LIFEWAY FOODS INC
Form 10-K/A
October 03, 2014

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

Form 10-K/A
Amendment No. 1

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

For the fiscal year ended December 31, 2013

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

For the transition period from: __________ to __________

Commission file number: 000-17363

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

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

6431 West Oakton St., Morton Grove, Illinois 60053
(Address of principal executive offices) (Zip Code)

(847) 967-1010
(Registrant’s telephone number, including area code)

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 þ 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. ¨

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 þ	Non-accelerated filer o	Smaller reporting company o

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the stock was last sold as of June 30, 2013 ($17.36 per share as quoted on the Nasdaq Global Market) was $80,688,689.

As of March 28, 2014, 16,346,017 shares of the registrant's common stock, no par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

None.

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EXPLANATORY NOTE

We are filing this Amendment No. 1 to amend the Form 10-K (the “Report”) of Lifeway Foods, Inc. (the “Company”) for the fiscal year ended December 31, 2013, as filed with the Securities and Exchange Commission on April 2, 2014, to (1) expand our discussion of the distribution of our products and our major customers in Part I, Item 1, “Business” and (2) expand our discussion of gross proceeds, cost of goods, total operating expenses, general and administrative expenses, selling expenses and liquidity and to correct disclosure about total operating expenses in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operation.”

Other than as discussed in this Explanatory Note, no other changes have been made. This Amendment No. 1 to the Report does not reflect events that may have occurred subsequent to the original filing date and does not modify or update in any way other disclosures made in the original Report.

PART I

ITEM 1. BUSINESS.

BUSINESS DEVELOPMENT

Lifeway Foods, Inc. (the "Company" or "Lifeway"), an Illinois corporation, commenced operations in February 1986, and was incorporated under the laws of the State of Illinois on May 19, 1986. The Company's principal business activity is the manufacturing of probiotic, cultured, functional dairy 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 yogurts sold under the "Lassi" brand; 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. Lifeway manufactures all of its products at Company-owned facilities and distributes its products throughout the United States. In the Chicago metropolitan area, Lifeway distributes its products on its own trucks and via one distributor. The Company directly distributes its products in the Philadelphia and Tri State metropolitan areas 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").

On July 2, 2013, the Company, through its wholly-owned subsidiary Lifeway Wisconsin, Inc., an Illinois corporation ("Lifeway Wisconsin") acquired substantially all of the assets of Golden Guernsey Dairy Limited Liability Company, a Wisconsin limited liability company ("Golden Guernsey").

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 ten live and active kefir cultures. Aimed at children ages 2-9, ProBugscomes in three flavors, "Sublime Slime Lime®," "Orange Creamy Crawler®" and "Goo-Berry Pie®" and is packaged in no spill spout pouches designed as cartoon bug characters Peter, Polly and Penelope ProBug®.

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 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 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 seventeen 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.

We do not generally enter into written agreements with our distributors, and where such agreements exist, they are generally terminable at will by the distributor. In addition, our distributors sometimes award contracts based on competitive bidding, which could result in lower profits for contracts we win and the loss of business for contracts we lose. The loss of any large distributor for an extended period of time could negatively affect our sales and results of operations.

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. The Company expects customers, either distributors who go into third party retail stores to sell the product they have purchased from us, or the direct retail customer that may service their own stores, as general good business practice to rotate the perishable products, make or obtain frequent delivery of products, replacement of damaged, old or substandard packages and deliver or have deliveries made directly to the refrigerated case. It is to the benefit of the distributor or retailer, as well as the Company, not to have spoiled, out dated, or substandard product on the shelf. However, due to the perishable nature of the product, the Company's distributors and retailers have no right to return any product to the Company.

Lifeway has not offered any exclusive territories to any distributors. Lifeway believes these 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 additionally sells its products directly to customers at its Starfuit Cafes. During the fiscal year ended December 31, 2013, the Company operated 4 Starfruit Cafes which accounted for approximately 1.5% of the Company's sales.

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 (via our website, social media and blogs), 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.

