U.S. Securities and Exchange Commission
Washington, D.C. 20549

Form 10-KSB

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

For the fiscal year ended December 31, 2004

[_] 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 small business issuer 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)

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

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

Securities registered under Section 12(g) of the Exchange Act: Common Stock, No Par Value

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB. [X]

The issuer's revenues for its most recent fiscal year were: $16,319,210

The aggregate market value of the voting and non-voting common equity held by non-affiliates (approximately 2,194,181 shares) computed by reference to the price at which the stock was sold as of December 31, 2004 ($9.14 per share as quoted on the National Market System of the Nasdaq Stock Market) was: $20,054,817

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

The number of shares outstanding of each of the issuer's classes of common equity, as of February 28, 2005 were: 8,419,938 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Notice of Annual Meeting and Proxy Statement, to be filed no later than April 30, 2005, for the Registrant's 2005 Annual Meeting of Shareholders, scheduled to be held June 11, 2005, are incorporated by reference in Part III.

Transitional Small Business Disclosure Format (check one): Yes [_] No [X]

LIFEWAY FOODS, INC.

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PART I

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.

ITEM 1. DESCRIPTION OF BUSINESS.

BUSINESS DEVELOPMENT

Lifeway Foods, Inc. 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"; a line of various drinkable yogurts sold under the "La Fruta" and "Tuscan" brands; and "BasicsPlus," a dairy based immune-supporting dietary supplement beverage. The Company also produces several soy-based kefir beverages under the "SoyTreat" trademark. In addition to the drinkable products, Lifeway manufactures "Lifeway Farmer Cheese," a line of various farmer cheeses; "Sweet Kiss," a fruit sugar-flavored spreadable cheese similar in consistency to cream cheese; and a line of assorted fruit and vegetable flavored cream cheese under the brand "Cream Cheese Gourmet." 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. The Company distributes "Cream Cheese Gourmet" branded cream cheese products in the Philadelphia metropolitan area using its own trucks**.** Lifeway manufactures all of its products at Company-owned facilities and distributes its products primarily throughout the United States.

SUBSIDIARY ENTITIES

On September 30, 1992, Lifeway formed a wholly-owned subsidiary, LFI Enterprises, Inc. ("LFIE"), incorporated in the State of Illinois. Until August 1, 2001, LFIE operated a "Russian" theme restaurant and supper club facility. On August 1, 2001, Lifeway ceased operations at the facility after condemnation proceedings were initiated by the Village of Niles, Illinois, which sought to control the property for municipal purposes. This property was sold in January 2003 for a capital gain of approximately $1.2 million.

On March 19, 2004, LFIE formed Lifeway Foods Canada, LLC, an Illinois limited liability company ("LFC"), to serve as a holding company for prospective operations within Canada. LFIE is the manager and sole member of LFC.

On July 26, 2004, Lifeway, by its subsidiary, LFIE, acquired certain assets and inventory of Ilya's Farms, Inc., a twelve year old, privately-held gourmet cream cheese producer based in the Philadelphia metropolitan area. No prior relationship existed between Ilya's Farms, Inc. or its principal, Michael Kofman, and either the Company or LFIE.

The total cash purchase consideration of $575,600 for the assets and inventory of Ilya's Farms, Inc. was paid by LFIE in cash from Company funds without financing. Additionally, there are certain royalty payments to be made in connection therewith. The

Company provided a guaranty of payment for the transaction. The acquisition included approximately $64,000 of tangible assets (including certain manufacturing equipment and a delivery truck) and inventory as well as the brand name "Ilya's Farms" and other trademarks and the recipes and manufacturing processes previously used by Ilya's Farms, Inc. The equipment acquired by LFIE from Ilya's Farms, Inc. was previously used to manufacture cream cheese products. The inventory which was purchased by LFIE consisted entirely of different varieties of cream cheese. The founder of Ilya's Farms, Inc., Michael Kofman, assisted LFIE over a one-month transition period and is available, if needed, on a consulting basis going forward. Additionally, LFIE has hired the 10 employees formerly employed by Ilya's Farms, Inc.

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 highly digestible and, due to its acidity and enzymes, stimulates digestion of other foods. Kefir is considered to be the most favorable milk product for people suffering from genetically-based lactose intolerance. A study published in the May 2003 issue of the Journal of the American Dietetic Association suggests that kefir improves lactose digestion and tolerance in adults with lactose maldigestion. Studies also indicate that kefir may stimulate protein digestion and appetite, decrease the cholesterol content in blood, improve salivation and excretion of stomach and pancreatic enzymes and peristalsis. As compared to yogurt, many naturopathic practitioners consider kefir to be the best remedy for digestive troubles because it has a very low curd tension (the curd breaks up very easily into small particles). The curd of yogurt, on the other hand, holds together or breaks into lumps. The small size of the kefir curd facilitates digestion by presenting a large surface area on which digestive agents may work.

Kefir is a good source of calcium, protein, and Vitamin B-complex. In addition, because the fermentation process produces a less sour tasting product than yogurt, less sugar is required to make a desirable product, and the end product contains fewer calories than regular yogurt.

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, raspberry, blueberry, strawberry, cherry, peach, banana-strawberry, cappuccino, chocolate and vanilla, and sold in 32 ounce 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 SOYTREAT. "SoyTreat" is a soy alternative to dairy kefir and is made from organic soy milk, which is derived from non-genetically modified soybeans. SoyTreat can be consumed by those who desire the benefits of kefir, but are lactose intolerant or interested in a soy-based alternative to milk. SoyTreat also provides 6.25g of soy protein per serving, and features the United States Food and Drug Administration-approved health claim, "25g of soy protein a day as part of a diet low in saturated fat can help lower cholesterol and reduce the risk of heart disease." At present SoyTreat is manufactured in five flavors: strawberry, apple, peach, coconut and coffee latte.

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 four flavors: plain, 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.

LA FRUTA DRINKABLE YOGURT. "La Fruta" is a yogurt like drink similar to a milkshake or smoothie that is specifically formulated to accommodate the Hispanic market, the fastest growing demographic in the U.S. La Fruta is manufactured in six flavors: strawberry, mango, pina colada, banana-strawberry, horchata and tres leches.

LA FRUTA CHEESE. "La Fruta Cheese" is a cheese product similar to cream cheese that is specifically formulated to accommodate the Hispanic market, the fastest growing demographic in the United States. La Fruta Cheese is manufactured in a tres leches flavor.

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.

CREAM CHEESE GOURMET. Lifeway produces a line of over 40 flavors of cream cheeses under the “Cream Cheese Gourmet” brand name. The different flavors are manufactured in original and low-fat varieties and include such flavors as plain, strawberry, horseradish, lox & onion, bleu cheese, pesto, cinnamon & raisin, and vegetable. The Cream Cheese Gourmet line of cream cheeses was acquired by Lifeway in the acquisition of substantially all of the assets of Ilya's Farms, Inc. described elsewhere in this report and is marketed primarily to smaller and ethnic grocers, delicatessens and coffee shops.

