LIFEWAY FOODS INC
Form 10-Q
November 14, 2008

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, 2008

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

For the transition period from __________ to __________

Commission File Number: 000-17363

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

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

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

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

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

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

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

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 September 30, 2008, the issuer had 16,730,226 shares of common stock, no par value, outstanding.

LIFEWAY FOODS, INC.

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LIFEWAY FOODS, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2008 and 2007

AND DECEMBER 31, 2007

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consoldiated Statements of Financial Condition
September 30, 2008 and 2007 (Unaudited) and December 31, 2007

	(Unaudited) September 30, 2008	(Unaudited) September 30, 2007	December 31, 2007
ASSETS			
Current assets			
Cash and cash equivalents	$ 530,866	$ 1,624,566	$ 595,885
Marketable securities	5,668,940	6,557,841	6,989,474
Inventories	4,207,094	4,061,189	3,506,554
Accounts receivable, net of allowance for doubtful accounts of $35,011 and $39,460 at September 30, 2008 and 2007 and $39,460 at December 31, 2007	5,161,414	4,845,956	4,209,662
Prepaid expenses and other current assets	20,864	13,051	21,253
Other receivables	28,918	45,810	43,111
Deferred income taxes	909,479	225,803	311,960
Refundable income taxes		125,763	240,880
Total current assets	16,527,575	17,499,979	15,918,779
Property and equipment, net	10,989,500	9,176,479	9,678,948
Intangible assets			
Goodwill	5,414,858	3,952,425	5,414,858
Other intangible assets, net of accumulated amortization of $841,561 and $520,979 at September 30, 2008 and 2007 and $601,976 at December 31, 2007	3,016,077	3,342,517	3,255,662
Total intangible assets	8,430,935	7,294,942	8,670,520
Other assets	500,000	500,000	500,000
Total assets	$ 36,448,010	$ 34,471,400	$ 34,768,247
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Current maturities of notes payable	$ 1,125,608	$ 1,434,903	$ 1,136,126
Accounts payable	2,361,318	1,865,041	1,594,330
Accrued expenses	532,662	441,068	414,039
Margin payable	428,951	—	—
Accrued income taxes	308,260	—	—
Total current liabilities	4,756,799	3,741,012	3,144,495
Notes payable	3,219,338	4,424,266	4,096,797
Deferred income taxes	1,615,421	510,000	1,712,795

Stockholders' equity			
Common stock, no par value; 20,000,000 shares authorized; 17,273,776 shares issued; 16,730,226 shares outstanding at September 30, 2008; 17,273,776 shares issued; 16,825,626 shares outstanding at September 30, 2007; and 17,273,776 shares issues; 16,897,726 shares outstanding at December 31, 2007	6,509,267	6,509,267	6,509,267
Paid-in-capital	1,175,539	1,103,630	1,120,669
Treasury stock, at cost	(3,207,213)	(2,081,915)	(2,078,165)
Retained earnings	23,126,672	20,318,323	20,471,432
Accumulated other comprehensive income (loss), net of taxes	(747,813)	(53,183)	(209,043)
Total stockholders' equity	26,856,452	25,796,122	25,814,160
Total liabilities and stockholders' equity	$ 36,448,010	$ 34,471,400	$ 34,768,247

See accompanying notes to financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consoldiated Statements of Income and Comprehensive Income
For the Three and Nine Months Ended September 30, 2008 and 2007 (Unaudited)
and the Year Ended December 31, 2007

