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Research Note

Investors should consider this report as only a single factor in making their investment decision.

Lifeway Foods, Inc.

Rating: Speculative Buy

Howard Halpern

February 27, 2008

LWAY $10.12 – (NasdaqGM)

	FY (12/05)A	FY (12/06) A	*FY (12/07) E*	*FY (12/08) E*
Revenue (in millions)	$20.13	$27.72	***$38.73***	***$48.51***
Earnings per share (diluted)*	$0.15	$0.17	***$0.19***	***$0.23***

52-Week range*	$20.75 – $8.55	Fiscal year ends:	December
Shares outstanding $_{\text{a/o 09/30/07}}$*	16.83 million	Revenue/shares (TTM) *	$2.16
Approximate float*	4.80 million	Price/Sales (TTM) *	4.7X
Market Capitalization	$170 million	Price/Sales (2008)E*	3.5X
Tangible Book value/shr	$1.52	Price/Earnings (TTM) *	48.1X
Price/Book*	6.7X	Price/Earnings (2008)E*	44.0X

* All per share figures reflect the 2-1 stock split effective March 9, 2004 and August 16, 2006.

Lifeway Foods, Inc. is a manufacturer of cultured, probiotic and functional food products in the health food industry, and is America's leading supplier of the cultured dairy product known as Kefir. Their products are sold to health conscious consumers through health food stores and to the mass-market consumers through supermarkets. Web site address is: www.kefir.com

Key investment considerations:

We are reiterating our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) and lowering our 12-month price target to $11.50 per share based on our sales per share estimate for 2008 (our prior target was $14.70). The reduction in our price target reflects a decline in the Company's share price due to lower gross margin and increased cost of goods sold (from the high price of milk), which contracted the relative price-to-sales multiple.

Our rating is primarily based on the top line growth generated from the Helios acquisition, growing awareness of LWAY's Kefir line, its kids Probugs™ Kefir drink, obtaining a foodservice distribution contract, distribution in Mexico, as well as a new smoothie drink called Lifeway Lassi, which is aimed at South Asian consumers in the U.S.

On January 7, 2008, LWAY pre-announced fourth quarter 2007 revenue of $10.170 million, which was an increase of 29% versus $7.894 million in the same period last year.

Based on expected top line results for 2007, trend analysis of LWAY's base business, and a contraction of gross margin due to relatively high input costs (i.e., price of milk, etc.), we are tweaking our 2007 revenue forecast to $38.725 million (prior was $38.520 million). Our reduced net income forecast is $3.249 million or $0.19 per diluted share (prior was $3.499 million or $0.21 per share).

We are adjusting our forecast for 2008, which calls for revenue of $48.510 million (prior was $48.225 million) and net income of $3.800 million or $0.23 per share (prior was $4.340 million or $0.26 per share). We believe the year-over-year top line growth should continue based on current trends and increased consumer awareness, offset by higher operating costs, which should mitigate during the second half of 2008.

**** Please view our disclaimer located on page 9.***

Recent Development

February 12, 2008, Lifeway Foods announced that four flavors of Lowfat Organic Kefir commenced distribution to Colorado's King Soopers Grocery stores, owned by Kroger. Shipments of organic Blueberry, Pomegranate/Acai, Raspberry, and Strawberries n' Cream kefir began during the week of February 18, 2008. According to the press release, expanded demo, marketing and advertising in the market is being coordinated in conjunction with Earth Month in April 2008, to support new kefir sales at the chain and promote the benefits of organic foods.

On February 7, 2008, the Company announced the completion of its production capacity expansion project at their main Morton Grove headquarters facility. The project, which cost approximately $2.5 million and took about one and a half years to complete, will approximately double Lifeway's existing production capacity. Management stated that is was the Company's first major expansion project in over 8 years. Also, this expansion project gives it with flexibility to finish moving the production of the Helios Organic kefir line, acquired in 2006, from its current production facility in Minnesota to this Illinois facility. This means that LWAY can use this larger scale and automated production efficiencies to produce product at a lower unit cost.