BASICS PLUS. "Basics Plus" is a patented kefir-based beverage product designed to improve gastrointestinal functions, enhancing the immune system. This product contains certain "passive immunity products" purchased from GalaGen, Inc. prior to its 2002 bankruptcy as described elsewhere in this report. 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 the product internationally and via the internet.

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.

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 twelve company-owned trucks, Lifeway distributes its products directly and extensively in the State of Illinois, primarily in the Chicago metropolitan area, including major retail chains such as Jewel Food Stores, Dominick's Finer Foods, Treasure Island Food Marts, Whole Foods and independent retailers. Lifeway also distributes over 40 different assorted cream cheese products under the Cream Cheese Gourmet brand name in the Philadelphia metropolitan area.

In addition to the Chicago and Philadelphia 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. These verbal distribution arrangements, in the opinion of Lifeway, 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 benefit for a wide range of ills, including intestinal disorders, and continues to educate the public on the possible health benefits which could be derived from the use of kefir and kefir-based products. Lifeway believes that the potential for healthful benefits as suggested by the educational information it has obtained properly serves as the basis for such an advertising strategy.

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 LaFruta and Tuscan brand names 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 these 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 and for three years after termination of the agreement with respect to certain yogurt, cheese and kefir products. Specifically, Lifeway agreed not to produce or sell in the United States or Western Europe any type of yogurt, fromage frais, Italian style cheese, chilled desserts or any soy-based products, other than those that are kefir-based or those that were already being produced and sold by Lifeway as of December 24, 1999; and Danone agreed not to produce or sell any type of kefir-based products in the United States. The term of the current non-competition covenant between Lifeway and Danone expires on December 30, 2005.

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. The customers are concentrated in the retail food industry. In 2004, Lifeway's largest customer represented approximately 9% of sales and reflected sales in various regions of the United States outside the Chicago, Illinois 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 split which occurred in the first quarter of 2004. On October 1, 1999, Lifeway sold 497,767 shares of restricted common stock to Danone at $10.00 per share. Danone also concurrently purchased 150,000 outstanding shares of common stock from Lifeway's founder, and then controlling shareholder, President and CEO, Michael Smolyansky; his wife and current Chairperson of the Board, Ludmila Smolyansky; his daughter and the current President and CEO, Julie Smolyansky; his son and current Chief Financial & Accounting Officer and Treasurer, Edward Smolyansky, on similar terms. Later in 1999, Danone purchased an additional 215,922 shares of common stock from certain individuals, including 52,262 shares purchased in transactions with certain Company affiliates, including Michael Smolyansky (38,362 shares), Val Nikolenko, Vice President of Production (3,900 shares) and Pol Sikar, a director, and his affiliates (10,000 shares).

As a result of these transactions, Danone became the beneficial owner of 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. From November 1999 through August 2004, Thomas Kunz served on Lifeway's Board of Directors as Danone's nominee. In August 2004, Mr. Kunz was replaced as Danone's nominee by Juan Carlos, the current President and CEO of Danone. In addition, as described above, Lifeway and Danone are parties to a Stockholders' Agreement dated October 1, 1999, pursuant to which the parties agreed that they would not compete with each other through December 30, 2005 with respect to certain yogurt, cheese and 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. Danone's interest as of December 31, 2004 was approximately 20.4% due to reductions in Lifeway's shares outstanding, primarily due to share repurchases by Lifeway. The term of the Stockholders’ Agreement has been extended through December 30, 2005. The ability of Danone to sell, or the prospect of Danone being able to sell should such restrictions lapse, such a large stake in Lifeway could have a negative effect on the Company's stock price.

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's	Cheese and kefir	December 12, 1989	December 12, 2009	Registration is renewable at the time of expiration.
Lifeway's (Canada)	Cheese and kefir	January 10, 1992	January 10, 2007	This registration was granted by the Canadian Intellectual Property Office based upon the use of the mark in Canada since September 9, 1988.
Golden Zesta	Dehydrated vegetable soup mix; and spices, seasonings, food for non-nutritional purposes for use as a flavoring	August 19, 1997	August 19, 2007	Registration is renewable at the time of expiration.
Sweet Kiss	Cheese, cottage cheese and other milk products, excluding ice cream, ice milk and frozen yogurt	February 10, 1998	February 10, 2008	Registration is renewable at the time of expiration.
Kwashenka	Kefir, yogurt, cheeses, cottage cheeses and other milk products, excluding ice cream, ice milk and frozen yogurt	February 10, 1998	February 10, 2008	Registration is renewable at the time of expiration.
Bambino	Cheeses, cottage cheeses and other milk products	October 7, 2003	October 7, 2013	Registration is renewable at the time of expiration provided mandatory documents are filed before the USPTO by October 7, 2009.
KPECTBRHCKNN (A stylized presentation of "Krestyanskiy" in Cyrillac characters)	Cheeses, cottage cheeses and other milk products excluding ice cream, ice milk and frozen yogurt	September 8, 1998	September 8, 2008	Registration is renewable at the time of expiration.
BasicsPlus	Dairy-based food beverages for use as a dietary supplement	September 7, 1999	September 7, 2009	In May 1998, GalaGen, Inc., assigned the entire interest, including the goodwill, of this mark to Lifeway. Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO by September 7, 2005.
BA3APHBIII (A stylized presentation of "Bazarniy" in Cyrillic characters)	Pressed unripened cheese	July 25, 2000	July 25, 2010	Registration is renewable at the time of expiration provided presentation of mandatory documents are filed "Bazarniy" in with the USPTO by July 25, 2006.
SoyTreat	Soy-based food beverage intended for use as cultured milk substitute	December 12, 2000	December 12, 2010	Registration is renewable at the time of expiration provided mandatory documents

				are filed with the USPTO by December 12, 2006.
Garden Harmony	Unripened cheese-based spread	March 20, 2001	March 20, 2011	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO by March 20, 2007.
Korovka	Dairy-based spread	November 6, 2001	November 6, 2011	Registration is renewable at the time of expiration provided mandatory documents are filed with the USPTO by November 6, 2007.
La Fruta	Cultured milk products, excluding ice cream, ice milk and frozen yogurt	Not applicable	Not applicable	This application was filed on January 17, 2003 and is still pending before the USPTO. Final review prior to publication has been completed; application will be published for opposition.
CREAM CHEESE GOURMET	Kefir, yogurt, cheeses, cream cheeses and other milk products, excluding ice cream, ice milk and frozen yogurt			This application has not been filed with United States Patent and Trademark Office.
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			This application has been approved for publication.
BIOKEFIR	yogurt, cheeses, cottage cheeses and other milk products, excluding ice cream, ice milk and frozen yogurt			Filed on an Intent-to-Use basis. The Company received the filing receipt in November.
SLIM 6	Cultured milk products, excluding ice cream, ice milk and frozen yogurt			Newly filed application; not yet assigned examining attorney.
СМОРОІННКА (a stylized presentation of “Smorodinka” in Cyrillic characters)	Kefir, yogurt, cheeses, cottage cheeses and other milk products, excluding ice cream, ice milk and frozen yogurt			Newly filed application; not yet assigned examining attorney.

