LIFEWAY FOODS INC
Form 10-K
March 31, 2011

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

Form 10-K

R ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2010

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

For the transition period from: _____ to _____
Commission file number: 0-17363

LIFEWAY FOODS, INC.
(Name of registrant as specified in its 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) (Zip Code)

Registrant's telephone number:
(847) 967-1010

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of each exchange on which registered
Common Stock, No Par Value	Nasdaq Global Market

Securities registered under Section 12(g) of the Exchange Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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 ¨	Accelerated filer ¨	Non-accelerated filer o	Smaller reporting company þ

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates (approximately 4,648,000 shares) computed by reference to the price at which the stock was last sold as of June 30, 2010 ($9.74 per share as quoted on the National Market System of The Nasdaq Global Market) was: $45,271,520.

The number of shares outstanding of each of the issuer's classes of common equity, as of March 1, 2011 is 16,502,566 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE:

None.

LIFEWAY FOODS, INC.

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CAUTIONARY STATEMENT IDENTIFYING IMPORTANT FACTORS THAT COULD CAUSE THE COMPANY'S ACTUAL RESULTS TO DIFFER FROM THOSE PROJECTED IN FORWARD LOOKING STATEMENTS

In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, readers of this document and any document incorporated by reference herein, are advised that this document and documents incorporated by reference into this document contain both statements of historical facts and forward looking statements. Forward looking statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those indicated by the forward looking statements. Examples of forward looking statements include, but are not limited to, (i) projections of revenues, income or loss, earnings or losses per share, capital expenditures, dividends, capital structure and other financial items, (ii) statements of Lifeway Foods, Inc.'s plans and objectives, including the introduction of new products, or estimates or predictions of actions by customers, suppliers, competitors or regulatory authorities, (iii) statements of future economic performance, and (iv) statements of assumptions underlying other statements and statements about Lifeway Foods, Inc. or its business.

This document and any documents incorporated by reference herein also identify important factors which could cause actual results to differ materially from those indicated by forward looking statements. These risks and uncertainties include price competition, the decisions of customers or consumers, the actions of competitors, changes in the pricing of commodities, the effects of government regulation, possible delays in the introduction of new products, customer acceptance of products and services, and other factors which are described herein and/or in documents incorporated by reference herein.

The cautionary statements made pursuant to the Private Litigation Securities Reform Act of 1995 above and elsewhere by Lifeway Foods, Inc. ("Lifeway" or the "Company") should not be construed as exhaustive or as any admission regarding the adequacy of disclosures made by Lifeway prior to the effective date of such act. Forward looking statements are beyond the ability of Lifeway to control and in many cases we cannot predict what factors would cause results to differ materially from those indicated by the forward looking statements.

PART I

ITEM 1. BUSINESS.

BUSINESS DEVELOPMENT

Lifeway Foods, Inc., 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 and non-dairy health food products. Lifeway's primary products are kefir, a drinkable dairy beverage similar to but distinct from yogurt, in several flavors sold under the name "Lifeway Kefir" and "Helios Nutrition Organic Kefir"; a line of various drinkable yogurts sold under the "Tuscan" and "Lassi" brands; and "BasicsPlus," a dairy based immune-supporting dietary supplement beverage. In addition to the drinkable products, Lifeway manufactures "Lifeway Farmer Cheese," a line of various farmer cheeses, a line of gourmet cream cheeses, and "Sweet Kiss," a fruit sugar-flavored spreadable cheese similar in consistency to cream cheese. The Company also manufactures and markets a vegetable-based seasoning under the "Golden Zesta" brand. In the Chicago metropolitan area, Lifeway distributes its products on its own trucks and via one distributor. Lifeway manufactures all of its products at Company-owned facilities and distributes its products primarily throughout the United States. The Company directly distributes its products in the Philadelphia metropolitan area using its own trucks.

SUBSIDIARY ENTITIES

On August 3, 2006, the Company acquired all of the issued and outstanding stock of Helios Nutrition, Ltd. ("Helios"). Pride of Main Street Dairy, L.L.C., a Minnesota limited liability company, is 100% owned by Helios.

Starfruit, L.L.C. and Starfruit Franchisor, L.L.C. are both wholly-owned subsidiaries formed on March 26, 2007 and July 15, 2008, respectively, in connection with the Company's Starfruit cafe activities.

On February 6, 2009, the Company acquired all of the issued and outstanding stock of Fresh Made, Inc., a Pennsylvania corporation ("Fresh Made").

On October 14, 2010, Lifeway First Juice, Inc., an Illinois corporation and a wholly-owned subsidiary of the Company ("Lifeway First Juice") acquired substantially all of the assets of First Juice, Inc., a Delaware corporation ("First Juice").

BUSINESS OF ISSUER

PRODUCTS

Lifeway's primary product is kefir, which, like the better-known product of yogurt, is a fermented dairy product. Kefir has a slightly effervescent quality, with a taste similar to yogurt and a consistency similar to buttermilk. It is a product distinct from yogurt because it incorporates the unique microorganisms of kefir as the cultures to ferment the milk. Lifeway's Kefir is a drinkable product intended for use as a breakfast meal or a snack, or as a base for lower-calorie dressings, dips, soups or sauces. Kefir is also used as the base of Lifeway's plain farmer's cheese, a cheese made without salt, sugar or animal rennet. In addition, kefir is the primary ingredient of Lifeway's "Sweet Kiss" product, a fruit sugar-flavored, cream cheese-like spread which is intended to be used as a dessert spread or frosting.

Kefir contains a unique mixture of several live microorganisms and nutrients such as proteins, minerals and vitamins. Kefir is a good source of calcium, protein and B Vitamins. In addition, because the fermentation process does not produce a highly sour-tasting product, the end product has fewer calories than some similar products in the dairy category.

Lifeway currently sells some or all of the products listed below, except as specifically noted, to various retail establishments including supermarkets, grocery stores, gourmet shops, delicatessens and convenience stores.

LIFEWAY'S KEFIR. "Lifeway's Kefir" is a drinkable kefir product manufactured in ten regular and low-fat varieties, including plain, pomegranate, raspberry, blueberry, strawberry, cherry, peach, banana-strawberry, cappuccino and vanilla, and sold in 32-ounce containers and 8-ounce single serving containers featuring color-coded caps and labels describing nutritional information. In March 1996, Lifeway began marketing its non-fat, low-cholesterol kefir in six flavors — plain, raspberry, strawberry, strawberry-banana, peach and blueberry. The kefir product is currently marketed under the name "Lifeway's Kefir," and is typically sold by retailers from their dairy sections.

LIFEWAY'S ORGANIC KEFIR. "Lifeway's Organic Kefir" meets the organic standards and specifications of the United States Department of Agriculture for organic products and is manufactured in five flavors: plain, wildberry, raspberry, strawberry and peach. Lifeway's Organic Kefir is sweetened with organic cane juice.

LIFEWAY'S SLIM6. "Lifeway's Slim6" is a line of low-fat kefir beverages with no added sugar designed for consumers who follow low-carbohydrate diets. Lifeway's Slim6 has only 8 grams of carbohydrates and 2.5 grams of fat per 8-ounce serving and is available in five flavors: strawberries n' cream, mixed berry, tropical fruit, strawberry-banana and an original, unsweetened version.

PROBUGS. "ProBugs" is a kefir product that contains 10 live and active kefir cultures. Aimed at children ages 2-9, ProBugs comes in three flavors, "Sublime Slime Lime®," "Orange Creamy Crawlert®" and "Goo-Berry Pie®" and is packaged in patented no spill spout pouches designed as cartoon bug characters Peter, Polly and Penelope ProBug®.

TUSCAN BRAND DRINKABLE YOGURT. "Tuscan Brand Drinkable Yogurt" is a cultured dairy beverage mainly marketed on the East Coast and manufactured in a variety of flavors which vary depending upon distributor demand.

FARMER CHEESE. "Farmer Cheese" is based on a cultured soft cheese and is intended to be used in a variety of recipes as a low fat, low-cholesterol, low-calorie substitute for cream cheese or ricotta, and is available in various styles.

SWEET KISS. "Sweet Kiss" is a sweet cheese probiotic spread available in five flavors: plain, plain with raisins, apple, peach and chocolate.

ELITA; BAMBINO. "Elita" and "Bambino" cheeses are low-fat, low-cholesterol kefir based cheese spreads which are marketed as an alternative to cream cheese.

KRESTYANSKI TWOROG. "Krestyanski Tworog" is a European-style kefir-based soft style cheese which can also be used in a variety of recipes, eaten with a spoon, used as a cheese spread, or substituted in recipes for cream cheese, ricotta cheese or cottage cheese and is marketed to consumers of various Eastern European ethnicities.

BASICS PLUS. "Basics Plus" is a patented kefir-based beverage product designed to support gastrointestinal functions and the immune system. This product contains certain "passive immunity products" purchased from GalaGen, Inc. prior to its 2002 bankruptcy. Lifeway is currently engaged in discussion with several potential new suppliers of passive immunity products and is not currently manufacturing this beverage.

KEFIR STARTER. "Kefir Starter" is a powdered form of kefir that is sold in envelope packets and allows a consumer to make his or her own drinkable kefir at home by adding milk. Lifeway continues to develop sales of this product internationally and via the internet.

LASSI. "Lassi" is a cultured drink inspired by the traditions of India. Sold in 8-ounce containers in two flavors, strawberry and mango.

GOLDEN ZESTA. "Golden Zesta" is a vegetable-based seasoning, which, because of its low sodium content, may also be used as a salt substitute and is marketed to delicatessens, gourmet shops and ethnic grocers.

HELIOS NUTRITION ORGANIC KEFIR. "Helios Nutrition Organic Kefir" is a kefir product made from organic milk and manufactured with a unique blend of active cultures. It is sold in 8 and 32 ounce bottles and made in five flavors: peach, plain, strawberry, vanilla and raspberry.

Lifeway intends to continue to develop new products based on kefir and Farmer Cheese. There is no assurance that such products or any other new products can be developed successfully or marketed profitably.

DISTRIBUTION

With its fifteen company-owned trucks, Lifeway distributes its products directly and extensively in the State of Illinois, primarily in the Chicago metropolitan area. Lifeway also directly distributes its products in the Philadelphia and Tri State metropolitan area.

In addition to the Chicago, Philadelphia and Tri State metropolitan areas, Lifeway's products are distributed to stores throughout the United States. Lifeway has verbal distribution arrangements with various distributors throughout the United States. Lifeway believes these verbal distribution arrangements allow management the necessary latitude to expand into new areas and markets and establish new relationships with distributors on an ongoing basis. Lifeway has not offered any exclusive territories to any distributors.

Distributors are provided Lifeway products at wholesale prices for distribution to their retail accounts. Lifeway believes that the price at which its products are sold to its distributors is competitive with the prices generally paid by distributors for similar products in the markets served. In all areas served, distributors currently deliver the products directly to the refrigerated cases of dairy sections of their retail customers. Each distributor carries a line of Lifeway's products on its trucks, checks the retail stores for space allocated to Lifeway's products, determines inventory requirements of the store and places Lifeway products directly into the retailers' dairy cases. Lifeway believes this method of distribution best serves the needs of each retail store, and is the best available means to ensure consistency and quality of product handling, quality control, flavor selection and favorable retail display. Under the distribution arrangements, each distributor must meet certain prescribed product handling, service and administrative requirements including, among others, frequency of delivery, replacement of damaged, old or substandard packages, and delivery of products directly to the refrigerated case.

Additionally, Lifeway has attempted international distribution of certain of its products by attempting to export to distributors operating in the Canadian provinces of Ontario and Quebec. Lifeway's products are subject to strict import quotas imposed by the Trade Control Policy Division of the Department of Foreign Affairs and International Trade of Canada. In an attempt to address this situation, management is exploring various alternatives to permit expansion of Lifeway's product line in Canada. Lifeway believes that it currently is in compliance with all applicable Canadian regulations.

MARKETING

Lifeway continues to promote the verifiable nutritional characteristics, purity and good taste of its kefir and kefir-based products. Lifeway primarily advertises its products through local radio stations, which advertisements are directed to both users and non-users of cultured milk products of all kinds. In addition, through newspaper and magazine advertising, Lifeway provides educational information on its products and appeals to the common perception that the products may be of particular health benefit, including promoting digestion, and continues to educate the public on the possible health benefits which could be derived from the use of kefir and kefir-based products.

