LIFEWAY FOODS INC
Form 10-Q
November 09, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2015

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

For the transition period from __________ to __________

Commission File Number: 000-17363

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

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

6431 West Oakton, Morton Grove, IL 60053
(Address of Principal Executive Offices, Zip Code)

(847) 967-1010
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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

As of October 27, 2015, 16,304,410 shares of the registrant’s common stock, no par value, were outstanding.

LIFEWAY FOODS, INC.

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ITEM 1. FINANCIAL STATEMENTS.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Financial Condition
September 30, 2015 and December 31, 2014

		September 30, 2015 (Unaudited)		December 31, 2014
ASSETS				
Current assets				
Cash and cash equivalents	$	5,010,669	$	3,260,244
Investments, at fair value		2,512,537		2,779,140
Certificates of deposits in financial institutions		534,678		149,965
Inventories		6,931,773		5,814,219
Accounts receivable, net of allowance for doubtful accounts and discounts of $1,100,000 and $1,050,000 at September 30, 2015 and December 31, 2014, respectively		10,753,485		10,213,541
Prepaid expenses and other current assets		53,966		251,922
Other receivables		37,850		134,338
Deferred income taxes		612,159		408,340
Refundable income taxes		129,426		1,140,796
Total current assets		26,576,273		24,152,505
Property and equipment, net		21,602,426		21,892,395
Intangible assets				
Goodwill		14,068,091		14,068,091
Other intangible assets, net		2,523,006		3,059,764
Total intangible assets		16,591,097		17,127,855
Other Assets				
Long-term accounts receivable, net of current portion		294,767		251,683
Total assets	$	65,064,563	$	63,424,438
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities				
Current maturities of notes payable	$	840,000	$	872,285
Accounts payable		5,190,593		5,586,755
Accrued expenses		3,104,452		2,066,076
Accrued income taxes		448,891		—
Total current liabilities		9,583,936		8,525,116
Notes payable		7,329,328		8,124,515
Deferred income taxes		1,806,539		2,075,095
Total liabilities		18,719,803		18,724,726

Stockholders’ equity				
Common stock, no par value; 40,000,000 shares authorized; 17,273,776 shares issued; 16,346,017 shares outstanding at September 30, 2015 and December 31, 2014		6,509,267		6,509,267
Paid-in-capital		2,032,516		2,032,516
Treasury stock, at cost		(8,187,682)		(8,187,682)
Retained earnings		46,189,101		44,543,618
Accumulated other comprehensive loss, net of taxes		(198,442)		(198,007)
Total stockholders’ equity		46,344,760		44,699,712
Total liabilities and stockholders’ equity	$	65,064,563	$	63,424,438

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Income and Comprehensive Income
For the Three Months and Nine Months Ended September 30, 2015 and 2014
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Gross sales	$ 33,519,071	$ 32,704,435	$ 102,913,996	$ 97,359,630
Less: discounts and promotional allowances	(3,920,406)	(2,594,213)	(13,872,019)	(8,552,286)
Net sales	29,598,665	30,110,222	89,041,977	88,807,344
Cost of goods sold	19,929,639	21,697,954	62,778,735	64,812,489
Depreciation expense	613,830	610,966	1,808,988	2,022,204
Total cost of goods sold	20,543,469	22,308,920	64,587,723	66,834,693
Gross profit	9,055,196	7,801,302	24,454,254	21,972,651
Selling expenses	2,706,375	2,804,127	9,486,177	9,977,636
General and administrative	4,117,811	2,627,566	10,919,862	7,115,393
Amortization expense	178,919	178,919	536,758	536,758
Total operating expenses	7,003,105	5,610,612	20,942,797	17,629,787
Income from operations	2,052,091	2,190,690	3,511,457	4,342,864
Other income (expense):				
Interest and dividend income	25,259	22,739	86,477	86,664
Rental income	1,800	1,201	5,400	2,900
Interest expense	(55,698)	(62,084)	(179,468)	(194,377)
(Loss)/Gain on sale of investments, net reclassified from OCI	839	(22,940)	(21,098)	39,190
Gain on sale of property and equipment	200	85,077	243,283	8,592
Other income (expense), net	(205,000)	—	(303,796)	1,674
Total other income (expense)	(232,600)	23,993	(169,202)	(55,357)
Income before provision for income taxes	1,819,491	2,214,683	3,342,255	4,287,507
Provision for income taxes	926,639	1,201,005	1,696,772	2,307,234
Net income	$ 892,852	$ 1,013,678	$ 1,645,483	$ 1,980,273
Basic and diluted earnings per common share	$ 0.05	$ 0.06	$ 0.10	$ 0.12
Weighted average number of common shares outstanding	16,346,017	16,346,017	16,346,017	16,346,017

COMPREHENSIVE INCOME

Net income	$	892,852	$	1,013,678	$	1,645,483	$	1,980,273
Other comprehensive income (loss), net of tax:								
Unrealized gains (losses) on investments (net of tax)		(183,170)		(93,679)		(247,645)		(22,524)
Less reclassification adjustment for (gains) losses and other than temporary impairments included in net income (net of taxes)		124,395		13,702		247,210		(23,408)
Comprehensive income	$	834,047	$	933,701	$	1,645,048	$	1,934,341

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
For the Nine Months Ended September 30, 2015 and 2014
(Unaudited)