PATENTS, TRADEMARKS, LICENSES, ROYALTY AGREEMENTS (CONTINUED)

Lifeway also uses the following unregistered trademarks, and claims common law rights to: "Elita," "Healthy Foods Today for a Better Life Tomorrow," "Milkshake Smoothie," "Toplenka," "White Cheese," "Drink It to Be Beautiful Inside and Out," and "Cream Cheese Gourmet."

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 Unites 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 the purchase of Ilya's Farm, Inc., the Company has undertaken a royalty obligation.

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 did not export any products to Canada in 2004.

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 2004, the amount Lifeway expended for research and new product development was not material to the financial position of Lifeway.

EMPLOYEES

Lifeway currently employs approximately 75 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. DESCRIPTION OF PROPERTY.

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. The acquisition loan to Lifeway from 1st National Bank of Morton Grove, collateralized by the real estate, was refinanced in 1998 by Lifeway and paid off in full on February 21, 2002. Lifeway is the only occupant of this property and presently holds fee simple title free and clear of all encumbrances thereto. 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. The Company's book value for this property is approximately $529,172.

On October 9, 1992, Lifeway purchased an approximately 75,000 square foot commercially zoned parcel of real property, including an approximately 7,750 square foot one-story building, located at 7800 N. Caldwell, Niles, Illinois. Until its closing on August 1, 2001, this property was the site of the "Moscow Nights" facility operated by LFIE. The acquisition loan to Lifeway from American National Bank and Trust Company of Chicago, collateralized by the real estate, was refinanced by Lifeway in 1998 and paid off in full on September 30, 2002. Lifeway held fee simple title to this property free and clear of all encumbrances until this property was transferred to the Niles Park District in January 2003 in exchange for approximately $1.8 million paid in settlement of a condemnation lawsuit previously reported.

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 acquisition loan to Lifeway from MB Financial Bank of Morton Grove. The acquisition loan was refinanced in September 2002 at a rate of 6.25% and is payable in monthly principal and interest installments of $3,273, with a balloon payment of $454,275 due in September 2006. At December 31, 2004, the loan had a balance of $472,325. 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. The Company's book value for this property is approximately $1,229,054.

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.

On April 14, 2003, Vera Smolyansky filed a complaint seeking unspecified damages in the Circuit Court of Cook County, Illinois naming Lifeway as a defendant. The complaint alleges breaches of the Uniform Commercial Code, the Magnunson-Moss Warranty Act and the Illinois Consumer Fraud Act with respect to the labeling of certain Lifeway products. Vera Smolyansky is the wife of Yuri Smolyansky, who is the brother of the late Michael Smolyansky (the founder of Lifeway), the uncle of Julie Smolyansky (the Company's Chief Executive Officer), the uncle of Edward Smolyansky (the Company's Chief Financial & Accounting Officer and Treasurer) and the brother-in-law of Ludmila Smolyansky (Lifeway's Chairperson of the Board). The Company believes that the lawsuit is without merit and is vigorously defending against these claims.

On December 4, 2004 a former employee requested a Motion for Summary Judgment on the issue of liability in a lawsuit filed against the Company by the former employee. The motion was granted on February 10, 2005 and on February 18, 2005 the case was referred to a Magistrate Judge for a settlement conference.

The lawsuit alleges non payment of overtime wages in violation of federal employment laws, with an estimated amount between $7,500 and $15,000. The suit was filed in the United States District Court for the Northern District of Illinois on behalf of all employees who were classified as non-exempt during 2001 through 2003. Outside counsel for the company has advised that at this stage in the proceedings he cannot offer an opinion as to the probable outcome.

In addition to the foregoing, Lifeway is from time to time engaged in other litigation matters arising in the ordinary course of business none of which presently is expected to have a material adverse effect on its business results or operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matter was submitted during the fourth quarter of the fiscal year ended December 31, 2004, to a vote of security holders through the solicitation of proxies or otherwise.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

MARKET INFORMATION

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

The range of high and low bid quotations for Lifeway's Common Stock for the quarterly periods within the two most recent fiscal years, as reported by The Nasdaq Stock Market National Market System, is set forth in the following table:

	Low Bid		High Bid
1st Qtr. 2003	$ 12.24		$ 15.00
2nd Qtr. 2003	$ 13.40		$ 17.00
3rd Qtr. 2003	$ 15.50		$ 30.50
4th Qtr. 2003	$ 25.12		$ 37.00
1st Qtr. 2004	$ 12.99		$ 46.98
2nd Qtr. 2004	$ 9.86		$ 28.24
3rd Qtr. 2004	$ 8.66		$ 20.31
4th Qtr. 2004	$ 8.80		$ 11.19

Note: The foregoing quotations have been adjusted for the March 8, 2004 two-for-one Company stock split.

As of March 16, 2005, there were approximately 77 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 and management does not anticipate that such dividends will be paid in the foreseeable future.

SALES OF UNREGISTERED SECURITIES

There were no sales of unregistered securities in 2004, 2003 or 2002.

PURCHASES OF THE COMPANY'S SECURITIES

Neither Lifeway nor any of its affiliates purchased any of the Company's securities in 2004.

EQUITY COMPENSATION PLAN INFORMATION

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities warrants and rights reflected in column (a))
Equity compensation plans approved by security holders	0	$0.00	468,000
Equity compensation plans not approved by security holders*	0	$0.00	0.00
Total	0	0	468,000

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

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION.

RESULTS OF OPERATIONS

For the year ended December 31, 2004, sales were $16,319,210, which is a $1,441,422 (approximately 10%) increase from $14,877,788 in 2003. We believe that approximately $600,000 of the 2004 increase in sales was attributable to a new customer as of June 2003, Sav-A-Lot, Ltd., the 13th largest grocery chain in the United States, operating more than 1000 Sav-A-Lot and Supervalu food stores nationwide, which represented sales of a significant amount of 8 oz. bottles of Lifeway's LaFruta line. Sav-A-Lot, ceased ordering Lifeway products in May 2004, and, during this first 5 months of 2004, Sav-A-Lot accounted for approximately $600,000 in sales. In June 2004, Lifeway also instituted a price increase of approximately 10-15% on all products.