In addition to local radio stations, newspapers and magazines, Lifeway promotes further exposure of its products through the internet, catalog advertising and promotion, store demonstrations throughout the United States, and participation in various trade shows. Lifeway also sponsors several different sporting events in the Chicago metropolitan area as an additional marketing tool.

Lifeway does not promote products manufactured under the Tuscan brand name with any marketing or advertising.

COMPETITION

Although Lifeway faces a small amount of direct competition in the United States and Canadian markets for kefir products, Lifeway's kefir-based products compete with all other yogurt and other dairy products. Many producers of yogurt and other dairy products are well-established and have significantly greater financial resources than Lifeway to promote their products.

In connection with the certain Stockholders' Agreement, as amended, between Lifeway, Danone Foods, Inc. and other parties, as well as certain other transactions between the two foregoing companies described elsewhere in this report, the parties agreed that they would not compete with each other during the term of the Stockholders' Agreement with respect to certain yogurt, cheese and kefir products. On December 31, 2009, the term of the non-compete obligation was extended to December 31, 2010 and the non-compete obligation was limited solely to kefir products. No further extensions to the term of the non-compete obligation have been agreed upon by Danone and Lifeway at this time, however, Lifeway is discussing further extensions with Danone. The remaining provisions of the Stockholders' Agreement are in full force and effect.

SUPPLIERS

Lifeway purchases its raw materials, such as milk, sugar and fruit from unaffiliated suppliers, and is not limited or contractually bound to any supplier. Lifeway has ready access to multiple suppliers for all of its raw materials and packaging requirements. Prior to making any purchase, Lifeway determines which supplier can offer the lowest price for the highest quality of product. The raw and packaging materials purchased by Lifeway are considered commodity items and are widely available on the open market with the exception of the licensed ingredient in BasicsPlus. Lifeway owns and operates the means of production of all of its products.

MAJOR CUSTOMERS

Lifeway distributes its products to numerous accounts throughout the United States. Concentrations of credit with regard to trade accounts receivable and sales are limited due to the fact that Lifeway's customers are spread across different geographic areas. However, customers are concentrated in the retail food industry, for example, Trader's Joe's. In 2010, Lifeway's largest customer represented approximately 9% of sales and reflected sales in various regions of the United States outside the Chicago metropolitan area.

TRANSACTIONS WITH GROUPE DANONE SA

All share amounts and prices in this subsection are historical and have not been adjusted for the stock splits which occurred in the first quarter of 2004 and the second quarter of 2006. On October 1, 1999, Lifeway and certain members of the Smolyansky family sold shares of restricted common stock to Danone at $10.00 per share. Later in 1999, Danone purchased additional shares of common stock from certain individuals, including shares purchased in transactions with certain Company affiliates, including Lifeway's founder Michael Smolyansky, Val Nikolenko, Vice President of Production and Pol Sikar, a director, and his affiliates. As a result of these transactions, Danone became the beneficial owner of approximately 20% of the outstanding common stock of Lifeway. Pursuant to the terms and conditions of the transaction, Lifeway granted certain limited rights to Danone, which include a right to nominate one director, anti-dilutive rights relating to future offerings and limited registration rights. In addition, as described above, Lifeway and Danone are parties to a Stockholders' Agreement dated October 1, 1999, as amended through extensions of certain provisions pursuant to which the parties agreed, among other things, that they would not compete with each other through December 31, 2010 with respect to certain kefir products. The Stockholders' Agreement also provides that Danone may not own more than 20% of the outstanding common stock of Lifeway as a result of direct or indirect acquisition of shares during the standstill period, which was extended to December 31, 2010. Danone's interest as of December 31, 2010 was approximately 20.9% due to reductions in Lifeway's shares outstanding, primarily due to

share repurchases by Lifeway. No further extensions of certain provisions to the Stockholders' Agreement have been agreed upon by Danone and Lifeway at this time, however, Lifeway is discussing further extensions with Danone. The remaining provisions of the Stockholders' Agreement are in full force and effect.

PATENTS, TRADEMARKS, LICENSES, ROYALTY AGREEMENTS

All trademark registrations have been granted by the United States Patent and Trademark Office ("USPTO"), unless otherwise noted below. Each trademark registration may be renewed upon expiration. Lifeway intends to make all timely filings as required for all trademarks listed.

Mark	Use	Date of Registration	Expiration of Registration	Comments
Lifeway	Cheese and kefir	December 12, 1989	December 12, 2019	Registration was timely renewed on December 12, 2009. Registration is renewable for ten year periods or during the six-month grace period following the registration expiration date.
Sweet Kiss	Cheese, cottage cheese and other milk products, excluding ice cream, ice milk and frozen yogurt	February 10, 1998	February 10, 2018	Registration was timely renewed on May 23, 2008. Registration is renewable for ten year periods or during the six-month grace period following the registration expiration date.
Kwashenka	Kefir, yogurt, cheeses, cottage cheeses and other milk products, excluding ice cream, ice milk and frozen yogurt	February 10, 1998	February 10, 2018	Registration was timely renewed on May 23, 2008. Registration is renewable for ten year periods or during the six-month grace period following the registration expiration date.
Bambino	Cheeses, cottage cheeses and other milk products	October 7, 2003	October 7, 2013	An Affidavit of Continued Use was timely filed between the 5th and 6th anniversaries of the registration date. Registration is renewable between the 9th and 10th anniversaries of the registration date or the six-month grace period following the registration expiration date.

Mark	Use	Date of Registration	Expiration of Registration	Comments
KPECTBRHCKNN (A stylized presentation of “Krestyanskiy” in Cyrillic characters-means “Peasant”)	Cheeses, cottage cheeses and other milk products excluding ice cream, ice milk and frozen yogurt	September 8, 1998	September 8, 2018	Registration was timely renewed on August 23, 2008. Registration is renewable for ten year periods or during the six-month grace period following the registration expiration date.
BA3APHBIII (A stylized presentation of “Bazarny” in Cyrillic characters)	Cultured milk products, excluding ice cream, ice milk and frozen yogurt; cheeses	March 17, 2009	March 17, 2019	Registration is renewable at the time of expiration provided mandatory documents are filed with the

and cottage cheese.	USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.

BAZARNY	Cultured milk products, excluding ice cream, ice milk and frozen yogurt; cheeses and cottage cheese.	March 31, 2009	March 31, 2019	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
SoyTreat	Soy-based food beverage intended for use as cultured milk substitute	November 11, 2008	November 11, 2018	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
Korovka	Dairy-based spread	November 6, 2001	November 6, 2011	An Affidavit of Continued Use was timely filed between the 5th and 6th anniversaries of the registration date. Registration is renewable between the 9th and 10th anniversaries of the registration date or the six-month grace period following the registration expiration date.
La Fruta	Cultured milk products, excluding ice cream, ice milk and frozen yogurt	March 29, 2005	March 29, 2015	An Affidavit of Continued Use was timely filed between the 5th and 6th anniversaries of the registration date. Registration is renewable between the 9th and 10th anniversaries of the registration date or the six-month grace period following the registration expiration date.

Mark	Use	Date of Registration	Expiration of Registration	Comments
PTICHYE MOLOKO (a stylized presentation of “Ptichye Moloko” in Cyrillic characters)	Kefir, yogurt, cheeses, cottage cheeses and other milk products, excluding ice cream, ice milk and frozen yogurt	October 18, 2005	October 18, 2015	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
BIO KEFIR	Yogurt, cheeses, cottage cheeses and other milk products, excluding ice cream, ice milk and frozen yogurt	December 7, 2010	December 7, 2020	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
SUBLIME SLIME LIME	Dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	July 10, 2007	July 10, 2017	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
PROBUGS	Dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	July 10, 2007	July 10, 2017	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
ORANGE CREAMY CRAWLER	Dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	July 10, 2007	July 10, 2017	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period

following the sixth anniversary date.

(DESIGN)	Dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	July 17, 2007	July 17, 2017	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
(DESIGN)	Dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	July 10, 2007	July 10, 2017	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.

Mark	Use	Date of Registration	Expiration of Registration	Comments
(DESIGN) Penelope	Dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	April 8, 2008	April 8, 2018	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
PRIDE OF MAIN STREET	Dairy Product	November 9, 1987	November 9, 2017	Only for the State of Minnesota, not in US – Registration was renewed in 2007. Registration is renewable for ten years.
HELIOS NUTRITION	Dairy products and functional foods	October 5, 1999	October 5, 2019	Registration was timely renewed on April 2, 2010. Registration is renewable for ten year periods or during the six-month grace period following the registration expiration date or the six-month grace period following the sixth anniversary date..

STARFRUIT	Franchise services, namely, offering technical and business management assistance in the establishment and operation of restaurants	October 7, 2008	October 7, 2018	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
STARFRUIT	Restaurant services	June 24, 2008	June 24, 2018	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
GOO-BERRY PIE	Dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as a milk substitute	April 1, 2008	April 1, 2018	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.

Mark	Use	Registration Date	Expiration of Registration	Comments
PHYTOBOOST	Dairy-based beverages; dairy-based food beverages; Kefir; soy-based food beverage used as a milk substitute	Pending – Application was filed April 6, 2010	N/A	Notice of Allowance (NOA) issued November 2, 2010. Applicant must file a Statement of Use or Extension Request within six months of the NOA issuance date.
TRAINING WHEELS FOR HEALTHY EATING (Stylized)	Fruit Juices	April 15, 2008	April 15, 2018	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period

following the sixth anniversary date.

FRUIT JUICE LOGO	Fruit Juices	May 20, 2008	May 20, 2018	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
PLAYGROUP PACK	Fruit Juices	June 9, 2009	June 9, 2019	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
FRUIT JUICE (Stylized)	Fruit Juices	April 15, 2008	April 15, 2018	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.

CHANGING THE WORLD, ONE MOUTHFUL AT A TIME. (Stylized)	Fruit Juices	December 2, 2008	December 2, 2018	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
TODDLER TASTEBUD TRAINING (Stylized)	Fruit Juices	December 2, 2008	December 2, 2018	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
FIRST POP	Frozen Confections	Pending – Application filed July 25, 2008	N/A	Notice of Allowance (NOA) issued June 22, 2010. A First Extension of Time was granted December 6, 2010. Applicant must file a Statement of Use or 2nd Extension Request by June 22, 2011.
FIRST WATER	Drinking Water	Pending – Application filed July 25, 2008	N/A	Notice of Allowance (NOA) issued January 12, 2010. First and Second Extensions of Time were granted. Applicant must file a Statement of Use or 3rd Extension Request by July 12, 2011.

FIRST SMOOTHIE	Smoothies	Pending – Application filed August 19, 2010	N/A	A non-final Office action issued December 6, 2010. This is a letter from the examining attorney requiring additional information and/or making an initial refusal. The applicant must respond to this Office action by June 6, 2011.
STARFRUIT (Stylized)	KEFIR	November 23, 2010	November 23, 2020	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the 5th and 6th anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
PROBOOST	Dairy-based beverages containing probiotic cultures; kefir	Pending – Application filed May 4, 2010	N/A	Final Office action issued February 23, 2011. Applicant has until August 23, 2011 to respond.

Lifeway also uses, and claims common law rights, the following unregistered trademarks to: “Elita,” “Healthy Foods Today for a Better Life Tomorrow,” “Milkshake Smoothie,” “Toplenka,” “White Cheese,” “Drink It to Be Beautiful Inside and Out,” “Golden Zesta” and “Pride of Main Street.”

On December 27, 1990, Lifeway purchased the Tuscan brand-name liquid drinkable yogurt customer list along with a limited license of the trademark and use of the Tuscan liquid yogurt U.P.C. codes from a third party.

In October 1998, Lifeway entered into a sublicense agreement with GalaGen, Inc. and Metagenics, Inc. with an effective date of May 1, 1998 (“Lifeway sublicense”), wherein GalaGen sublicensed patent rights of Metagenics for kefir-based products containing natural immune components exclusively to Lifeway. Under the rights granted to it by the Lifeway sublicense, Lifeway manufactures and sells products using the Basics Plus trademark. GalaGen had acquired the primary license for such patent rights in an agreement executed with Metagenics in April 1998.