	Common Stock						Accumulated Other Comprehensive Income (Loss), Net of Tax	
	Issued		In treasury		Paid In	Retained		
	Shares	$	Shares	$	Capital	Earnings		Total Equity
Balances at December 31, 2013	17,273,776	$ 6,509,267	(927,759)	$ (8,187,682)	$ 2,032,516	$ 42,587,214	$ 7,807	$ 42,949,122
Other comprehensive loss	—	—	—	—	—	—	(45,932)	(45,932)
Net income for the nine months ended September 30, 2014	—	—	—	—	—	1,980,273	—	1,980,273
Balances at September 30, 2014	17,273,776	$ 6,509,267	(927,759)	$ (8,187,682)	$ 2,032,516	$ 44,567,487	$ (38,125)	$ 44,883,463
Balances at December 31, 2014	17,273,776	$ 6,509,267	(927,759)	$ (8,187,682)	$ 2,032,516	$ 44,543,618	$ (198,007)	$ 44,699,712
Other comprehensive loss	—	—	—	—	—	—	(435)	(435)
Net income for the nine months ended September 30, 2015	—	—	—	—	—	1,645,483	—	1,645,483
	17,273,776	$ 6,509,267	(927,759)	$ (8,187,682)	$ 2,032,516	$ 46,189,101	$ (198,442)	$ 46,344,760

Balances at
September 30,
2015

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Nine Months Ended September 30, 2015 and 2014
(Unaudited)

	September 30, 2015	September 30, 2014
Cash flows from operating activities:		
Net income	$ 1,645,483	$ 1,980,273
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	2,345,746	2,558,962
Loss (gain) on sale of investments, net	21,098	(39,190)
Impairment of investments	384,500	—
Deferred income taxes	(472,375)	(783,607)
Bad debt expense	250	76,049
Gain on sale of property and equipment	(243,083)	(8,592)
(Increase) decrease in operating assets:		
Accounts receivable	(540,194)	(1,548,110)
Other receivables	53,674	76,552
Inventories	(1,117,554)	(235,849)
Refundable income taxes	1,011,370	972,522
Prepaid expenses and other current assets	197,956	73,379
Increase (decrease) in operating liabilities:		
Accounts payable	(396,162)	595,333
Accrued expenses	1,038,376	(40,184)
Accrued income taxes	448,891	—
Net cash provided by operating activities	4,377,976	3,677,538
Cash flows from investing activities:		
Purchases of investments	(1,369,285)	(2,319,742)
Proceeds from sale of investments	1,229,855	1,736,946
Redemption of certificates of deposits	249,965	15,000
Investments in certificates of deposits	(634,678)	—
Purchases of property and equipment	(1,618,716)	(3,052,303)
Proceeds from sale of property and equipment	342,780	89,076
Net cash used in investing activities	(1,800,079)	(3,531,023)
Cash flows from financing activities:		
Repayment of notes payable	(827,472)	(657,694)
Net cash used in financing activities	(827,472)	(657,694)
Net (decrease) increase in cash and cash equivalents	1,750,425	(511,179)
Cash and cash equivalents at the beginning of the period	3,260,244	3,306,608
Cash and cash equivalents at the end of the period	$ 5,010,669	$ 2,795,429
	$ 1,120,000	$ 2,131,658
Supplemental cash flow information		

Cash paid for income taxes				
Cash paid for interest	$	177,521	$	195,275

See accompanying notes to consolidated financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2015 and December 31, 2014
(Unaudited)

Note 1 – Nature of business

Lifeway Foods, Inc. (the “Company” or “Lifeway”), an Illinois corporation, commenced operations in February 1986, and was incorporated under the laws of the State of Illinois on May 19, 1986. The Company’s principal business activity is the manufacturing of probiotic, cultured, functional dairy health food products. Lifeway’s primary product is kefir, a dairy beverage similar to but distinct from yogurt, in several flavors and in several packages. In addition to kefir, Lifeway manufactures “Lifeway Farmer Cheese,” a line of various farmer cheeses. Lifeway distributes its products throughout the United States and in London, England. The Company manufactures all of its products distributed in the United States at Company-owned facilities. In the Chicago metropolitan area, Lifeway distributes its products on its own trucks and via distributors. The Company directly distributes its products in the Philadelphia and Tri State metropolitan areas using its own trucks. The Company distributes its products throughout the remainder of the United States via distributors. The Company’s products distributed in London are manufactured and shipped to retailers by a third party co-packer. Products sold by the Company to distributors in the United States may be resold by such distributors within or outside of the United States, including in Mexico, Costa Rica and the Caribbean. The Company’s products are also manufactured and distributed in Canada by a third party co-packer.

Note 2 – Basis of Presentation and Significant Accounting Policies

Corrections of prior period financial statements
As reported in the Company’s fiscal 2014 annual report on Form 10-K, the Company recorded out-of-period adjustments during fiscal 2014 to correct the accounting for certain errors related primarily to the provision for income taxes and an understatement of depreciation expense arising from assigning incorrect useful lives. The Company has revised its previously reported fiscal 2014 interim consolidated financial statements to correct for these matters. The adjustments decreased previously reported net income by approximately $12,000 and $800,000 for the three-month and nine-month periods ended September 30, 2014. The adjustments had no impact on previously reported net income for the year ended December 31, 2014.

There was no impact to quarterly cash flows in 2014 as the decrease in net income was offset by the increase in the non-cash reconciling items for depreciation expense and refundable income taxes. The Company does not believe that these adjustments are material to the results of operations, financial position or cash flows for any of its previously filed interim consolidated financial statements. Accordingly, the September 30, 2014 interim consolidated financial statements included herein have been revised to reflect the adjustments discussed above.