COMPETITION

Although Lifeway faces a small amount of direct competition 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. The term of the non-compete obligation expired on December 31, 2010. 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 one ingredient in BasicsPlus which we are not currently manufacturing. 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 as further described above under "Distribution". 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. In 2013, one distributor, United Natural Foods, Inc., represented approximately 20% of sales and reflected sales in various regions of the United States outside the Chicago metropolitan area and one retail customer represented 7% of the Company's sales.

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 with respect to certain kefir products. The terms of the non-compete obligation expired on December 31, 2010. 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 expired on December 31, 2010. Danone's interest as of December 31, 2013 was approximately 21.1% due to reductions in Lifeway's shares outstanding, primarily due to share repurchases by Lifeway. 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/Reg. No.	Goods/Services	Date of Registration	Expiration of Registration	Comments
ProBug Design 1, Reg. No. 3266378	dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	July 17, 2007	July 17, 2017	An Affidavit of Continued Use was timely filed between the fifth and sixth anniversaries of the registration date. Registration is renewable between the ninth and tenth anniversaries of the registration date or the six-month grace period following the registration expiration date.
ProBug Design 2, Reg. No. 3263130	dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	July 10, 2007	July 10, 2017	An Affidavit of Continued Use was timely filed between the fifth and sixth anniversaries of the registration date. Registration is renewable between the ninth and tenth anniversaries of the registration date or the six-month grace period following the registration expiration date.
Penelope ProBug Design, Reg. No. 3408792	dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used	April 8, 2008	April 8, 2018	An Affidavit of Continued Use was timely filed between the fifth and sixth anniversaries of the registration date. Registration is

	as milk substitute			renewable between the ninth and tenth anniversaries of the registration date or the six-month grace period following the registration expiration date.
BA3APHBIII (a Stylized presentation of “bazarny” in Cyrillic characters), Reg. No. 3590660	cultured milk products, excluding ice cream, ice milk and frozen yogurt; cheeses and cottage cheese	March 17, 2009	March 17, 2019	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.

BAMBINO, Reg. No. 2770522	cheeses, cottage cheeses and other dairy products, excluding ice cream, ice milk, and frozen yogurt	October 7, 2003	October 7, 2023	A Renewal application was timely filed May 13, 2013. Registration is renewable for ten year periods or during the six-month grace period following the registration expiration date.
BAZARNY, Reg. No. 3597883	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 fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
BIO KEFIR, Reg. No. 3886709	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 fifth and sixth 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), Reg. No. 3541999	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 fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.

FRUIT JUICE (Stylized), Reg. No. 3413276	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 fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
Fruit Juice Logo, Reg. No. 3432421	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 fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.

GOO-BERRY PIE, Reg. No. 3405134	dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverages used as a milk substitute	April 1, 2008	April 1, 2018	An Affidavit of Continued Use was timely filed between the fifth and sixth anniversaries of the registration date. Registration is renewable between the ninth and tenth anniversaries of the registration date or the six-month grace period following the registration expiration date.
HELIOS NUTRITION, Reg. No. 2283716	health foods, functional foods and medical foods, namely, dairy products excluding ice cream, ice milk and frozen yogurt	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.
KOROVKA, Reg. No. 2504027	dairy-based spread	November 6, 2001	November 6, 2021	Registration was timely renewed on November 6, 2011. Registration is renewable for ten year periods or during the six-month grace period following the registration expiration date.
KPECTBRHCKNN (a Stylized presentation of “krestyanskiy” in Cyrillic characters-means “peasant”), Reg. No. 2187363	cheeses, cottage cheeses and other milk products excluding ice cream,	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

	ice milk and frozen yogurt			following the registration expiration date.
KWASHENKA, Reg. No. 2135974	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.
LA FRUTA, Reg. No. 2937061	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 fifth and sixth anniversaries of the registration date. Registration is renewable between the ninth and tenth anniversaries of the registration date or the six-month grace period following the registration expiration date.

