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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended September 30, 2005

[_] 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.

(Exact name of small business issuer as specified in it charter)

Illinois — (State or other jurisdiction of incorporation or organization)

36-3442829 — (IRS Employer Identification No.)

6431 WEST OAKTON, MORTON GROVE, ILLINOIS 60053

(Address of principal executive offices)

(847) 967-1010

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

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 such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of September 30, 2005, the issuer had 8,393,855 shares of common stock, no par value, outstanding.

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

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LIFEWAY FOODS, INC. AND SUBSIDIARY
Consolidated Statements of Financial Condition
September 30, 2005 and 2004
and December 31, 2004

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	SEPTEMBER 30, 2005	SEPTEMBER 30, 2004	DECEMBER 31, 2004
<S>	<C>	<C>	<C>
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	$ 4,191,755	$ 5,348,135	$ 5,773,285
Marketable securities	7,580,531	6,727,867	6,741,987
Accounts receivable, net of allowance for doubtful accounts of $15,000 at September 30, 2005 and 2004 and December 31, 2004	2,637,528	1,943,032	2,024,036
Other receivables	109,093	80,582	72,137
Inventories	1,301,066	915,951	905,697
Prepaid expenses and other current assets	82,293	8,344	7,260
Deferred income taxes	46,881	90,937	--
Refundable income taxes	58,037	68,042	258,617
TOTAL CURRENT ASSETS	16,007,184	15,182,890	15,783,019
PROPERTY AND EQUIPMENT, NET	7,755,352	3,482,524	3,420,138
INTANGIBLE ASSETS			
Goodwill	75,800	511,800	75,800
Other intangible assets, net of amortization of $59,379 and $26,990 at September 30, 2005 and December 31, 2004	366,567	--	409,010
TOTAL INTANGIBLE ASSETS	442,367	511,800	484,810
TOTAL ASSETS	$ 24,204,903	$ 19,177,214	$ 19,687,967
LIABILITIES AND STOCKHOLDERS' EQUITY			
CURRENT LIABILITIES			
Current maturities of notes payable	$ 534,938	$ 11,716	$ 8,784
Accounts payable	648,881	701,145	641,651
Accrued expenses	453,895	186,591	195,541
Deferred income taxes		--	36,214
TOTAL CURRENT LIABILITIES	1,637,714	899,452	882,190
NOTES PAYABLE	2,919,656	465,796	463,541
DEFERRED INCOME TAXES	362,314	426,895	424,039
STOCKHOLDERS' EQUITY			
Common stock	6,509,267	6,509,267	6,509,267
Paid-in-capital	82,738	56,540	64,314
Stock subscription receivable		(5,000)	--
Treasury stock, at cost	(1,034,172)	(652,776)	(649,039)
Retained earnings	13,715,660	11,534,832	11,874,475
Accumulated other comprehensive income (loss), net of taxes	11,726	(57,792)	119,180
TOTAL STOCKHOLDERS' EQUITY	19,285,219	17,385,071	17,918,197
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 24,204,903	$ 19,177,214	$ 19,687,967

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See accompanying notes to financial statements

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LIFEWAY FOODS, INC. AND SUBSIDIARY
Consolidated Statements of Income and Comprehensive Income
For the Three and Nine Months Ended September 30, 2005 and 2004
and The Year Ended December 31, 2004

