LIFEWAY FOODS INC
Form 10QSB
November 14, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

þ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2007

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from ____________________ to ____________________

Commission file number: 0-17363

LIFEWAY FOODS, INC.
(Exact name of small business issuer as specified in it charter)

Illinois	36-3442829
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6431 WEST OAKTON, MORTON GROVE, ILLINOIS 60053

(Address of principal executive offices)

(847) 967-1010

(Issuer’s telephone number)

(Former name, former address and former fiscal year, if changed since last report)

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of September 30, 2007, the issuer had 16,825,626 shares of common stock, no par value, outstanding.

Transitional Small Business Disclosure Format (Check one): Yes **o** No **þ**

INDEX

PART I — FINANCIAL INFORMATION

LIFEWAY FOODS, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2007 AND 2006

AND DECEMBER 31, 2006

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Financial Condition
September 30, 2007 and 2006 (Unaudited) and December 31, 2006

	(Unaudited) September 30, 2007	2006	December 31, 2006
ASSETS			
Current assets			
Cash and cash equivalents	$ 1,624,566	$ 1,242,306	$ 1,547,812
Marketable securities	6,557,841	8,042,189	8,491,363
Investment, at cost	500,000	—	—
Inventories	4,061,189	2,628,508	2,522,196
Accounts receivable, net of allowance for doubtful accounts of $39,460 and $45,000 at September 30, 2007 and 2006 and $80,000 at December 31, 2006	4,845,956	3,984,991	3,942,717
Prepaid expenses and other current assets	13,051	46,547	11,983
Other receivables	45,810	59,810	71,050
Deferred income taxes	225,803	108,154	32,234
Refundable income taxes	125,763	68,346	267,771
Total current assets	**17,999,979**	**16,180,851**	**16,887,126**
Property and equipment, net	**9,176,479**	**8,574,181**	**8,580,716**
Intangible assets			
Goodwill	3,952,425	3,906,114	3,952,425
Other intangible assets, net of accumulated amortization of $520,979 and $142,010 at September 30, 2007 and 2006 and $278,710 December 31, 2006	3,342,517	3,715,628	3,578,928
Total intangible assets	**7,294,942**	**7,621,742**	**7,531,353**
Total assets	**$ 34,471,400**	**$ 32,376,774**	**$ 32,999,195**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Current maturities of notes payable	$ 1,434,903	$ 1,124,284	$ 1,131,336
Accounts payable	1,865,041	1,251,720	1,463,014
Accrued expenses	441,068	270,990	480,101
Total current liabilities	**3,741,012**	**2,646,994**	**3,074,451**
Notes payable	**4,424,266**	**6,191,521**	**5,746,718**
Deferred income taxes	**510,000**	**346,217**	**449,619**
Stockholders' equity			
	6,509,267	6,509,267	6,509,267

Common stock, no par value; 20,000,000 shares authorized; 17,273,776 shares issued; 16,825,626 shares outstanding at September 30, 2007; 17,273,776 shares issued; 16,908,144 shares outstanding at September 30, 2006; and 17,273,776 shares issued; 16,897,826 shares outstanding at December 31, 2006			
Paid-in-capital	1,103,630	1,080,911	1,080,911
Treasury stock, at cost	(2,081,915)	(1,235,542)	(1,334,313)
Retained earnings	20,318,323	16,807,609	17,318,772
Accumulated other comprehensive income (loss), net of taxes	(53,183)	29,797	153,770
Total stockholders' equity	**25,796,122**	**23,192,042**	**23,728,407**
Total liabilities and stockholders' equity	**$ 34,471,400**	**$ 32,376,774**	**$ 32,999,195**

See accompanying notes to financial statements.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Income and Comprehensive Income
For the Three and Nine Months Ended September 30, 2007 and 2006 (Unaudited)
and The Year Ended December 31, 2006

	(Unaudited) Three Months Ended September 30,				(Unaudited) Nine Months Ended September 30,				Year Ended December 31,	
		2007		**2006**		**2007**		**2006**		**2006**
Sales	$	9,817,478	$	7,456,649	$	28,554,984	$	19,827,069	$	27,720,713
Cost of goods sold		7,096,819		4,616,366		18,432,830		11,709,587		17,081,992
Gross profit		**2,720,659**		**2,840,283**		**10,122,154**		**8,117,482**		**10,638,721**
Selling Expenses		1,174,140		890,563		2,856,483		2,323,155		3,065,254
General and Administrative		965,476		830,400		3,121,851		2,338,483		3,343,341
Total Operating Expenses		2,139,616		1,720,963		5,978,334		4,661,638		**6,408,595**
Income from operations		**581,043**		**1,119,320**		**4,143,820**		**3,455,844**		**4,230,126**
Other income (expense):										
Interest and dividend income		84,918		86,318		249,082		294,583		388,339
Rental Income		9,731		—		27,912		—		11,401
Interest expense		(102,197)		(96,557)		(321,009)		(209,983)		(345,525)
Gain (loss) on sale of marketable securities, net		208,629		89,260		662,009		277,674		355,767
Gain on marketable securities classified as trading		578		(2,370)		1,529		691		791
Total other income (Expense)		201,659		76,651		619,523		362,965		410,773
Income before provision for income taxes		**782,702**		**1,195,971**		**4,763,343**		**3,818,809**		**4,640,899**
Provision for income taxes		314,508		456,012		1,763,792		1,434,148		1,745,075
Net income	**$**	**468,194**	**$**	**739,959**	**$**	**2,999,551**	**$**	**2,384,661**	**$**	**2,895,824**
		0.03		0.04		0.18		0.14		0.17