LIFEWAY, Reg. No. 1571136	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.
ORANGE CREAMY CRAWLER, Reg. No. 3263128	dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	July 10, 2007	July 10, 2017	An Affidavit of Continued Use was timely filed between the fifth and sixth anniversaries of the registration date. Registration is renewable between the ninth and tenth anniversaries of the registration date or the six-month grace period following the registration expiration date.
PHYTOBOOST, Reg. No. 3982487	dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as a milk substitute	June 21, 2011	June 21, 2021	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
PLAYGROUP PACK, Reg. No. 3634999	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 fifth and sixth anniversaries of the registration date or the

				six-month grace period following the sixth anniversary date.
PRIDE OF MAIN STREET, MN Reg. No. 12947	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.
PRO2O, Reg. No. 4226923	dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as a milk substitute beverages, namely, water and fruit and vegetable juices and fruit juices flavored with tea	October 16, 2012	October 16, 2022	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO between the fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.

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PROBUGS, Reg. No. 3263129	dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	July 10, 2007	July 10, 2017	An Affidavit of Continued Use was timely filed between the fifth and sixth anniversaries of the registration date. Registration is renewable between the ninth and tenth anniversaries of the registration date or the six-month grace period following the registration expiration date.
SOYTREAT, Reg. No. 3530754	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 fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
STARFRUIT, Reg. No. 3513252	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 fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
STARFRUIT, Reg. No. 3454746	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

fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.

STARFRUIT (Stylized), Reg. No. 3879939	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 fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.
SUBLIME SLIME LIME, Reg. No. 3263134	dairy-based beverages; dairy-based food beverages; kefir; soy-based food beverage used as milk substitute	July 10, 2007	July 10, 2017	An Affidavit of Continued Use was timely filed between the fifth and sixth anniversaries of the registration date. Registration is renewable between the ninth and tenth anniversaries of the registration date or the six-month grace period following the registration expiration date.
SWEET KISS, Reg. No. 2135975	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.
TODDLER TASTEBUD TRAINING (Stylized), Reg. No. 3542008	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 fifth and sixth anniversaries of the registration date or the

				six-month grace period following the sixth anniversary date.
TRAINING WHEELS FOR HEALTHY EATING (Stylized), Reg. No. 3412314	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 fifth and sixth anniversaries of the registration date or the six-month grace period following the sixth anniversary date.

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

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.

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 2012 and 2013, 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 350 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. The Company only has distributor relationships with third party distributors. No distributors are considered to be employees. Company-owned vehicles are used by Company employees for local same day deliveries only and revenue is recognized on the date of delivery to the end retail customers. Drivers of those vehicles are employees of the Company and all payroll, withholdings, and income taxes are accounted for in the same manner.

PART II

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

Results of Operations

Comparison of Quarter Ended December 31, 2013 to Quarter Ended December 31, 2012

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 financial statements and Management's Discussion and Analysis contained in our quarterly reports on Form 10-Q, for the fiscal quarters ended March 31, 2013, June 30, 2013, and September 30, 2013.

Total consolidated gross sales increased by $6,059,052 (approximately 26%) to $28,936,073 during the three-month period ended December 31, 2013 from $22,877,021 during the same three-month period in 2012. This increase is primarily attributable to an increase in the amount of the Company's kefir products sold, including the Company's flagship line, Kefir, ProBugs® Organic Kefir for kids and BioKefir™.

Total consolidated net sales increased by $5,485,743 (approximately 26%) to $26,266,697 during the three-month period ended December 31, 2013 from $20,780,954 during the same three-month period in 2012. Net sales are recorded as gross sales less promotional activities such as slotting fees paid, couponing, spoilage and promotional allowances as well as early payment terms given to customers.

Cost of goods, excluding depreciation expense, increased by $6,731,201 (approximately 47%) to $21,057,495 during the three-month period ended December 31, 2013 from $14,326,294 during the same three-month period in 2012. Cost of goods sold as a percentage of net sales, excluding depreciation expense, were approximately 80% during the fourth quarter of 2013, compared to approximately 69% during the same period in 2012. The increase was primarily attributable to the increased cost of conventional and organic milk, the Company's largest raw material. The cost of milk constituted approximately 65% of cost of goods sold during each of the three-month periods ended December 31, 2013 and December 31, 2012. The total cost of milk was approximately 30% higher during the three-month period ended December 31, 2013 when compared to the same period in 2012 as a result of higher prices of milk and increased volume purchased in the three-month period ended December 31, 2013 when compared to the same period in 2012.