	(Unaudited) Three Months Ended September 30, 2008	(Unaudited) Three Months Ended September 30, 2007	(Unaudited) Nine Months Ended September 30, 2008	(Unaudited) Nine Months Ended September 30, 2007	Year Ended December 31, 2007
Sales	$ 11,240,282	$ 9,817,478	$ 33,885,912	$ 28,554,984	$ 38,729,156
Cost of goods sold	7,505,794	6,901,471	22,403,574	17,885,885	25,582,981
Depreciation expense	197,366	195,348	581,920	546,945	726,647
Total cost of goods sold	7,703,160	7,096,819	22,985,494	18,432,830	26,309,628
Gross profit	3,537,122	2,720,659	10,900,418	10,122,154	12,419,528
Selling Expenses	957,978	1,174,140	3,171,269	2,856,483	3,744,388
General and Administrative	1,032,043	916,893	3,109,506	2,879,582	3,914,825
Amortization expense	79,862	48,583	239,585	242,269	323,266
Total Operating Expenses	2,069,883	2,139,616	6,520,360	5,978,334	7,982,479
Income from operations	1,467,239	581,043	4,380,058	4,143,820	4,437,049
Other income (expense):					
Interest and dividend income	95,042	84,918	261,037	249,082	350,286
Rental Income	13,647	9,731	36,940	27,912	48,305
Interest expense	(71,928)	(102,197)	(226,851)	(321,009)	(410,180)
Impairment of marketable securities	(270,908)	—	(270,908)		
Gain (loss) on sale of marketable securities, net	(110,259)	209,207	(146,404)	663,538	539,739
Total other income (Expense)	(344,406)	201,659	(346,186)	619,523	528,150
Income before provision for income taxes	1,122,833	782,702	4,033,872	4,763,343	4,965,199
Provision for income taxes	267,917	314,508	1,378,632	1,763,792	1,812,539
Net income	$ 854,916	$ 468,194	$ 2,655,240	$ 2,999,551	$ 3,152,660
	0.05	0.03	0.16	0.18	0.19

Basic and diluted earnings per common share				
Weighted average number of shares outstanding	16,730,526	16,824,911	16,772,280	16,865,390	16,855,611
COMPREHENSIVE INCOME					
Net income	$ 854,916	$ 468,194	$ 2,655,240	$ 2,999,551	$ 3,152,660
Other comprehensive income (loss), net of tax: Unrealized gains (losses) on marketable securities (net of tax benefits)	(480,045)	(57,187)	(895,641)	181,647	(47,091)
Less reclassification adjustment for (gains) losses included in net income (net of taxes)	64,746	(123,372)	85,963	(388,600)	(315,721)
Comprehensive income	$ 439,617	$ 287,635	$ 1,845,562	$ 2,792,598	$ 2,789,848

See accompanying notes to financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consoldiated Statements of Changes in Stockholders' Equity
For the Nine Months Ended September 30, 2008 (Unaudited)
and the Year Ended December 31, 2007

	Common Stock, No Par Value 20,000,000 Shares Authorized							Accumulated
	# of Shares Issued	# of Shares Outstanding	# of Shares of Treasury Stock	Common Stock	Paid In Capital	Treasury Stock	Retained Earnings	Other Comprehensive Income (Loss), Net of Tax
Balances at 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	—	4,900	(4,900)	—	39,758	8,751	—	—
Other comprehensive income (loss): Unrealized losses on securities, net of taxes and reclassification adjustment	—	—	—	—	—	—	—	(362,813)
Net income for the year ended December 31, 2007	—	—	—	—	—	—	3,152,660	—
Balances at December 31, 2007	17,273,776	16,827,726	446,050	6,509,267	1,120,669	(2,078,165)	20,471,432	(209,043)
Redemption of stock	—	(100,000)	100,000	—	—	(1,139,987)	—	—
	—	2,500	(2,500)	—	54,870	10,939	—	—

Issuance of treasury stock for compensation									
Other comprehensive income (loss): Unrealized gains on securities, net of taxes and reclassification adjustment	—	—	—	—	—	—	—	(538,770)	
Net income for the nine months ended September 30, 2008	—	—	—	—	—	—	2,655,240		—
Balances at September 30, 2008	17,273,776	16,730,226	543,550	$ 6,509,267	$ 1,175,539	$ (3,207,213)	$ 23,126,672	$ (747,813)	$

See accompanying notes to financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consoldiated Statements of Cash Flows
For the Nine Months Ended September 30, 2008 and 2007 (Unaudited)
and the Year Ended December 31, 2007