The net-of-tax effect of these adjustments decreases the Company’s previously reported 2014 earnings per common and diluted share by $0.02 for the quarter ended March 31, 2014 and $0.03 for the quarter ended June 30, 2014, and increases the Company’s 2014 earnings per common and diluted share by $0.05 for the quarter ended December 31, 2014. The Company’s previously reported earnings per common and diluted share for the quarter ended September 30, 2014 are unchanged.

Basis of presentation
The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information, and do not include all of the information and disclosures required for complete financial statements. In the opinion of management, all

adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation, have been included. For further information, refer to the consolidated financial statements and disclosures included in the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

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,

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2015 and December 31, 2014
(Unaudited)

Note 2 – Basis of Presentation and Significant Accounting Policies – Continued

L.L.C. 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 consolidated financial statements in conformity with U.S. GAAP 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 reserve for promotional allowances, the fair value of investment securities, the valuation of goodwill and 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.

The Company routinely offers sales allowances and discounts to our customers and consumers. These programs include rebates, in-store display and demo allowances, allowances for non-salable product, coupons and other trade promotional activities. These allowances are considered reductions in the price of our products and thus are recorded as reductions to gross sales. Some of these incentives are recorded by estimating incentive costs based on our historical experience and expected levels of performance of the trade promotion. We maintain a reserve for the estimated allowances incurred but unpaid. Differences between estimated and actual allowances are normally insignificant and are recognized in earnings in the period such differences are determined. Product returns have historically not been material.

Bulk cream is a by-product of the Company’s fluid milk manufacturing process. The Company does not use bulk cream in any of its end products, but rather disposes of it through sales to other companies. Bulk cream by-product sales are included in gross sales.

Advertising and promotional costs
The Company expenses advertising costs as incurred. For the nine months ended September 30, 2015 and 2014 total advertising expenses were $4,033,240 and $2,462,313, respectively. For the three months ended September 30, 2015 and 2014 total advertising expenses were $1,291,405 and $637,281, respectively.

Recent Accounting Pronouncements
In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 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. In August 2015 the FASB delayed the effective

date for implementation of ASU 2014-09. Under the delayed effective date, the Company is required to adopt the new standard not later than January 1, 2018. Management is currently evaluating the impact the adoption of ASU 2014-09 will have on the Company's consolidated financial position, results of operations or cash flows and the method of retrospective application, either full or modified.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2015 and December 31, 2014
(Unaudited)

Note 2 – Basis of Presentation and Significant Accounting Policies – Continued

In July 2015, the FASB issued new accounting guidance for measuring inventory. The core principal of the guidance is that an entity should measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This guidance does not apply to inventory that is being measured using the Last-In, First-Out (LIFO) or the retail inventory method. The guidance is effective for financial statements issued for annual and interim periods beginning after December 15, 2016 on a prospective basis. Early adoption is permitted. Management is currently evaluating the impact this will have on the consolidated financial statements.

Note 3 – Intangible Assets

Intangible assets, net consists of the following:

	As of	
	September 30, 2015	December 31, 2014
Recipes	$ 43,600	$ 43,600
Customer lists and other customer related intangibles	4,529,200	4,529,200
Customer relationship	985,000	985,000
Trade names	2,248,000	2,248,000
Formula	438,000	438,000
Subtotal	8,243,800	8,243,800
Accumulated amortization	(5,720,794)	(5,184,036)
Intangible assets, net	$ 2,523,006	$ 3,059,764

Note 4 – Investments

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

September 30, 2015	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Common stocks & ETF's	$ 1,041,953	$ 12,102	$ (175,470)	$ 878,585
Mutual Funds	77,109	—	(10,243)	66,866
Preferred Securities	97,405	515	—	97,920
Corporate Bonds	1,621,586	24	(152,444)	1,469,166
Total	$ 2,838,053	$ 12,641	$ (338,157)	$ 2,512,537

December 31, 2014	Cost	Unrealized Gains	Unrealized Losses	Fair Value

Common stocks & ETF's	$ 530,328	$ 19,608	$ (64,046)	$ 485,890
Mutual Funds	445,337	—	(10,624)	434,713
Preferred Securities	180,120	195	(2,075)	178,240
Corporate Bonds	1,948,596	1,880	(270,179)	1,680,297
Total	$ 3,104,381	$ 21,683	$ (346,924)	$ 2,779,140

Proceeds from the sale of investments were $1,229,855 and $1,736,946 for the nine months ended September 30, 2015 and 2014, respectively. Proceeds from the sale of investments were $96,208 and $317,584 for the three months ended September 30, 2015 and 2014, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2015 and December 31, 2014
(Unaudited)

Note 4 – Investments - Continued

Gross gains of $13,852 and $83,810 and gross losses of $34,950 and $44,620 were realized on these sales during the nine months ended September 30, 2015 and 2014, respectively. Gross gains of $840 and $2,988 and gross losses of $2 and $25,928 were realized on these sales during the three months ended September 30, 2015 and 2014, respectively.