The terms of the Lifeway sublicense provide that Metagenics will permit Lifeway to continue to have the exclusive patent rights to produce or sell kefir-based products containing natural immune components in the event the original license between GalaGen and Metagenics is terminated, and such termination was not caused by Lifeway. On February 25, 2002, GalaGen filed a petition for bankruptcy in the United States Bankruptcy Court, District of Minnesota, which terminated both its primary license with Metagenics and its participation in the Lifeway sublicense. The license and sublicense were excluded from the sale of assets of GalaGen pursuant to an order of the Bankruptcy Court. Lifeway has not received any indication that Metagenics will not permit Lifeway to continue to have the exclusive patent rights to produce or sell kefir-based products containing natural immune components. Thus, Lifeway believes that it continues to have the exclusive patent rights licensed directly from Metagenics. Either party may terminate the license agreement for cause. The term of the license agreement expires when the last valid claim of the patent rights expires, which currently is July 2, 2013, however, this term can be extended in accordance with the terms of the license agreement.

In connection with its purchase of Ilya's Farm, Inc., the Company has undertaken a royalty obligation of 5% of all sales of Ilya's Farm, Inc.'s products paid quarterly, in arrears.

REGULATION

Lifeway is subject to regulation by federal, state and local governmental authorities regarding the distribution and sale of food products. Although Lifeway believes that it currently has all material government permits, licenses, qualifications and approvals for its operations, there can be no assurance that Lifeway will be able to maintain its existing licenses and permits or to obtain any future licenses, permits, qualifications or approvals which may be required for the operation of Lifeway's business.

Lifeway believes that it is currently in compliance with all applicable environmental laws and that the cost of such compliance was not material to the financial position of Lifeway.

In addition, any Lifeway products exported to Canada would be subject to strict quotas imposed by the Trade Control Policy Division of the Department of Foreign Affairs and International Trade of Canada. Lifeway believes that it currently is in compliance with all applicable Canadian regulations. The Company exported no products to Canada in 2010.

RESEARCH AND DEVELOPMENT

Lifeway continues its program of new product development, centered around the nutritional and "low calorie" features of its proprietary kefir formulas.

Lifeway conducts primarily all of its research internally, but at times will employ the services of an outside testing facility. During 2009 and 2010, the amount Lifeway expended for research and new product development was not material to the financial position of Lifeway and no amount was customer supported.

EMPLOYEES

Lifeway currently employs approximately 315 employees, all of whom are full-time employees. Substantially all of these employees are engaged in the manufacturing of the Company's products. None of Lifeway's employees are covered by collective bargaining agreements.

ITEM 2. PROPERTIES.

On May 16, 1988, Lifeway purchased an approximately 26,000 square foot parcel of real property, including an approximately 8,500 square foot one-story brick building in good condition, located at 7625 N. Austin Avenue, Skokie, Illinois. Lifeway uses this facility for manufacturing and storage and has no plans to improve or renovate this property. Lifeway is the only occupant of this property and presently holds fee simple title subject to a mortgage which secures the property as collateral for certain loans to Lifeway from The Private Bank & Trust as discussed in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operation (the "Loans"). The Loans are secured by all of the assets of Lifeway, including a first mortgage on Lifeway's real property located in Skokie, Illinois, Niles, Illinois and Morton Grove, Illinois. A portion of the proceeds of the Loans was used to pay off previously existing mortgage loans. The value of this property may be subject to real estate market forces that typically affect industrial real estate in the area immediately surrounding the property.

On October 16, 1996, Lifeway purchased a 110,000 square foot commercially-zoned parcel of real property, including a 46,000 square foot one-story brick building in good condition, located at 6431 Oakton Avenue, Morton Grove, Illinois. This property is used as Lifeway's corporate headquarters and main manufacturing facility. This property has been improved every year since the time of purchase by the addition of custom-built refrigerated storage space and the addition of various machinery and equipment used to manufacture, package and store Lifeway's products. Lifeway is the only occupant of this property and presently holds fee simple title subject to a mortgage which secures the property as collateral for the Loans discussed above. The value of this property may be subject to real estate market forces that typically affect industrial real estate in the area immediately surrounding the property.

In June 2005, the Company purchased a 100,000-square-foot distribution and warehousing facility that is equipped with 40,000 square feet of refrigeration. The facility, located at 6101 Gross Point Road in Niles, Illinois, will be used to store raw materials and finished goods in order to relieve space pressures at the Company's existing 50,000-square foot building, less than a mile away. The additional space at the Company's main plant will be used to expand production capacity for the Company's kefir and other probiotic products. Lifeway is the only occupant of this property and presently holds fee simple title subject to a mortgage which secures the property as collateral for the Loans discussed above. The value of this property may be subject to real estate market forces that typically affect industrial real estate in the area immediately surrounding the property.

Included in the purchase of Pride of Main Street Dairy on August 3, 2006, Lifeway acquired an approximately 35,000 square foot commercially-zoned parcel of real estate located at 214 Main Street S. Sauk Centre, Minnesota, including a 16,000 square foot two-story brick building used for production, and a 5,600 square foot storage facility. This property is used as the main headquarters and main production facility for Pride of Main Street Dairy. The building was built in the 1920's with an addition in 1990. The facility is being used to produce all of the Pride of Main Street Dairy products, and approximately 70% of the Helios Nutrition Organic Kefir, with the remaining 30% being produced in Lifeway's main production facility in Morton Grove, Illinois. Lifeway is the only occupant of this property and presently holds fee simple title subject to negative mortgage pledge as part of the collateral package for the Loans discussed above. The value of this property may be subject to real estate market forces that typically affect industrial real estate in the area immediately surrounding the property.

On February 6, 2009, in connection with the Company's acquisition of Fresh Made, Inc., Lifeway also acquired 1.135 acres of land in Philadelphia. Lifeway is the only occupant of this property and presently holds fee simple title subject to a negative mortgage pledge as part of the collateral package for the Loans discussed above. The value of this property may be subject to real estate market forces that typically affect industrial real estate in the area immediately surrounding the property.

For financial statement and tax purposes, Lifeway depreciates its buildings and improvements on a straight line basis over 31 and 39 years.

Management believes that Lifeway has adequate insurance coverage for all its properties.

ITEM 3. 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.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

MARKET INFORMATION

Lifeway's Common Stock, no par value, the only class of common equity of Lifeway, is traded on The Nasdaq Global Market under the symbol "LWAY." Trading commenced on March 29, 1988.

The high and low sales prices for Lifeway's Common Stock for the quarterly periods within the two most recent fiscal years, as reported by The Nasdaq Global Market, is set forth in the following table:

	Low Bid	High Bid
First Qtr. 2009	6.07	9.72
Second Qtr. 2009	6.57	13.50
Third Qtr. 2009	10.67	14.94
Fourth Qtr. 2009	9.87	12.50
First Qtr. 2010	11.34	12.70
Second Qtr. 2010	8.07	12.07
Third Qtr. 2010	9.60	11.27
Fourth Qtr. 2010	9.31	10.60

As of March 15, 2011, there were approximately 82 holders of record of Lifeway's Common Stock. The Company has no information regarding beneficial owners whose shares are held in street name.

DIVIDENDS

Lifeway has paid no cash dividends on its Common Stock since inception and management does not anticipate that such dividends will be paid in the foreseeable future.

SALES OF UNREGISTERED SECURITIES

None.

PURCHASES OF THE COMPANY'S SECURITIES

Period	(a) Total Numbers of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
October 1 to October 31, 2010	10,886	11.65	10,886	97,808
November 1 to November 30, 2010	35,071	9.83	35,071	62,737
December 1 to December 31, 2010	15,135	9.63	15,135	47,602
Total	61,092	10.10	61,092	47,602

The Company established a share repurchase program approved December 17, 2009 (for 100,000 shares with a plan expiration date of one year) and on May 7, 2010, the Company approved a new share repurchase program of up to 200,000 shares with a plan expiration date of one year from the date of the first purchase. As of the date of this filing, Lifeway has repurchased 252,398 shares of the Company's securities in 2010 pursuant to these programs at a total cost of $2,666,288.

EQUITY COMPENSATION PLAN INFORMATION

See Part III, Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters, of this Annual Report on Form 10-K for information regarding securities authorized for issuance under our equity compensation plans.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Comparison of Quarter Ended December 31, 2010 to Quarter Ended December 31, 2009

The following analysis should be read in conjunction with the audited financial statements of the Company and related notes included elsewhere in this annual report and the unaudited financial statements and Management's Discussion and Analysis contained in our Form 10-Q, for the fiscal quarters ended March 31, 2010, June 30, 2010, and September 30, 2010.

Results of Operations

Total gross consolidated group sales increased by $1,657,451 (approximately 11%) to $16,123,946 during the three month period ended December 31, 2010, from $14,466,495 during the three month period ended December 31, 2009. This increase is primarily attributable to increased sales and awareness of Lifeway's flagship line, Kefir, as well as ProBugs® Organic Kefir for kids.

Cost of goods sold as a percentage of gross sales, excluding depreciation, were approximately 71% during the fourth quarter 2010, compared to about 66% during the same period in 2009. This increase is a result of higher prices of conventional milk, our largest raw material, and higher costs of other raw materials, such as cost of transportation and other petroleum based production supplies, which were partially offset through higher sales volume as well as an increase in production efficiencies. The cost of milk was approximately 30% higher during the fourth quarter 2010 when compared to the same period in 2009. Gross profit decreased approximately 5% during the fourth quarter of 2010, when compared with the same period in 2009.

Operating expenses as a percentage of sales were approximately 22% during the fourth quarter of 2010 compared to approximately 21% during the same period in 2009. This increase is primarily attributable to a planned increase in selling expenses due to increased advertising spend in order to drive awareness of our expanding product offerings. Advertising costs were $1,008,849 compared to $160,000 for the same period in 2009. We expect advertising expense to be approximately 10% of sales in coming quarters.

Interest expense during the fourth quarter 2010 increased to $88,723 compared to interest expense of $78,366 during the same period a year ago. Notes payable are discussed in Note 9 of the Notes to Consolidated Financial Statements.

Total loss before taxes increased by $343,444 to a loss of $368,862 during the fourth quarter 2010, from a loss of $25,418 during the same period in 2009.

Income tax benefit was $133,299 for the 2010 fourth quarter compared with an income tax benefit of $145,011 during the same period in 2009.

Total loss was $235,563, or $0.01 per share, for the fourth quarter ended December 31, 2010, compared to net income of $119,593, or $0.01 per share, for the same period in 2009.

Comparison of Year Ended December 31, 2010 to Year Ended December 31, 2009

Results of Operations

Sales increased by $5,427,576 (approximately 9%) to $63,543,445 during the twelve month period ended December 31, 2010, from $58,115,878 during the same twelve month period in 2009. This increase is primarily attributable to increased sales and awareness of Lifeway's flagship line, Kefir, as well as Lifeway's kids Kefir drink, ProBugs®.

Cost of goods sold as a percentage of gross sales, excluding depreciation expense, was approximately 58% in 2010, which compares to about 55% for the same period in 2009. Cost of goods sold were impacted by the higher cost of conventional milk, our largest raw material, which was approximately 30% higher in full year 2010 when compared to full year 2009. We were able to offset the majority of the impact of increases in milk prices through other operational efficiencies.

Operating expenses as a percentage of sales were approximately 22% in 2010, compared to 21% in 2009. This increase is primarily attributable to a $1.6 million, or 60%, planned increase in selling expenses due to an increased advertising spend in order to drive awareness of our expanding product offerings. Total advertising costs increased by $2.7 million in 2010 when compared to 2009. We expect advertising expense to be approximately 10% of sales in fiscal 2011.

Total other income in 2010 was $171,820 compared with total other expenses of $489,716 in 2009. This increase is attributable to our gains on the sale of marketing securities of $250,480 in 2010, compared to a loss on the sale of marketable securities of $278,474 in 2009. Marketable securities are discussed in Note 5 of the Notes to Consolidated Financial Statements. We also benefitted from higher interest dividend income in 2010 as compared to 2009 and lower interest expenses.