	(Unaudited) Nine Months Ended September 30, 2008	(Unaudited) Nine Months Ended September 30, 2007	December 31, 2007
Cash flows from operating activities:			
Net income	$ 2,655,240	$ 2,999,551	$ 3,152,660
Adjustments to reconcile net income to net cash flows from operating activities, net of acquisition:			
Depreciation and amortization	821,505	789,215	1,049,913
(Gain)Loss on sale of marketable securities, net	146,404	(663,538)	(539,739)
Impairment of marketable securities	270,908	—	—
Deferred income taxes	(125,221)	12,419	(223,717)
Treasury stock issued for compensation	65,809	27,720	48,509
Increase (decrease) in allowance for doubtful accounts	(4,449)	(40,540)	(40,540)
(Increase) decrease in operating assets:			
Accounts receivable	(947,303)	(862,699)	(226,405)
Other receivables	14,193	25,240	27,939
Inventories	(700,540)	(1,538,993)	(984,358)
Refundable income taxes	240,880	142,008	26,891
Prepaid expenses and other current assets	665	(1,068)	(9,270)
Increase (decrease) in operating liabilities:			
Accounts payable	766,988	402,027	131,316
Accrued expenses	118,650	(44,891)	(66,062)
Accrued income taxes	308,260	—	—
Net cash provided by operating activities	3,631,989	1,246,451	2,347,137
Cash flows from investing activities:			
Investment in cost method securities	—	(500,000)	(500,000)
Purchases of marketable securities	(4,864,873)	(4,408,170)	(5,744,697)
Sale of marketable securities	4,659,350	6,652,670	7,168,246
Increase in margin payable	428,951	—	—
Purchases of property and equipment	(1,892,472)	(1,142,709)	(1,824,879)
Net cash used in investing activities	(1,669,044)	601,791	(901,330)
Cash flows from financing activities:			
Proceeds of note payable	—	300,000	300,000
Purchases of treasury stock, net	(1,139,987)	(752,603)	(752,603)
Repayment of notes payable	(887,977)	(1,318,885)	(1,945,131)
Net cash used in financing activities	(2,027,964)	(1,771,488)	(2,397,734)
Net decrease in cash and cash equivalents	(65,019)	76,754	(951,927)
Cash and cash equivalents at the beginning of the period	595,885	1,547,812	1,547,812
Cash and cash equivalents at the end of the period	$ 530,866	$ 1,624,566	$ 595,885

See accompanying notes to financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2008 and 2007
and December 31, 2007

Note 1 – NATURE OF BUSINESS

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

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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, L.L.C. 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, 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.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2008 and 2007
and December 31, 2007

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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

	September 30, 2008	September 30, 2007	December 31, 2007
Amounts insured	$ 138,913	$ 251,315	$ 576,563
Uninsured and uncollateralized amounts	846,239	1,992,169	523,295
Total bank balances	$ 985,152	$ 2,243,484	$ 1,099,858

Marketable securities

All investment securities are classified 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 FASB Staff Position 115-1 and 124-1 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.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2008 and 2007
and December 31, 2007

Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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

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

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2008 and 2007
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Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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.

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, 2007 and for the nine months ended September 30, 2008 and 2007, approximately $1,642,114, $1,241,442 and $1,356,850 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, 2008 and 2007 and the year ended December 31, 2007, diluted and basic earnings per share were the same, as the effect of dilutive securities options outstanding was not significant.

Reclassification
Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2008 and 2007
and December 31, 2007

Note 3 – INTANGIBLE ASSETS

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

	September 30, 2008		September 30, 2007		December 31, 2007	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Recipes	$ 43,600	$ 42,009	$ 43,600	$ 34,517	$ 43,600	$ 37,242
Customer lists and other customer related intangibles	305,200	172,583	305,200	131,163	305,200	141,518
Lease acquisition	87,200	51,904	87,200	39,448	87,200	42,562
Other	6,638	4,317	12,496	2,987	6,638	3,319
Customer relationship	985,000	177,848	985,000	95,764	985,000	116,285
Contractual backlog	12,000	12,000	12,000	12,000	12,000	12,000
Trade names	1,980,000	286,000	1,980,000	154,000	1,980,000	187,000
Formula	438,000	94,900	438,000	51,100	438,000	62,050
	$ 3,857,638	$ 841,561	$ 3,863,496	$ 520,979	$ 3,857,638	$ 601,976