LFIE accounted for $421,726 of total sales revenues during the period from August 1, 2004 to December 31, 2004. Of the total $421,726 revenues from LFIE, $155,446 was earned due to sales of Lifeway's Kefir and Farmer Cheese products sent from our Morton Grove, Illinois facility to Philadelphia, Pennsylvania for distribution in the tri-state area of Pennsylvania, New Jersey and New York. The remaining $266,280 of LFIE revenues for the period from August 1, 2004 through December 31, 2004 was earned from sales of the Cream Cheese Gourmet line of products acquired from Ilya's Farms, Inc. in the third quarter of 2004. Ilya’s Farms had approximately $525,000 in sales from its cream cheese line in 2003.

Cost of goods sold as a percentage of sales was approximately 55% in 2004, compared to about 53% in 2003. This increase is directly related to the increased cost of milk during 2004. The average cost of milk, Lifeway’s largest cost of goods sold component increased approximately 35-40% in 2004 compared to 2003. Even though the price of milk experienced such a dramatic increase, Lifeway was able to maintain strong relative gross margins by more efficiently using our other material components.

Operating expenses as a percentage of sales in was approximately 26% in 2004, compared to about 24% in 2003. This increase is primarily attributable to two expenses: (1) a $41,860 expense recognized in connection with the vesting in the third quarter 2004 of 2,000 shares (valued at $20.93 per share at the time of grant) of a total of 5,100 shares of Company stock granted to Lifeway employees on February 12, 2004 and (2) an overall increase in utility expenses and rising insurance and professional fees associated with the Sarbanes-Oxley Act of 2002 and other regulatory compliance requirements. Lifeway also experienced increased professional expenses in connection with the acquisition by LFI Enterprises, Inc. of substantially all of the assets of Ilya's Farms, Inc. on July 23, 2004. Also, the Company's advertising cost increased to $909,179 in 2004 as compared to $629,500 in 2003.

Provision for income taxes was $1,390,167 in 2004 compared with $1,354,548 in 2003. Income taxes are discussed in Note 8 of the Notes to Consolidated Financial Statements.

SOURCES AND USES OF CASH IN 2004

Net cash used in investing activities was $1,011,230 for 2004 as compared to net cash provided of $39,349 during 2003. The decrease in the net investing activity cash flow during the year ended December 31, 2004 relative to the same period in 2003 was attributable to the sale of property for $1,712,660 during 2003 and due to the purchase by LFI Enterprises, Inc. of substantially all of the assets of Ilya’s Farms, Inc. in exchange for $575,600 paid in cash during 2004. Of the total cash amount of $575,600 used by LFI Enterprises, Inc. in connection with the Ilya's Farms, Inc. asset acquisition, $511,800 was recognized by Lifeway as intangible assets and goodwill, while $63,800 is accounted for as part of the "Purchases of Property and Equipment" line item on the Consolidated Statement of Cash Flows for 2004. In the opinion of Lifeway's management, the acquisition by LFI Enterprises, Inc. of substantially all of the assets of Ilya's Farms, Inc. is a positive step to broaden Lifeway's presence in the market for manufactured dairy products.

During the twelve month period ended December 31, 2004, Lifeway also experienced net negative investing cash flows in the amount of $169,019 ($6,265,671 used for purchases less $6,096,652 used for sales) used for the purchase and sale of marketable securities due to our continued efforts to move away from higher-risk securities towards large cap value, higher dividend yielding and tax-advantaged equities. Our efforts in this regard during 2004 also are reflected in a gain of $354,128 on the sale of marketable securities. We believe, given the current market conditions, this asset allocation strategy offers a positive risk-reward ratio for our Company.

OTHER DEVELOPMENTS

On February 12, 2004, Lifeway's Board of Directors approved awards of an aggregate amount of 5,100 shares to be awarded under its Employee and Consulting Services and Compensation Plan to certain employees and consultants for services rendered to the Company. The stock awards were made on April 1, 2004 and have vesting periods that vary from six months to one year, depending upon the individual grantee. The expense for the awards is measured as of April 1, 2004 at $20.93 per share for 5,100 shares, or a total stock award expense of $106,743. This expense will be recognized as the stock awards vest beginning with the recognition of $41,860 for 2,000 shares vested on April 1, 2004. An additional 2,000 shares of the total 5,100 vested in the third quarter of 2004. The share numbers and per share expense have been adjusted to reflect the stock split as of March 8, 2004. The vesting of certain of the restricted stock awards had the effect of positively impacting financing activities because the shares were awarded out of treasury shares. The stock award was recognized as a $41,860 expense ($20.93 per share, reflecting fair market value on the date of grant).

MARKETABLE SECURITIES

During the course of 2004, and now in 2005, we have been and will continue to move away from higher-risk securities towards large cap value, higher dividend yielding and tax-advantaged equities. Our investment portfolio presently consists of approximately 45% fixed income securities, and about 55% equity investments. Of the equity portion, approximately 85% is invested in large cap value stocks, 10% in small cap growth stocks, and 5% in large cap growth stocks. We believe, given the current market conditions, this asset allocation strategy offers a positive risk-reward ratio for our Company.

A significant portion of our assets are held in marketable securities. The majority of our marketable securities are classified as available-for-sale on our balance sheet, while the mortgage-backed securities are classified as trading. All of these securities are stated thereon at market value as of the end of the applicable period. Gains and losses on the portfolio are determined by the specific identification method.

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 ("US GAAP") consistently applied. 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 – Summary of Significant Accounting Policies in the notes to the consolidated financial statements.

FORWARD-LOOKING STATEMENTS

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

- Changes in economic conditions, commodity prices;

- Shortages of and price increase for fuel, labor strikes or work stoppages, market acceptance of the Company's new products;

- Significant changes in the competitive environment;

- Changes in laws, regulations, and tax rates; and

- The ability of the Company to achieve reductions in cost and employment levels, to realize production efficiencies, and to implement capital expenditures, all at of the levels and times planned by management.

ITEM 7. FINANCIAL STATEMENTS.

The annotated consolidated financial statements of the Company that constitute Item 7 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 Subsidiary

We have audited the accompanying consolidated statements of financial condition of **Lifeway Foods, Inc. and Subsidiary** (the "Company") as of December 31, 2004 and the related consolidated statements of income and comprehensive income, changes in stockholders' equity and cash flows for the year ended December 31, 2004. 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 audit.

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. An audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Lifeway Foods, Inc. and Subsidiary** as of December 31, 2004 and the results of its operations and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Plante & Moran, PLLC
March 24, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of
Lifeway Foods, Inc. and Subsidiary
Morton Grove, Illinois

We have audited the accompanying consolidated statements of financial condition of **Lifeway Foods, Inc. and Subsidiary** (the "Company") as of December 31, 2003 and the related consolidated statements of income and comprehensive income, changes in stockholders' equity and cash flows for the year ended December 31, 2003. 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 audit.