On January 7, 2008, Lifeway Foods pre-announced sales for its fourth quarter ended December 31, 2007. The Company expects fourth quarter 2007 sales of approximately $10.170 million, which is a 28.8% increase versus $7.894 million reported in the fourth quarter of 2006. Taglich Brothers' sales estimate for the fourth quarter of 2007 was $9.965 million. In addition, Lifeway's Board of Directors approved a new share repurchase program of up to 100,000 shares. The Company will use its available cash resources to fund the stock repurchase program, which will occur through the open market over the next year.

On November 29, 2007, the Company announced that it implemented a price increase of approximately 10-15% on its full catalog of products. This price increase went into effect during December 2007.

Outlook

Based on the Company's pre-announced fourth quarter expectations (on January 7, 2008), we anticipate that the Company experienced a weekly sales run-rate on its core business of approximately $0.672 million for the thirteen weeks ended December 31, 2007. This continues the trend of sequential growth of a weekly sales run-rate from the first, second, and third quarters of 2007 of $0.592 million, $0.637 million, and $0.645 million, respectively. On a stand alone basis, the Helios operation should have a weekly run-rate of approximately $0.110 million in the fourth quarter of 2007.

Our belief that the weekly run rate will continue to expand is based primarily on increased orders from existing customers, as well as expanded distribution opportunities (that may include food services such as restaurants, hotels, schools, etc.), the continued rollout of its Probugs™ offering, new foodservices contract, as well as the introduction of a new product (Lifeway Lassi). Lifeway continues to market its products through local radio station, newspaper, and magazines advertisements, as well as gaining additional exposure through the Internet, catalog advertising and promotion, in store demonstration throughout the U.S., and participation in various trade shows.

However, investors need to be aware that gross margin is likely to have been negatively impacted over the last three months of 2007 and into 2008. We are coming to that conclusion based on negative comments from companies that have recently reported results:

- Forbes Magazine reported that Dean Foods (NYSE: DF) announced that rising dairy costs sent ripples through the company in the fourth quarter, cutting into profits. According to the Forbes article, it does not look like the turmoil in the industry is going to end soon. Commodity costs have reached all-time highs and fuel prices have incrementally increased the cost of transporting materials;
- On January 29, 2008, Kraft Foods, Inc. (NYSE: KFT) reported that its fourth-quarter profit fell 6% due to higher dairy prices and one-time costs. The company primarily blamed a nearly 40% boost in dairy prices during the quarter for the earnings decline;

- Starbucks (NasdaqGS: SBUX) reported that results for the three months ending December 30, 2007, were negatively impacted due to increased dairy costs, which was a component of the 110 basis point increase in cost of sales for the quarter; and
- Groupe Danone experienced in-line results for 2007, in spite of unprecedented milk input cost headwinds, as stated in their press release on February 14, 2008.

On November 29, 2007, the Company announced that during December 2007, it implemented a price increase of approximately 10-15% on its full catalog of products. Since it takes time for prices increases to work through the distribution system (maybe a full quarter), we believe cost of goods sold due to high commodity prices (i.e., cost of milk) probably did not fair well in comparison to third quarter results. Gross margin in the third quarter of 2007 was 27.71%.

The January 2008 Dairy Market Report from the National Milk Producers Federation (NMPF is a farm commodity organization representing most of the dairy marketing cooperatives) stated that Class III milk price in December was $20.60 per cwt (abbreviation for hundred-weight), up 53% from the year ago period. The 2007 average price for the year was a record $18.04 per cwt. The report projected that January Class III price was near $19.15. The U.S. Department of Agriculture price forecast for Class III milk is $16.55 cwt for 2008. However, investors should be aware that the average cost of milk production is up as much as $6 or $7 per cwt over the last three years. This has potential negative implications for 2008.

Projections

Based on public comments made by Management in the Company's press releases and SEC filings, results for the first nine months of 2007, and relatively high cost of milk during the fourth quarter of 2007, we are adjusting our 2007 revenue estimate to $38.725 million (prior was $38.520 million). If our top line estimate is achieved it would translate into year-over-year growth of 39.70%. Given our revenue estimate, third quarter results, our belief that a further contraction of gross margin occurred during the fourth quarter due to the high cost of milk, we are lowering our 2007 forecast for net income to $3.249 million or $0.19 per diluted share (prior was $3.499 million or $0.21 per diluted share).