<TABLE><CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,		DECEMBER 31,
	2005	2004	2005	2004	2004
<S>	<C>	<C>	<C>	<C>	<C>
SALES	$ 5,194,648	$ 4,138,606	$ 14,924,076	$ 12,075,778	$ 16,319,210
Cost of goods sold	3,073,314	2,239,553	$ 8,607,538	$ 6,604,554	9,034,971
GROSS PROFIT	2,121,334	1,899,053	6,316,538	5,471,224	7,284,239
Operating expenses	1,359,171	1,157,906	$ 3,793,394	$ 3,089,336	4,333,788
INCOME FROM OPERATIONS	762,163	741,147	2,523,144	2,381,888	2,950,451
Other income (expense):					
Interest and dividend income	72,363	49,689	212,927	124,897	185,575
Interest expense	(36,877)	(7,584)	(51,195)	(23,103)	(31,441)
Gain (loss) on sale of marketable securities, net	162,446	12,386	324,433	321,716	354,128
Gain (loss) on marketable securities classified as trading	(681)	15,681	14,355	(12,077)	(16,487)
Total other income	197,251	70,172	500,520	411,433	491,775
INCOME BEFORE PROVISION FOR INCOME TAXES	959,414	811,319	3,023,664	2,793,321	3,442,226
Provision for income taxes	400,464	296,210	1,182,479	1,080,905	1,390,167
NET INCOME	$ 558,950	$ 515,109	$ 1,841,185	$ 1,712,416	$ 2,052,059
BASIC AND DILUTED EARNINGS PER COMMON SHARE	0.07	0.06	0.22	0.20	0.24
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	8,400,700	8,440,888	8,400,750	8,440,888	8,439,159
COMPREHENSIVE INCOME					
NET INCOME	$ 558,950	$ 515,109	$ 1,841,185	$ 1,712,416	$ 2,052,059
Other comprehensive income (loss), net of tax:					
Unrealized gains (losses) on marketable securities (net of tax benefits)	7,089	(16,385)	(107,454)	(214,029)	170,107
Less reclassification adjustment for gains (losses) included in net income (net of taxes)					(207,164)
Comprehensive income	$ 566,039	$ 498,724	$ 1,733,731	$ 1,498,387	$ 2,015,002

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See accompanying notes to financial statements

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LIFEWAY FOODS, INC. AND SUBSIDIARY
Consolidated Statements of Changes in Stockholders' Equity
For the Nine Months Ended September 30, 2005
and the Year Ended December 31, 2004

<TABLE><CAPTION>

	COMMON STOCK, NO PAR VALUE 10,000,000 SHARES AUTHORIZED				
	# OF SHARES ISSUED	# OF SHARES OUTSTANDING	# OF SHARES OF TREASURY STOCK	COMMON STOCK	PAID IN CAPITAL
<S>	<C>	<C>	<C>	<C>	<C>
BALANCES AT DECEMBER 31, 2003	8,636,888	8,436,888	200,000	$ 6,509,267	$ --
Issuance of treasury stock	--	4,550	(4,550)	--	64,314
Other comprehensive income (loss): Unrealized losses on securities, net of taxes and reclassification adjustment	--	--	--	--	--
Payment on subscription receivable	--	--	--	--	--
Net income for the year ended December 31, 2004	--	--	--	--	--
BALANCES AT DECEMBER 31, 2004	8,636,888	8,441,438	195,450	$ 6,509,267	$ 64,314
Issuance of treasury stock	--	2,417	(2,417)	--	18,424
Redemption of treasury stock	--	(50,000)	50,000	--	--
Other comprehensive income (loss): Unrealized losses on securities, net of taxes and reclassification adjustment	--	--	--	--	--
Net income for the nine months ended September 30, 2005	--	--	--	--	--
BALANCES AT SEPTEMBER 30, 2005	8,636,888	8,393,855	243,033	$ 6,509,267	$ 82,738

	STOCK SUBSCRIPTION RECEIVABLE	TREASURY STOCK	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	TOTAL
BALANCES AT DECEMBER 31, 2003	$ (15,000)	$ (679,956)	$ 9,822,416	$ 156,237	$ 15,792,964
Issuance of treasury stock	--	30,917	--	--	95,231
Other comprehensive					

income (loss): 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	$ --	$ (649,039)	$ 11,874,475	$ 119,180	$ 17,918,197
Issuance of treasury stock	--	16,421	--	--	34,845
Redemption of treasury stock	--	(401,554)	--	--	(401,554)
Other comprehensive income (loss): Unrealized losses on securities, net of taxes and reclassification adjustment	--	--	--	(107,454)	(107,454)
Net income for the nine months ended September 30, 2005	--	--	1,841,185	--	1,841,185
BALANCES AT SEPTEMBER 30, 2005	$ --	$ (1,034,172)	$ 13,715,660	$ 11,726	$ 19,285,219

</TABLE>

See accompanying notes to financial statements

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LIFEWAY FOODS, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows
For the Nine Months Ended September 30, 2005 and 2004
and the Year Ended December 31, 2004