Basic and diluted earnings per common share					
Weighted average number of shares outstanding	**16,824,911**	**16,860,139**	**16,865,390**	**16,855,889**	**16,829,601**
<u>COMPREHENSIVE INCOME</u>					
Net income	**$ 468,194**	**$ 739,959**	**$ 2,999,551**	**$ 2,384,661**	**$ 2,895,824**
Other comprehensive income (loss), net of tax:					
Unrealized gains (losses) on marketable securities (net of tax benefits)	(57,187)	102,436	181,647	312,717	(251,021)
Less reclassification adjustment for gains (losses) included in net income (net of taxes)	(123,372)	(73,184)	(388,600)	(183,406)	504,305
Comprehensive income	**$ 287,635**	**$ 769,211**	**$ 2,792,598**	**$ 2,513,972**	**$ 3,149,108**

See accompanying notes to financial statements.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholder's Equity
For the Nine Months Ended September 30, 2007 (Unaudited)
and the Year Ended December 31, 2006

	Common Stock, No Par Value 20,000,000 Shares Authorized		# of Shares of					Accumulated Other Comprehensive Income (Loss), Net of Tax	
	# of Shares Issued	# of Shares Outstanding	Treasury Stock	Common Stock	Paid In Capital	Treasury Stock	Retained Earnings		
Balances at December 31, 2005	**17,273,776**	**16,790,510**	**483,266**	**$ 6,509,267**	**$ 90,725**	**$ (1,024,659)**	**$ 14,422,948**	**$ (99,514)**	**$**
Issuance of treasury stock for compensation	—	4,666	(4,666)	—	13,311	15,855	—	—	
Issuance of treasury stock for acquisition of Helios	—	202,650	(202,650)	—	976,875	323,125	—	—	
Redemption of stock	—	(100,000)	100,000	—	—	(648,634)	—	—	
Other comprehensive income (loss): Unrealized losses on securities, net of taxes and reclassification adjustment	—	—	—	—	—	—	—	253,284	
Net income for the year ended December 31, 2006	—	—	—	—	—	—	2,895,824	—	
Balances at December 31, 2006	**17,273,776**	**16,897,826**	**375,950**	**6,509,267**	**1,080,911**	**(1,334,313)**	**17,318,772**	**153,770**	

Redemption of stock	—	(75,000)	75,000	—	—	(752,603)	—	—	
Issuance of treasury stock for compensation	—	2,800	(2,800)	—	22,719	5,001	—	—	
Other comprehensive income (loss): Unrealized gains on securities, net of taxes and reclassification adjustment	—	—	—	—	—	—	—	(206,953)	
Net income for the nine months ended September 30, 2007	—	—	—	—	—	—	2,999,551	—	
Balances at September 30, 2007	**17,273,776**	**16,825,626**	**448,150**	**$ 6,509,267**	**$ 1,103,630**	**$ (2,081,915)**	**$ 20,318,323**	**$ (53,183)**	**$**

See accompanying notes to financial statements.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Nine Months Ended September 30, 2007 and 2006 (Unaudited)
and the Year Ended December 31, 2006

	(Unaudited) Nine Months Ended September 30, 2007	(Unaudited) Nine Months Ended September 30, 2006	Year Ended December 31, 2006
Cash flows from operating activities:			
Net income	**$ 2,999,551**	**$ 2,384,661**	**$ 2,895,824**
Adjustments to reconcile net income to net cash flows from operating activities, net of acquisition:			
Depreciation and amortization	789,215	457,844	758,754
(Gain)Loss on sale of marketable securities, net	(662,009)	(277,674)	(355,767)
Gain on marketable securities classified as trading	(1,529)	(691)	(791)
Deferred income taxes	12,419	(58,932)	33,031
Treasury stock issued for services	27,720	29,166	29,166
Increase (decrease) in allowance for doubtful accounts	(40,540)	10,000	45,000
(Increase) decrease in operating assets:			
Accounts receivable	(862,699)	(1,197,722)	(1,190,448)
Other receivables	25,240	(3,375)	(14,615)
Inventories	(1,538,993)	(691,875)	(585,563)
Refundable income taxes	142,008	(56,784)	(256,209)
Prepaid expenses and other current assets	(1,068)	468	35,032
Increase (decrease) in operating liabilities:			
Accounts payable	402,027	427,705	638,999
Accrued expenses	(39,033)	(84,021)	125,090
Net cash provided by operating activities	**1,252,309**	**938,770**	**2,157,503**
Cash flows from investing activities:			
Investment in cost method securities	(500,000)	—	—
Purchases of marketable securities	(4,408,170)	(5,258,207)	(7,509,692)
Sale of marketable securities	6,652,670	5,193,235	7,285,071
Purchases of property and equipment	(1,142,709)	(500,118)	(680,174)
Acquisition of Helios, net of cash acquired	—	(2,514,679)	(2,551,679)
Purchases of organizational costs	(5,858)	—	—
Net cash provided by (used in) investing activities	**595,933**	**(3,079,769)**	**(3,456,474)**
Cash flows from financing activities:			
Proceeds of note payable	300,000	—	—
Purchases of treasury stock	(752,603)	(549,863)	(648,634)
Repayment of notes payable	(1,318,885)	(420,913)	(858,664)
Net cash used in financing activities	**(1,771,488)**	**(970,776)**	**(1,507,298)**
Net increase (decrease) in cash and cash equivalents	**76,754**	**(3,111,775)**	**(2,806,269)**
Cash and cash equivalents at the beginning of the period	1,547,812	4,354,081	4,354,081
Cash and cash equivalents at the end of the period	**$ 1,624,566**	**$ 1,242,306**	**$ 1,547,812**

See accompanying notes to financial statements.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 1 – NATURE OF BUSINESS AND BASIS OF PRESENTATION

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

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the rules and regulations of the Securities and Exchange Commission for interim financial statements. These financial statements reflect all adjustments and accruals of a normal recurring nature, which, in the opinion of management are necessary in order to make the financial statements not misleading. The results for the interim periods presented are not necessarily indicative of results to be expected for any future period.