We are also reducing our bottom line forecast for 2008, primarily due to lower gross margin prospects as milk is likely to stay at relatively high levels during the 2008, mitigated to some degree by the previously discussed price increases that will help offset increased cost of goods sold, as well as completing its production capacity expansion project at their main Morton Grove headquarters facility (which should create economies of scale). Our revised outlook calls for revenue of $48.510 million (prior was $48.225 million) and net income of $3.800 million or $0.23 per diluted share (prior was $4.340 million or $0.26 per share). We believe the year-over-year growth should continue to occur based on current trends, increased consumer awareness, new product introductions such as its Lifeway Lassi product, as well as gross margin contraction for all of 2008.

Our forecast for 2007 and 2008 incorporates the following:

- Distribution agreements with Ralph's Grocery stores in Southern California, ACME Grocery in the Philadelphia and Tri-state area, as well as Colorado's King Soopers Grocery stores;
- The continued rollout across the U.S. of its ProBugs™ offering;
- Distribution of Lifeway Kefir in Mexico;;
- Completing its production capacity expansion project at their main Morton Grove headquarters facility. The project, will nearly double Lifeway's existing production capacity and create economies of scale;
- Increased interest expense for 2007. We anticipate interest expense for 2007 of $0.421 million versus $0.346 million in 2006, primarily due to the acquisition of Helios. In 2008, we estimate interest expense should be reduced to approximately $0.360 million, as a consequence of lower aggregate debt;
- Relatively high energy and raw material cost of resin for its containers and packaging, as well as the relatively high cost of milk, the Company's largest raw material expense; and

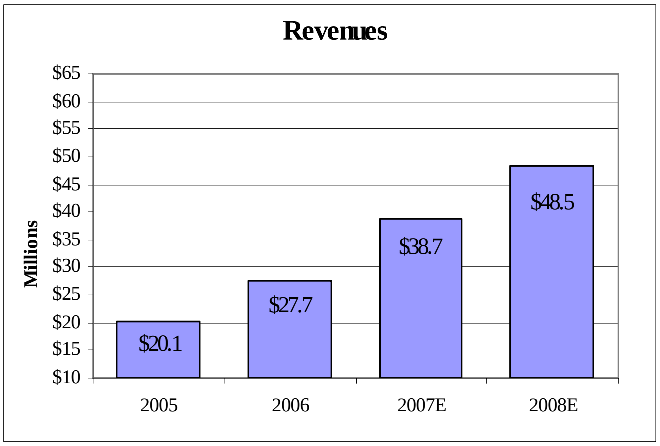
- The continued cost of being a public company (i.e., insurance, legal, and regulatory compliance).

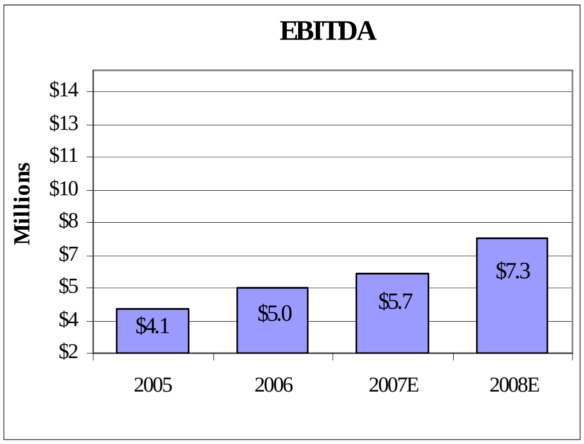
We have adjusted the following from our prior forecast, based on the previously discussed operating trends:

- Gross margin in 2007 to 32.83% from 34.01%. This compares to 38.38% for all of 2006. While, first and second quarter 2007 experienced gross margin of 39.60% and 39.41%, respectively, third quarter gross margin fell to 27.71%, and our expectation is that fourth quarter gross margin should approximate 25.47%. We are using the results from the third quarter of 2007 as a starting point; therefore, based on other companies that have reported and showed the impact of high milk prices, we have reduced our fourth quarter and 2008 gross margin expectations. It should be noted that we do expect to see an upward trending of gross margin in 2008, albeit from a lower starting point then our prior expectations. We believe that the price increase starting during December 2007 should help moderate the contraction of gross margin by the second quarter of 2008, as well as economies of scale at the Company's production facility. Our 2008 forecast for gross margin is 31.24% versus our prior forecast of 33.15%; and

- SG&A expenses, as a percentage of revenues, in 2007 to 20.91% from 21.97%. Our revised forecast for 2008 calls for SG&A expenses, as a percentage of revenues to 18.45% versus our prior expectation of 18.48%. This compares to 23.12% for all of 2006.