<TABLE><CAPTION>

	NINE MONTHS ENDED SEPTEMBER 30,		YEAR ENDED DECEMBER 31,
	2005	2004	2004
<S>	<C>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:			
NET INCOME	$ 1,841,185	$ 1,712,416	$ 2,052,059
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation and amortization	486,050	474,876	669,994
Gain on sale of marketable securities, net	(324,433)	(321,716)	(354,128)
(Gain)/Loss on marketable securities classified as trading	(14,355)	12,077	16,487
Deferred income taxes	(69,219)	45,776	45,560
Treasury stock issued for services	34,845	--	95,231
(Increase) decrease in operating assets:			
Accounts receivable	(613,492)	(142,891)	(223,895)
Other receivables	(36,956)	85,185	93,630
Inventories	(395,369)	(104,379)	(94,125)
Refundable income taxes	200,580	238,129	47,554
Prepaid expenses and other current assets	(75,033)	(7,551)	(6,469)
Increase (decrease) in operating liabilities:			
Accounts payable	7,230	(94,176)	(153,670)
Accrued expenses	258,354	2,991	11,941
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,299,387	1,900,737	2,200,169
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of marketable securities	(5,149,008)	(5,790,781)	(6,265,671)
Sale of marketable securities	4,466,197	5,306,395	6,096,652
Purchases of property and equipment	(4,778,821)	(224,669)	(330,411)
Purchase of Goodwill	--	(511,800)	--
Acquisition of Ilya's Farms, Inc. net of assets acquired	--	--	(511,800)
NET CASH USED IN INVESTING ACTIVITIES	(5,461,632)	(1,220,855)	(1,011,230)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from stock subscription receivable	--	83,720	15,000
Proceeds from note payable	3,000,000	--	--
Purchases of treasury stock	(401,554)	10,000	--
Repayment of notes payable	(17,731)	(23,286)	(28,473)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	2,580,715	70,434	(13,473)
Net increase/(decrease) in cash and cash equivalents	(1,581,530)	750,316	1,175,466
Cash and cash equivalents at the beginning of the period	5,773,285	4,597,819	4,597,819
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	$ 4,191,755	$ 5,348,135	$ 5,773,285

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004
AND DECEMBER 31, 2004

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.

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 the Public Company Accounting Oversight Board (PCAOB) 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.

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004
AND DECEMBER 31, 2004

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Cash and cash equivalents

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

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

	September 30,		December 31,
	2005	2004	2004
Amounts insured	$ 500,000	$ 500,000	$ 472,341
Uninsured and uncollateralized amounts	3,959,945	5,041,913	5,456,188
Total bank balances	$4,459,945	$5,541,913	$5,928,529

Marketable securities

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

Inventories

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

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004
AND DECEMBER 31, 2004

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

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

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004
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NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Income taxes

Deferred income taxes arise from temporary differences resulting from income and expense items reported for financial accounting and tax purposes in different periods. Deferred taxes are classified as current or non-current, depending on the classification of the assets and liabilities to which they relate. Deferred taxes arising from temporary differences that are not related to an asset or liability are classified as current or non-current depending on the periods in which the temporary differences are expected to reverse.

The principal sources of temporary differences are different depreciation and amortization methods for financial statement and tax purposes, unrealized gains or losses related to marketable securities, capitalization of indirect costs for tax purposes, and the recognition of an allowance for doubtful accounts for financial statement purposes.

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 for the nine months ended September 30, 2005 and 2004, approximately $909,179, $914,598 and $619,852, of such costs respectively, were expensed.

Earning per common share

Earnings per common share were computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. For all periods presented, 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 of the acquired business 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

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004
AND DECEMBER 31, 2004

NOTE 4 - INTANGIBLE ASSETS

Intangible assets, and the related accumulated amortization, consist of the following as of September 30, 2005:

	Cost	Accumulated Amortization
Loan acquisition costs	$ 6,638	$ 498
Recipes	43,600	12,717
Customer lists and other customer related intangibles	305,200	48,323
Lease acquisition	87,200	14,533
Goodwill	75,800	--
	$ 518,438	$ 76,071

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

2006	$ 66,105
2007	66,105
2008	66,105
2009	56,113
2010	54,873
Thereafter	57,266
	$ 366,567

Amortization expense during the nine months ended September 30, 2005 and year ended December 31, 2004 was $49,081 and $26,990. Goodwill amortization, for tax purposes, totaled $3,790 and $2,527 for the nine months ended September 30, 2005 and year ended December 31, 2004, respectively.