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. An audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Lifeway Foods, Inc. and Subsidiary** as of December 31, 2003 and the results of its operations and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Gleeson, Sklar, Sawyers & Cumpata LLP
Elgin, Illinois
February 19, 2004

LIFEWAY FOODS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2004 AND 2003

	December 31,	
	2004	**2003**
ASSETS		
Current assets		
Cash and cash equivalents	$ 5,773,285	$ 4,597,819
Marketable securities	6,741,987	6,302,606
Accounts receivable, net of allowance for doubtful accounts of $15,000 at Dec. 31, 2004 and 2003	2,024,036	1,800,141
Other receivables	72,137	165,767
Inventories	905,697	811,572
Prepaid expenses and other current assets	7,260	791
Deferred income taxes	---	27,038
Refundable income taxes	258,617	306,171
Total current assets	**15,783,019**	**14,011,905**
Property and equipment, net	**3,420,138**	**3,732,731**
Intangible assets		
Goodwill	75,800	---
Other intangible assets, net of amortization of $26,990	409,010	---
Total intangible assets	**484,810**	**---**
Total assets	**$ 19,687,967**	**$ 17,744,636**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current maturities of notes payable	$ 8,784	$ 28,289
Accounts payable	641,651	795,321
Accrued expenses	195,541	183,600
Deferred income taxes - current portion	36,214	---
Total current liabilities	**882,190**	**1,007,210**
Notes payable	**463,541**	**472,509**
Deferred income taxes	**424,039**	**471,953**
Stockholders' equity		
Common stock	6,509,267	6,509,267
Paid-in-capital	64,314	---
Stock subscription receivable	---	(15,000)
Treasury stock, at cost	(649,039)	(679,956)
Retained earnings	11,874,475	9,822,416
Accumulated other comprehensive income, net of taxes	119,180	156,237
Total stockholders' equity	**17,918,197**	**15,792,964**
Total liabilities and stockholders' equity	**$ 19,687,967**	**$ 17,744,636**

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS

LIFEWAY FOODS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	Years Ended December 31,	
	2004	**2003**
Sales	$ 16,319,210	$ 14,877,788
Cost of goods sold	9,034,971	7,840,782
Gross profit	**7,284,239**	**7,037,006**
Operating expenses	4,333,788	3,558,362
Income from operations	**2,950,451**	**3,478,644**
Other income (expense):		
Interest and dividend income	185,575	96,850
Interest expense	(31,441)	(41,205)
Gain (loss) on sale of marketable securities, net	354,128	(1,293,579)
Gain on sale of property and equipment	---	1,246,287
Loss on marketable securities classified as trading	(16,487)	---
Other income	---	89,490
Total other income (expense)	491,775	97,843
Income before provision for income taxes	**3,442,226**	**3,576,487**
Provision for income taxes	1,390,167	1,354,548
Net income	**$ 2,052,059**	**$ 2,221,939**
Basic and Diluted Earnings per common share	0.24	0.26
Weighted average number of shares outstanding	**8,439,159**	**8,436,888**
<u>COMPREHENSIVE INCOME</u>		
Net income	**$ 2,052,059**	**$ 2,221,939**
Other comprehensive income (loss), net of tax:		
Unrealized gains on marketable securities (net of taxes)	170,107	212,634
Less reclassification adjustment for (gains) losses included in net income (net of taxes)	(207,164)	1,278,473
Comprehensive income	**$ 2,015,002**	**$ 3,713,046**

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS

LIFEWAY FOODS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	Common Stock, No Par Value 10,000,000 Shares Authorized		# of Shares of Treasury Stock						Accumulated Other Comprehensive Income (Loss), Net of Tax	
	# of Shares Issued	**# of Shares Outstanding**		**Common Stock**	**Paid In Capital**	**Stock Subscription Receivable**	**Treasury Stock**	**Retained Earnings**		**Total**
Balances at December 31, 2002	**8,636,888**	**8,437**	**200,000**	**$ 6,509,267**	**$ ---**	**$ (15,000)**	**$ (679,956)**	**$ 7,600,477**	**$ (1,334,870)**	**$ 12,079,918**
Other comprehensive income:										
Unrealized gains on securities, net of taxes and reclassification adjustment	---	---	---	---	---	---	---	---	1,491,107	1,491,107
Net income for the year ended December 31, 2003	---	---	---	---	---	---	---	2,221,939	---	2,221,939
Balances at December 31, 2003	**8,636,888**	**8,436,888**	**200,000**	**$ 6,509,267**	**---**	**$ (15,000)**	**$ (679,956)**	**$ 9,822,416**	**$ 156,237**	**$ 15,792,964**
Issuance of Treasury stock	---	4,550	(4,550)	---	64,314	---	30,917	---	---	95,231
Other comprehensive income:										
Unrealized losses on securities, net of taxes and reclassification adjustment	---	---	---	---	---	---	---	---	(37,057)	(37,057)
Payment on Subscription Receivable	---	---	---	---	---	15,000	---	---	---	15,000
Net income for the year ended December 31, 2004	---	---	---	---	---	---	---	2,052,059	---	2,052,059
Balances at December 31, 2004	**8,636,888**	**8,441,438**	**195,450**	**$ 6,509,267**	**$ 64,314**	**$ ---**	**$ (649,039)**	**$ 11,874,475**	**$ 119,180**	**$ 17,918,197**

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS

LIFEWAY FOODS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	Years Ended December 31, 2004	Years Ended December 31, 2003
Cash flows from operating activities:		
NET INCOME	**$ 2,052,059**	**$ 2,221,9**
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	669,994	688,3
(Gain)/Loss on sale of marketable securities, net	(354,128)	1,293,5
Loss on marketable securities classified as trading	16,487	
Gain on sale of property and equipment	---	(1,246,28
Deferred income taxes	45,560	9,0
Treasury stock issued for services	95,231	
(Increase) decrease in operating assets:		
Accounts receivable	(223,895)	(364,92
Other receivables	93,630	(105,51
Inventories	(94,125)	(91,06
Refundable income taxes	47,554	(306,17
Prepaid expenses and other current assets	(6,469)	4
Increase (decrease) in operating liabilities:		
Accounts payable	(153,670)	155,9
Accrued expenses	11,941	
Income taxes payable	---	(397,90
Net cash provided by operating activities	**2,200,169**	**1,857,5**
Cash flows from investing activities:		
Purchase of marketable securities	(6,265,671)	(4,283,53
Sales of marketable securities	6,096,652	3,025,2
Sale of assets	---	1,712,6
Purchases of property and equipment	(330,411)	(415,06
Acquisition of Ilya's Farms, Inc. net of assets acquired	(511,800)	
Net cash provided by (used in) investing activities	**(1,011,230)**	**39,34**
Cash flows from financing activities:		
Proceeds from stock subscription receivable	15,000	
Repayment of notes payable	(28,473)	(30,70
Net cash used in financing activities	**(13,473)**	**(30,70**
Net increase in cash and cash equivalents	**1,175,466**	**1,866,1**
Cash and cash equivalents at the beginning of the year	4,597,819	2,731,6
Cash and cash equivalents at end of year	**$ 5,773,285**	**$ 4,597,8**