The chart below shows our revenue and EBITDA projections:





Source: Company Filings and Taglich Brothers Estimates

Risks

<u>Commodities</u>

The Company's products use raw materials, such as milk, sugar, and fruit from unaffiliated suppliers. Lifeway is not limited or contractually bound to any supplier. The raw and packaging materials purchased by the Company are considered commodity items and are widely available on the open market. If the price of those commodity products were to unexpectedly rise, it could negatively impact margins. Case in point is the current high price of milk (as previously discussed).

<u>Regulation</u>

Lifeway is subject to regulation by federal, state and local governmental authorities regarding the distribution and sale of food products. Management believes that the Company is currently in compliance with all material government permits, licenses, qualifications, and approvals for its operations; however, there can be no assurance that it will be able to maintain its existing licenses and permits. In addition, the Company believes that it is currently in compliance with all applicable environmental laws. Also, the products exported to Canada are subject to strict quotas imposed by the Trade Control Policy Division of the Department of Foreign Affairs and International Trade of Canada. Management believes that the Company is in compliance with all applicable Canadian regulations.

Groupe Danone SA Relationship

According to an 8-K filed with the SEC on January 3, 2008, the Company entered into a sixth extension of the stockholders' agreement with Danone Foods, Inc. (the terms of the non-compete period and standstill period of the stockholders' agreement expire on December 31, 2008, which was originally entered into on October 1 1999. In the filing, on January 3, 2007, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the fifth extension of the stockholders' agreement and all Lifeway shares held by Danone Foods, Inc., were transferred to DS Waters on November 10, 2005. Also, included in the agreement was a non-compete provision, with the specific exclusion of Stonyfield Farms, Inc., an affiliate of Danone Foods, Inc. and DS Waters. Investors should be aware that Stonyfield Farms is not in direct competition with LWAY, since it does not produce Kefir. However, the competitive landscape could increase as yogurt products (especially in the natural and organic categories) could increase the general competitive landscape in the future. **According to SEC filings, as of December 31, 2006, Danone owned approximately 20.1% of LWAY's common shares.**

Legal Issue

Lifeway is from time to time engaged in other litigation matter 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.

Corporate Governance

Corporate governance may be an issue facing Lifeway Foods in light of new rules and regulation being issued by government regulatory agencies. This could mean that the Company will eventually be required to hire additional management personnel in order to diversify various operational functions.

Growth Management

LWAY has returned to growing revenues in excess of 25% annually. As a result, the Company will need to meet the challenges associated with growth, such as management of raw materials and increased production staff. If Lifeway Foods is not successful in meeting these challenges, revenue growth may slow in future periods.

Integration of Acquisitions

Acquisitions involve numerous risks that include difficulties in the assimilation of the acquired operations (i.e., technology and product(s)), the diversion of Management's attention, entering markets in which the Company has limited or no direct experience, as well as the potential loss of key employees of the acquired company. Achieving and maintaining anticipated benefits of an acquisition will depend in part upon whether the integration of the acquired assets is accomplished in an efficient and effective manner. Therefore, in the event Lifeway makes an acquisition (such as the Helios Nutrition), no assurance can be given that it will be successful in terms of improving bottom line results.

Management Control

Ludmila Smolyansky, who is Chairperson of the Board of Directors of Lifeway Foods, beneficially owns or controls approximately 44.98% of common shares outstanding, as of September 10, 2007.

As a result, she has the ability to substantially influence matters submitted to stockholders for approval, including election or removal of a member of the Board of Directors, amendment to the Company's certificate of incorporation or bylaws, adoption of measures that could delay or prevent a change in control or impede a merger, takeover, or other business combination, and adoption of stock-based compensation plans. Accordingly, this could have a negative impact if her interests do not coincide with other shareholders on a particular issue.

Marketable Securities

At September 30, 2007, the fair value of the Company's marketable securities available for sale was $6.558 million. In the Company's SEC filings, Management states that investments in equity securities, mutual funds, and corporate bonds consist of investments in common stock and debt securities of companies in various industries.