Total income before taxes decreased by $1,947,236 (approximately 22%) to $6,446,452 in 2010, from $8,448,952 in 2009.

Provision for income taxes was $2,823,986, or a 44% tax rate, in 2010 compared to $2,879,250, or a 34% tax rate, in 2009. Income taxes are discussed in Note 10 of the Notes to Consolidated Financial Statements.

Total net income was $3,622,466, or $0.22 per share, in 2010 compared to $5,569,702, or $0.33 per share, in 2009.

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

On February 6, 2009, Lifeway entered into a Loan and Security Agreement with The Private Bank & Trust (the "Loan Agreement") which provided for (i) a term loan to Lifeway in the principal amount of $7,600,000, due on February 6, 2014 (the "Term Loan") with annual interest rate equal to either the London Inter-Bank Offer Rate ("LIBOR"), plus 2.5% or the prime lending rate, and (ii) a revolving line of credit in the principal amount of $5,000,000 (the "Line of Credit," together with the Term Loan, the "Loans"), which originally matured February 6, 2010. The original maturity date was extended to May 31, 2011 on March 31, 2011. The Line of Credit has an annual interest rate equal to either LIBOR, plus 2.5% or the prime lending rate. The Loans are secured by all of the assets of Lifeway, including a first mortgage on Lifeway's real property located in Skokie, Illinois, Niles, Illinois and Morton Grove, Illinois. A portion of the proceeds of the Loans was used to pay off previously existing mortgage loans. At December 31, 2010, the Loans had a balance of $6,628,889, and $0, respectively. The Company entered into to a First Modification Agreement to Loan and Security Agreement dated as of August 13, 2009, a Second Modification Agreement dated November 12, 2009, a Third Modification Agreement dated February 6, 2010 and the Fourth Modification Agreement dated March 31, 2011 pursuant to which the allowed borrowing limits under the Line of Credit was reduced from $5,000,000 to $2,000,000 and certain covenants related to allowable capital expense limits and tangible net worth covenants were immaterially relaxed. The Fourth Modification Agreement is filed herewith as Exhibit 10.10.

Net cash provided by operating activities was $5,615,943 in 2010, which is a decrease of $1,987,118 when compared to 2009. This decrease is primarily attributable to the decrease in net income of $1,947,236.

Net cash provided by investing activities was $1,410,337 in 2010, compared to net cash used in investing activities of $12,037,187 in 2009. This improvement is primarily due to the acquisition of Fresh Made Dairy, net of cash acquired in 2009. The Company purchased $2,229,274 of property, plant and equipment in 2010 compared to the purchases of $1,766,280 in 2009. This represents an increase of $462,994 in 2010 when compared to 2009.

Lifeway had a net increase in cash and cash equivalents of $2,599,532 during the twelve months ended December 31, 2010, compared to a net increase in cash and cash equivalents of $353,159 during the same period in 2009. Lifeway had cash and cash equivalents at December 31, 2010, of $3,229,939, compared to cash and cash equivalents at the end of 2009 of $630,407.

Assets and Liabilities

Total assets were $52,058,731 as of December 31, 2010, which is a decrease of $588,888 when compared to total assets of the end of 2009. Additionally, the value of the Company's property, plant and equipment was $15,152,713 as of December 31, 2010, compared to $16,622,140 at the end of 2009.

Total current liabilities were $8,885,760 at the end of 2010, which is an increase of $322,125 when compared to the end of 2009. This is primarily due to an increase in accounts payable.

We previously had held significant portions of our assets in marketable securities. During the fourth quarter, we converted certain securities to cash and cash equivalents in order to ensure we had easy access to capital to capitalize on the opportunities we see ahead for our business. All of our marketable securities are classified as available-for-sale on our balance sheet. All of these securities are stated thereon at market value as of the end of the applicable period. Gains and losses on the portfolio are determined by the specific identification method.

We anticipate being able to fund the Company's foreseeable liquidity requirements internally. 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.

Other Developments

On August 24, 2010 the USDA ruled to exempt Kefir beverages from the Class I milk classification, which provides exemptions from the Class I definition for Kefir and other drinkable yogurt products containing at least 20 percent yogurt (by weight) as well as products intended to be meal replacements. The final rule will take effect January 01, 2011.

This change from Class 1 to Class 2 costing should have a positive impact on what Lifeway pays for its key milk ingredient, which is about 80 percent of the products' cost of goods sold.

In addition to having a positive effect on gross margins, the improved input costs will allow all of Lifeway's Kefir-based products to be more competitive with other non-Class I milk products, such as yogurts in the marketplace. This expected increase in cash flow will provide greater financial flexibility, enabling the Company to expand marketing efforts or retain cash for future initiatives. Lifeway expects to see this improvement in the 2011 first quarter.

The company reported that in September 2010, it purchased approximately 4.3 million pounds of Class 1 conventional milk at an average price of $0.18 per pound. Under the new pricing structure, the company would have paid about $0.16 per pound and saved approximately $85,000. Historically, the price of Class 2 milk is typically 10-to-15 percent lower than the price of Class 1 milk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The annotated consolidated financial statements of the Company that constitute Item 8 of this report commence on the pages that follow this page.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of
LIFEWAY FOODS, INC. AND SUBSIDIARIES

We have audited the accompanying consolidated balance sheets of LIFEWAY FOODS, INC. AND SUBSIDIARIES (the "Company") as of December 31, 2010 and 2009, and the related consolidated statements of income and comprehensive income, changes in stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of LIFEWAY FOODS, INC. AND SUBSIDIARIES as of December 31, 2010 and 2009, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America.

/s/ Plante & Moran, PLLC

Grand Rapids, MI
March 31, 2011

LIFEWAY FOODS, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2010 and 2009

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Financial Condition
December 31, 2010 and 2009

	December 31, 2010	2009
ASSETS		
Current assets		
Cash and cash equivalents	$3,229,939	$630,407
Investments	1,079,232	4,392,125
Certificates of deposits in financial institutions	250,000	652,005
Inventories	3,985,374	3,296,976
Accounts receivable, net of allowance for doubtful accounts and discounts	6,793,276	5,999,738
Prepaid expenses and other current assets	158,315	40,697
Other receivables	104,680	49,758
Deferred income taxes	328,470	251,456
Refundable income taxes	906,748	1,308,978
Total current assets	16,836,034	16,622,140
Property and equipment, net	15,152,713	14,282,182
Intangible assets		
Goodwill and other non amortizable brand assets	14,068,091	13,806,091
Other intangible assets, net of accumulated amortization of $2,322,745 and $1,598,208 at December 31, 2010 and 2009, respectively	6,001,893	6,259,430
Total intangible assets	20,069,984	20,065,521
Other assets	—	500,000
Total assets	$52,058,731	$51,469,843
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Checks written in excess of bank balances	$1,341,210	$342,976
Current maturities of notes payable	2,851,610	4,842,315
Accounts payable	4,183,481	2,764,000
Accrued expenses	509,459	614,344
Total current liabilities	8,885,760	8,563,635
Notes payable	6,122,225	6,890,214
Deferred income taxes	3,401,728	3,444,664
Total liabilities	18,409,713	18,898,513
Stockholders' equity		
Common stock, no par value; 20,000,000 shares authorized; 17,273,776 shares issued; 16,536,657 shares outstanding at December 31, 2010; 17,273,776 shares issued; 16,778,555 shares outstanding at December 31, 2009	6,509,267	6,509,267

Paid-in-capital	2,032,516	1,965,786
Treasury stock, at cost	(6,425,546)	(3,846,773)
Retained earnings	31,575,875	27,953,409
Accumulated other comprehensive income (loss), net of taxes	(43,094)	(10,359)
Total stockholders' equity	33,649,018	32,571,330
Total liabilities and stockholders' equity	$52,058,731	$51,469,843

See accompanying notes to financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Income and Comprehensive Income
For the Years Ended December 31, 2010 and 2009

	Year Ended December 31, 2010		Year Ended December 31, 2009	
Gross Sales	$ 63,543,445		$ 58,115,878	
Less: Promotional allowances	(5,043,552)		(4,198,235)	
Net Sales	58,499,893	58,499,893	53,917,643	53,917,643
Cost of goods sold		36,926,973		31,885,318
Depreciation expense		1,393,745		1,134,404
Total cost of goods sold		38,320,718		33,019,722
Gross profit		20,179,175		20,897,921
Selling expenses		7,603,098		5,987,917
General and administrative		5,576,908		5,294,550
Amortization expense		724,537		676,786
Total Operating Expenses		13,904,543		11,959,253
Income from operations		6,274,632		8,938,668
Other income (expense):				
Interest and dividend income		260,552		199,047
Rental income		11,785		35,240
Interest expense		(350,997)		(442,703)
Loss on disposition of equipment		—		(2,826)
Gain (loss) on sale of investments, net		250,480		(278,474)
Total other income (expense)		171,820		(489,716)
Income before provision for income taxes		6,446,452		8,448,952
Provision for income taxes		2,823,986		2,879,250
Net income	$	3,622,466	$	5,569,702
Basic and diluted earnings per common share		0.22		0.33
Weighted average number of shares outstanding		16,663,557		16,798,164

COMPREHENSIVE INCOME

Net income	$ 3,622,466	$ 5,569,702
Other comprehensive income (loss), net of tax:		
Unrealized gains (losses) on investments (net of tax)	114,297	325,086
Less reclassification adjustment for (gains) losses included in net income (net of taxes)	(147,032)	163,464
Comprehensive income	$ 3,589,731	$ 6,058,252

See accompanying notes to financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
For the Years Ended December 31, 2010 and 2009

	Common Stock, No Par Value							Accumulated
	20,000,000 Shares Authorized		# of Shares of					Other Comprehensive Income
	# of Shares Issued	# of Shares Outstanding	Treasury Stock	Common Stock	Paid In Capital	Treasury Stock	Retained Earnings	(Loss), Net of Tax
Balances at December 31, 2008	17,273,776	16,724,467	549,309	$6,509,267	$1,202,009	$(3,302,025)	$22,383,707	$(498,909) $
Redemption of stock	—	(87,991)	87,991	—	—	(905,607)	—	—
Issuance of treasury stock for compensation	—	13,132	(13,132)	—	119,039	25,597	—	—
Issuance of treasury stock for Fresh Made acquisition	—	128,947	(128,947)	—	644,738	335,262	—	—
Other comprehensive income (loss): Unrealized gains on securities, net of taxes and reclassification adjustment	—	—	—	—	—	—	—	488,550
Net income for the year ended December 31, 2009	—	—	—	—	—	—	5,569,702	—
Balances at December 31, 2009	17,273,776	16,778,555	495,221	$6,509,267	$1,965,786	$(3,846,773)	$27,953,409	$(10,359) $

Redemption of stock	—	(252,398)	252,398	—	—	(2,666,288)	—	—	
Issuance of treasury stock for compensation	—	10,500	(10,500)	—	66,730	87,515	—	—	
Issuance of treasury stock for Fresh Made acquisition	—			—			—	—	
Other comprehensive income (loss): Unrealized gains on securities, net of taxes and reclassification adjustment	—	—	—	—	—	—	—	(32,735)	
Net income for the year ended December 31, 2010	—	—	—	—	—	—	3,622,466	—	
Balances at December 31, 2010	17,273,776	16,536,657	737,119	$6,509,267	$2,032,516	$(6,425,546)	$31,575,875	$(43,094)	$

See accompanying notes to financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2010 and 2009

	December 31, 2010	2009
Cash flows from operating activities:		
Net income	$3,622,466	$5,569,702
Adjustments to reconcile net income to net cash flows from operating activities, net of acquisition:		
Depreciation and amortization	2,118,282	1,811,190
(Gain) Loss on sale of investments, net	(250,480)	278,474
Loss on disposition of assets	—	2,826
Deferred income taxes	(96,918)	389,754
Treasury stock issued for compensation	154,245	144,636
Increase (Decrease) in allowance for doubtful accounts	17,754	(75,000)
(Increase) Decrease in operating assets:		
Accounts receivable	(811,292)	(612,915)
Other receivables	(54,922)	(7,758)
Inventories	(682,398)	173,419
Refundable income taxes	402,230	(475,635)
Prepaid expenses and other current assets	(117,618)	9,506
Increase (decrease) in operating liabilities:		
Accounts payable	1,419,479	298,800
Accrued expenses	(104,885)	96,062
Net cash provided by operating activities	5,615,943	7,603,061
Cash flows from investing activities:		
Purchases of investments	(2,161,552)	(6,156,682)
Proceeds from sale of investments	5,669,158	6,928,321
Proceeds from redemption of certificates of deposit	402,005	—
Purchases of property and equipment	(2,229,274)	(1,766,280)
Acquisition of the assets of First Juice	(270,000)	—
Acquisition of Fresh Made, net of cash acquired	—	(11,042,546)
Net cash provided (used) in investing activities	1,410,337	(12,037,187)
Cash flows from financing activities:		
Proceeds of note payable	250,000	9,353,504
Checks written in excess of bank balances	998,234	342,976
Purchases of treasury stock	(2,666,288)	(905,607)
Repayment of notes payable	(3,008,694)	(4,003,588)
Net cash (used in) provided by in financing activities	(4,426,748)	4,787,285
Net increase in cash and cash equivalents	2,599,532	353,159
Cash and cash equivalents at the beginning of the period	630,407	277,248
Cash and cash equivalents at the end of the period	$3,229,939	$630,407

See accompanying notes to financial statements

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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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 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., Starfruit, L.L.C., Fresh Made, Inc. and Starfruit Franchisor, L.L.C. In 2010, the Company acquired the assets of First Juice and consolidated the operations into the operations of Lifeway. All significant intercompany accounts and transactions have been eliminated. The financial statements include the results of operations from the acquisition of Fresh Made, Inc. from February 6, 2009 through the end of the period and the operations from the acquisition of the assets of First Juice from October 14, 2010 through the end of the year (see Note 3).