These financial statements should be read in conjunction with the audited financial statements and the notes thereto of all the companies included in Lifeway's 2006 Annual Report on Form 10-KSB filed with the Securities Exchange Commission for the year ended December 31, 2006.

On August 3, 2006 the Company executed a Stock Purchase Agreement with George Economy, Amani Holdings, LLC and other shareholders ("the stockholders") of the capital stock of Helios Nutrition, Ltd. ("Helios") and Pride Main Street Dairy, L.L.C. pursuant to which the Company purchased all of the issued and outstanding stock of Helios from the Stockholders for a combination of an aggregate amount of 202,650 in shares of the Company's common stock, no par value, $2,563,000 in cash, and a promissory note issued by the Company in favor of the Stockholders in the principal amount of $4,200,000. The Stock Payment, the Cash Payment and Promissory Note are subject to adjustment under certain circumstances in accordance with the terms of the Stock Purchase Agreement.

The final net purchase price for the assets was $8,063,000 including professional fees related to the acquisition. The following table summarizes the fair values of the assets acquired and the liabilities assumed at the date of acquisition.

Cash	$ 11,321
Accounts Receivable Assumed	279,654
Inventories	219,634
Equipment, Building and Land	721,572
Prepaid Items	37,871
Trade Name - Intangible Asset	1,980,000
Formula - Intangible Asset	438,000
Contractual Backlog - Intangible Asset	12,000
Customer Relationships - Intangible Asset	985,000
Goodwill	3,876,625
Total Assets Acquired	8,561,677

Note Payable and Accounts Payable Assumed	(498,677)
Net Assets Acquired	$ 8,063,000

At closing, $2,563,000 was paid of the total purchase, $1,300,000 was paid in stock, with the balance due as a $4,200,000 note to be paid in sixteen equal installments over sixteen quarters. The goodwill is expected to be deductible for tax purposes.

The September 30, 2006 financial statements were prepared before the final purchase price allocation was completed. Goodwill and intangible assets have been reclassified on these financial statements to reflect the purchase price allocation.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 1 – NATURE OF BUSINESS - Continued

The following unaudited proforma information presents the results of operations of the Company as if the acquisition had taken place at the beginning of 2006:

	9 months ended September 30, 2006	Year ended December 31, 2006
Net Sales	$ 22,831,688	$ 30,804,309
Net Income	$ 2,076,051	$ 2,621,228
EPS	$ 0.12	$ 0.16

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Principles of consolidation
The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, LFI Enterprises, Inc., Helios Nutrition, Ltd., Pride of Main Street, L.L.C. and STARFRUIT, LLC. 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 Goodwill and intangible assets and deferred taxes.

Revenue Recognition
Sales represent sales of Company produced dairy products that 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.

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. Deposits at each institution are insured up to $100,000 by the Federal Deposit Insurance Corporation or the Securities Investor Protector Corporation.

Bank balances of amounts reported by financial institutions are categorized as follows:

	September 30, 2007	2006	December 31, 2006
Amounts insured	$ 251,315	$ 392,445	$ 432,678
Uninsured and uncollateralized amounts	1,992,169	1,101,926	1,412,560
Total bank balances	$ 2,243,484	$ 1,494,371	1,845,238

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Marketable securities

All investment securities are classified as either as available-for-sale or trading, and are carried at fair value or quoted market prices. Unrealized gains and on available-for-sale securities losses 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. Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) 59, *Accounting for Noncurrent Marketable Equity Securities*, and Emerging Issue Task Force Abstract 03-01 *The Meaning of Other-than-temporary Impairment and its Application to Certain Investments,* provide guidance on determining when an investment is other-than-temporarily impaired. This evaluation depends on the specific facts and circumstances. Factors that we consider in determining whether an other-than-temporary decline in value has occurred include: the market value of the security in relation to its cost basis; the financial condition of the investee; and the intent and ability to retain the investment for a sufficient period of time to allow for possible recovery in the market value of the investment.

Accounts receivable

Credit terms are extended to customers in the normal course of business. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral.

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

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

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

Property and equipment are 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

- 10 -

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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

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

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

Intangible assets are being amortized over the following useful lives:

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

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

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

As of January 1, 2007, the Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109" (FIN 48), which clarifies the accounting and disclosure for uncertainty in tax positions, as defined. Pursuant to FIN 48, the Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The only periods subject to examination for the Company's federal return are the 2003 through 2006 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 pursuant to FIN 48. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

The Company's policy for recording interest and penalties associated with audits is to record such items as a component of income before taxes. There were no such items during the periods covered in this report.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Treasury stock
Treasury stock is recorded using the cost method.

Advertising costs
The Company expenses advertising costs as incurred. During the year ended December 31, 2006 and for the nine months ended September 30, 2007 and 2006, approximately $1,435,758, $1,356,850 and $1,092,560 of such costs respectively, were expensed.

Earning per common share
Earnings per common share were computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. For the nine months ended September 30, 2007 and 2006 and the year ended December 31, 2006, diluted and basic earnings per share were the same, as the effect of dilutive securities options outstanding was not significant.

Reclassification

Certain 2006 amounts have been reclassified to conform to the 2007 presentation.

