net cash used in investing activities of $838,074 during the same period in 2013. This increase in net cash used in investing activities is primarily attributable to the purchase of property and equipment of $1,761,401 in the first six months of 2014 as compared to the same period in 2013.

The Company had a net decrease in cash and cash equivalents of $436,970 during the six month period ended June 30, 2014 compared to a net increase in cash and cash equivalents of $2,653,722 during the same period in 2013. The Company had cash and cash equivalents of $2,869,638 as of June 30, 2014 compared to cash and cash equivalents of $4,939,948 as of June 30, 2013.

Assets and Liabilities

Total current assets were $24,677,202 as of June 30, 2014, which is a decrease of $1,617,680 when compared to June 30, 2013. This is primarily due to a decrease in cash and cash equivalents of $2,070,310 as of June 30, 2014 when compared to June 30, 2013.

Total current liabilities were $8,248,307 as of June 30, 2014, which is a decrease of $1,782,499 when compared to June 30, 2013. This is primarily due to a $694,935, $195,017 and $1,224,115 decrease in accounts payable, accrued expenses and accrued income taxes, respectively, as of June 30, 2014 when compared to June 30, 2013.

Long-term portion of notes payable increased by $3,829,259 as of June 30, 2014, when compared to June 30, 2013. The balance of the notes payable as of June 30, 2014 was $8,555,731. 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 $44,737,762 as of June 30, 2014, which is an increase of $3,044,375 when compared to June 30, 2013. This is primarily due to an increase in retained earnings of $2,975,314 when compared to June 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 June 30, 2014, we had an outstanding balance under our term loans of approximately $9.3 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 June 30, 2014 of approximately $9.3 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 $99,000. 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 June 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

The Company has reviewed the accessibility for the accounting and finance department and updated the security clearance to provide for more robust segregation of duties.

The Company has 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.

The Company has also updated its policies to include a formal checklist to be adhered to by the controller and accounting department. The chief financial officer will review the final checklist as well as undertake a post period closing internal audit which is used to identify, record and review period end activity.

The Company is continuing the process of engaging an outside consultant to assist in our ongoing remediation with respect to the material weaknesses identified above and to assist us in improving the design and operations of our internal controls over financial reporting generally.

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

Conclusion

We believe the measures we have taken to remediate the material weaknesses we have identified will strengthen our internal controls over financial reporting. Additionally, we believe that with the assistance of a specialist we can implement additional measures to remediate the material weaknesses we have identified. 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 above there were no changes in our internal control over financial reporting that occurred during the second 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 evaluating and understanding us and our business, you should carefully consider the risks described below, in conjunction with all of the other information included in this Quarterly Report on Form 10-Q, including “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained in Part I, Item 2 and “Quantitative and Qualitative Disclosures About Market Risk” contained in Part I, Item 3. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may become important factors that adversely affect our business. If any of the events or circumstances described in the following risk factors actually occurs, our business, financial condition, results of operations, and future prospects could be materially and adversely affected.

Our product categories face a high level of competition, which could negatively impact our sales and results of operations.

We face significant competition in each of our product categories. Competition in our product categories is based on product innovation, product quality, price, brand recognition and loyalty, effectiveness of marketing, promotional activity, and our ability to identify and satisfy consumer tastes and preferences. We believe that our brands have benefited in many cases from being the first to introduce products in their categories, and their success has attracted competition from other food and beverage companies that produce branded products, as well as from private label competitors. Some of our competitors, such as Groupe Danone, General Mills, Inc., Kraft Foods Group, Inc., Nestle S.A., Chiquita Brands International, Inc. and Dole Food Company, Inc. have substantial financial and marketing resources. These competitors and others may be able to introduce innovative products more quickly or market their products more successfully than we can, which could cause our growth rate in certain categories to be slower than we have forecasted and could cause us to lose sales.