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2015 and December 31, 2014:

	Less Than 12 Months		12 Months or Greater		Total	
September 30, 2015	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stocks & ETF's	$ 456,047	$ (104,176)	$ 276,028	$ (71,293)	$ 732,075	$ (175,470)
Mutual Funds	62,744	(7,326)	4,122	(2,918)	66,866	(10,243)
Preferred Securities	—	—	—	—	—	—
Corporate Bonds	552,809	(76,352)	906,304	(76,092)	1,459,113	(152,444)
	$ 1,071,600	$ (187,854)	$ 1,186,454	$ (150,303)	$ 2,258,054	$ (338,157)

	Less Than 12 Months		12 Months or Greater		Total	
December 31, 2014	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stocks & ETF's	$ 162,268	$ (49,053)	$ 141,417	$ (14,993)	$ 303,685	$ (64,046)
Mutual Funds	434,713	(10,624)	—	—	434,713	(10,624)
Preferred Securities	80,640	(2,075)	—	—	80,640	(2,075)
Corporate Bonds	1,056,140	(194,641)	497,277	(75,538)	1,553,417	(270,179)
	$ 1,733,761	$ (256,393)	$ 638,694	$ (90,531)	$ 2,372,455	$ (346,924)

The Company's investments in equity securities, mutual funds, preferred securities, and corporate bonds consist of investments in common stock, preferred stock, structured notes and other debt securities of companies in various industries. The Company recorded other-than-temporary impairment losses of approximately $180,000 during the first quarter of 2015 and $205,000 during third quarter of 2015 with respect to certain structured notes. The impairment losses are included in "other income (expense), net" in the accompanying consolidated statements of income and comprehensive income. The structured notes allow the issuer to settle at an amount less than par in certain circumstances. In reaching a conclusion to record these other-than-temporary impairment losses, the Company evaluated the near-term prospects of the issuers and determined it was probable the issuers would have the ability to settle the bonds for an amount less than par value at maturity.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2015 and December 31, 2014
(Unaudited)

Note 5 – Inventories

Inventories consist of the following:

	September 30, 2015	December 31, 2014
Finished goods	$ 1,966,744	$ 2,373,476
Production supplies	2,754,577	2,069,742
Raw materials	2,210,452	1,371,001
Total inventories	$ 6,931,773	$ 5,814,219

Note 6 – Property and Equipment

Property and equipment consist of the following:

	September 30, 2015	December 31, 2014
Land	$ 1,756,673	$ 1,856,370
Buildings and improvements	16,419,430	15,125,803
Machinery and equipment	22,794,894	20,434,910
Vehicles	1,310,527	1,244,560
Office equipment	709,188	465,801
Construction in process	64,505	2,408,754
	43,055,217	41,536,198
Less accumulated depreciation	21,452,791	19,643,803
Total property and equipment	$ 21,602,426	$ 21,892,395

Note 7 – Accrued Expenses

Accrued expenses consist of the following:

	September 30, 2015	December 31, 2014
Accrued payroll and payroll taxes	$ 945,883	$ 891,763
Accrued property tax	305,659	331,278
Other	1,852,910	843,035
	$ 3,104,452	$ 2,066,076

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2015 and December 31, 2014
(Unaudited)

Note 8 – Notes Payable

Notes payable consist of the following:

	September 30, 2015	December 31, 2014
Note payable to Private Bank in monthly installments of $42,222, plus variable interest rate (currently 2.67%) with a balloon payment for the remaining balance. Collateralized by substantially all assets of the Company. Maturity date - May 31, 2018.	$ 3,972,223	$ 4,352,222
Note payable to Private Bank in monthly installments of $27,778, plus variable interest rate (currently 2.67%) with a balloon payment for the remaining balance, maturing on May 31, 2019, collateralized by substantially all assets of the Company.	4,197,105	4,583,333
Notes payable to Ford Credit Corp. payable in monthly installments of $1,778 at 5.99%, paid in March 2015.	—	12,198
Note payable to Fletcher Jones of Chicago, Ltd LLC in monthly installments of $1,769 at 6.653%, paid in March 2015.	—	49,047
Total notes payable	8,169,328	8,996,800
Less current maturities	840,000	872,285
Total long-term portion	$ 7,329,328	$ 8,124,515

In accordance with the Private Bank agreements referenced above, the Company is subject to minimum fixed charged ratio and tangible net worth thresholds. The Company was in compliance with these financial covenants at September 30, 2015. Further, the Company is required to deliver its annual and quarterly consolidated financial statements and related SEC filings within specified timeframes.

In addition, as of September 30, 2015 the Company had a $5 million revolving credit facility with The Private Bank. Borrowings under the facility were subject to interest at the prime rate or LIBOR plus 2.5%. At September 30, 2015 there were no borrowings under the facility. The facility expires on July 31, 2016.

Maturities of notes payables are as follows:

For the 12 Months Ended September 30,		
2016	$	840,000
2017		840,000
2018		3,292,231
2019		3,197,097
Total	$	8,169,328

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2015 and December 31, 2014
(Unaudited)

Note 9 – Commitments and contingencies

Lease obligations -The Company leases three stores for its Starfruit subsidiary. Total rent expense for these leases was $92,852 and $108,426 for the nine months ended September 30, 2015 and 2014, respectively. The Company is also responsible for additional rent equal to real estate taxes and other operating expenses. Future annual minimum base rental payments under these leases as of September 30, 2015 are approximately $70,000 for each of the next three years and are not significant thereafter.

Litigation -The Company is 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 10 – Income taxes

The effective tax rate for the three and nine months ended September 30, 2015 was 50.9% and 50.8% respectively, compared to 54.2% and 53.8%, respectively, for the three and nine months ended September 30, 2014. The difference between the statutory and effective tax rate reflects certain operating expenses that are not fully deductible for federal income tax purposes.

Note 11 – 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.

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.

The following is a description of the valuation methodologies used for assets measured at fair value on a recurring basis. There have been no changes in the methodologies used as of September 30, 2015 and December 31, 2014.