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004
AND DECEMBER 31, 2004

NOTE 5 - MARKETABLE SECURITIES

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

<TABLE><CAPTION>

September 30, 2005	Cost	Unrealized Gains	Unrealized Losses	Loss on Marketable Securities Classified as Trading	Fair Value
Equities and Mutual Funds	4,136,818	221,349	(121,835)		4,236,332
Preferred Securities	955,233		(19,849)		935,384
Certificates of Deposit	150,000		(3,630)		146,370
Corporate Bonds	2,159,363		(55,732)		2,103,631
Municipal Bonds	61,275	1,012	(1,341)		60,946
Government agency obligations	100,000			(2,132)	97,868
Total	7,562,689	222,361	(202,387)	(2,132)	7,580,531

September 30, 2004	Cost	Unrealized Gains	Unrealized Losses	Loss on Marketable Securities Classified as Trading	Fair Value
Equities/Mutual Funds	$3,713,163	$ 101,144	$ (188,299)	$ --	$3,626,008
Preferred Securities	75,505	1,825	--	--	77,330
Certificates of Deposit	150,000	--	(7,440)	--	142,560
Corporate Bonds	1,614,275	--	(8,177)	--	1,606,098
Municipal bonds, maturing within five years	132,224	2,490	--	--	134,714
Government agency Obligations, maturing After five years	1,153,234	--	--	(12,077)	1,141,157
Total	$6,838,401	$ 105,459	$ (203,916)	$ (12,077)	$6,727,867

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004
AND DECEMBER 31, 2004

NOTE 5 - MARKETABLE SECURITIES - CONTINUED

<TABLE><CAPTION>

December 31, 2004	Cost	Unrealized Gains	Unrealized Losses	Loss on Marketable Securities Classified as Trading	Fair Value
<S>	<C>	<C>	<C>	<C>	<C>
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

</TABLE>

Proceeds from the sale of marketable securities were $6,096,652, $1,589,538 and $5,306,395 during the year ended December 31, 2004 and for the nine months ended September 30, 2005 and 2004, respectively.

Gross gains of $354,128, $324,433 and $321,716 were realized on these sales during the year ended December 31, 2004 and for the nine months ended September 30, 2005 and 2004, respectively.

NOTE 6 - INVENTORIES

Inventories consist of the following:

	September 30, 2005	September 30, 2004	December 31, 2004
Finished goods	$ 537,514	$ 386,700	$ 404,206
Production supplies	460,664	308,766	297,791
Raw materials	302,888	220,485	203,700
Total inventories	$1,301,066	$ 915,951	$ 905,697

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004
AND DECEMBER 31, 2004

NOTE 7 - PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	September 30, 2005	September 30, 2004	December 31, 2004
Land	$ 909,232	$ 470,900	$ 470,900
Buildings and improvements	6,441,412	2,453,681	2,481,257
Machinery and equipment	5,667,016	5,316,766	5,394,932
Vehicles	510,510	408,898	408,898
Office equipment	78,763	78,763	78,763
	13,606,938	8,729,008	8,834,750
Less accumulated depreciation	5,851,581	5,246,484	5,414,612
Total property and equipment	$ 7,755,352	$3,482,524	$ 3,420,138

Depreciation expense during the year ended December 31, 2004 and for the nine months ended September 30, 2005 and 2004 was $643,004, $436,969 and $474,876, respectively.