We also compete, particularly in our premium dairy and organic greens and produce categories, with producers of non-organic products, which usually have lower production costs. As a result, non-organic producers may be able to offer conventional products to customers at lower costs than organic products. This could cause us to lower our prices, resulting in lower profitability or, in the alternative, cause us to lose market share if we fail to lower prices. Furthermore, private label competitors are generally able to sell their products at lower prices because private label products typically have lower marketing costs than their branded counterparts. If our products fail to compete successfully with other branded or private label offerings in the industry, demand for our products and our sales volumes could be negatively impacted.

Additionally, due to high levels of competition in our product categories, certain of our key retailers may demand price concessions on our products or may become more resistant to price increases for our products. Increased price competition and resistance to price increases have had, and may continue to have, a negative effect on our results of operations.

We may not be able to successfully implement our growth strategy for our brands on a timely basis or at all.

We believe that our future success depends, in part, on our ability to implement our growth strategy of leveraging our existing brands and products to drive increased sales. Our ability to implement this strategy depends, among other things, on our ability to:

Ÿ enter into distribution and other strategic arrangements with third-party retailers and other potential distributors of our products;

Ÿ compete successfully in the product categories in which we choose to operate;

Ÿ introduce new and appealing products and innovate successfully on our existing products;

Ÿ develop and maintain consumer interest in our brands;

Ÿ increase our brand recognition and loyalty; and

Ÿ enter into strategic arrangements with third-party growers and other providers to supply our necessary raw materials.

We may not be able to implement this growth strategy successfully, and our sales and income growth rates may not be sustainable over time. Our sales and results of operations will be negatively affected if we fail to implement our growth strategy or if we invest resources in a growth strategy that ultimately proves unsuccessful.

If we fail to anticipate and respond to changes in consumer preferences, demand for our products could decline.

Consumer tastes and preferences are difficult to predict and evolve over time. Demand for our products depends on our ability to identify and offer products that appeal to these shifting preferences. Factors that may affect consumer tastes and preferences include:

- dietary trends and increased attention to nutritional values, such as the sugar, fat, protein, fiber or calorie content of different foods and beverages;
- concerns regarding the health effects of specific ingredients and nutrients, such as sugar, other sweeteners, dairy, soybeans, nuts, oils, vitamins, fiber and minerals;
- concerns regarding the public health consequences associated with obesity, particularly among young people; and
- increasing awareness of the environmental and social effects of product production. If consumer demand for our products declines, our sales volumes and our business could be negatively affected.

We are subject to the risk of product contamination and product liability claims, which could harm our reputation, force us to recall products and incur substantial costs.

The sale of food products for human consumption involves the risk of injury to consumers. Such injuries may result from tampering by unauthorized third parties, misbranding, product contamination or spoilage, including the presence of foreign objects, substances, chemicals, other agents, or residues introduced during the growing, storage, handling or transportation phases. We also may be subject to liability if our products or operations violate applicable laws or regulations, including environmental, health, and safety requirements, or in the event our products cause injury, illness, or death.

In addition, our product advertising could make us the target of claims relating to false or deceptive advertising under U.S. federal and state laws, including the consumer protection statutes of some states, or laws of other jurisdictions in which we operate. Lifeway is from time to time engaged in such litigation matters none of which presently is expected to have a material adverse effect on its business results or operations.

A significant product liability, consumer fraud, or other legal judgment against us or a widespread product recall would negatively impact our profitability. Moreover, claims or liabilities of this sort might not be covered by insurance or by any rights of indemnity or contribution that we may have against others. Even if a product liability, consumer fraud, or other claim is found to be without merit or is otherwise unsuccessful, the negative publicity surrounding such assertions regarding our products or processes could materially and adversely affect our reputation and brand image, particularly in categories that are promoted as having strong health and wellness credentials. Any loss of consumer confidence in our product ingredients or in the safety and quality of our products would be difficult and costly to overcome.

The loss of any of our largest customers could negatively impact our sales and results of operations.

Two of our customers together accounted for 30% of our net sales and 34% of accounts receivables in the quarter ended June 30, 2014. We do not generally enter into written agreements with our customers, and where such agreements exist, they are generally terminable at will by the customer. In addition, our customers sometimes award contracts based on competitive bidding, which could result in lower profits for contracts we win and the loss of business for contracts we lose. The loss of any large customer for an extended period of time could negatively affect our sales and results of operations.