The majority of the Company's fair value measurements for investments are classified within Level 1 or Level 2 of the fair value hierarchy. The Company's Level 1 fair value measurements, which include mutual funds and common stock, is based on quoted market prices in active markets for identical securities. The Company's Level 2 fair value

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 11 – Fair Value Measurements - Continued

measurements, which include corporate bonds, is based on quoted prices in inactive markets for identical or similar assets. The Company's level 3 fair value measurements is based on the estimated proceeds expected to be received at maturity of the corporate bonds.

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 measured at fair value on a recurring basis as of September 30, 2015 and December 31, 2014. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

	Assets and Liabilities at Fair Value as of September 30, 2015			
	Level 1	Level 2	Level 3	Total
Mutual Funds	$ 66,866	$ —	$ —	$ 66,866
Common Stocks& ETF's	878,586	—	—	878,586
Preferred Securities	—	97,920	—	97,920
Corporate Bonds	—	1,204,102	265,063	1,469,165

	Assets and Liabilities at Fair Value as of December 31, 2014			
	Level 1	Level 2	Level 3	Total
Mutual Funds	$ 434,713	$ —	$ —	$ 434,713
Common Stocks& ETF's	485,890	—	—	485,890
Preferred Securities	—	178,240	—	178,240
Corporate Bonds	—	1,680,297	—	1,680,297

The Company's financial assets and liabilities which are not carried at fair value on a recurring basis include cash and cash equivalents, certificates of deposit, accounts receivable, other receivables, accounts payable and notes payable for which carrying value approximates fair value.

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Note 12 – Share repurchase program

On September 24, 2015, the Company's Board of Directors authorized a stock repurchase program under which the Company may repurchase up to $3,500,000 of the Company's common stock not to exceed an aggregate of 250,000 shares, in the open market or in privately negotiated transactions, in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Securities Exchange Act of 1934, as amended. The extent to which the Company repurchases its shares and the timing of such repurchases will depend upon a variety of factors, including market conditions, regulatory requirements and other corporate considerations, as determined by management. The repurchase program may be suspended or discontinued at any time. There were no share repurchases during the nine months ended September 30, 2015.

Note 13 – Segments, Products and Customers

The Company manufactures probiotic, cultured, functional dairy health food products. The Company's primary product is kefir, a dairy beverage similar to but distinct from yogurt, in several flavors and in several packages. In addition to the drinkable products, Lifeway manufactures "Lifeway Farmer Cheese," a line of various farmer cheeses.

Net sales of products by category for the three and nine months ended September 30 were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Drinkable Kefir other than ProBugs	$25,901,949	$26,142,269	$76,723,238	$76,793,828
Pro Bugs	1,702,481	1,898,439	5,999,457	5,582,374
Lifeway Farmer Cheese	1,660,377	1,565,652	5,124,754	4,933,441
Frozen Kefir	333,858	503,862	1,194,528	1,497,701
Net Sales	$29,598,665	$30,110,222	$89,041,977	$88,807,344

The Company has two operating segments, the sale of fermented dairy products and three retail locations in Illinois that sell the Company's fermented dairy products. The Company has determined reportable segments based on how the Company's chief operating decision maker manages the business and in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Financial Officer and the board of directors that makes strategic decisions. Substantially all of the consolidated revenues of the Company relate to the sale of fermented dairy products which are produced using the same processes and materials and are sold to consumer retail food sellers through direct delivery and distributors in the United States.

The Company has less than $1 million in revenues attributable to its retail locations during the three and nine months ended September 30, 2015 and 2014. The annual revenues attributable to the three retail locations are not material and accordingly the Company has not presented financial information separately for this operating segment. Substantially all of the consolidated revenues and assets of the Company are within the United States.

Significant Customers -Sales are predominately to companies in the retail food industry, located within the United States. Two major customers accounted for approximately 27% and 28% of gross sales for the nine months ended September 30, 2015 and 2014, respectively and 25% and 29% of gross sales for the three months ended September 30, 2015 and 2014, respectively.

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. as of and for the three and nine months ended September 30, 2015 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 for the year ended December 31, 2014 (the “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”, “ similar terms or terminology, or the negative of such terms or other comparable terminology. Although we believe the expectations expressed in these forward-looking statements are based on reasonable assumptions within the bound of our knowledge of our business, our actual results could differ materially from those discussed in these statements. Factors that could contribute to such differences include, but are not limited to, those discussed in the “Risk Factors” section of the Form 10-K. 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.

Comparison of the three month period ended September 30, 2015 to the three month period ended September 30, 2014

Results of Operations

Net sales

The following table summarizes our net sales:

		Three months ended September 30,				Change	
		2015		2014		$	%
Gross Sales	$	33,519,071	$	32,704,435	$	814,636	2.5%
Less: Discounts & promotional allowances		(3,920,406)		(2,594,213)		(1,326,193)	51.1%
Net Sales	$	29,598,665	$	30,110,222	$	(511,557)	-1.7%
Discounts & promotional allowances % to gross sales		11.7%		7.9%			

Net sales declined by $511,557 or 1.7% to $29,598,665. The decrease in net sales reflects a 2.5% increase in gross sales reflecting higher volumes of drinkable Kefir offset by significantly higher discounts and promotional allowances given to customers.