NOTE 8 - NOTES PAYABLE

Notes payable consist of the following:
<TABLE><CAPTION>

<S>	September 30, 2005 <C>	September 30, 2004 <C>	December 31, 2004 <C>
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.	$ 465,179	$ 474,659	$ 472,325
Mortgage note payable to a bank, payable in monthly installments of $19,513 including interest at 5.6%, with a balloon payment of $2,652,143 due July 14, 2010. Collateralized by real estate.	2,989,415		
Notes payable to finance companies; paid in full November 2004.	--	2,853	--
Total notes payable	3,454,596	477,512	472,325
Less current maturities	534,938	11,716	8,784
Total long-term portion	$2,919,656	$ 465,796	$ 463,541

</TABLE>

Maturities of notes payables are as follows:

As of September 30,	
2006	$ 534,938
2007	73,767
2008	78,005
2009	82,488
2010	2,685,396
Total	$3,454,594

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 9 - PROVISION FOR INCOME TAXES

The provision for income taxes consists of the following:

	For the Nine Months Ended September 30, 2005	For the Nine Months Ended September 30, 2004	For the Year Ended December 31, 2004
Current:			
Federal	$1,050,319	$ 841,895	$ 1,084,557
State and local	201,380	193,231	260,050
Total current	1,251,699	1,035,126	1,334,607
Deferred	(69,220)	45,779	45,560
Provision for income taxes	$1,182,479	$ 1,080,905	$ 1,390,167

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

	For the Nine Months Ended September 30, 2005	For the Nine Months Ended September 30, 2004	For the Year Ended December 31, 2004
Federal income tax expense computed at the statutory rate	$1,003,298	$ 880,399	$ 1,084,921
State and local tax expense	197,254	203,912	251,283
Permanent book/tax differences	(18,073)	(3,406)	53,963
Provision for income taxes	$1,182,479	$1,080,905	$ 1,390,167

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LIFEWAY FOODS, INC. AND SUBSIDIARY
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NOTE 9 - PROVISION FOR INCOME TAXES - CONTINUED

Amounts for deferred tax assets and liabilities are as follows:

<TABLE><CAPTION>

	For the Nine Months Ended September 30,		For the Year Ended December 31,
	2005	2004	2004
<S>	<C>	<C>	<C>
Non-current deferred tax liabilities a rising from:			
Temporary differences - principally Book/tax, accumulated depreciation	$ (362,314)	$ (426,895)	$ (424,039)
Current deferred tax liability arising from:			
Book/tax, unrealized losses (gains) on marketable securities	(8,250)	40,663	(83,850)
Current deferred tax assets arising from:			
Book/tax, inventory	55,131	50,273	47,636
Total current deferred tax assets (liabilities)	46,881	90,936	(36,214)
Net deferred tax liability	$ (315,433)	$ (335,959)	$ (460,253)

</TABLE>

NOTE 10 - SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest and income taxes are as follows:

	(Unaudited) For the Nine Months Ended September 30,		For the Year Ended December 31,
	2005	2004	2004
Interest	$ 51,195	$ 7,623	$ 31,441
Income taxes	$1,053,064	$ 798,147	$ 1,298,348

NOTE 11 - 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 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 at September 30, 2005 and 2004. 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 at September 30, 2005 and 2004, there were no stock options outstanding or exercisable.

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004
AND DECEMBER 31, 2004

NOTE 11 - STOCK OPTION PLANS - CONTINUED

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, and an additional 1,400 shares vested during the quarter ended September 30, 2005 for an additional expense of $17,500.

NOTE 12 - 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 13 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Company's financial instruments is as follows at:
<TABLE><CAPTION>

	September 30, 2005		September 30, 2004		December 31, 2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Cash and cash equivalents	$4,191,755	$4,191,755	$5,348,135	$5,348,135	$5,773,285	$5,773,285
Marketable securities	$7,580,531	$7,580,531	$6,727,869	$6,727,869	$6,741,987	$6,741,987
Notes payable	$3,454,594	$3,437,469	$ 477,512	$ 454,773	$ 472,325	$ 469,696

</TABLE>

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.

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LIFEWAY FOODS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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AND DECEMBER 31, 2004

NOTE 14 - 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 $90,000 and $100,000. 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. The Company has accrued a $95,000 liability in anticipation of a settlement.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

COMPARISON OF QUARTER ENDED SEPTEMBER 30, 2005 TO QUARTER ENDED SEPTEMBER 30, 2004

The following analysis should be read in conjunction with the unaudited financial statements of the Company and related notes included elsewhere in this quarterly report and the audited financial statements and Management's Discussion and Analysis contained in our Form 10-KSB, for the fiscal year ended December 31, 2004, and in the Management's Discussion and Analysis contained in our Form 10-QSB, for the fiscal quarters ended March 31, 2005, and June 30, 2005.