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS

Note 1 – NATURE OF BUSINESS

Lifeway Foods, Inc. (The "Company") commenced operations in February 1986 and incorporated under the laws of the state of Illinois on May 19, 1986. The Company's principal business activity is the production of dairy products. Specifically, the Company produces Kefir, a drinkable product which is similar to but distinct from yogurt, in several flavors sold under the name "Lifeway's Kefir;" a plain farmer's cheese sold under the name "Lifeway's Farmer's Cheese;" a fruit sugar-flavored product similar in consistency to cream cheese sold under the name of "Sweet Kiss;" and a dairy beverage, similar to Kefir, with increased protein and calcium, sold under the name "Basics Plus." The Company also produces several soy-based products under the name "Soy Treat" and a vegetable-based seasoning under the name "Golden Zesta." The Company currently distributes its products throughout the Chicago Metropolitan area 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. During the year ended December 31, 2004 and 2003, export sales of the Company were approximately $37,050 and $221,000, respectively.

On September 30, 1992, the Company formed a wholly owned subsidiary corporation, LFI Enterprises, Inc., (LFIE) incorporated in the state of Illinois. LFIE was formed for the purpose of operating a "Russian" theme restaurant and supper club on property acquired by the Company on October 9, 1992. The restaurant/supper club commenced operations in late November 1992. As of July 2001, the restaurant/supper club terminated all operations. In January 2003, the Company sold the building and the land that housed LFIE for $1,712,660 and recognized a gain of $1,246,287 on this transaction.

On July 23, 2004, LFIE acquired certain assets and inventory of Ilya's Farms, Inc., a Pennsylvania corporation, for a total purchase price of $575,600. The asset acquisition included approximately $63,800 of tangible assets (including certain manufacturing equipment, a delivery truck and inventory) as well as intangible assets such as the brand name "Ilya's Farms" and the recipes and manufacturing processes previously used by Ilya's Farms, Inc. At present, LFIE manufactures and distributes certain cream cheese products under the brand names "Ilya's Farms" and under Lifeway Foods in the Philadelphia, Pennsylvania metropolitan area.

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 subsidiary, LFI Enterprises, Inc. All significant intercompany accounts and transactions have been eliminated.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

Sales represent sales of Company produced dairy products that are recorded at the time of shipment. In addition, shipping costs invoiced to the customers are included in net sales and the related cost in cost of sales.

Cash and cash equivalents

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

The Company maintains cash deposits at several institutions located in the greater Chicago, Illinois metropolitan area. Deposits at each institution are insured up to $100,000 by the Federal Deposit Insurance Corporation or the Securities Investor Protector Corporation.

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

	December 31,	
	2004	2003
Amounts insured	$ 472,341	$ 400,000
Uninsured and uncollateralized amounts	5,456,188	4,212,259
Total bank balances	$ 5,928,529	$ 4,612,259

Marketable securities

Marketable securities are classified as available-for-sale or trading and are stated at fair market value based or quoted prices. Gains and losses related to marketable securities sold are determined by the specific identification method.

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

Inventories

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

Property and equipment

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

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

Category	Years
Buildings and improvements	31 and 39
Machinery and equipment	5 – 12
Office equipment	5 – 7
Vehicles	5

Intangible assets

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

Goodwill is reviewed for impairment at least annually. The Company will perform its annual impairment test on July 23 (or the first business day immediately following that date). Since the Company only has one reporting unit, the test is based on a fair value approach applied for the entire company.

The Company will review 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. This review is called an impairment assessment. The Company will conduct 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	8
Lease agreement	7

Income taxes

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

Treasury stock

Treasury stock is recorded using the cost method.

Advertising costs

The Company expenses advertising costs as incurred. During the years ended December 31, 2004 and 2003, approximately $909,179 and $629,500, of such costs respectively, were expensed.

Earning per common share

Earnings per common share were computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the year. For 2004 and 2003, diluted and basic earnings per share were the same, as the effect of dilutive securities options outstanding was not significant.

Note 3 – ACQUISITION OF ILYA'S FARMS, INC.

On July 23, 2004, LFI Enterprises, Inc., an Illinois corporation and wholly owned subsidiary of Lifeway ("LFIE"), acquired certain assets of Ilya's Farms, Inc., a Pennsylvania corporation. The aggregate purchase price was $575,600, paid by LFIE in cash from its current assets.

As a result of the acquisition LFIE now manufactures and distributes certain cream cheese products under the brand name "Ilya's Farms" in the Philadelphia, Pennsylvania metropolitan area. The results of operations have been included in the consolidated financial statements since the acquisition date.

The following table summarizes the values of the assets and inventory acquired at the date of acquisition, July 23, 2004.

Assets and Inventory Acquired	Value

Machinery and equipment	$ 38,200
Inventory	25,600
Intangible assets	511,800
Total aggregate purchase price	$ 575,600

Intangible assets, and the related accumulated amortization, consist of the following as of December 31, 2004:

	Cost	Accumulated Amortization
Recipes	$ 43,600	$ 4,542
Customer lists and other customer related intangibles	305,200	17,258
Lease acquisition	87,200	5,190
Goodwill	5,800	--
	$511,800	$ 26,990

Amortization expense is expected to be as follows for the years ending December 31:

2005	$ 64,777
2006	64,777
2007	64,777
2008	60,235
2009	50,244
Thereafter	104,200
	$ 409,010

Amortization expense during the year ended December 31, 2004 was $26,990. Goodwill amortization for tax purposes totaled $2,527 for the year ended December 31, 2004.