We may not be able to successfully complete strategic acquisitions, establish joint ventures, or integrate brands that we acquire.

We have grown and intend to continue to grow our business in part through the acquisition of new brands and the establishment of joint ventures in the United States, in Europe, and globally. We cannot be certain that we will successfully be able to:

Ÿ identify suitable acquisition candidates or joint venture partners and accurately assess their value, growth potential, strengths, weaknesses, contingent and other liabilities, and potential profitability;

Ÿ secure regulatory clearance for our acquisitions and joint ventures;

Ÿ negotiate acquisitions and joint ventures on terms acceptable to us; or

Ÿ integrate any acquisitions that we complete.

Acquired companies or brands may not achieve the level of sales or profitability that justify our investment in them, or an acquired company may have unidentified liabilities for which we, as a successor owner, may be responsible. These transactions typically involve a number of risks and present financial and other challenges, including the existence of unknown disputes, liabilities, or contingencies and changes in the industry, location, or regulatory or political environment in which these investments are located, that may arise after entering into such arrangements.

The success of any acquisitions we complete will depend on our ability to effectively integrate the acquired brands or products into our existing operations. We may experience difficulty entering new categories or geographies, integrating new products into our product mix, integrating an acquired brand's distribution channels and sales force, achieving anticipated cost savings, or retaining key personnel and customers of the acquired business. Integrating an acquired brand into our existing operations requires management resources and may divert management's attention from our day-to-day operations. If we are not successful in integrating the operations of acquired brands, or in executing strategies and business plans related to our joint ventures, our business could be negatively affected.

We may have to pay cash, incur debt, or issue equity, equity-linked, or debt securities to pay for any such acquisition, any of which could adversely affect our financial results.

Our continued success depends on our ability to innovate successfully and to innovate on a cost-effective basis.

A key element of our growth strategy is to introduce new and appealing products and to successfully innovate on our existing products. Success in product development is affected by our ability to anticipate consumer preferences, and to utilize our management's ability to launch new or improved products successfully and on a cost-effective basis. Furthermore, the development and introduction of new products requires substantial marketing expenditures, which we may not be able to finance or which we may be unable to recover if the new products do not achieve commercial success and gain widespread market acceptance. If we are unsuccessful in our product innovation efforts and demand for our existing products declines, our business could be negatively affected.

Reduced availability of raw materials and other inputs, as well as increased costs for our raw materials and other inputs, could adversely affect us.

Our business depends heavily on raw materials such as conventional and organic raw milk used in the production of our products. Our raw materials are generally sourced from third-party suppliers, and we are not assured of continued supply, pricing, or exclusive access to raw materials from any of these suppliers. In addition, a substantial portion of our raw materials are agricultural products, which are vulnerable to adverse weather conditions and natural disasters, such as floods, droughts, frost, earthquakes, and pestilence. Adverse weather conditions and natural disasters also can lower dairy and crop yields and reduce supplies of these ingredients or increase their prices. Other events that adversely affect our third-party suppliers and that are out of our control could also impair our ability to obtain the raw materials and other inputs that we need in the quantities and at the prices that we desire. Such events include problems with our suppliers' businesses, finances, labor relations, costs, production, insurance, and reputation. Over the past several years, we have experienced increased costs as a result of weather conditions and other events outside our and our suppliers' control and this may continue given recent weather conditions, which may negatively affect our business.

The organic ingredients (including milk) for our products is less plentiful and available from fewer suppliers than their conventional counterparts. Competition with other manufacturers in the procurement of organic product ingredients may increase in the future if consumer demand for organic products increases. In addition, the dairy industry continues to experience periodic imbalances between supply and demand for organic raw milk. Industry regulation and the costs of organic farming compared to costs of conventional farming can impact the supply of organic raw milk in the market. Oversupply levels of organic raw milk can increase competitive pressure on our products and pricing, while supply shortages can cause product shortages and higher costs to us. Cost increases in raw materials and other inputs could cause our profits to decrease significantly compared to prior periods, as we may be unable to increase our prices to offset the increased cost of these raw materials and other inputs. If we are unable to obtain raw materials and other inputs for our products or offset any increased costs for such raw materials and inputs, our business could be negatively affected.