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

2009	$ 313,225
2010	312,756
2011	300,964
2012	285,133
2013	257,883
Thereafter	1,546,116
	$ 3,016,077

Amortization expense during the nine months September 30, 2008 and 2007 and for the year ended December 31, 2007 was $239,585, $242,269 and $323,266, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2008 and 2007
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Note 4 – MARKETABLE SECURITIES

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

September 30, 2008	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	$ 3,077,340	$ 55,002	$ (639,374)	$ 2,492,968
Mutual Funds	940,322	—	(287,919)	652,403
Preferred Securities	1,714,758	—	(509,150)	1,205,608
Corporate Bonds	917,990	—	(75,144)	842,846
Municipal Bonds	4,586	374	—	4,960
Government agency Obligations	478,507	—	(8,352)	470,155
Total	$ 7,133,503	$ 55,376	$ (1,519,939)	$ 5,668,940

September 30, 2007	Cost	Unrealized Gains	Unrealized Losses	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	100,000	—	(393)	99,607
Total	$ 6,648,834	$ 336,782	$ (427,775)	$ 6,557,841

December 31, 2007	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	$ 3,037,507	$ 331,776	$ (309,014)	$ 3,060,269
Mutual Funds	946,357	4,978	(104,529)	846,806
Preferred Securities	1,776,750	40,020	(241,726)	1,575,044
Corporate Bonds	1,480,433	1,556	(79,433)	1,402,556
Municipal Bonds	4,586	253	—	4,839
Government agency Obligations	100,000	—	(40)	99,960
Total	$ 7,345,633	$ 378,583	$ (734,742)	$ 6,989,474

Proceeds from the sale of marketable securities were $7,168,246, $4,659,350 and $6,652,670 during the year ended December 31, 2007 and for the nine months ended September 30, 2008 and 2007, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2008 and 2007
and December 31, 2007

Note 4 – MARKETABLE SECURITIES - Continued

Gross gains of $876,527, $376,751, and $665,067 and gross losses of $336,788, $523,155, and $1,529 were realized on these sales during the year ended December 31, 2007 and for the nine months ended September 30, 2008 and 2007, 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, 2008:

	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	$ 1,588,687	$ (496,916)	$ 309,164	$ (142,458)	$ 1,897,851	$ (639,374)
Mutual Funds	255,835	(28,923)	253,461	(258,996)	509,296	(287,919)
Preferred Securities	463,578	(60,188)	660,720	(448,962)	1,124,298	(509,150)
Corporate Bonds	474,208	(34,858)	351,468	(40,286)	825,676	(75,144)
Government Agency Obligations	470,155	(8,352)	—	—	470,155	(8,352)
	$ 3,252,463	$ (629,237)	$ 1,574,813	$ (890,702)	$ 4,827,276	$ (1,519,939)

During the third quarter of 2008, we recorded other than temporary impairments related to investment in marketable securities in certain equity and corporate bonds of $270,908. The impairments recognized during the third quarter of 2008 related to securities that were in an unrealized loss position at the balance sheet date that have subsequently been sold and equity and corporate bonds that we consider other than temporarily impaired due to the recent performance of the issuers of those securities.

Equities, Mutual Funds, Corporate Bonds and Government Agency Obligations - 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, other than the impairment noted in the preceding paragraph, the Company does not consider any material investments to be other-than-temporarily impaired at September 30, 2008.

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, 2008.

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LIFEWAY FOODS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2008 and 2007
and December 31, 2007

Note 5 – INVENTORIES

Inventories consist of the following:

	September 30, 2008	September 30, 2007	December 31, 2007
Finished goods	$ 1,375,304	$ 1,835,452	$ 1,296,985
Production supplies	1,604,106	1,318,991	1,383,384
Raw materials	1,227,684	906,746	826,185
Total inventories	$ 4,207,094	$ 4,061,189	$ 3,506,554

Note 6 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	September 30, 2008	September 30, 2007	December 31 2007
Land	$ 969,232	$ 969,232	$ 969,232
Buildings and improvements	7,102,608	6,813,045	6,743,647
Machinery and equipment			