Note 3 – INTANGIBLE ASSETS

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

	September 30, 2007		September 30, 2006		December 31, 2006	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Recipes	$ 43,600	$ 34,517	$ 43,600	$ 23,617	$ 43,600	$ 26,342
Customer lists and other customer related intangibles	305,200	131,163	305,200	89,743	305,200	100,098
Lease acquisition	87,200	39,448	87,200	26,990	87,200	30,105
Goodwill	3,952,425	—	3,906,114	—	3,952,425	—
Loan acquisition costs	12,496	2,987	6,638	1,660	6,638	1,991
Customer relationship	985,000	95,764	985,000	—	985,000	34,924
Contractual backlog	12,000	12,000	12,000	—	12,000	12,000
Trade names	1,980,000	154,000	1,980,000	—	1,980,000	55,000
Formula	438,000	51,100	438,000	—	438,000	18,250
	$ 7,815,921	$ 520,979	$ 7,763,752	$ 142,010	$ 7,810,063	$ 278,710

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

2007	$ 322,835
2008	313,585
2009	310,306
2010	303,040

2011		300,965
Thereafter		1,791,786
	$	3,342,517

Amortization expense during the nine months ended September 30, 2007 and 2006 and the year ended 2006 was $242,269, $49,579 and $186,278, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 4 – MARKETABLE SECURITIES AND OTHER INVESTMENTS

The cost and fair value of marketable securities classified as available for sale and trading are as follows:

September 30, 2007	Cost	Unrealized Gains	Unrealized Losses	Loss on Marketable Securities Classified as Trading	Fair Value
Equities	$ 2,323,985	$ 318,165	$ (168,993)	—	$ 2,473,157
Mutual Funds	1,146,517	10,889	(67,705)	—	1,089,701
Preferred Securities	1,417,978	6,570	(84,438)	—	1,340,110
Certificates of Deposit	75,000	—	(395)	—	74,605
Corporate Bonds	1,580,768	971	(105,851)	—	1,475,888
Municipal Bonds	4,586	187	—	—	4,773
Government agency Obligations	100,000	—	—	(393)	99,607
Total	$ 6,648,834	$ 336,782	$ (427,382)	$ (393)	$ 6,557,841

September 30, 2006	Cost	Unrealized Gains	Unrealized Losses	Loss on Marketable Securities Classified as Trading	Fair Value
Equities	$ 2,918,943	$ 249,781	$ (150,197)		$ 3,018,527
Mutual Funds	288,630	2,447	(3,666)		287,411
Preferred Securities	1,491,741	5,214	(28,560)		1,468,395
Private Investment LP	600,000	42,660	—		642,660
Certificates of Deposit	225,000	1,305	(2,393)		223,912
Corporate Bonds	2,153,896	3,238	(70,694)		2,086,440
Municipal Bonds, maturing within five years	160,757	1,828	(203)		162,382
Government agency obligations, maturing after five years	154,483	—	—	(2,021)	152,462
Total	$ 7,993,450	$ 306,473	$ (255,713)	(2,021)	$ 8,042,189

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 4 – MARKETABLE SECURITIES - Continued

December 31, 2006	Cost	Unrealized Gains	Unrealized Losses	Loss on Marketable Securities Classified as Trading	Fair Value
Equities	$ 3,048,755	$ 359,729	$ (69,950)	—	$ 3,338,534
Mutual Funds	522,492	3,248	(7,675)	—	518,065
Preferred Securities	1,353,568	6,554	(11,347)	—	1,348,775
Private Investment LP	600,000	71,632	—	—	671,632
Certificates of Deposit	225,000	2,190	(2,393)	—	224,797
Corporate Bonds	2,185,982	2,408	(95,075)	—	2,093,315
Municipal Bonds	160,757	2,937	(303)	—	163,391
Government agency	134,776	—	—	(1,922)	132,854
Total	$ 8,231,330	$ 448,698	$ (186,743)	$ (1,922)	$ 8,491,363

Proceeds from the sale of marketable securities were $7,285,071, $6,652,670 and $5,193,235 during the year ended December 31, 2006 and for the nine months ended September 30, 2007 and 2006, respectively.

Gross gains (loss) of $355,767, $662,009 and $277,674 were realized on these sales during the year ended December 31, 2006 and for the nine months ended September 30, 2007 and 2006, respectively. Gross gains (loss) of $208,629 and $89,260 were realized on these sales for the three months ended September 30, 2007 and 2006, respectively.

The following table shows the gross unrealized losses and fair value of Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2007:

	Less Than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	$ 744,341	$ (138,770)	$ 222,571	$ (30,223)	$ 966,912	$ (168,993)
Mutual Funds	820,127	(67,638)	7,404	(67)	827,531	(67,705)
Preferred Securities	725,815	(55,111)	457,725	(29,327)	1,183,540	(84,438)
Certificates of Deposit	—	—	74,605	(395)	74,605	(395)
Corporate Bonds	178,530	(21,470)	1,240,828	(84,381)	1,419,358	(105,851)
Municipal Bonds	—	—	—	—	—	—
	$ 2,468,813	$ (282,989)	$ 2,003,133	$ (144,393)	$ 4,471,946	$ (427,382)

Equities, Mutual Funds and Corporate Bonds - The Company's investments in equity securities, mutual funds and corporate bonds consist of investments in common stock and debt securities of companies in various industries. The Company evaluated the near-term prospects of the issuer in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider any material investments to be other-than-temporarily impaired at September 30, 2007.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 4 – MARKETABLE SECURITIES - Continued

Preferred Securities - The Company's investments in preferred securities consist of investments in preferred stock of companies in various industries. The Company evaluated the near-term prospects of the security in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider any material investments to be other-than-temporarily impaired at September 30, 2007.