Failure to maintain sufficient internal production capacity may result in our inability to meet customer demand and/or increase our operating costs and capital expenditures.

The success of our business depends, in part, on maintaining a strong production platform and we rely primarily on internal production resources to fulfill our manufacturing needs. Certain of our manufacturing plants are operating at high rates of utilization, and we may need to expand our production facilities or increase our reliance on third parties to provide manufacturing and supply services, commonly referred to as “co-packing” agreements, for a number of our products. A failure by any future co-packers to comply with food safety, environmental, or other laws and regulations may disrupt our supply of products. In addition, we have experienced, and expect to continue to experience, increased distribution and warehousing costs due to capacity constraints resulting from our growth. If we need to enter into co-packing, warehousing or distribution agreements in the future, we can provide no assurance that we would be able to find acceptable third party providers or enter into agreements on satisfactory terms or at all. Our inability to maintain sufficient internal capacity or establish satisfactory co-packing, warehousing and distribution arrangements could limit our ability to operate our business or implement our strategic growth plan, and could negatively affect our sales volumes and results of operations. In addition, we may need to expand our internal capacity, which would increase our operating costs and could require significant capital expenditures. If we cannot maintain sufficient production, warehousing and distribution capacity, either internally or through third party agreements, we may be unable to meet customer demand and/or our manufacturing, distribution and warehousing costs may increase, which could negatively affect our business.

An economic downturn could negatively affect our sales and results of operations.

The branded food and beverage industry is sensitive to changes in international, national, and local economic conditions. The most recent economic downturn has had an adverse effect on consumer spending patterns. Consumers may shift purchases to lower-priced or private label products or forego certain purchases altogether. They may also reduce the number of organic and premium products that they purchase because organic and premium products generally have higher retail prices than their conventional counterparts. Lower consumer demand resulting from an economic downturn could decrease our sales volumes and negatively affect our results of operations.

Disruption of our supply or distribution chains could adversely affect our business.

Damage or disruption to our manufacturing or distribution capabilities due to weather, natural disaster, fire, environmental incident, terrorism, pandemic, strikes, the financial or operational instability of key suppliers, distributors, warehousing, and transportation providers, or other reasons could impair our ability to manufacture or distribute our products. In addition, most of our products are processed in a single facility, and damage or disruption to this facility could impair our ability to process and sell those products. If we are unable or it is not financially feasible to mitigate the likelihood or potential impact of such events, our business and results of operations could be negatively affected and additional resources could be required to restore our supply chain.

Our earnings are sensitive to fluctuations in market prices and demand for our products.

Excess supply can cause significant price competition in our businesses. Growing conditions in various parts of the world, particularly weather conditions such as windstorms, floods, droughts and freezes, as well as diseases and pests, are primary factors affecting market prices because of their influence on the supply and quality of product.

Some of our products are highly perishable and generally must be refrigerated and brought to market and sold soon after production. The selling price received for each type of product depends on all of these factors, including the availability and quality of the products in the market, and the availability and quality of competing types of products.

In addition, general public perceptions regarding the quality, safety or health risks associated with particular food products could reduce demand and prices for some of our products. To the extent that consumer preferences evolve away from products that we produce for health or other reasons, and we are unable to modify our products or to develop products that satisfy new consumer preferences, there will be a decreased demand for our products. However, even if market prices are unfavorable, produce items which are ready to be, or have been, harvested must be brought to market promptly. A decrease in the selling price received for our products due to the factors described above could have a material adverse effect on our business, results of operations and financial condition.

Our substantial debt and financial obligations could adversely affect our financial condition and ability to operate our business, and we may incur additional debt.

As of June 30, 2014, we had outstanding borrowings of approximately $9.4 million of which approximately $9.3 million consists of term loan borrowings from The Private Bank. We also had additional borrowing capacity of approximately $5.0 million under our line of credit from The Private Bank, of which none was outstanding as of June 30, 2014.