RESULTS OF OPERATIONS

Sales increased by $1,056,042 (approximately 26%) to $5,194,648 during the three month period ended September 30, 2005 from $4,138,606 during the same three month period in 2004. This increase is primarily attributable to increased sales and awareness of Lifeway's existing drinkable dairy products including La Fruta, and its flagship line, Kefir.

Lifeway's wholly-owned subsidiary, LFI Enterprises, Inc. ("LFIE") accounted for $247,416 of total sales revenues during the third quarter of 2005. Of the total $264,807 revenues from LFIE, $112,671 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 $134,745 of LFIE revenues for the third quarter of 2005 was earned from sales of the Cream Cheese Gourmet line of products acquired from Ilya's Farms, Inc. in the third quarter of 2004. Sales from the acquired Ilya's Farms cream cheese line in the third quarter 2004 were $103,635. This represents a 30% increase in sales for the cream cheese line in the third quarter 2005 when compared to the same period year ago.

Cost of goods sold as a percentage of sales was approximately 59% during the third quarter 2005, compared to about 54% during the same period in 2004. The average cost of milk, Lifeway's largest cost of goods sold component, was similar in the third quarter 2005 compared to the same period in 2004. Beginning January 1, 2005, the minimum wage payable to Company's employees in Illinois increased 18%. This higher wage increase (and indirect pressure for additional increases) has had a negative impact on our gross margins in 2005, when compared to 2004. We intend to primarily offset these wage increases by continuing to invest in the automation of our production processes.

As we increased our shipments, the rise in fuel and transportation costs in the third quarter, when compared to the same period a year ago, had a negative impact on our gross margins. We were able to partially off-set this increase in fuel costs by making prudent investments in the energy markets, as is evident in our gains from the sale of marketable securities.

Operating expenses as a percentage of sales was approximately 26% during the third quarter 2005, compared to about 28% during the same period in 2004. This decrease is primarily attributable to our continuing efforts to improve our production automation, through capital investments, thereby improving our overall operating income. Lifeway also recognized an expense related to an increase in a reserve established with respect to a lawsuit brought be a previous employee, as discuss in Part II, Item 2 of this report.

Provision for income taxes was $400,464, or a 42% tax rate during the third quarter 2005 compared with $296,210, or a 36% tax rate during the same period in 2004. Income taxes are discussed in Note 9 of the Notes to Consolidated Financial Statements.

COMPARISON OF NINE MONTH PERIOD ENDED SEPTEMBER 30, 2005 TO NINE MONTH PERIOD ENDED SEPTEMBER 30, 2004

RESULTS OF OPERATIONS

Sales increased by $2,848,298 (approximately 24%) to $14,924,076 during the nine month period ended September 30, 2005 from $12,075,778 during the same nine month period in 2004. This increase is primarily attributable to increased sales and awareness of Lifeway's existing drinkable dairy products including La Fruta, and its flagship line, Kefir.

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Cost of goods sold as a percentage of sales was approximately 58% during the nine month period ended September 30, 2005, compared to about 55% during the same period in 2004. The average cost of milk, Lifeway's largest cost of goods sold component, approximately 20% higher in the first quarter 2005, compared to the same period in 2004, but was similar in the second and third quarters 2005 compared to the same periods in 2004. Beginning January 1, 2005, the minimum wage payable to Company's employees in Illinois increased 18%. This higher wage increase (and indirect pressure for additional increases) has had a negative impact on our gross margins in 2005, when compared to 2004. We intend to primarily offset these wage increases by continuing to invest in the automation of our production processes.

Total other income for the six months ended September 30, 2005 was $500,520, compared with $411,433 during the same period in 2004. This increase is primarily attributable to the company earning more interest and dividends in 2005, when compared to the same period in 2004.

SOURCES AND USES OF CASH

Net cash used in investing activities was $5,461,631 during the nine months ended September 30,2005, which is an increase of $4,240,776 compared to the same period in 2004. This increase is primarily due to the Company's purchase of a storage and distribution facility.