Certificates of Deposit - The unrealized losses on the Company's investments in certificates of deposit were caused by interest rate increases since the date of purchase. The contractual terms of these investments do not permit the issuers to settle the securities at a price less than the face value of the investment. Because the Company has the ability and intent to hold these investments until maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2007.

Municipal Bonds - The unrealized losses on the Company's investments in mutual bonds were caused by interest rate increases since the date of purchase. Because the Company has the ability and intent to hold these investments until maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2007.

The Company holds a minority equity investment in convertible preferred stock of a privately held company. Because this security is not publicly traded, it is not practical to regularly estimate its fair value. Investments of this nature are subject to an evaluation for other than temporary impairment on a quarterly basis. This quarterly evaluation consists of reviewing, among other things, company business plans and current financial statements, if available, for factors that may indicate an impairment of our investment. Such factors may include, but are not limited to, cash flow concerns, material litigation, violations of debt covenants and changes in business strategy. The fair value of the equity investment is not estimated unless there are identified changes in circumstances that may indicate impairments exists and these changes are likely to have a significant adverse effect on the fair value of the investment. As of September 30, 2007, management reviewed the carrying value of the investment and estimated the aggregate fair value to be $500,000. No impairment was recorded on the investment during the nine months ended September 30, 2007.

Note 5 – INVENTORIES

Inventories consist of the following:

	September 30,		December 31,
	2007	2006	2006
Finished goods	$ 1,835,452	$ 988,212	$ 952,484
Production supplies	1,318,991	905,615	988,174
Raw materials	906,746	734,681	581,538
Total inventories	$ 4,061,189	$ 2,628,508	$ 2,522,196

Note 6 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	September 30,	December 31,

	2007	2006	2006
Land	$ 969,232	$ 969,232	$ 969,232
Buildings and improvements	6,813,045	6,715,371	6,713,743
Machinery and equipment	8,127,460	6,961,853	7,143,537
Vehicles	581,458	534,365	534,365
Office equipment	101,582	89,192	89,192
	16,592,777	15,270,013	15,450,069
Less accumulated depreciation	7,416,298	6,695,832	6,869,353
Total property and equipment	$ 9,176,479	$ 8,574,181	$ 8 ,580,716

Depreciation expense during the year ended December 31, 2006 and for the nine months ended September 30, 2007 and 2006 was $572,476, $546,945 and $408,266 respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 7 – ACCRUED EXPENSES

Accrued expenses consist of the following:

	September 30, 2007	September 30, 2006	December 31, 2006
Accrued payroll and payroll taxes	$ 82,981	$ 34,979	$ 139,367
Accrued property tax	340,717	202,080	269,435
Other	17,370	33,931	71,299
	$ 441,068	$ 270,990	$ 480,101

Note 8 – NOTES PAYABLE

Notes payable consist of the following:

	September 30, 2007	September 30, 2006	December 31, 2006
Mortgage note payable to a bank, payable in monthly installments of $3,273 including interest at 7%, with a balloon payment of $416,825 due September 25, 2011. Collateralized by real estate.	$ 448,269	$ 455,079	$ 453,355
Mortgage note payable to a bank, payable in monthly installments of $19,513 including interest at 5.6%, with a balloon payment of $2,652,143 due July 14, 2010. Collateralized by real estate.	2,853,203	2,923,226	2,905,988
Note payable to Amani Holding LLC, payable in quarterly installments of $262,500 plus interest at the floating prime rate per annum (8.25% at December 31, 2006) due September 1, 2010 secured by letter of credit	2,257,697	3,937,500	3,518,711
Note payable to officer, payable on demand	300,000	—	—
Total notes payable	5,859,169	7,315,805	6,878,054
Less current maturities	1,434,903	1,124,284	1,131,336
Total long-term portion	$ 4,424,266	$ 6,191,521	$ 5,746,718

Maturities of notes payables are as follows:

For the year ended September 30,

2008	$	1,434,903
2009		1,139,904
2010		2,862,795
2011		421,567
Total	$	5,859,169

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 9 – PROVISION FOR INCOME TAXES

The provision for income taxes consists of the following:

	For the Nine Months Ended September 30, 2007	For the Nine Months Ended September 30, 2006	For the Year Ended December 31, 2006
Current:			
Federal	$ 1,465,229	$ 1,203,942	$ 1,390,590
State and local	286,145	289,274	321,454
Total current	1,751,374	1,493,216	1,712,044
Deferred	12,418	(59,068)	33,031
Provision for income taxes	$ 1,763,792	$ 1,434,148	$ 1,745,075

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

	For the Nine Months Ended September 30, 2007	For the Nine Months Ended September 30, 2006	For the Year Ended December 31, 2006
Federal income tax expense computed at the statutory rate	$ 1,619,535	$ 1,298,395	$ 1,577,226
State and local tax expense, net	228,640	183,268	222,667
Permanent differences	(84,383)	(47,515)	(54,818)
Provision for income taxes	$ 1,763,792	$ 1,434,148	$ 1,745,075

Amounts for deferred tax assets and liabilities are as follows:

	September 30, 2007	September 30, 2006	December 31, 2006
Non-current deferred tax liabilities arising from:			
Temporary differences - accumulated depreciation and amortization	$ (510,000)	$ (346,217)	$ (449,619)
Current deferred tax assets (liabilities) arising from:			
Unrealized losses (gains) on marketable securities	37,418	(20,965)	(108,188)
Inventory	172,088	110,533	107,382
Allowance for doubtful accounts	16,297	18,585	33,040
Total current deferred tax assets (liabilities)	225,803	108,153	32,234
Net deferred tax liability	$ (284,197)	$ (238,064)	$ (417,385)

- 17 -

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 10 – SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest and income taxes are as follows:

	For The Nine Months Ended September 30, 2007	For The Nine Months Ended September 30, 2006	For The Year Ended December 31, 2006
Interest	$ 313,215	$ 209,983	$ 337,768
Income taxes	$ 1,626,031	$ 1,555,444	$ 1,556,586

Note 11 – STOCK OPTION PLANS

The Company has a registration statement filed with the Securities and Exchange Commission in connection with a Consulting Service Compensation Plan covering up to 600,000 of the Company's common stock shares. Pursuant to such Plan, the Company may issue common stock or options to purchase common stock to certain consultants, service providers, and employees of the Company. There were 468,000 shares available for issuance under the Plan at December 31, 2006 and at September 30, 2007 and 2006. The option price, number of shares, grant date, and vesting terms are determined at the discretion of the Company's Board of Directors.