Our loan agreements contain certain restrictions and requirements regarding our business:

Ÿ require us to maintain minimum fixed charged ratio and tangible net worth thresholds;

Ÿ

limit our ability to obtain additional financing in the future for working capital, capital expenditures and acquisitions, to fund growth or for general corporate purposes;

- limit our future ability to refinance our indebtedness on terms acceptable to us or at all;

- limit our flexibility in planning for or reacting to changes in our business and market conditions or in funding our strategic growth plan; and

- impose on us financial and operational restrictions.

Our debt level and the terms of our financing arrangements could adversely affect our financial condition and limit our ability to successfully implement our growth strategy.

Our ability to meet our debt service obligations will depend on our future performance, which will be affected by the other risk factors described in this Quarterly Report on Form 10-Q. If we do not generate enough cash flow to pay our debt service obligations, we may be required to refinance all or part of our existing debt, sell our assets, borrow more money or raise equity. There is no guarantee that we will be able to take any of these actions on a timely basis, on terms satisfactory to us, or at all.

Our notes issued to The Private Bank bear interest at variable rates. If market interest rates increase, variable rate debt will create higher debt service requirements, which could adversely affect our cash flow.

The credit agreement governing our senior secured credit facilities contains various covenants that impose restrictions on us that may affect our ability to operate our business.

The credit agreement governing our senior secured credit facilities contains covenants that, among other things, restricts our ability to:

- Ÿ borrow money or guarantee debt;
- Ÿ create liens;
- Ÿ make specified types of investments and acquisitions;
- Ÿ pay dividends on or redeem or repurchase stock;
- Ÿ enter into new lines of business;
- Ÿ enter into transactions with affiliates; and
- Ÿ sell assets or merge with other companies.

These restrictions on the operation of our business could harm us by, among other things, limiting our ability to take advantage of financing, merger and acquisition opportunities, and other corporate opportunities. Various risks, uncertainties, and events beyond our control could affect our ability to comply with these covenants. A default would permit lenders to accelerate the maturity of the debt under the credit agreement and to foreclose upon the collateral securing the debt.

We may need additional financing in the future, and we may not be able to obtain that financing.

From time to time, we may need additional financing to support our business and pursue our growth strategy, including strategic acquisitions. Our ability to obtain additional financing, if and when required, will depend on investor demand, our operating performance, the condition of the capital markets, and other factors.

We cannot assure you that additional financing will be available to us on favorable terms when required, or at all. If we raise additional funds through the issuance of equity, equity-linked, or debt securities, those securities may have rights, preferences, or privileges senior to those of our common stock, and, in the case of equity and equity-linked securities, our existing stockholders may experience dilution.

Our results of operations will fluctuate from quarter to quarter, which makes them difficult to predict.

Our quarterly financial results have fluctuated in the past and will fluctuate in the future. Our financial results in any given quarter can be influenced by numerous factors, many of which we are unable to predict or are outside of our control, including:

- Ÿ product quality issues or negative publicity about our products or ingredients;
- Ÿ investments that we make to acquire new brands and to launch products;
- Ÿ changes in consumer preferences and discretionary spending;
- Ÿ availability of raw materials and fluctuations in their prices; and

- variations in general economic conditions.

As a result of these factors, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year.

Our international operations subject us to business risks that could cause our revenue and profitability to decline.

We plan to expand distribution worldwide. Our products are currently sold in the U.S. and a non-material amount of product is sold in England. We plan to expand distribution worldwide. Risks associated with our operations as we expand outside of the United States will include:

- legal and regulatory requirements in multiple jurisdictions that differ from those in the United States and change from time to time, such as tax, labor, and trade laws, as well as laws that affect our ability to manufacture, market, or sell our products;
- foreign currency exposures;
- political and economic instability, such as the recent debt crisis in Europe;
- trade protection measures and price controls; and
- diminished protection of intellectual property in some countries.

If one or more of these business risks occur, our business and results of operations could be negatively affected. As we increase our distribution worldwide, we will become subject to greater risks to operations outside the U.S.

Loss of our key management or other personnel, or an inability to attract such management and other personnel, could negatively impact our business.