Note 4 – MARKETABLE SECURITIES

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

December 31, 2004	Cost	Unrealized Gains	Unrealized Losses	Loss on Marketable Securities Classified as Trading	Fair Value
Equities and Mutual Funds	$ 3,414,459	$ 341,230	$ (120,991)	$ ---	$ 3,634,698
Preferred Securities	65,000	596	---	---	65,596
Certificates of Deposit	150,000	---	(4,935)	---	145,065
Corporate Bonds	1,639,275	---	(14,862)	---	1,624,413
Municipal bonds, maturing within five years	132,226	1,992	---	---	134,218

Government agency obligations, maturing after five years	1,154,484	---	---	(16,487)	1,137,997
Total	$ 6,555,444	$ 343,818	$ (140,788)	$ (16,487)	$ 6,741,987

December 31, 2003	Cost	Unrealized Gains	Unrealized Losses	Loss on Marketable Securities Classified as Trading	Fair Value
Equities	$ 2,326,722	$ 315,348	$ (48,837)	$ ---	$ 2,593,233
Preferred securities	200,505	2,985	(80)	---	203,410
Certificates of deposit	150,000	---		---	150,000
Corporate Bonds	500,005	---	(1,333)	---	498,672
Municipal bonds, maturing within five years	2,405,067	1,545	(10)	---	2,406,602
Government agency obligation	450,000	689		---	450,689
Total	$ 6,032,299	$ 320,567	$ (50,260)	$ ---	$ 6,302,606

Proceeds from the sale of marketable securities were $6,096,652 and $3,025,285 during the years ended December 31, 2004 and 2003, respectively. Gross gains (losses) of $354,128 and $(1,293,579), were realized on these sales during the years ended December 31, 2004 and 2003, respectively.

Note 5 – INVENTORIES

Inventories consist of the following:

	December 31,	
	2004	2003
Finished goods	$ 404,206	$ 436,291
Production supplies	297,791	231,376
Raw materials	203,700	143,905
Total inventories	$ 905,697	$ 811,572

Note 6 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	December 31,	
	2004	2003
Land	$ 470,900	$ 470,900
Buildings and improvements	2,481,257	2,435,111
Machinery and equipment	5,394,932	5,138,822

Vehicles	408,898	380,743
Office equipment	78,763	78,763
	8,834,750	8,504,339
Less accumulated depreciation	5,414,612	4,771,608
Total property and equipment	$ 3,420,138	$ 3,732,731

Depreciation expense during the years ended December 31, 2004 and 2003 was $643,004 and $688,309, respectively.

Note 7 – NOTES PAYABLE

Notes payable consist of the following:

	December 31,	
	2004	2003
Mortgage note payable to a bank, payable in monthly installments of $3,273 including interest at 6.25%, with a balloon payment of $454,275 due September 25, 2006. Collateralized by real estate.	$ 472,325	$ 481,281
Notes payable to finance companies; paid in full November 2004.	---	19,517
Total notes payable	472,325	500,978
Less current maturities	8,784	28,289
Total long-term portion	$ 463,541	$ 472,509

Maturities of notes payables are as follows:

As of December 31,	
2005	$ 8,784
2006	463,541
Total	$ 472,325

Note 8 – PROVISION FOR INCOME TAXES

The provision for income taxes consists of the following:

	Year Ended December 31,	
	2004	2003
Current:		
Federal	$ 1,084,557	$ 1,075,623
State	260,050	269,841
Total current	1,334,607	1,345,464

Deferred	45,560	9,084
Provision for income taxes	$ 1,390,167	$ 1,354,548

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

	Year Ended December 31,	
	2004	2003
Federal income tax expense computed at the statutory rate	$ 1,084,921	$ 1,127,237
State taxes, expense	251,283	261,084
Permanent book/tax differences	53,963	(33,773)
Provision for income taxes	$ 1,390,167	$ 1,354,548

Amounts for deferred tax assets and liabilities are as follows:

	December 31,	
	2004	2003
Non-current deferred tax liabilities arising from:		
Temporary differences - principally Book/tax, accumulated depreciation	$ (424,039)	$ (471,953)
Current deferred tax liability arising from:		
Book/tax, unrealized gains on marketable securities	(83,850)	(114,070)
Current deferred tax assets arising from:		
Book/tax, capital loss carryforward	---	104,683
Book/tax, inventory	47,636	36,425
Total current deferred tax assets (liability)	(36,214)	27,038
Net deferred tax liability	$ (460,253)	$ (444,915)

Note 9 – SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest and income taxes are as follows:

	Years Ended December 31,	
	2004	2003
Interest	$ 31,441	$ 41,205
Income taxes	$ 1,298,348	$ 2,055,000

Note 10 – STOCK OPTION PLANS

The Company has a registration statement filed with the Securities and Exchange Commission in connection with a Consulting Service Compensation Plan covering up to 600,000, as adjusted, of the Company's common stock shares. Pursuant to such Plan, the Company may issue common stock or options to purchase common stock to certain consultants, service providers, and employees of the Company. There were 468,000 shares available for issuance under the Plan at December 31, 2004 and 2003. 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, 2004 and 2003, there were no stock options outstanding or exercisable.

On February 12, 2004, Lifeway's Board of Directors approved awards of an aggregate amount of 5,100 shares to be awarded under its Employee and Consulting Services and Compensation Plan to certain employees and consultants for services rendered to the Company. The stock awards were made on April 1, 2004 and have vesting periods that vary from six months to one year, depending upon the individual grantee. The expense for the awards is measured as of April 1, 2004 at $20.93 per share for 5,100 shares, or a total stock award expense of $106,743. This expense is being recognized as the stock awards vest beginning with the recognition of $41,860 for 2,000 shares vested on April 1, 2004. There were a total of 4,550 vested shares resulting in a stock award expense of $95,231 for the year ended December 31, 2004.

Note 11 – STOCK SPLIT

On February 12, 2004, the Board of Directors of the Company declared a two-for-one stock split of the common stock of the Company payable on March 8, 2004 to all of the Company's shareholders of record as of February 27, 2004.

As a result of the stock split, shareholders received two shares of common stock for every one share held on the record date. Upon completion of the split, the total number of shares of common stock outstanding increased from 4,218,444 to 8,436,888.

The earnings per share calculations as presented on the consolidated statements of income and comprehensive income and the number of shares issued and outstanding per statement of changes in stockholders' equity have been adjusted to reflect split adjusted share amounts.

Note 12 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Company's financial instruments are as follows at December 31,:

	2004		2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	$ 5,773,285	$ 5,773,285	$ 4,597,819	$ 4,597,819
Marketable securities	$ 6,741,987	$ 6,741,987	$ 6,302,606	$ 6,302,606
Notes payable	$ 472,325	$ 469,696	$ 500,798	$ 483,469

The carrying values of cash and cash equivalents, and marketable securities approximate fair values. The fair value of the notes payable is based on the discounted value of contractual cash flows. The discount rate is estimated using rates currently offered for debt with similar maturities.

Note 13 – PENDING LITIGATION

On December 4, 2004 a former employee requested a Motion for Summary Judgment on the issue of Liability in a lawsuit filed against the Company by the former employee. The motion was granted on February 10, 2005 and on February 18, 2005 the case was referred to a Magistrate Judge for a settlement conference.