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates made in preparing the consolidated financial statements include the allowance for doubtful accounts and discounts, the valuation of investment securities, the valuation of goodwill, intangible assets, and deferred taxes.

Revenue Recognition

Sales of Company produced dairy products are recorded at the time of shipment and the following four criteria have been met: (i) The product has been shipped and the Company has no significant remaining obligations; (ii) Persuasive evidence of an agreement exists; (iii) The price to the buyer is fixed or determinable and (iv) Collection is probable. In addition, shipping costs invoiced to the customers are included in net sales and the related cost in cost of sales. Discounts and allowances are reported as a reduction of gross sales unless the allowance is attributable to an identifiable benefit separable from the purchase of the product, the value of which can be reasonably estimated, which would be charged to the appropriate expense account.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Cash and cash equivalents
All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents.

The Company maintains cash deposits at several institutions located in the greater Chicago, Illinois and Philadelphia, Pennsylvania metropolitan areas.

Investments
All investment securities are classified as available-for-sale and are carried at fair value. Unrealized gains and losses on available-for-sale securities are reported as a separate component of stockholders' equity. Amortization, accretion, interest and dividends, realized gains and losses, and declines in value judged to be other-than-temporary on available-for-sale securities are recorded in other income. All of the Company's securities are subject to a periodic impairment evaluation. This evaluation depends on the specific facts and circumstances. Factors that we consider in determining whether an other-than-temporary decline in value has occurred include: the market value of the security in relation to its cost basis; the financial condition of the investee; and the intent and ability to retain the investment for a sufficient period of time to allow for possible recovery in the market value of the investment.

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

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

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

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

Property and equipment is being depreciated over the following useful lives:

Category	Years
Buildings and improvements	31 and 39

Machinery and equipment	5 – 12
Office equipment	5 – 7
Vehicles	5

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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

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

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

Intangible assets are being amortized over the following useful lives:

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

Income taxes
Deferred income taxes are the result of temporary differences that arise from income and expense items reported for financial accounting and tax purposes in different periods. Deferred taxes are classified as current or non-current, depending on the classification of the assets and liabilities to which they relate. Deferred taxes arising from temporary differences that are not related to an asset or liability are classified as current or non-current depending on the periods in which the temporary differences are expected to reverse.
The principal sources of temporary differences are different depreciation and amortization methods for financial statement and tax purposes, unrealized gains or losses related to investments, capitalization of indirect costs for tax purposes, purchase price adjustments, and the recognition of an allowance for doubtful accounts for financial statement purposes.

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

The Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The only periods subject to examination for the Company's federal return are the 2006 through 2009 tax years. The Company believes that its income tax filing positions and deductions would be sustained on audit and does not anticipate any adjustments that would result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded.

During the year ended December 31, 2010, the IRS completed a review of the Company's 2007 and 2008 federal tax return filings, resulting in a liability of approximately $220,000 being recognized and paid during the year. 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 and promotional costs
The Company expenses advertising costs as incurred. For the years ended December 31, 2010 and 2009 total advertising and promotion costs were $4,386,606 and $1,689,540, respectively. In 2010 and 2009 $2,390,003 and $1,689,540, respectively, were classified as advertising expense and $1,996,603 and $0, respectively, were classified as reductions of sales.

Earnings per common share
Earnings per common share were computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. For the years ended December 31, 2010 and 2009, diluted and basic earnings per share were the same, as the effect of dilutive securities options outstanding was not significant.

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

Beginning in 2010 the company concluded to separately report discounts and allowances on the face of the income statement. The Company's agreements with its distributors and retail customers have continued evolve. The Company determined that it was more appropriate to report the allowances and costs under those programs in this manner. The 2009 income statement has been restated to reflect that change. The discounts and allowances had been previously allocated between cost of sales and advertising. The change had no effect on previously reported gross profit or net income.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 3 – ACQUISITIONS

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

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

The acquisition was consummated to expand the geographic footprint of Lifeway as well as grow market share. The acquisition was accounted for using the purchase accounting method of accounting, and accordingly, the purchase price was allocated to assets acquired and the liabilities assumed based on the fair value as of the merger date. Acquisition costs for legal and professional fees have been included in General and Administrative costs. None of the goodwill resulting from the acquisition is tax deductible.

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

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

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

	For the Year Ended December 31, 2009
Gross revenue	$ 59,231,461
Net income	$ 5,618,471
Earnings per share	$ 0.33

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 3 – ACQUISITIONS - Continued

On October 20, 2010, Lifeway purchased certain assets of First Juice, Inc., a producer of organic fruit and vegetable juice beverages designed for children ("First"). The consideration for substantially all of the assets was an aggregate of $770,000, consisting of a $500,000 previous investment in preferred stock and an additional $270,000 cash paid in 2010. Production was moved to Lifeway facilities upon closing of the acquisition. The acquisition was consummated to expand the Company's presence in the children's market, increase distribution channels for existing Lifeway products, and increase diversification of the Company's products. There were no significant liabilities assumed. Acquisition costs for legal and professional fees have been included in General and Administrative costs and were not significant. The entire amount of goodwill resulting from the acquisition is tax deductible.

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

Trade names	$268,000
Other current assets	6,000
Customer lists	199,000
Fixed assets	35,000
Non-compete agreement	-0-
Non amortizable goodwill and brand asset	262,000
Total fair value of assets acquired and liabilities assumed	$770,000

Had the acquisition occurred on January 1, 2010, the impact on the gross revenue and net income of the Company would not have been significant and would have had no impact on earnings per share.

Note 4 – INTANGIBLE ASSETS

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

	December 31, 2010		December 31, 2009	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Recipes	$43,600	$43,600	$43,600	$43,600
Customer lists and other customer related intangibles	4,504,200	1,039,323	4,305,200	587,393
Lease acquisition	87,200	79,941	87,200	67,473
Customer relationship	985,000	362,526	985,000	280,454
Trade names	2,248,000	585,267	1,980,000	451,000
Formula	438,000	193,450	438,000	149,650
	$8,306,000	$2,304,107	$7,839,000	$1,579,570

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 4 – INTANGIBLE ASSETS - Continued

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

2011	$	737,320
2012		716,428
2013		697,353
2014		697,353
2015		697,353
Thereafter		2,456,086
	$	6,001,893

Amortization expense during the years ended December 31, 2010 and 2009 was $724,537 and $676,786, respectively.

Note 5 – INVESTMENTS

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

December 31, 2010	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equities	$225,573	$16,173	$(68,974)	$172,772
Mutual Funds	202,108	4,661	(2,017)	204,752
Preferred Securities	228,514	—	(18,329)	210,185
Corporate Bonds	496,451	843	(5,771)	491,523
Total	$1,152,646	$21,677	$(95,091)	$1,079,232

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

Proceeds from the sale of investments were $5,669,158 and $6,928,321 during the years ended December 31, 2010 and 2009, respectively.

Gross gains of $451,420 and $351,419 and gross losses of $200,940 and $629,893 were realized on these sales during the years ended December 31, 2010 and 2009, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 5 – INVESTMENTS - Continued

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 December 31, 2010 and 2009:

	Less Than 12 Months		12 Months or Greater		Total	
December 31, 2010	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equities	$ 48,202	$ (11,675)	$ 101,467	$ (57,299)	$ 149,669	$ (68,974)
Mutual Funds	—	—	85,061	(2,017)	85,061	(2,017)
Preferred Securities	—	—	210,185	(18,329)	210,185	(18,329)
Corporate Bonds	146,710	(2,296)	122,532	(3,475)	269,242	(5,771)
	$ 194,912	$ (13,971)	$ 519,245	$ (81,120)	$ 714,157	$ (95,091)

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

Equities, Mutual Funds, Corporate Bonds and Government Agency Obligations - The Company's investments in equity securities, mutual funds, corporate bonds and government agency obligations consist of investments in common stock, preferred stock and debt securities of companies in various industries. The Company evaluated the near-term prospects of the issuer in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider any material investments to be other-than-temporarily impaired at December 31, 2010.

Preferred Securities - The Company's investments in preferred securities consist of investments in preferred stock of companies in various industries. The Company evaluated the continuing performance of the securities, the credit worthiness of the issuers as well as the near-term prospects of the security in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider any material investments to be other-than-temporarily impaired at December 31, 2010.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 6 – INVENTORIES

Inventories consist of the following:

	December 31,	
	2010	2009
Finished goods	$ 1,636,988	$ 1,101,885
Production supplies	1,527,064	1,367,457
Raw materials	821,322	827,634
Total inventories	$ 3,985,374	$ 3,296,976

Note 7 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	December 31,	
	2010	2009
Land	$ 1,178,160	$ 1,178,160
Buildings and improvements	11,328,860	10,380,393
Machinery and equipment	13,713,649	12,525,241
Vehicles	976,745	961,245
Office equipment	352,135	255,616
Construction in process	96,990	81,608
	27,646,539	25,382,263
Less accumulated depreciation	12,493,826	11,100,081
Total property and equipment	$ 15,152,713	$ 14,282,182

Depreciation expense during the years ended December 31, 2010 and 2009 was $1,393,745 and $1,134,404, respectively.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 8 – ACCRUED EXPENSES

Accrued expenses consist of the following:

	December 31,	
	2010	2009
Accrued payroll and payroll taxes	$ 181,274	$ 191,744
Accrued property tax	273,876	306,707
Other	54,309	115,893
	$ 509,459	$ 614,344

Note 9 – NOTES PAYABLE

Notes payable consist of the following:

	December 31,	
	2010	2009
Note payable to Private Bank in monthly installments of $42,222, plus variable interest rate, currently at 2.761%, with a balloon payment of $5,066,667 due February 6, 2014. Collateralized by substantially all assets of the Company.	$ 6,628,889	$ 7,135,556
Line of credit with Private Bank at variable interest rate, currently at 2.761%. The agreement has been extended with terms allowing borrowings up to $2.0 million, maturing in May 2011. Collateralized by substantially all assets of the Company.	—	500,000
Line of credit with Morgan Stanley for borrowings up to $2.8 million at variable interest rate, currently at 3.01% due on demand. Collateralized by investments with a fair value of $679,508, cash and cd's totaling $2,578,373 at December 31, 2010.	2,344,946	2,468,151
Notes payable to Ilya Mandel & Michael Edelson, subordinated to Private Bank, payable in quarterly installments of $341,875, plus interest at the floating rate per annum (3.25% at December 31, 2010). This balance was paid in full during August, 2010.	—	1,628,822
Total notes payable	8,973,835	11,732,529
Less current maturities	2,851,610	4,842,315
Total long-term portion	$ 6,122,225	$ 6,890,214

At December 31, 2010, the Company was not in compliance with the fixed charge ratio and capital expenditure covenants with Private Bank at December 31, 2010. A debt covenant waiver was obtained subsequent to year end.