As of December 31, 2006 and at September 30, 2007 and 2006, there were no stock options outstanding or exercisable.

On February 12, 2004, Lifeway's Board of Directors approved awards of an aggregate amount of 10,200 shares to be awarded under its Employee and Consulting Services and Compensation Plan to certain employees and consultants for services rendered to the Company. The stock awards were made on April 1, 2004 and have vesting periods that vary from six months to one year, depending upon the individual grantee. During 2005, 550 shares vested for a total expense of $11,512.

On May 23, 2005, Lifeway's Board of Directors approved awards of an aggregate amount of 11,200 common shares to be awarded under its Employee and Consulting Services and Compensation Plan to certain employees and consultants for services rendered to the Company. The stock awards were made on June 1, 2005 and have vesting periods of one year. The expense for the awards is measured as of June 1, 2005 at $6.25 per share for 11,200 shares, or a total stock award expense of $70,000. This expense will be recognized as the stock awards vest in 12 equal portions of $5,833, or 932 shares per month for one year. During 2005, 7,534 shares vested and the Company recognized a related expense of $40,833. During the year ended December 31, 2006, 4,666 shares vested for an expense of $29,166.

On May 18, 2007, Lifeway's Board of Directors approved awards of an aggregate amount of 8,400 shares to be awarded under its Employee and Consulting Services and Compensation Plan to certain key employees and consultants for services rendered to the Company. The stock awards were made on June 1, 2007 and have vesting periods of one year. The expense for the awards is measured as of June 1, 2007 at $9.90 per share for 8,400 shares, or a total stock award expense of $83,160. This expense will be recognized as the stock awards vest in 12 equal portions of $6,930, or 700 shares per month for one year.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 12 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Company's financial instruments is as follows at:

	September 30, 2007		September 30, 2006		December 31, 2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	$ 1,624,566	$ 1,624,566	$ 1,242,306	$ 1,242,306	$ 1,547,812	$ 1,547,812
Marketable securities	$ 6,557,841	$ 6,557,841	$ 8,042,189	$ 8,042,189	$ 8,491,363	$ 8,491,363
Notes payable	$ 5,859,169	$ 5,859,169	$ 7,315,805	$ 7,275,702	$ 6,878,054	$ 6,878,054

A summary of the methods and significant assumptions used to estimate the fair values of financial instruments is as follows:

Investments - Investments are recorded at fair value in the accompanying financial statements. Fair value is determined based on quoted market prices.

Long-term Obligations - The fair value of long-term obligations approximates the carrying amounts in the accompanying financial statements. The carrying value of the debt approximates market based on current borrowing rates.

Note 13 – RECENT ACCOUNTING PRONOUNCEMENTS

In March 2006, the Financial Accounting Standards Board issued SFAS No. 156, "*Accounting for Servicing of Financial Assets,"* an amendment of FASB Statement No. 140. SFAS No. 156 requires an entity to recognize a servicing asset or liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract. It requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value. SFAS No. 156 permits an entity to choose either an amortization or fair value measurement method for each class of separately recognized servicing assets and servicing liabilities. It also permits a one-time reclassification of available-for-sale securities to trading securities with recognized servicing rights. Lastly, it requires separate presentation of servicing assets and servicing liabilities. Adoption of the initial measurement provision of this statement is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The adoption of this standard is not expected to have a material impact on the Company's financial condition, results of operations or liquidity.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2007 and 2006
and December 31, 2006

Note 13 – RECENT ACCOUNTING PRONOUNCEMENTS - Continued

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. The Statement clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The statement emphasizes that fair value is a market-based measurement and not an entity-specific measurement. The statement establishes a fair value hierarchy used in fair value measurements and expands the required disclosures of assets and liabilities measured at fair value. Management will be required to adopt this statement beginning in 2008. The adoption of this standard is not expected to have a material impact on the Company's financial condition, results of operations or liquidity.

In September 2006, the FASB issued SFAS No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement* Plans." SFAS No. 158 amends SFAS No. 87, 88, 106, and 123(R). SFAS No. 158 requires employers to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status. Secondly, it requires employers to measure the plan assets and obligations that determine its funded status as of the end of the fiscal year. Lastly, employers are required to recognize changes in the funded status of the defined benefit pension or postretirement plan in the year that the changes occur with the changes reported in comprehensive income. The standard is required to be adopted by entities having fiscal years ending after December 15, 2006. The Company is a participant in a multi-employer defined benefit plan, which is not within the scope of this pronouncement. This standard is not expected to have an impact on the Company's financial condition, results of operations or liquidity.

Note 14 - STOCK SPLIT

On June 8, 2006, the Board of Directors approved a two-for-one split of the Company's common stock and an amendment to its charter to increase the number of common shares authorized from 10 million to 20 million. As a result of the stock split, each shareholder of record at the close of business on July 19, 2006 received one additional share of common stock for every one share held on such date. Upon completion of the split, the total number of shares of common stock outstanding increased from approximately 8,391,000 to approximately 16,782,000.