The lawsuit alleges non payment of overtime wages in violation of federal employment laws, with an estimated amount between $7,500 and $15,000. The suit was filed in the United States District Court for the Northern District of Illinois on behalf of all employees who were classified as non-exempt during 2001 through 2003. Outside counsel for the Company has advised that at this stage in the proceedings he cannot offer an opinion as to the probable outcome.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

ITEM 8A. DISCLOSURE CONTROLS AND PROCEDURES

The Chief Executive Officer and the Chief Financial and Accounting Officer conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures pursuant to Rule 13a-14 under the Securities Exchange Act of 1934 as of December 31, 2004. While the Company operates on strictly monitored cost constraints, based on that evaluation, the Chief Executive Officer and the Chief Financial and Accounting Officer concluded that the disclosure controls and procedures are effective in ensuring that all material information required to be filed in this annual report has been made known to her. As of the date of this annual report, there have been no known significant changes in internal controls or in other factors that could significantly affect these controls subject to the date of such evaluation.

ITEM 8B OTHER INFORMATION

None.

PART III

Certain information required by Part III is omitted from this report in that Lifeway intends to file a definitive proxy statement pursuant to Regulation 14A (the "Proxy Statement") not later than 120 days after the end of the fiscal year covered by this report, and certain information included therein is incorporated herein by reference. Only those sections of the Proxy Statement which specifically address the items set forth herein are incorporated by reference.

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT.

DIRECTORS. The information regarding Lifeway's directors and certain other information required by this Item is incorporated by reference to the Proxy Statement.

EXECUTIVE OFFICERS. The information regarding Lifeway's executive officers and certain other information required by this Item is incorporated by reference to the Proxy Statement.

COMPLIANCE WITH SECTION 16(A) OF THE SECURITIES EXCHANGE ACT OF 1934

The information required by this Item regarding compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference to the Proxy Statement.

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 which is incorporated in this report by reference to this report as an exhibit hereto.

ITEM 10. EXECUTIVE COMPENSATION.

The information required by this Item is incorporated by reference to the Proxy Statement filed by Lifeway on April 29, 2004.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The information required by this Item is incorporated by reference to the Proxy Statement.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information required by this Item is incorporated by reference to the Proxy Statement.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K.

FINANCIAL STATEMENTS AND SCHEDULES

A list of the Financial Statements and Financial Statement Schedules filed as part of this Report is set forth in Item 7, which list is incorporated herein by reference.

(a) EXHIBITS

Exhibit Number	Description
3.4	Amended and Restated By-laws (incorporated by reference to Exhibit No. 3.5 of Lifeway's Current Report on Form 8-K dated and filed on December 10, 2002). (File No. 000-17363)
3.5	Articles of Incorporation, as amended and currently in effect (incorporated by reference to Exhibit 3.5 of Lifeway's Quarterly Report on Form 10-QSB for the quarter ended June 30, 2000 and filed on August 8, 2000). (File No. 000-17363)
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). (File No. 000-17363)
10.10	Stock Purchase Agreement with Danone Foods, Inc., dated October 1, 1999 (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)
10.11	Stockholders' Agreement with Danone Foods, Inc. dated October 1, 1999 (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)
10.12	Extension to Stockholders' Agreement with Danone Foods, Inc. dated September 28, 2004 (incorporated by reference to Exhibit 10.1 of Lifeway's Current Report on Form 8-K dated October 1, 2004 and filed October 18, 2004). (File No. 000-17363)
10.13	Second Extension to Stockholders' Agreement with Danone Foods, Inc. dated October 29, 2004 (incorporated by reference to Exhibit 10.1 of Lifeway's Current Report on Form 8-K dated October 29, 2004 and filed November 4, 2004). (File No. 000-17363)
10.14	Third Extension of Stockholders' Agreement dated as of December 30, 2004 between Lifeway Foods, Inc. and

Danone Foods, Inc. (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K dated December 24, 2004 and filed December 27, 2004). (File No. 000-17363)

10.15	Letter Agreement dated December 24, 1999 amending the Stockholders' Agreement with Danone Foods, Inc. dated October 1, 1999 (incorporated by reference to Exhibit 10.12 of Lifeway's Current Report on Form 8-K dated December 24, 1999 and filed January 11, 2000). (File No. 000-17363)
10.16	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)
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 Lifeway's Proxy Statement on Schedule 14A filed on April 29, 2004). (File No. 000-17363)
21	List of Subsidiaries of the Registrant
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.

(b) Reports on Form 8-K

Current Report on Form 8-K dated December 24, 2004 and filed December 27, 2004.

Current Report on Form 8-K dated November 15, 2004 and filed November 19, 2004.

Current Report on Form 8-K dated October 29, 2004 and filed November 4, 2004.

Current Report on Form 8-K dated October 1, 2004 and filed October 18, 2004.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

AUDIT FEES

In 2003, Gleeson Sklar, Sawyers and Cumpata, Lifeway's principal accountant, billed approximately $41,500 for professional services rendered for the audit of Lifeway's annual financial statements and review of financial statements included in the registrant's Form 10-Q (17 CFR 249.308a) or 10-QSB (17 CFR 249.308b) or services that are normally provided in connection with statutory and regulatory filings or engagements in 2003.

On May 13, 2004, the accounting firm of Gleeson Sklar, Sawyers and Cumpata, merged with and into Plante & Moran, PLLC.

In 2004, Plante & Moran, PLLC, Lifeway's principal accountant, billed approximately $70,000 for professional services rendered for the audit of Lifeway's annual financial statements and review of financial statements included in the registrant's Form 10-QSB (17 CFR 249.308b) or services that are normally provided in connection with statutory and regulatory filings or engagements in 2004.

AUDIT-RELATED FEES

In 2003, Lifeway's principal accountant billed approximately $4,701 for assurance and related services that are reasonably related to the performance of the audit or review of the registrant's financial statements.

In 2004, Lifeway's principal accountant billed approximately $8,900 for assurance and related services that are reasonably related to the performance of the audit or review of the registrant's financial statements.

TAX FEES

No professional services were rendered by the principal accountant for tax advice, tax compliance and tax planning.

ALL OTHER FEES

No other fees were billed by the principal accountant other than those described in this report.

No hours expended on Lifeway's principal accountant's engagement to audit Lifeway's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time permanent employees.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunder duly authorized.

Date: March 31, 2005

LIFEWAY FOODS, INC.

By: /s/ Julie Smolyansky

Julie Smolyansky, Chief Executive Officer,
President, and Director

By: /s/ 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.

In accordance with 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: March 31, 2005

/s/ Julie Smolyansky

Julie Smolyansky, Chief Executive Officer,
President, and Director

Date: March 31, 2005

/s/ Ludmila Smolyansky

Ludmila Smolyansky
Chairperson of the Board of Directors

Date: March 31, 2005

/s/ Pol Sikar

Pol Sikar, Director

Date: March 31, 2005

/s/ Rick D. Salm

Rick D. Salm, Director

Date: March 31, 2005

Juan Carlos, Director

Date: March 31, 2005

Renzo Bernardi, Director

INDEX OF EXHIBITS

21	List of Subsidiaries
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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.