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 9 – NOTES PAYABLE - Continued

Maturities of notes payables are as follows:

For the Period Ended December 31,

2011	$	2,851,610
2012		506,664
2013		506,664
2014		5,108,897
Total	$	8,973,835

Note 10 – PROVISION FOR INCOME TAXES

The provision for income taxes consists of the following:

	For the Years Ended December 31,	
	2010	2009
Current:		
Federal	$ 2,269,819	$ 2,045,904
State and local	651,085	443,592
Total current	2,920,904	2,489,496
Deferred	(96,918)	389,754
Provision for income taxes	$ 2,823,986	$ 2,879,250

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

	For the Years Ended December 31,	
	2010	2009
Federal income tax expense computed at the statutory rate	$ 2,180,228	$ 2,872,644
State and local tax expense, net	651,085	405,550
Permanent differences	(117,247)	(178,160)
Tax credits and other	109,920	(220,784)
Provision for income taxes	$ 2,823,986	$ 2,879,250

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Amounts for deferred tax assets and liabilities are as follows:

	December 31,	
	2010	2009
Non-current deferred tax assets (liabilities) arising from:		
Temporary differences -		
Accumulated depreciation and amortization from purchase accounting adjustments	$(3,673,296)	$(3,781,680)
Capital loss carry-forwards	271,568	337,016
Total non-current net deferred tax liabilities	(3,401,728)	(3,444,664)
Current deferred tax assets arising from:		
Unrealized losses on investments	30,320	7,288
Impairment of investments	4,232	59,003
Inventory	168,875	139,730
Allowance for doubtful accounts and discounts	125,043	45,435
Total current deferred tax assets	328,470	251,456
Net deferred tax liability	$(3,073,258)	$(3,193,208)

LIFEWAY FOODS, INC. AND SUBSIDIARIES
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Note 11 – SUPPLEMENTAL CASH FLOW INFORMATION

The Company applied a previous investment in First Juice of $500,000 toward the acquisition. The impact on the acquisition and intangible assets has been omitted from the investing section of the cash flow statement.

Cash paid for interest and income taxes are as follows:

	For the Years Ended December 31,	
	2010	2009
Interest	$ 375,347	$ 419,186
Income taxes	$ 2,824,824	$ 3,432,228

Note 12 – STOCK AWARD AND 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 1,200,000 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. 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, 2010 and 2009, there were no stock options outstanding or exercisable. There were approximately 940,000 shares available for issuance under the Plan at December 31, 2010.

On May 28, 2009, Lifeway's Board of Directors approved awards of an aggregate amount of 18,000 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 May 28, 2009 and have vesting periods of one year. The expense for the awards is measured as of July 14, 2009 at $14.69 per share for 18,000 shares, or a total stock award expense of $264,420. This expense was recognized as the stock awards vested in 12 equal portions of $22,035, or 1,500 shares per month for one year.

On June 13, 2008, Lifeway's Board of Directors approved awards of an aggregate amount of 10,500 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 13, 2008 and had vesting periods of one year. The expense for the awards was measured as of July 1, 2008 at $11.87 per share for 10,500 shares, or a total stock award expense of $124,635. This expense was recognized as the stock awards vested in 12 equal portions of $10,386, or 875 shares per month for one year.

Note 13 – FAIR VALUE MEASUREMENTS

Generally accepted accounting principles define fair value as the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The standards emphasize that fair value is a market-based measurement, not an entity-specific measurement and establish the following fair value

hierarchy used in fair value measurements:

Level 1 – Inputs use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

Level 2 – Inputs use other inputs that are observable, either directly or indirectly. These inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

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Note 13 – FAIR VALUE MEASUREMENTS - Continued

Level 3 – Inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company's assessment of the significance of particular inputs to these fair measurements requires judgment and considers factors specific to each asset or liability.

The Company has available for sale investment securities measured at fair value on a recurring basis. All categories of investment securities noted in Note 5 were valued using Level 1 inputs as described above, in 2010 and 2009. There were no other assets or liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2010 or 2009.

Note 14 – RECENT ACCOUNTING PRONOUNCEMENTS

In June 2009, FASB issued FASB ASC 810, Consolidation. The objective of FASB ASC 810 is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. FASB ASC 810 shall be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The adoption of this standard did not have an impact on the Company's financial position or results of operation.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures. FASB ASU 2010-06 amends the fair value disclosure guidance to include new disclosures and changes to clarify existing disclosure requirements. ASU 2010-06 was effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements of Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The impact of ASU 2010-06 on the Company's disclosures was not significant to the consolidated financial statements.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

ITEM 9A. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure material information required to be disclosed in our reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial and Accounting Officer, as appropriate, to allow timely decisions regarding required financial disclosure. In designing and evaluating the disclosure controls and procedures, we recognized that a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

As of December 31, 2010, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial and Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial and Accounting Officer concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of December 31, 2010 in ensuring that information required to be disclosed by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified under the Exchange Act rules and forms due to the material weaknesses described below. As a result, we performed additional analysis and other post-closing procedures to ensure our consolidated financial statements were prepared in accordance with generally accepted accounting principles. Accordingly, management believes the consolidated financial statements included in this Form 10-K fairly present, in all material respects, our financial condition, results of operations and cash flows for the periods presented.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Act Rule 13a-15(f). The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, management assessed the effectiveness of our internal control over financial reporting as of December 31, 2010. In making its assessment of internal control over financial reporting, management used the criteria described in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. In conjunction with our auditors, management identified certain material weaknesses in the Company's internal control over financial reporting. A material weakness is a significant deficiency, or a combination of significant deficiencies which when aggregated, results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by employees in the normal course of their assigned functions. As a result of these material weaknesses, we concluded that the Company's internal control over financial reporting was not effective as of December 31, 2010 based on the criteria in Internal Control — Integrated Framework. We are taking steps to address these material weaknesses which could possibly have led to a material misstatement in our financial statements if not detected and corrected.

We have identified material weaknesses in our internal control over financial reporting due to incomplete and undocumented system for tracking current programs for advertising and sales promotional discount with current customers. Additionally there was inadequate monitoring of the systems used to generate the financial statements including controls over the identification, recording and review of period end activity pertaining to accounts receivable, accounts payable transactions, fixed assets and inventory. There were inadequate controls over the computation of deferred income tax accounts and inadequate systems in place to review the disclosures for acquisitions required to be included in the financial statements under generally accepted accounting principles.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting, identified in connection with the evaluation required by the Exchange Act, that occurred during this fiscal quarter ended December 31, 2010, which has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION.

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

DIRECTORS AND EXECUTIVE OFFICERS.

LUDMILA SMOLYANSKY, 60, was appointed as a Director by the Board to fill a vacancy created by an increase of the maximum number of Directors up to seven and unanimously elected as the Chairperson of the Board in November 2002. For more than 20 years, Mrs. Smolyansky has been the operator of several independent delicatessen, gourmet food distributorship businesses and imported food distributorships. In 2002, prior to the commencement of her tenure as a Director, she was hired by the Company as its General Manager. Mrs. Smolyansky devotes as much time as necessary to the business of the Company and currently holds no other directorships in any other reporting company. Mrs. Smolyansky is the mother of Julie Smolyansky (the President, Chief Executive Officer, and a Director of the Company) and Edward P. Smolyansky (the Company Treasurer and Chief Financial and Accounting Officer). Mrs. Smolyansky brings many years of food industry experience to the Board.

JULIE SMOLYANSKY, 35, was appointed as a Director, and elected President, CEO, CFO and Treasurer of the Company by the Board of Directors to fill the vacancies in those positions created by the death of her father, Michael Smolyansky, in June 2002. She is a graduate with a Bachelor’s degree from the University of Illinois at Chicago. Prior to her appointment, Ms. Smolyansky spent six years as the Company’s Director of Sales and Marketing. She devotes as much time as necessary to the business of the Company and currently holds no other directorships in any other reporting company. Ms. Smolyansky is the daughter of Ludmila Smolyansky, the Chairperson of the Board. In 2004, Ms. Smolyansky resigned as CFO and Treasurer and Edward Smolyansky, Ms. Smolyansky’s brother, was appointed to such positions. Ms. Smolyansky brings historical and operational expertise and experience to the Board.

POL SIKAR, 62, has been a Director of the Company since its inception in February 1986. He is a graduate with a Master’s degree from the Odessa State Institute of Civil Engineering in Russia. For more than 12 years, he has been President and a major shareholder of Montrose Glass & Mirror Co., a company providing glass and mirror products to the wholesale and retail trade in the greater Chicago area. Mr. Sikar devotes as much time as necessary to the business of the Company. Mr. Sikar holds no other directorships in any other reporting company. Mr. Sikar has been a Director since inception and brings a histroical perspective to the Board.

RENZO BERNARDI, 58, has been a Director of the Company since 1994. Mr. Bernardi is the president and founder of Renzo & Sons, Inc., a Dairy and Food Service Company which has been in business since 1969 (formerly, Renzo-Milk Distribution Systems). He has over 30 years of experience in the dairy distribution industry. Mr. Bernardi is a graduate of Instituto Teonico E Commerciale of Macomer, Sardinia. Mr. Bernardi devotes as much time as necessary to the business of the Company. Mr. Bernardi holds no other directorships in any other reporting company. Mr. Bernardi brings deep industry experience to the Board.

GUSTAVO CARLOS VALLE, 46, has been a Director of the Company since June 19, 2009. He is an Argentine citizen and was appointed President and CEO of the Dannon Company, Inc. effective April 1, 2009. Mr. Valle joined Danone Argentina in 1996 as Vice President Finance where he became CEO of Danone Waters Argentina in 2002. Two years later, he was appointed CEO of Danone Brazil. Mr. Valle graduated in Economics from Buenos Aires University in Argentina. Mr. Valle holds no other directorships in any other reporting company. Mr. Valle has been designated by DS Waters, L.P. (as the related successor to The Dannon Company, Inc.) to be its representative to the Board in accordance with the terms of that certain Stockholder's Agreement, as amended, between the Company and Dannon. Mr. Valle brings deep industry experience to the Board.

JULIE OBERWEIS, 36, has served as a Director of the Company since June 2006. She is the co-founder and CFO of Stratigent, LLC, a web analytics consulting company. Prior to Stratigent, she worked in investment consulting at Cambridge Associates as well as at Ritchie Capital Management, L.L.C., a global alternative asset management firm. She currently sits on the board of Oberweis Group, Inc., the holding company of Oberweis Dairy, and the DuPage Childrens Museum. Julie holds a degree in finance from the University of Illinois and is a Chartered Financial Analyst (CFA) charterholder. Ms Oberweis brings to the Board financial and accounting experience, as well as industry experience.

EDWARD P. SMOLYANSKY, 31, was appointed as Chief Financial and Accounting Officer and Treasurer of Lifeway in November 2004. He had served as the Controller of the Company from June 2002 until such time. He received his baccalaureate degree in finance from Loyola University of Chicago in December 2001. Edward P. Smolyansky is the brother of Company President and CEO Julie Smolyansky and the son of Lifeway's Chairperson of the Board, Ludmila Smolyansky.

KEY EMPLOYEES.

VALERIY NIKOLENKO, 65, Vice President of Operations, has been VP of Operations for 14 years with Lifeway Foods.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities and Exchange Act of 1934 requires the Company's Officers and Directors, and persons who own more than 10% of a registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission ("SEC"). Officers, Directors, and greater than 10% shareholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file. Based solely on its review of copies of such reports received or representations from certain reporting persons, the Company believes that, during the year ended December 31, 2010, all Section 16(a) filing requirements applicable to its Officers, Directors and 10% shareholders were timely met.