Net cash provided by financing activities was $2,580,715 during the nine months ended September 30, 2005, which is an increase of $2,510,281 compared to the same period in 2004. This increase is primarily attributable to the Company financing the purchase of the above- mentioned facility. The Company entered into a $3 million note that has a maturity of 5 years, at an interest rate of 5.6%. The Company also purchased 50,000 shares of its treasury stock at a cost of $401,554 in the first nine months of 2005.

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.

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

OTHER DEVELOPMENTS

On May 23, 2005, Lifeway's Board of Directors approved awards of an aggregate amount of 5,600 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 June 1, 2005 and have vesting periods of one year. The expense for the awards is measured as of June 1, 2005 at $12.50 per share for 5,600 shares, or a total stock award expense of $70,000. This expense will be recognized as the stock awards vest in 12 equal portions of $5,833, or 466 shares per month for one year.

CRITICAL ACCOUNTING POLICIES

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

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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 "believe," "expect," "anticipate," "estimate," "forecast," "objective," "plan," "goal," "project," "explore," "priorities/targets," 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:

o Changes in economic conditions, commodity prices;

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

o Significant changes in the competitive environment;

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

o Management's ability 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 3. CONTROLS AND PROCEDURES

The Chief Executive Officer and the Chief 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 September 30, 2005. The Company has historically operated on strictly monitored cost constraints. With that perspective, the Chief Executive Officer and the Chief Accounting Officer concluded that the disclosure controls and procedures are effective in ensuring that all material information required to be filed in this quarterly report has been made known to them. However, based upon the Company's recent growth and improved cash position, as well as consultation with its auditors, management intends to implement additional procedures to improve internal controls over financial reporting in 2005. Specifically, an enhanced accounting software package has been identified and continues to be evaluated which will permit enhanced data recording and internal reporting as well as additional on-site accounting staff and some changes to the Company's internal control procedures over financial reporting.

As of the date of this quarterly 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.

PART II - OTHER INFORMATION

ITEM 2. LEGAL PROCEEDINGS

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 $90,000 and $100,000. 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 it cannot offer an opinion as to the probable outcome. The Company continues to vigorously defend this matter. The Company has accrued a $95,000 liability in anticipation of a settlement.

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. This case was dismissed, with prejudice on June 30, 2005.

ITEM 5. OTHER INFORMATION

On October 3, 2005, the Company announced its financial results for the fiscal quarter and six months ended September, 30, 2005 and certain other information. A copy of the Company's press release announcing these financial results and certain other information is attached as Exhibit 99.1 hereto. The information contained in Exhibit 99.1 hereto is being furnished, and should not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities imposed by that Section. The information contained in Exhibit 99.1 shall not be incorporated by reference into any registration statement or other document or filing under the Securities Act of 1933, as amended, except as may be expressly set forth in a specific filing. The press

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release filed as an exhibit to this report includes "safe harbor" language pursuant to the Private Securities Litigation Reform Act of 1995, as amended, indicating that certain statements about the Company's business and other matters contained in the press release are "forward-looking." The press release also cautions investors that "forward-looking" statements may be different from actual operating results. Finally, the press release states that a more thorough discussion of risks and uncertainties which may affect the Company's operating results is included in the Company's reports on file with the Securities and Exchange Commission.

ITEM 6. 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-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)
11	Statement re: Computation of per share earnings (incorporated by reference to Note 2 of the Consolidated Financial Statements)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Julie Smolyansky.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Edward P. Smolyansky.
32.1	Section 1350 Certification of Julie Smolyansky.
32.2	Section 1350 Certification of Edward P. Smolyansky.
99.1	Press Release dated October 3, 2005- "Lifeway Foods Reports Record Third Quarter and Nine Months Sales Results."

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SIGNATURE

In accordance with the requirements of the Exchange Act, the Company caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 14, 2005

LIFEWAY FOODS, INC.

By: /s/ Julie Smolyansky

Julie Smolyansky
Chief Executive Officer, President,
and Director

/s/ Edward P. Smolyansky

Chief Financial and Accounting Officer
and Treasurer

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EXHIBIT INDEX

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