Total operating expenses increased by $921,520 (approximately 22%) to $5,198,088 during the three-month period ended December 31, 2013 from $4,276,568 during the same three-month period in 2012. Total operating expenses as a percentage of net sales were approximately 20% during the fourth quarter of 2013, compared to approximately 21% during the same period in 2012. The increase was primarily attributable to an increase in general and administrative expenses and selling expenses.

General and administrative expenses increased by $321,629 (approximately 19%) to $2,014,748 during the three-month period ended December 31, 2013 from $1,693,119 during the same three-month period in 2012. This increase resulted from expenses related to the Company's acquisition of the Golden Guernsey facility in Wisconsin.

Selling expenses increased by $601,251 (approximately 25%) to $3,004,421 during the three-month period ended December 31, 2013 from $2,403,170 during the same three-month period in 2012. This increase resulted from an increase in the volume of the Company's advertising.

The company reported a loss in operations of $388,832 during the fourth quarter of 2013, a decrease of $2,157,051 from income from operations of 1,768,219 during the same period in 2012.

Provision for income tax was a benefit of $392,053 for the fourth quarter of 2013 compared to a provision for income tax of $721,860, or a 40% effective tax rate for same period last year.

Total net loss was $469,208 or $0.02 per diluted share for the three-month period ended December 31, 2013 compared to net income of $1,073,502 or $0.07 per diluted share in the same period in 2012. Net loss includes an approximate $305,000 loss on disposition of assets due to the closing of a non-performing Starfruit store location. This is viewed as a one time, non-cash expense.

Comparison of Year Ended December 31, 2013 to Year Ended December 31, 2012

Total consolidated gross sales increased by $19,212,087 (approximately 21%) to $108,966,094 during the twelve-month period ended December 31, 2013 from $89,754,007 during the same twelve-month period in 2012. This increase is primarily attributable to an increase in the amount of the Company's kefir products sold, including the Company's flagship line, Kefir, ProBugs® Organic Kefir for kids and BioKefir™.

Total consolidated net sales increased by $16,172,877 (approximately 20%) to $97,524,142 during the twelve-month period ended December 31, 2013 from $81,351,265 during the same twelve month period in 2012. Net sales are recorded as gross sales less promotional activities such as slotting fees paid, couponing, spoilage and promotional allowances as well as early payment terms given to customers.

Cost of goods sold, excluding depreciation expense, increased by $6,752,674 (approximately 29%) to $68,274,674 during the twelve-month period ended December 31, 2013 from $53,098,191 during the same period in 2012. Cost of goods sold as a percentage of net sales, excluding depreciation expense, were approximately 70% during the twelve month ended December 31, 2013, compared to approximately 65% during the same period in 2012. The increase was primarily attributable to the increased cost of conventional and organic milk, the Company's largest raw material. The cost of milk constituted approximately 65% of cost of goods sold during each of the twelve-month periods ended December 31, 2013 and December 31, 2012. The total cost of milk was approximately 25% higher during the twelve-month period ended December 31, 2013 when compared to the same period in 2012 as a result of higher prices of milk and increased volume purchased in the twelve-month period ended December 31, 2013 when compared to the same period in 2012.

Total operating expenses increased by $1,812,812 (approximately 10%) to $19,591,581 during the twelve-month period ended December 31, 2013 from $17,778,769 during the same twelve-month period in 2012. Total operating expenses as a percentage of net sales were approximately 20% during the twelve-month period ended December 31, 2013, compared to approximately 22% during the same period in 2012. The increase was primarily attributable to an increase in general and administrative expenses and selling expenses.

General and administrative expenses increased by $1,262,425 (approximately 20%) to $7,582,397 during the twelve-month period ended December 31, 2013 from $6,319,972 during the same twelve-month period in 2012. This increase resulted from expenses related to the Company's acquisition of the Golden Guernsey facility in Wisconsin.