FAMILY RELATIONSHIPS

Julie Smolyansky, the President, CEO and Director of Lifeway is the daughter of Ludmila Smolyansky, Chairperson of the Board of Directors of Lifeway and the sister of Edward P. Smolyansky. Edward P. Smolyansky, the Chief Financial and Accounting Officer and Treasurer of Lifeway is the son of Ludmila Smolyansky and the brother of Julie Smolyansky.

CODE OF ETHICS

The Company has adopted a Code of Ethics applicable to all Officers which is included in this report as an exhibit hereto. Any person may, without charge, request a copy of such Code of Ethics by contacting the Company at (847) 967-1010 or by email at info@lifeway.net.

CORPORATE GOVERNANCE

The Board does not have any formal policy regarding the consideration of director candidates recommended by shareholders; any recommendation would be considered on an individual basis. The Board believes this is appropriate due to the lack of such recommendations made in the past, and its ability to consider the establishment of such a policy in the event of an increase of such recommendations. Accordingly, there have been no material changes to the procedure by which any security holder may recommend nominees to the Board.

The Company's Audit Committee consists of Mr. Sikar and Ms. Oberweis, each of whom has an understanding of finance and accounting and is able to read and understand fundamental financial statements. Audit Committee members are appointed by the full Board. The functions of the Audit Committee are to review the Company's internal controls, accounting policies and financial reporting practices; to review the financial statements, the arrangements for and scope of the independent audit, as well as the results of the audit engagement; to review the services and fees of the independent auditors, including pre-approval of non-audit services and the auditors' independence; and to recommend to the Board of Directors for its approval and for ratification by the shareholders the engagement of the independent auditors to serve the following year in examining the accounts of the Company. No member of the Audit Committee is a "financial expert," as defined in Item 407(d)(5)(ii) of Regulation S-K promulgated by the SEC. The Board examined the qualifications of its Audit Committee members and determined that the present members of the Audit Committee, based on their prior education and professional experience, were sufficiently capable of performing the duties of the Audit Committee in 2010 without being "financial experts" within such definition.

ITEM 11. EXECUTIVE COMPENSATION.

Summary Compensation Table as of December 31, 2009 and December 31, 2010

Name	Year	Salary	Bonus	Stock Awards	All other Comp.	Total
Julie Smolyansky, CEO and President(1)(5)	2010	$530,000	$75,000	$55,087	$22,726	$682,813
	2009	$390,153	$50,000	$84,762	$16,926(5)	$541,841
Edward P. Smolyansky, CFO Chief Accounting Officer and Treasurer (2)(6)	2010	$530,000	$110,000	$55,087	$28,792	$723,879
	2009	$467,153	$50,000	$84,762	$19,632(6)	$621,547
Ludmila Smolyansky, Chairman (3)	2010	$440,000	$120,000		$11,234	$463,234
	2009	$359,926	$60,000	—	$8,700	$428,626
Val Nikolenko, Vice President of Operations and Secretary (4)(7)	2010	$122,000	$40,000	$5,508	$15,930	$183,438
	2009	$124,602	$20,000	$8,476	$15,664(7)	$168,742

NOTES TO SUMMARY COMPENSATION TABLE

(1) The Board appointed Julie Smolyansky as the CEO, CFO, President and Treasurer of the Company on June 10, 2002. From September 21, 1998 until such appointments, she had been Director of Sales and Marketing of the Company. Since November 2004, Ms. Smolyansky has served solely as CEO and President.

(2) The Board appointed Edward Smolyansky as the CFO, Chief Accounting Officer and Treasurer of the Company in November 2004.

(3) The Company approves, on an annual basis, the payment to Ludmila Smolyansky of salary and bonus as other compensation for continuing advisory services to the Company and in light of her extensive experience. Ludmila Smolyansky devotes as much time as necessary to the business of the Company.

(4) The Board appointed Val Nikolenko as the Vice President of Operations and Secretary of the Company in December 1993.

(5) Represents (i) the Company's portion of the matching contributions to the Company's 401(k) plan on behalf of the following named executive officer, Julie Smolyansky: $0 for 2010 and $0 for 2009; and (ii) the following amounts related to personal usage of automobiles leased by the Company, and related insurance and fuel, for 2009 and 2010; $13,126 for 2010 and $13,126 for 2009 for 2010 of lease payments, $7,800 for 2010 and $2,000 for 2009 of insurance premiums and $1,800 for 2010 and $1,800 for 2009 of fuel.

(6) Represents (i) the Company's portion of the matching contributions to the Company's 401(k) plan on behalf of the following named executive officer, Edward Smolyansky: $16,860 for 2010 and $8,700 for 2009; and (ii) the following amounts related to personal usage of automobiles leased by the Company, and related insurance and fuel, for 2009 and 2010; $7,132 for 2010 and $7,132 for 2009 of lease payments, $3,000 for 2010 and $2,000 for 2009 of insurance premiums and $1,800 for 2010 and $1,800 for 2009 of fuel.

(7) Represents (i) the Company's portion of the matching contributions to the Company's 401(k) plan on behalf of the following named executive officer, Val Nikolenko: $6,050 for 2010 and $5,784 for 2009; and (ii) the following amounts related to personal usage of automobiles leased by the Company, and related insurance and fuel, for 2009 and 2010; $7,080 for 2010 and $7,080 for 2009 of lease payments, $1,000 for 2010 and $1,000 for 2009 of insurance premiums and $1,800 for 2010 and $1,800 for 2009 of fuel.

The Company does not maintain any formal bonus or cash incentive plans or arrangements. However, the Board determines bonus awards, if any, on an annual basis for other persons.

Julie Smolyansky has an employment agreement (the "Employment Agreement") with the Company pursuant to which she serves as Chief Executive Officer. Pursuant to the Employment Agreement, Ms. Smolyansky is entitled to an annual base salary and an annual bonus subject to such incentive bonus targets and plans which the Company may adopt from time to time. The Company has not currently set any such targets in advance or adopted any such plans. In lieu thereof, the Board of Directors determines Ms. Smolyansky's salary and bonus on an annual basis concurrently with determining amounts for other executive officers. In the event that (a) Ms. Smolyansky is terminated other than for Cause (as defined therein) or (b) Ms. Smolyansky terminates her employment for Good Reason (as defined therein) or death, then Ms. Smolyansky is entitled to a lump sum payment consisting of (y) twice her then-current base salary and (z) the aggregate of the annual bonus for which she is then eligible under the Employment Agreement and any such plans.

There are no employment agreements with other executive officers (written or unwritten).

Outstanding Equity Awards At December 31, 2010

	Stock Awards	
Name	Number of Shares or Units of Stock That Have Not Vested	Market Value of Shares or Units of Stock That Have Not Vested
Julie Smolyansky	0	$0

Edward Smolyansky	0	$0
Ludmila Smolyansky	0	$0
Val Nikolenko	0	$0

On June 9, 1995, the Company filed a registration statement on Form S-8 with the Securities and Exchange Commission in connection with the “Lifeway Foods, Inc. Consulting and Services Compensation Plan” (the “Plan”) covering 1,200,000, as adjusted, shares of its Common Stock. The Plan was adopted by the Company on June 5, 1995. 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 a total of approximately 940,000 shares eligible for issuance under the Plan at December 31, 2010. 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, 2010, there were no stock options outstanding or exercisable.

On May 28, 2009, Lifeway's Board of Directors approved awards of an aggregate amount of 18,000 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 May 28, 2009 and have vesting periods of one year. The expense for the awards is measured as of July 14, 2009 at $14.69 per share for 18,000 shares, or a total stock award expense of $264,420. This expense was recognized as the stock awards vest in 12 equal portions of $22,035, or 1,500 shares per month for one year.

Director Compensation as of December 31, 2010

Name	Fees Earned or Paid in Cash	Total
Pol Sikar	$2,000	$2,000
Renzo Bernardi	$2,000	$2,000
Julie Oberweis	$2,000	$2,000

During 2010, each outside (non-employee) director was compensated at the rate of $500 per non-annual meeting attended. Neither any employee director (Ludmila Smolyansky and Julie Smolyansky) nor any Director serving as the nominee of Danone (Gustavo Carlos Valle) was compensated as a Director during 2010.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	0	$0	940,000
Equity compensation plans not approved by security holders	0	$0	---
Total	0	$0	---

*All of Lifeway’s equity compensation plans have been approved by its shareholders.

The following table sets forth certain information known to the Company regarding the beneficial ownership of the Company’s Common Stock, the Company’s only outstanding class of securities, as of March 1, 2011 by (a) each shareholder known by the Company to be the beneficial owner of more than five percent of the Company’s Common Stock, (b) each of the Company’s directors, (c) each of the Company’s executive officers named in the Summary Compensation Table above and (d) all executive officers and directors of the Company as a group. The shareholders listed below have sole voting and investment power except as noted.

Name and Address of Beneficial Owner(1)	Amount and Nature of Beneficial Ownership	Percent of Class(2)
Ludmila Smolyansky(3)	7,503,354	45.5%
Julie Smolyansky(3)	539,560	3.27%
Edward Smolyansky(3)	326,046	1.98%
Pol Sikar(3)	3,000	*
Renzo Bernardi(3)	14,900	*
Gustavo Carlos Valle (3,4)	0	*
Julie Oberweis(3)	0	*
Val Nikolenko	5,000	*
All Directors and Officers of the Company as a Group (Eight persons in total)	8,391,860	50.9%
Danone Foods, Inc.	3,454,756	20.9%
GAMCO Investors, Inc.(5)	831,105	5.03%

*Less than .01%.

NOTES TO BENEFICIAL OWNERSHIP TABLE

(1) With the exception of Gustavo Carlos Valle and Danone Foods, Inc., the address for all Directors and shareholders listed in this table is 6431 Oakton St., Morton Grove, IL 60053. The address Gustavo Carlos Valle and Danone Foods, Inc. is 100 Hillside Avenue, White Plains, NY 10603-2861.

(2) Based upon 16,502,566 shares of Common Stock outstanding as of March 1, 2011.

(3) A director or officer of the Company.

(4) Mr. Valle is also an officer of the Dannon Company, Inc., which is an affiliate of Danone Foods, Inc.

(5) Mario J. Gabelli directly or indirectly controls or acts as the chief investment officer of the following entities. Gabelli Funds, LLC owns 326,000 shares or 1.96% of the Company; GAMCO Asset Management, Inc. owns 286,305 shares or 1.73% of the Company; Teton Advisors, Inc. owns 213,000 shares or 1.29% of the Company; Mario J. Gabelli owns 5,500 shares or 0.03% of the Company. Collectively, Mario J. Gabelli and the foregoing entities hold more than 5% of the aggregate outstanding shares of the Company. The foregoing is based solely on the number of shares reported in the most recent Schedule 13D, and filed by such shareholders with the SEC through February 7, 2011.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.

Related Transactions

Based on a review of the questionnaires that our directors and employees subject to Section 16 of the Exchange Act of 1934 completed and a review of our internal records on any related person that were identified in such questionnaires, we have determined that there are no related party transactions in excess of the lesser $120,000 or 1% of the average of the Company's total assets for each of 2009 and 2010, since the beginning of 2009 or currently proposed, involving the Company.

Director Independence

In evaluating director independence, the Company has adopted the definition set forth in Rule 4200 of the NASDAQ Marketplace Rules. The Company's board of directors, taking into consideration the relationships described in the Certain Relationships and Related Transactions section above, has determined that of the Company's current directors, Pol Sikar, Renzo Bernardi, and Julie Oberweis were independent of management.

The Board of Directors does not have a standing nominating committee, compensation committee or any committees performing similar functions. As there are only six Directors serving on the Board, it is the view of the Board that all Directors should participate in the process for the nomination and review of potential Director candidates and for the review of the Company's executive pay practices. Accordingly, Julie Smolyansky, Ludmila Smolyansky and Gustavo Carlos Valle, who are not considered independent, participate in the nominating process, in the review of executive employment contracts and in review of the Company's executive compensation practices, together with the independent directors.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

AUDIT FEES

In 2010 and 2009, Plante & Moran, PLLC, billed Lifeway approximately $186,665 and $177,536, respectively, for professional services rendered for the audit of Lifeway's annual financial statements and review of financial statements included in Lifeway's Forms 10-Q or services that are normally provided in connection with statutory and regulatory filings or engagements in 2009 and 2010.