The earnings per share calculations as presented on the Consolidated Statements of Income and Comprehensive Income, the number of shares issued and outstanding per the Statement of Changes in Stockholders' Equity and share amounts referenced throughout the Notes to the Consolidated Financial Statements have been adjusted to reflect split adjusted share amounts.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Comparison of Quarter Ended September 30, 2007 to Quarter Ended September 30, 2006

The following analysis should be read in conjunction with the unaudited financial statements of the Company and related notes included elsewhere in this quarterly report and the audited financial statements and Management's Discussion and Analysis contained in our Form 10-KSB, for the fiscal year ended December 31, 2006, and in the Management's Discussion and Analysis contained in our Form 10-QSB, for the fiscal quarters ended March 31, 2007, and June 30, 2007.

Results of Operations

Total sales increased by $2,360,829, (approximately 32%) to $9,817,478 during the three-month period ended September 30, 2007 from $7,456,649 during the same three-month period in 2006. This increase is primarily attributable to increased sales and awareness of Lifeway's flagship line, Kefir, as well as the acquisition of the Helios Organic Kefir line and the Pride of Main Street milk line. Helios Nutrition and its subsidiary, Pride of Main Street Dairy, which were acquired August 3, 2006, accounted for a total of $1,434,517 in sales, with the Helios kefir brand accounting for $1,183,287 in sales, and the Pride of Main Street line accounting for $251,230 in sales.

Sales for the existing Lifeway Foods line increased by $1,823,927 (approximately 28%) to $8,382,961 during the three-month period ended September 30, 2007 from $6,559,034 during the same three-month period in 2006. This increase is primarily attributable to increased sales and awareness of Lifeway's existing drinkable dairy products including La Fruta, its flagship line, Kefir, as well as Lifeway's new kids kefir drink, Probugs™.

Total cost of goods sold as a percentage of sales for Lifeway Foods was approximately 72% during the third quarter 2007, compared to about 62% during the same period in 2006. The increase was primarily attributable to the cost of milk, Lifeway's largest cost of goods sold component, which was approximately 110% higher in the third quarter 2007 compared to the same period in 2006. The price of milk in the month of September was the highest ever recorded, and we have since seen the price slightly drop during the month of October, 2007, however, we can make no assurances that the price of milk will continue to decline from its September 2007 record highs. In addition, on July 1, 2007 the minimum wage in Illinois increased to $7.50 per hour from $6.50 per hour, which also had a negative impact our gross margins.

Total operating expenses as a percentage of sales for Lifeway Foods were approximately 22% during the third quarter 2007, compared to about 23% during the same period in 2006. This decrease is primarily attributable to operating synergies gained by the consolidation of the recently-acquired Helios Nutrition into our overall operations, as well as our continuing efforts to maximize efficiency through capital investments.

Total other income for the third quarter ended September 30, 2007 was $201,658, compared with $76,651 during the same period in 2006. This increase is primarily attributable to gains on the sale of marketable securities, which was $201,658 in the third quarter ended September 2007, compared with $89,260 in the same period in 2006. Marketable securities are discussed in Note 4 of the Notes to Consolidated Financial Statements.

Provision for income taxes was $314,508, or a 40% tax rate during the third quarter 2007 compared with $456,012 or a 38% tax rate during the same period in 2006. Income taxes are discussed in Note 9 of the Notes to Consolidated Financial Statements.

Total net income for the group was $468,194 or $.03 per split adjusted share for the third quarter ended September 30, 2007, compared with $739,959 or $.04 per split adjusted share in the same period in 2006.

Total net income for the group was $468,194 or $.03 per split adjusted share for the third quarter ended September 30, 2007, compared with $739,959 or $.04 per split adjusted share in the same period in 2006. This decrease was primarily attributable to the reduced margins as a result of the increased cost of milk as discussed above.

Comparison of Nine-Month Period Ended September 30, 2007 to Nine Month Period Ended September 30, 2006

Results of Operations

Total sales increased by $8,727,915, (approximately 44%) to $28,554,984 during the nine-month period ended September 30, 2007 from $19,827,069 during the same nine-month period in 2006. This increase is primarily attributable to increased sales and awareness of Lifeway's flagship line, Kefir, as well as the acquisition of the Helios Organic Kefir line and the Pride of Main Street milk line. Helios Nutrition and its subsidiary, Pride of Main Street Dairy, which were acquired August 3, 2006, accounted for a total of $4,189,011 in sales, with the Helios kefir brand accounting for $3,519,872 in sales, and the Pride of Main Street line accounting for $669,139 in sales for the first nine-months of 2007

Sales for the existing Lifeway Foods line increased by $5,436,518 (approximately 29%) to $24,365,971 during the nine month period ended September 30, 2007 from $18,929,453 during the same nine-month period in 2006. This increase is primarily attributable to increased sales and awareness of Lifeway's existing drinkable dairy products including La Fruta, its flagship line, Kefir, as well as Lifeway's new kids kefir drink, Probugs™.

Cost of goods sold, as a percentage of sales for the Lifeway Foods line was approximately 65% during the nine-month period ended September 30, 2007, compared to about 59% during the same period in 2006. The increase was primarily attributable to the cost of milk, Lifeway's largest cost of goods sold component, which was approximately 80% higher in the first nine-months of 2007 compared to the same period in 2006. The price of milk in the month of September was the highest ever recorded, and we have since seen the price slightly drop during the month of October, 2007, however, we can make no assurances that the price of milk will continue to decline from its September 2007 record highs. In addition, on July 1, 2007 the minimum wage in Illinois increased to $7.50 per hour from $6.50 per hour, which also had a negative impact our gross margins.