Cost of goods sold

The following table summarizes our cost of goods sold:

	Three months ended September30,		Change	
	2015	2014	$	%
Purchases, net	$ 12,412,786	$ 14,514,267	$ (2,101,481)	-14.5%
Testing	29,333	7,841	21,492	274.1%
Supplies	497,564	330,409	167,155	50.6%
Salaries production	2,850,876	2,350,648	500,228	21.3%
Contract work	35,498	31,565	3,933	12.5%
Freight	2,869,114	3,203,229	(334,115)	-10.4%
Delivery expense	96,560	131,495	(34,935)	-26.6%
Labor and overhead	1,137,908	1.128,500	9,408	0.8%
Cost of Goods Sold, excluding depreciation	19,929,639	21,697,954	(1,768,315)	-8.1%
Depreciation expense	613,830	610,966	2,864	0.5%
Cost of Goods Sold	$ 20,543,469	$ 22,308,920	$ (1,765,451)	-7.9%
Gross Profit % to net sales	30.6%	25.9%		

Gross profit as a percent of net sales increased to 30.6% during the three-month period ended September 30, 2015 from 25.9% during the same three-month period in 2014. The increase in the gross profit percent reflects lower input costs, primarily lower milk prices, partially offset by the elevated level of promotional allowances and discounts given to customers.

Selling Expenses

The following table summarizes our selling expenses:

	Three months ended September 30,		Change	
	2015	2014	$	%
Salesperson commissions	$ 528,559	$ 358,626	$ 169,933	47.4%
Advertising	1,291,405	637,281	654,124	102.6%
Salaries	829,964	1,362,969	(533,005)	-39.1%
Promotions payable	47,837	44,053	3,784	8.6%
Travel	8,610	401,198	(392,588)	-97.9%
Selling expense	$ 2,706,375	$ 2,804,127	$ (97,752)	-3.5%
% to net sales	9.1%	9.3%		

Selling expenses decreased by $97,752 or 3.5% to $2,706,375 during the three-month period ended September 30, 2015 from $2,804,127 during the same period in 2014 reflecting an increase in advertising programs offset by lower salaries and travel related costs. The lower salaries reflects the reassignment of Company personnel in 2015 from principally selling responsibilities to broader general management responsibilities. Selling expenses as a percentage of sales were 9.1% for the three-month period ended September 30, 2015 compared to 9.3% for the same period in 2014.

General and administrative expenses

The following table summarizes our general and administrative expenses:

	Three months ended September 30, 2015	Three months ended September 30, 2014	Change $	Change %
Salaries	$ 2,093,638	$ 968,616	$ 1,125,022	116.1%
Rent	66,635	75,713	(9,078)	-12.0%
Equipment lease	2,026	2,576	(550)	-21.4%
Auto expense	30,092	25,430	4,662	18.3%
Office supplies	30,123	100,577	(70,454)	-70.0%
Professional fees	1,516,506	1,009,070	507,436	50.3%
Permits and licenses	—	21,905	(21,905)	-100.0%
Telephone expense	33,169	21,001	12,168	57.9%
Facilities	130,745	320,029	(189,284)	-59.1%
Tax	20,749	21,948	(1,199)	-5.5%
Miscellaneous	194,128	60,701	133,427	219.8%
General & administrative expense	$ 4,117,811	$ 2,627,566	$ 1,490,245	56.7%
% to net sales	13.9%	8.7%		

General and administrative expenses increased $1,490,245 or 56.7% to $4,117,811 during the three-month period ended September 30, 2015 from $2,627,566 during the same period in 2014. The increase is primarily a result of increases in salaries and professional fees. Salaries increased $1,125,022 or116.1 % to $2,093,638 during the three-month period ended September 30, 2015 from $968,616 during the same period in 2014. The increase reflects the reassignment of Company personnel in 2015 from principally selling responsibilities to broader general management responsibilities and an increase in headcount, primarily in finance. Professional fees, which consists primarily of legal and accounting fees increased by $507,436 or 50.3% to $1,516,506 in the three-month period ended September 30, 2015 from $1,009,070 during the same period in 2014. The higher professional fees are primarily due to costs associated the company’s delayed SEC filings.

Income from operations and net income

The company reported income from operations of $2,052,091 during the third quarter of 2015, compared to $2,190,690 during the same period in 2014. Provision for income taxes was $926,639, or a 50.9% effective rate for the third quarter of 2015 compared to a provision for income taxes of $ 1,201,005 or a 54.2% effective tax rate, during the same period in 2014. Income taxes are discussed in Note 10 to the Notes to the Consolidated Financial Statements.

Net income was $892,852 or $0.05 per basic and diluted common share for the three-month period ended September 30, 2015 compared to $1,013,678 or $0.06 per basic and diluted common share in the same period in 2014.

Comparison of nine month period ended September 30, 2015 to the nine month period ended September 30, 2014

Results of Operations

Net sales

The following table summarizes our net sales:

	Nine months ended September 30, 2015	Nine months ended September 30, 2014	Change $	Change %
Gross Sales	$ 102,913,996	$ 97,359,630	$ 5,554,366	5.7%
Less: Discounts & promotional allowances	(13,872,019)	(8,552,286)	(5,319,733)	62.2%
Net Sales	$ 89,041,977	$ 88,807,344	$ 234,633	0.3%
Discounts &promotional allowances % to gross sales	13.5%	8.8%		

Net sales increased by $234,633 or 0.3% to $89,041,977 during the nine-month period ended September 30, 2015 from $88,807,344 during the same period in 2014. The 0.3% increase reflects a $5,554,366 or 5.7% increase in gross sales reflecting higher volumes of drinkable Kefir, higher volumes of ProBugs and the commencement of cream sales in the second quarter of 2014 offset by significantly higher discounts and promotional allowances and lower volumes of frozen Kefir in 2015.