AUDIT-RELATED FEES

None.

TAX FEES

No professional services were rendered by Plante & Moran, PLLC to Lifeway regarding tax advice, tax compliance and tax planning during 2009 and 2010.

ALL OTHER FEES

No other fees were billed to Lifeway by Plante & Moran, PLLC during 2009 and 2010 other than those described in this report.

No hours expended by Plante & Moran, PLLC in its engagement to audit Lifeway's financial statements for the most recent fiscal year were attributable to work performed by persons other than Plante's full-time permanent employees. The Audit Committee has approved 100% of all services performed by Plante for Lifeway and disclosed above.

AUDIT COMMITTEE PRE-APPROVAL POLICIES AND PROCEDURES

The Lifeway Audit Committee (the "Committee"), comprised of Messrs. Julie Oberweis and Pol Sikar, pre-approved Plante & Moran, PLLC as the Company's independent auditor for the year-ended December 31, 2010 and has adopted the following guidelines regarding the engagement of the Company's independent auditor to perform services for the Company:

For audit services (including statutory audit engagements as required under local country laws), the independent auditor will provide the Committee with an engagement letter during the January-March quarter of each year outlining the scope of the audit services proposed to be performed during the fiscal year. If agreed to by the Committee, this engagement letter will be formally accepted by the Committee at its first or second quarter meeting.

The independent auditor will submit to the Committee for approval an audit services fee proposal after acceptance of the engagement letter.

For non-audit services, the Company's management will submit to the Committee for approval (during the second or third quarter of each fiscal year) the list of non-audit services that it recommends the Committee engage the independent auditor to provide for the fiscal year. Company management and the independent auditor will each confirm to the Committee that each non-audit service on the list is permissible under all applicable legal requirements. In addition to the list of planned non-audit services, a budget estimating non-audit service spending for the fiscal year will be provided. The Committee will approve both the list of permissible non-audit services and the budget for such services. The Committee will be informed routinely as to the non-audit services actually provided by the independent auditor pursuant to this pre-approval process.

To ensure prompt handling of unexpected matters, the Committee delegates to either member thereof the authority to amend or modify the list of approved permissible non-audit services and fees. Either member will report action taken to the Committee at the next Committee meeting.

The independent auditor must ensure that all audit and non-audit services provided to the Company have been approved by the Committee. The Chief Financial Officer will be responsible for tracking all independent auditor fees against the budget for such services and report at least annually to the Committee.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

A list of the Financial Statements and Financial Statement Schedules filed as part of this Report is set forth in Item 8, which list is incorporated herein by reference.

EXHIBITS

2.1	Stock Purchase Agreement dated February 6, 2009 by and among Lifeway Foods, Inc., Iyla Mandel and Michael Edelson (incorporated by reference to Exhibit 2.1 of Lifeway's Current Report on Form 8-K dated February 6, 2009 and filed February 13, 2009). (File No. 000-17363)
3.1	Amended and Restated Bylaws (incorporated by reference to Exhibit No. 3.5 of Lifeway's Current Report on Form 8-K dated and filed on December 10, 2002). (File No. 000-17363)
3.2	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)
4.1	Revolving Note dated February 6, 2009 (incorporated by reference to Exhibit 10.2 on Lifeway's Current Report on Form 8-K dated February 6, 2009 and filed on February 13, 2009). (File No. 000- 17363)
4.2	Term Note dated February 6, 2009 (incorporated by reference to Exhibit 10.3 on Lifeway's Current Report on Form 8-K dated February 6, 2009 and filed on February 13, 2009). (File No. 000-17363)
10.1	Lifeway Foods, Inc. Consulting and Services Compensation Plan, dated June 5, 1995 (incorporated by reference to Lifeway's Registration Statement on Form S-8, File No. 33-93306).
10.2	Stock Purchase Agreement dated October 1, 1999 by and among Danone Foods, Inc., Lifeway Foods, Inc., Michael Smolyansky and certain other parties (incorporated by reference to Exhibit 10.10 of Lifeway's Current Report on Form 8-K dated October 1, 1999, and filed October 12, 1999). (File No. 000-17363)
10.3	Stockholders' Agreement dated October 1, 1999 by and among Danone Foods, Inc., Lifeway Foods, Inc., Michael Smolyansky and certain other parties

(incorporated by reference to Exhibit 10.11 of Lifeway's Current Report on Form 8-K dated October 1, 1999, and filed October 12, 1999). (File No. 000-17363)

10.4 Letter Agreement dated December 24, 1999 (amending original Stockholders' Agreement with Danone Foods, Inc.) (incorporated by reference to Exhibit 10.12 of Lifeway's Current Report on Form 8-K dated December 24, 1999, and filed January 12, 2000). (File No. 000-17363)

10.5 Employment Agreement, dated September 12, 2002, between Lifeway Foods, Inc. and Julie Smolyansky (incorporated by reference to Exhibit 10.14 of Amendment No. 2 filed April 30, 2003 to Lifeway's Quarterly Report on Form 10-QSB/A for the quarter ended September 30, 2002). (File No. 000-17363)

10.6 Loan and Security Agreement dated February 6, 2009 by and among Lifeway Foods, Inc., Fresh Made, Inc., LFI Enterprises, Inc., Helios Nutrition Limited, Pride Main Street Dairy, LLC and Starfruit, LLC and The Private Bank and Trust Company (incorporated by reference to Exhibit 10.1 of Lifeway's Current Report on Form 8-K dated February 6, 2009 and filed on February 13, 2009). (File No. 000- 17363)

10.7 First Modification Agreement dated August 13, 2009 by and among The PrivateBank and Trust Company, Lifeway Foods, Inc., Fresh Made, Inc., Helios Nutrition Limited, Pride of Main Street Dairy, LLC and Starfruit, LLC (incorporated by reference to Exhibit 10.15 of Lifeway's Current Report on Form 10-K dated December 31, 2010 and filed on March 31, 2010). (File No. 000- 17363)

10.8 Second Modification Agreement dated November 12, 2009 by and among The PrivateBank and Trust Company, Lifeway Foods, Inc., Fresh Made, Inc., Helios Nutrition Limited, Pride of Main Street Dairy, LLC and Starfruit, LLC (incorporated by reference to Exhibit 10.16 of Lifeway's Current Report on Form 10-K dated December 31, 2010 and filed on March 31, 2010). (File No. 000- 17363)

10.9 Third Modification Agreement dated February 6, 2010 by and among The PrivateBank and Trust Company, Lifeway Foods, Inc., Fresh Made, Inc., Helios Nutrition Limited, Pride of Main Street Dairy, LLC and Starfruit, LLC (incorporated by reference to Exhibit 10.17 of Lifeway's Current Report on Form 10-K dated December 31, 2010 and filed on March 31, 2010). (File No. 000- 17363)

10.10 Fourth Modification Agreement dated March 31, 2011 by and among The PrivateBank and Trust Company, Lifeway Foods, Inc., Fresh Made, Inc., Helios Nutrition Limited, Pride of Main Street Dairy, LLC and Starfruit, LLC as filed herewith.

11 Statement re: computation of per share earnings. (Incorporated by reference to Note 2 of the Consolidated Financial Statements).

14 Code of Ethics (incorporated by reference to Exhibit 14 on Lifeway's Annual Report on Form 10-KSB for the year ended December 31, 2007 and filed on March 31, 2008). (File No. 000-17363).

21	List of Subsidiaries of the Registrant
23.1	Consent of Independent Registered Public Accounting Firm
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
99.1	Press Release

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: March 31, 2011 By: /s/ Julie Smolyansky
Julie Smolyansky
Chief Executive Officer,
President, and
Director

Date: March 31, 2011 By: /s/ Edward P. Smolyansky
Edward P. Smolyansky
Chief Financial and
Accounting Officer
and Treasurer

KNOW ALL MEN BY THESE PRESENTS, that each individual whose signature appears below hereby constitutes and appoints Julie Smolyansky and Edward P. Smolyansky, and each of them individually, his or her true and lawful agent, proxy and attorney-in-fact, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to (i) act on, sign and file with the Securities and Exchange Commission any and all amendments to this Report together with all schedules and exhibits thereto, (ii) act on, sign and file with the Securities and Exchange Commission any and all exhibits to this Report and any and all exhibits and schedules thereto, (iii) act on, sign and file any and all such certificates, notices, communications, reports, instruments, agreements and other documents as may be necessary or appropriate in connection therewith and (iv) take any and all such actions which may be necessary or appropriate in connection therewith, granting unto such agents, proxies and attorneys-in-fact, and each of them individually, full power and authority to do and perform each and every act and thing necessary or appropriate to be done, as fully for all intents and purposes as he or she might or could do in person, and hereby approving, ratifying and confirming all that such agents, proxies and attorneys-in-fact, any of them or any of his, her or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Julie Smolyansky
Julie Smolyansky
Chief Executive Officer,
Date: March 31, 2011 President, and Director

/s/ Ludmila Smolyansky
Ludmila Smolyansky
Date: March 31, 2011 Chairperson of the Board of
Directors

/s/ Pol Sikar
Pol Sikar
Date: March 31, 2011 Director

Gustavo Carlos Valle
Date: Director

/s/ Renzo Bernardi
Renzo Bernardi
Date: March 31, 2011 Director

Julie Oberweis
Date: Director

INDEX OF EXHIBITS

2.1 Stock Purchase Agreement dated February 6, 2009 by and among Lifeway Foods, Inc., Iyla Mandel and Michael Edelson (incorporated by reference to Exhibit 2.1 of Lifeway's Current Report on Form 8-K dated February 6, 2009 and filed February 13, 2009). (File No. 000-17363)

3.1 Amended and Restated By-laws (incorporated by reference to Exhibit No. 3.5 of Lifeway's Current Report on Form 8-K dated and filed on December 10, 2002). (File No. 000-17363)

3.2 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)

4.1 Revolving Note dated February 6, 2009 (incorporated by reference to Exhibit 10.2 on Lifeway's Current Report on Form 8-K dated February 6, 2009 and filed on February 13, 2009). (File No. 000- 17363)

4.2 Term Note dated February 6, 2009 (incorporated by reference to Exhibit 10.3 on Lifeway's Current Report on Form 8-K dated February 6, 2009 and filed on February 13, 2009). (File No. 000-17363)

10.1 Lifeway Foods, Inc. Consulting and Services Compensation Plan, dated June 5, 1995 (incorporated by reference to Lifeway's Registration Statement on Form S-8, File No. 33-93306).

10.2 Stock Purchase Agreement dated October 1, 1999 by and among Danone Foods, Inc., Lifeway Foods, Inc., Michael Smolyansky and certain other parties (incorporated by reference to Exhibit 10.10 of Lifeway's Current Report on Form 8-K dated October 1, 1999, and filed October 12, 1999). (File No. 000-17363)

10.3 Stockholders' Agreement dated October 1, 1999 by and among Danone Foods, Inc., Lifeway Foods, Inc., Michael Smolyansky and certain other parties (incorporated by reference to Exhibit 10.11 of Lifeway's Current Report on Form 8-K dated October 1, 1999, and filed October 12, 1999). (File No. 000-17363)

10.4 Letter Agreement dated December 24, 1999 (amending original Stockholders' Agreement with Danone Foods, Inc.) (incorporated by reference to Exhibit 10.12 of Lifeway's Current Report on Form 8-K dated December 24, 1999, and filed January 12, 2000). (File No. 000-17363)

10.5 Employment Agreement, dated September 12, 2002, between Lifeway Foods, Inc. and Julie Smolyansky (incorporated by reference to Exhibit 10.14 of Amendment No. 2 filed April 30, 2003 to Lifeway's Quarterly Report on Form 10-QSB/A for the quarter ended September 30, 2002). (File No. 000-17363)

10.6	Loan and Security Agreement dated February 6, 2009 by and among Lifeway Foods, Inc., Fresh Made, Inc., LFI Enterprises, Inc., Helios Nutrition Limited, Pride Main Street Dairy, LLC and Starfruit, LLC and The Private Bank and Trust Company (incorporated by reference to Exhibit 10.1 of Lifeway's Current Report on Form 8-K dated February 6, 2009 and filed on February 13, 2009). (File No. 000- 17363)
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