Total operating expenses as a percentage of sales for Lifeway Foods were approximately 21% during the nine-month period ending September 30, 2007, compared to about 24% during the same period in 2006. This decrease is primarily attributable to operating synergies gained by the consolidation of the recently-acquired Helios Nutrition into our overall operations, as well as our continuing efforts to maximize efficiency through capital investments.

Total other income for the nine-months ended September 30, 2007 was $619,523, compared with $362,965 during the same period in 2006. This increase is primarily attributable to gains on the sale of marketable securities, which was $662,009 in the nine-month period ending September 30, 2007, compared with $277,674 in the same period in 2006. Marketable securities are discussed in Note 4 of the Notes to Consolidated Financial Statements.

Total net income for the group was $2,999,551, or $.18 per split adjusted share for the nine-months ended September 30, 2007, compared with $2,384,661 or $.14 per split adjusted share in the same period in 2006. This represents a 26% year over year increase.

Sources and Uses of Cash

Net cash provided by operating activities increased $313,539 to $1,252,309 during the nine-month period ended September 30, 2007 from $938,770 during the same period in 2006. This increase is primarily attributable to the increase in net income during the first nine months of 2007.

Net cash used by financing activities was $1,771,488 during the nine months ended September 30, 2007, which is an increase of $800,712 compared to $970,776 of net cash used by financing activities during the same period in 2006. This increase is primarily attributable to the Company repaying $1,261,014 of the $4.2 million note issued in connection with the Helios acquisition in August 2006, which was absent in 2006. This note payable is discussed in Note 8 of the Notes to Consolidated Financial Statements

Net cash provided by investing activities was $595,933 during the nine months ended September 30, 2007, which is an increase of $3,675,702 compared to $3,079,769 net cash used in investing activities during the same period in 2006. This increase is primarily due to the Company's use of $2,514,679 net of cash acquired to purchase Helios Nutrition in August of 2006. The acquisition is discussed in Note 1 of the Notes to Consolidated Financial Statements.

Significant portions of our assets are held in marketable securities. The majority of our marketable securities are classified as available-for-sale on our balance sheet, while the mortgage-backed securities are classified as trading. 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.

Other Developments

On May 18, 2007, Lifeway's Board of Directors approved awards of an aggregate amount of 8,400 shares to be awarded under its Employee and Consulting Services and Compensation Plan to certain key employees and consultants for services rendered to the Company. The stock awards were made on June 1, 2007 and have vesting periods of one year. The expense for the awards is measured as of June 1, 2007 at $9.90 per share for 8,400 shares, or a total stock award expense of $83,160. This expense will be recognized as the stock awards vest monthly in 12 equal portions of $6,930, based upon the vesting of 700 shares per month.

Critical Accounting Policies

Lifeway's analysis and discussion of its financial condition and results of operations are based upon its consolidated financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). The preparation of financial statements in accordance with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. US GAAP provides the framework from which to make these estimates, assumptions and disclosures. Lifeway chooses accounting policies within US GAAP that management believes are appropriate to accurately and fairly report Lifeway's operating results and financial position in a consistent manner. Management regularly assesses these policies in light of current and forecasted economic conditions and has discussed the development and selection of critical accounting policies with its audit committee of the Board of Directors. For further information concerning accounting policies, refer to Note 2 -- Nature of Business and Significant Accounting Policies in the notes to the consolidated financial statements.

Forward Looking Statements

In this report, in reports subsequently filed by Lifeway with the SEC on Form 10-QSB and filed or furnished on Form 8-K, and in related comments by management, our use of the words "believe," "expect," "anticipate," "estimate," "forecast," "objective," "plan," "goal," "project," "explore," "priorities/targets," and similar expressions is intended to identify forward-looking statements. While these statements represent our current judgment on what the future may hold, and we believe these judgments are reasonable, actual results may differ materially due to numerous important factors that are described in this report and other factors that may be described in subsequent reports which Lifeway may file with the SEC on Form 10-QSB and filed or furnished on Form 8-K, including but not limited to:

- Changes in economic conditions, commodity prices;
- Shortages of and price increase for fuel, labor strikes or work stoppages, market acceptance of the Company's new products;
- Significant changes in the competitive environment;
- Changes in laws, regulations, and tax rates; and
- Management's ability to achieve reductions in cost and employment levels, to realize production efficiencies and to implement capital expenditures, all at of the levels and times planned by management.

ITEM 3. CONTROLS AND PROCEDURES

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 are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms.

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

PART II — OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

Exhibit Number	Description
3.4	Amended and Restated By-laws (incorporated by reference to Exhibit No. 3.5 of Lifeway's Current Report on Form 8-dated and filed on December 10, 2002). (File No. 000-17363)
3.5	Articles of Incorporation, as amended and currently in effect (incorporated by reference to Exhibit 3.5 of Lifeway's Quarterly Report on Form 10-QSB for the quarter ended June 30, 2000 and filed on August 8, 2000). (File No. 000-17363)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Julie Smolyansky.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Edward P. Smolyansky.
32.1	Section 1350 Certification of Julie Smolyansky.
32.2	Section 1350 Certification of Edward P. Smolyansky.

Reports on Form 8-K

None.

SIGNATURE

In accordance with the requirements of the Exchange Act, the Company caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LIFEWAY FOODS, INC.

Date: November 14, 2007

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

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

EXHIBITS INDEX

Exhibit Number	Description
31.1	Rule 13a-14(a)/15d-14(a) Certification of Julie Smolyansky.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Edward P. Smolyansky.
32.1	Section 1350 Certification of Julie Smolyansky.
32.2	Section 1350 Certification of Edward P. Smolyansky.

Reports on Form 8-K

None.