Cost of goods sold

The following table summarizes our cost of goods sold:

	Nine months ended September 30, 2015	Nine months ended September 30, 2014	Change $	Change %
Purchases, net	$ 38,109,683	$ 44,703,124	$ (6,593,441)	-14.7%
Testing	82,210	29,299	52,911	180.6%
Supplies	1,687,467	990,254	697,213	70.4%
Salaries production	8,679,120	6,719,070	1,960,050	29.2%
Contract work	106,496	153,224	(46,728)	-30.5%
Freight	9,597,724	8,999,827	597,897	6.6%
Delivery expense	339,381	292,948	46,433	15.9%
Outside services	4,176,654	2,924,743	1,251,911	42.8%
Cost of Goods Sold, excluding depreciation	62,778,735	64,812,489	(2,033,754)	-3.1%
Depreciation expense	1,808,988	2,022,204	(213,216)	-10.5%
Cost of Goods Sold	$ 64,587,723	$ 66,834,693	$ (2,246,970)	-3.4%
Gross Profit % to net sales	27.5%	24.7%		

Gross profit as a percent of net sales increased to 27.5% during the nine-month period ended September 30, 2015 from 24.7% during the same nine-month period in 2014. The increase in the gross profit percent reflects lower input costs, primarily lower milk prices, partially offset by the elevated level of promotional allowances and discounts given to customers. In April, 2014 the Company began processing raw milk and producing Kefir related packaging in its Waukesha, Wisconsin facility, contributing to increased labor and overhead, production salaries and supplies in the nine month period ended September 30, 2015 compared to the same period in 2014.

Depreciation expense decreased by $213,216 or about 10.5% to $1,808,988 during the nine-month period ended September 30, 2015 from $2,022,204 during the same period in 2014. The decrease reflects a $400,000 correction of depreciation expense related to periods prior to 2014 recognized in the first quarter of 2014 partially offset by increased depreciation expense associated with assets placed in service at the Lifeway Wisconsin location in 2015.

Selling Expenses

The following table summarizes our selling expenses:

	Nine months ended September 30, 2015	Nine months ended September 30, 2014	Change $	Change %
Salesperson commissions	$ 1,872,777	$ 1,692,421	$ 180,356	10.7%
Advertising	4,033,240	2,462,313	1,570,927	63.8%
Salaries	3,210,988	4,301,159	(1,090,171)	-25.3%
Promotions payable	138,567	248,486	(109,919)	-44.2%
Travel	230,605	1,273,257	(1,042,652)	-81.9%
Selling expense	$ 9,486,177	$ 9,977,636	$ (491,459)	-4.9%
% to net sales	10.7%	11.2%		

Selling expenses decreased by $491,459 or 4.9% to $9,486,177 during the nine-month period ended September 30, 2015 from $9,977,636 during the same period in 2014. Selling expenses as a percentage of sales were 10.7% for the nine-month period ended September 30, 2015 compared to 11.2% for the same period in 2014. The decrease reflects a concerted effort to reduce travel activities in 2015, and lower salaries due to the reassignment of Company personnel in 2015 from principally selling responsibilities to broader general management responsibilities offset partially by an increase in advertising programs. During the first quarter of 2015 the company ran its first national TV commercial contributing to the increased advertising expense.

General and administrative expenses

The following table summarizes our general and administrative expenses:

	Nine months ended September 30, 2015	Nine months ended September 30, 2014	Change $	Change %
Salaries	$ 4,812,979	$ 2,702,560	$ 2,110,419	78.1%
Rent	201,369	226,279	(24,910)	-11.0%
Equipment lease	5,667	5,770	(103)	-1.8%
Auto expense	105,681	74,706	30,975	41.5%
Office supplies	111,267	168,022	(56,755)	-33.8%
Professional fees	3,767,384	2,376,006	1,391,378	58.6%
Permits and licenses	—	106,062	(106,062)	-100.0%
Telephone expense	114,411	77,893	36,518	46.9%
Facilities	1,172,708	706,792	465,916	65.9%
Tax	144,361	110,322	34,039	30.9%
Miscellaneous	484,035	560,981	(76,946)	-13.7%
General & administrative expense	$ 10,919,862	$ 7,115,393	$ 3,804,469	53.5%
% to net sales	12.3%	8.0%		

General and administrative expenses increased $3,804,469 or 53.5% to $10,919,862 during the nine-month period ended September 30, 2015 from $7,115,393 during the same period in 2014. The increase is primarily a result of increases in salaries, professional fees and facilities expense. The higher salaries reflects the reassignment of Company personnel in 2015 from principally selling responsibilities to broader general management responsibilities. Professional fees, which consists primarily of legal and accounting fees increased by $1,391,378 or 58.6% to $3,767,384 in the nine-month period ended September 30, 2015 from $2,376,006 during the same period in 2014. The higher professional fees are due to costs associated the company's delayed SEC filings. Expenses related to our facilities, increased by $465,916 or 65.9% to $1,172,708 in the nine-month period ended September 30, 2015 from $706,792 during the same period in 2014. The increase is primarily due to higher utility costs associated with the Wisconsin facility.

Income from operations and net income

The company reported income from operations of $3,511,457 during the nine months ended September 30, 2015, compared to $4,342,864 during the same period in 2014. Provision for income taxes was $1,696,772, or a 50.8% effective rate for nine months ended September 30, 2015 compared to a provision for income taxes of $2,307,234, or a 53.8% effective tax rate, during the same period in 2014. Income taxes are discussed in Note 10 to the Notes to the Consolidated Financial Statements.

Net income was $ 1,645,483 or $0.10 per basic and diluted common share for the nine-month period ended September 30, 2015 compared to $1,980,273 or $0.12 per basic and diluted common share in the same period in 2014.