Selling expenses increased by $592,401 (approximately 6%) to $11,296,381 during the twelve-month period ended December 31, 2013 from $10,703,980 during the same twelve-month period in 2012. This increase resulted from an increase in the volume of the Company's advertising.

Total operating income decreased by $813,399 (approximately 9%) to $8,031,312 during the twelve-month period ended December 31, 2013, from $8,844,711 during the same period in 2012.

Provision for income taxes was 2,866,875 or a 37% effective tax rate, for the twelve-month period ended December 31, 2013 compared with $3,205,076 or a 36% effective tax rate, during the same period in 2012. Income taxes are discussed in Note 10 of the Notes to Consolidated Financial Statements.

Total net income was $4,990,298 or $0.31 per share for the twelve-month period ended December 31, 2013 compared to $5,619,798 or $0.34 per share in the same period in 2012.

Liquidity and Capital Resources

Sources and Uses of Cash

Net cash provided by operating activities was $5,841,128 during the twelve-months ended December 31, 2013 compared to net cash provided by operating activities of $6,627,684 in the same period in 2012. This decrease is primarily attributable to the decrease in refundable income taxes of $886,607 in 2013.

Net cash used in investing activities was $7,862,973 during the twelve-months ended December 31, 2013 compared to net cash used in investing activities of $1,555,914 in the same period in 2012. This increase is primarily due to an increase in purchases of property and equipment of $7,051,169 compared to 2012 resulting from the Company's purchase of Golden Guernsey in Wisconsin in July 2013.

The Company had a net increase of cash and cash equivalents of $1,020,382 during the twelve month period ended December 31, 2013 compared to a net decrease in cash and cash equivalents of $1,171,079 during the same period in 2012. The Company had cash and cash equivalents of $3,306,608 as of December 31, 2013 compared to cash and cash equivalents of $2,286,226 as of December 31, 2012.

In July 2013, Lifeway purchased Golden Guernsey to allow the Company to purchase raw, instead of processed, milk and to process that raw milk on its own. The Company also intends to increase its kefir production capability by adding production capability at Golden Guernsey which will allow the Company to increase the amount of product it can produce and sell as demand increases. The Company anticipates that processing its own milk will allow the Company to purchase its major ingredient, milk, at approximately 5% less than if the Company was purchasing processed milk. The Company has not yet begun production of kefir at Golden Guernsey.

Assets and Liabilities

Total assets were $63,673,801 as of December 31, 2013, which is an increase of $10,167,175 when compared to December 31, 2012. This is primarily due to $20,824,448 of net property and equipment as of December 31, 2013, which is an increase of $5,837,672, when compared to December 31, 2012.

Total current liabilities were $8,882,241 as of December 31, 2013, which is an increase of $2,672,547 when compared to December 31, 2012. This is primarily due to a $2,466,454 increase in accounts payable.

Notes payable increased by $4,043,067 as of December 31, 2013, when compared to December 31, 2012. The balance of the notes payable as of December 31, 2013 was $8,999,012.

Total stockholder's equity was $42,949,122 as of December 31, 2013, which is an increase of $3,636,653 when compared to December 31, 2012. This is primarily due the increase in retained earnings of $3,682,437 when compared to December 31, 2012.

We previously held significant portions of our assets in investment securities. All of our marketable securities are classified as available-for-sale on our balance sheet. All of these securities are stated there on 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.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet financing arrangements.

Critical Accounting Policies

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

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

EXHIBITS

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

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: October 3, 2014

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

Date: October 3, 2014

By: /s/ Edward P. Smolyansky
Edward P. Smolyansky
Chief Financial and Accounting Officer, Treasurer, Chief Operating Officer and Secretary

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.

Date: October 3, 2014

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

Date: October 3, 2014

/s/ Ludmila Smolyansky
Ludmila Smolyansky
Chairperson of the Board of Directors

Date: October 3, 2014

*
Pol Sikar
Director

Date:

Gustavo Carlos Valle
Director

Date: October 3, 2014

*
Renzo Bernardi
Director

Date: October 3, 2014

*
Paul Lee
Director

Date: October 3, 2014		*
	Jason Scher Director	

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