We depend on the skills, working relationships, and continued services of key personnel, including our experienced senior management team. We also depend on our ability to attract and retain qualified personnel to operate and expand our business. If we lose one or more members of our senior management team, or if we fail to attract talented new employees, our business and results of operations could be negatively affected.

Our workforce could become unionized in the future, which could materially and adversely affect the stability of our production and materially reduce our profitability.

Although none of our employees are currently represented by a labor union, our employees have the right at any time under the National Labor Relations Act to form or affiliate with a union and certain employees at our Wisconsin facility have undertaken the process of asking for a vote on forming a union. If our employees choose to form or affiliate with a union and the terms of a union collective bargaining agreement are significantly different from our current compensation and job assignment arrangements with our employees, these arrangements could materially and adversely affect the stability of our operations and materially reduce our profitability.

Our intellectual property rights are valuable, and any inability to protect them could reduce the value of our products and brands.

We consider our intellectual property rights, particularly our trademarks, but also our trade secrets, copyrights, and licenses, to be a significant and valuable aspect of our business. We attempt to protect our intellectual property rights through a combination of trademark, copyright, and trade secret laws, as well as licensing agreements, third-party confidentiality, nondisclosure, and assignment agreements, and by policing third-party misuses of our intellectual property. Our failure to obtain or maintain adequate protection of our intellectual property rights, or any change in law or other changes that serve to lessen or remove the current legal protections of our intellectual property, may diminish our competitiveness and could materially harm our business.

We also face the risk of claims that we have infringed third parties' intellectual property rights. Any claims of intellectual property infringement, even those without merit, could be expensive and time consuming to defend, cause us to cease making, licensing, or using products that incorporate the challenged intellectual property, require us to redesign or rebrand our products or packaging, divert management's attention and resources, or require us to enter into royalty or licensing agreements to obtain the right to use a third party's intellectual property. Any royalty or licensing agreements, if required, may not be available to us on acceptable terms or at all. Additionally, a successful claim of infringement against us could result in our being required to pay significant damages, enter into costly license or royalty agreements, or stop the sale of certain products, any of which could have a negative effect on our results of operations.

Litigation or legal proceedings could expose us to significant liabilities and have a negative impact on our reputation.

We are party to various litigation claims and legal proceedings. We evaluate these litigation claims and legal proceedings to assess the likelihood of unfavorable outcomes and to estimate, if possible, the amount of potential losses. Based on these assessments and estimates, we establish reserves or disclose the relevant litigation claims or legal proceedings, as appropriate. These assessments and estimates are based on the information available to management at the time and involve a significant amount of management judgment. Actual outcomes or losses may differ materially from our current assessments and estimates.

Our business is subject to various environmental and health and safety laws and regulations, which may increase our compliance costs or subject us to liabilities.

Our business operations are subject to numerous requirements in the United States relating to the protection of the environment and health and safety matters, including the Clean Air Act, the Clean Water Act, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, and the National Organic Standards of the U.S. Department of Agriculture, as well as similar state and local statutes and regulations in the United States and in each of the countries in which we do business in Europe. These laws and regulations govern, among other things, air emissions and the discharge of wastewater and other pollutants, the use of refrigerants, the handling and disposal of hazardous materials, and the cleanup of contamination in the environment. We could incur significant costs, including fines, penalties and other sanctions, cleanup costs, and third-party claims for property damage or personal injury as a result of the failure to comply with, or liabilities under, environmental, health, and safety requirements. New legislation, as well as current federal and other state regulatory initiatives relating to these environmental matters, could require us to replace equipment, install additional pollution controls, purchase various emission allowances, or curtail operations. These costs could negatively affect our results of operations and financial condition.

Violations of laws or regulations related to the food industry, as well as new laws or regulations or changes to existing laws or regulations related to the food industry, could adversely affect our business.