Liquidity and Capital Resources

Sources and Uses of Cash

We anticipate being able to fund the Company's foreseeable liquidity requirements internally. We continue to explore potential acquisition opportunities in our industry in order to boost sales while leveraging our distribution system to consolidate and lower costs.

Net cash provided by operating activities was $4,377,976 during the nine-months ended September 30, 2015 compared to net cash provided by operating activities of $3,677,538 in the same period in 2014. The increase is primarily attributable to the favorable timing of payments to suppliers and service providers and lower income tax payments in 2015 partially offset by increased inventory levels in 2015.

Net cash used in investing activities was $1,800,079 during the nine-months ended September 30, 2015 compared to net cash used in investing activities of $3,531,023 in the same period in 2014. The lower level of net cash used in investing activities reflects the elevated spending on purchases of property and equipment in 2014, primarily related to the Waukesha Wisconsin facility, and proceeds related to the sale of property and equipment during the 2015 period.

The Company had a net increase in cash and cash equivalents of $1,750,425 during the nine month period ended September 30, 2015 compared to a net decrease in cash and cash equivalents of $511,179 in the same period in 2014.

On September 24, 2015, the Company's Board of Directors authorized a stock repurchase program under which the Company may repurchase up to $3,500,000 of the Company's common stock not to exceed an aggregate of 250,000 shares, in the open market or in privately negotiated transactions, in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Securities Exchange Act of 1934, as amended. The extent to which the Company repurchases its shares and the timing of such repurchases will depend upon a variety of factors, including market conditions, regulatory requirements and other corporate considerations, as determined by management. The repurchase program may be suspended or discontinued at any time. There were no share repurchases during the nine months ended September 30, 2015.

At September 30, 2015, the Company had $840,000 of current maturities of notes payable. The Company also has a $5 million revolving credit facility with The Private Bank. This facility remained unused at September 30, 2015 and is available for other general corporate purposes.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

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

As of September 30, 2015, we had an outstanding balance under our bank term loans of approximately $8.2 million, and we have the option to borrow an additional $5 million from our line of credit. The term loans bear interest at variable rates. Based on the outstanding amount under such loans at September 30, 2015 of approximately $8.2 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 $82,000. For a detailed discussion of our notes payable, 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

Our evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act was performed under the supervision and with the participation of our senior management, including our Chief Executive Officer and Chief Financial Officer. The purpose of disclosure controls and procedures is to ensure that information required to be disclosed in the reports 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 management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

As previously disclosed under “Item 9A—Controls and Procedures” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014, we concluded that our internal control over financial reporting was not effective based on the material weaknesses identified. Based on those material weaknesses, which we view as an integral part of our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the quarter ended September 30, 2015, our disclosure controls and procedures were not effective. Nevertheless, based on a number of factors, including the performance of additional procedures by management designed to ensure the reliability of our financial reporting, we believe that the consolidated financial statements in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with GAAP.

Management’s Remediation Initiatives

We continue to make progress toward achieving the effectiveness of our disclosure controls and procedures. Remediation generally requires making changes to how controls are designed and implemented and then adhering to those changes for a sufficient period of time such that the effectiveness of those changes is demonstrated with an appropriate amount of consistency. We believe that we have made significant improvements in our internal control over financial reporting and are committed to remediating our material weaknesses. Our Sarbanes Oxley compliance function is responsible for helping develop and monitor our short-term and long-term remediation plans. In addition, we have assigned owners to each material weakness to oversee the necessary remedial changes to the overall design of our internal control environment and to address the root causes of our material weaknesses.

In addition to the actions previously disclosed under “Item 9A—Controls and Procedures” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014, our remediation initiatives summarized below, are intended to further address our specific material weaknesses and to continue to enhance our internal control over financial reporting.

Our leadership team remains committed to achieving and maintaining a strong control environment, high ethical standards and financial reporting integrity. This commitment will continue to be communicated to and reinforced with our employees.

We continue to foster awareness and understanding of standards and principles for accounting and financial reporting. This includes the implementation and clarification of specific accounting policies and procedures.

We continue to enhance the development, communication, and monitoring of processes and controls to ensure that appropriate account reconciliations and journal entry controls are performed, documented, and reviewed as part of our standardized procedures.

We continue to redesign our period-end closing and financial statement preparation process in order to improve both its effectiveness and efficiency.

The audit committee of our board of directors has increased the frequency and depth of its discussions with management regarding financial reporting and internal control matters.

Collectively, these and other actions are improving the foundation of our internal control 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 third quarter of 2015 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.

There have been no material changes to the Risk Factors disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

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.

10.1 Eleventh Modification to Loan and Security Agreement dated as of August 11, 2015, by and among The PrivateBank and Trust Company, Lifeway Foods, Inc., Fresh Made, Inc., Helios Nutrition Limited, Pride of Main Street Dairy, LLC, Starfruit, LLC and Lifeway Wisconsin, Inc. (incorporated by reference to Exhibit 10.22 to Lifeway's Annual Report on Form 10-K dated December 31, 2014 and filed on August 14, 2015 (File No. 000-17363)).

31.1 Officer's Certificate Pursuant to 15 U.S.C. 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Officer's Certificate Pursuant to 15 U.S.C. 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive Data Files.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LIFEWAY FOODS, INC.

Date: November 9, 2015	By:	/s/ Julie Smolyansky Julie Smolyansky Chief Executive Officer, President, and Director (Principal Executive Officer)
Date: November 9, 2015	By:	/s/ Edward P. Smolyansky Edward P. Smolyansky Chief Financial and Accounting Officer, Treasurer, Chief Operating Officer and Secretary (Principal Financial and Accounting Officer)

INDEX OF EXHIBITS

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