The food production and marketing industry is subject to a variety of federal, state, local, and foreign laws and regulations, including food safety requirements related to the ingredients, manufacture, processing, storage, marketing, advertising, labeling, and distribution of our products, as well as those related to worker health and workplace safety. Our activities, both in and outside of the United States, are subject to extensive regulation. We are regulated by, among other federal and state authorities, the U.S. FDA, the U.S. Federal Trade Commission (“FTC”), and the U.S. Departments of Agriculture, Commerce, and Labor, as well as by similar authorities abroad within the regulatory framework of the European Union and its members. Governmental regulations also affect taxes and levies, healthcare costs, energy usage, immigration, and other labor issues, all of which may have a direct or indirect effect on our business or those of our customers or suppliers. In addition, the marketing and advertising of our products could make us the target of claims relating to alleged false or deceptive advertising under federal, state, and foreign laws and regulations, and we may be subject to initiatives that limit or prohibit the marketing and advertising of our products to children. We are also subject to federal laws and regulations relating to our organic products and production. For example, as required by the National Organic Program (“NOP”), we rely on third parties to certify certain of our products and production locations as organic. Because the Organic Foods Production Act of 1990, which created the NOP, was so recently adopted, many regulations and informal positions taken by the NOP are subject to continued review and scrutiny. Changes in these laws or regulations or the introduction of new laws or regulations could increase our compliance costs, increase other costs of doing business for us, our customers, or our suppliers, or restrict our actions, which could adversely affect our results of operations. In some cases, increased regulatory scrutiny could interrupt distribution of our products, as could be the case in the United States as the FDA enacts the Food Safety Modernization Act of 2011, or force changes in our production processes and our products. Further, if we are found to be in violation of applicable laws and regulations in these areas, we could be subject to civil remedies, including fines, injunctions, or recalls, as well as potential criminal sanctions, any of which could have a material adverse effect on our business.

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.

Ludmila Smolyansky, the chairman of our board, Julie Smolyansky, our chief executive officer, president and director and Edward Smolyansky, our chief financial and accounting officer, chief operating officer, treasurer and secretary (together, the “Smolyansky Family”), collectively control a majority of the voting power of our outstanding common stock. As a result, we are a “controlled company” pursuant to Rule 5615(c) of the corporate governance requirements of the NASDAQ Stock Market. Under such rules, a company of which more than 50% of the voting power for the election of directors is held by an individual, a group or another company is a “controlled company” and may elect not to comply with certain corporate governance requirements of the NASDAQ Stock Market, including the requirements that:

- a majority of our Board of Directors consist of independent directors;

- the nominating and corporate governance committee be composed entirely of independent directors with a written charter addressing the committee’s purpose and responsibilities;

- the compensation committee be composed entirely of independent directors with a written charter addressing the committee’s purpose and responsibilities; and

- there be an annual performance evaluation of the nominating and corporate governance and compensation committees.

This controlled company exemption does not extend to the audit committee requirements under Rule 5605(c) or the requirement for executive sessions of Independent Directors under Rule 5605(b)(2).

We elect to be treated as a “Controlled Company”. As a result, you may not have the same protections afforded to shareholders of companies that are mandatorily subject to all of the corporate governance requirements of the NASDAQ Stock Market.

One of our directors and officers controls a majority of our common stock and his interests may not align with the interests of our other shareholders.

The Smolyansky Family controls our company and owns in excess of 50% of our issued and outstanding common stock. This significant concentration of share ownership may adversely affect the trading price of our common stock because investors often perceive a disadvantage in owning shares in a company with one or several controlling shareholders. Furthermore, our directors and officers, as a group, which own in excess of 50% of our issued and outstanding common stock have the ability to significantly influence or control the outcome of all matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions, such as mergers, consolidations or the sale of substantially all of our assets. This concentration of ownership may have the effect of delaying or preventing a change in control of our company which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of our company and might reduce the price of our common stock. In addition, without the consent of the Smolyansky Family, we could be prevented from entering into transactions that could be beneficial to us. The Smolyansky Family may cause us to take actions that are opposed by other shareholders as his interests may differ from those of other shareholders.

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.

99.1 Press Release dated August 11, 2014.

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: August 11, 2014	By:	/s/ Julie Smolyansky Julie Smolyansky Chief Executive Officer, President, and Director (Principal Executive Officer)
Date: August 11, 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)

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