Miscellaneous

The Company's financial results and equity values are subject to other risks and uncertainties known and unknown, including but not limited to competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Trading Volume

Liquidity has the potential to be a concern. Based on our calculations average daily-volume during 2003 increased to 4,451 shares from 1,943 shares in 2002. During 2004, average volume increased significantly to 154,399 shares traded a day. In 2005, average volume declined to 43,400 shares traded a day. During 2006, average daily volume has declined to 30,756 shares traded a day and rebounded during 2007 to 69,402 shares traded daily. Average daily volume remains relatively low; therefore, investors need to be aware that by nature a thinly traded equity can have significant price volatility.

Conclusion

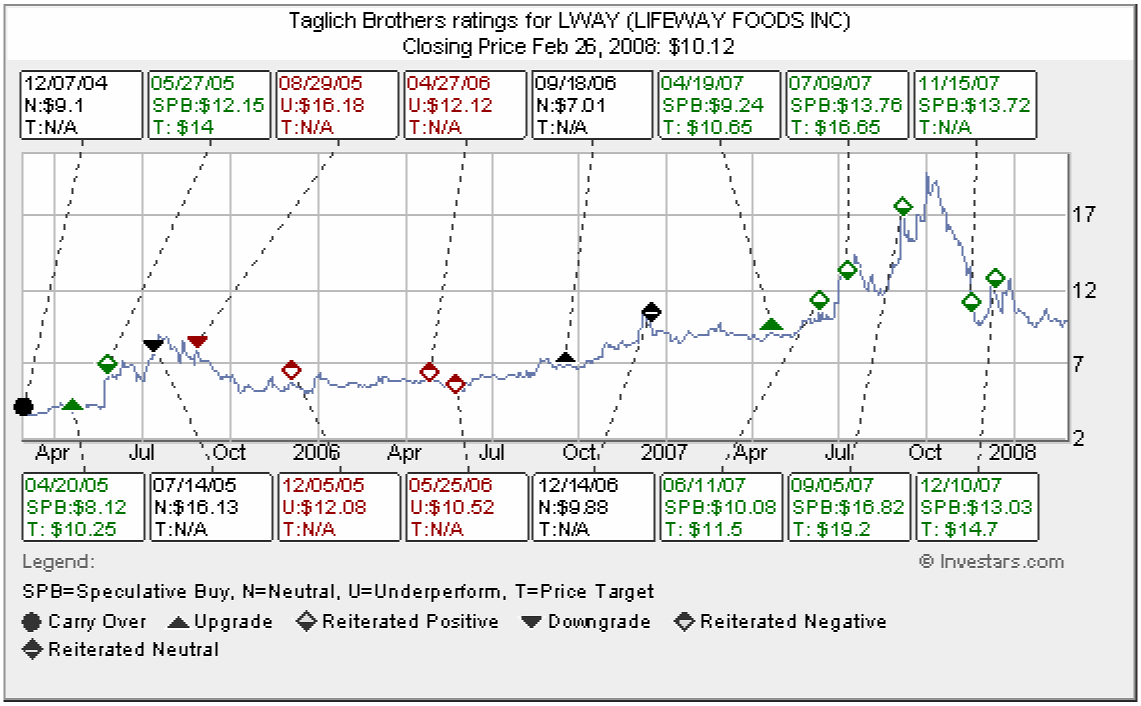
We are reiterating our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) and lowering our twelve-month price target of $11.50 per share based on our sales per share estimates for 2008. Our prior twelve-month price target was $14.70. The reduction in our price target reflects a decline in gross margin, as well as the record high price of milk. Although increased expenses are likely to occur, it has not diminished the Company's ability to grow top line results. Also, we have incorporated in our outlook, the price increase that began during December 2007, believing that it should not materially impact top line growth. Additionally, it should help alleviate increasing input costs (i.e., milk prices).

Our rating is primarily based on momentum that is occurring from the Helios acquisition, a growing awareness of Lifeway's flagship Kefir line, its kids Kefir drink, called Probugs™, securing its first foodservice distribution contract (which occurred on May 18, 2007), and distribution in Mexico, as well as introduction of a new smoothie drink called Lifeway Lassi, which is aimed at South Asian consumers in the U.S.

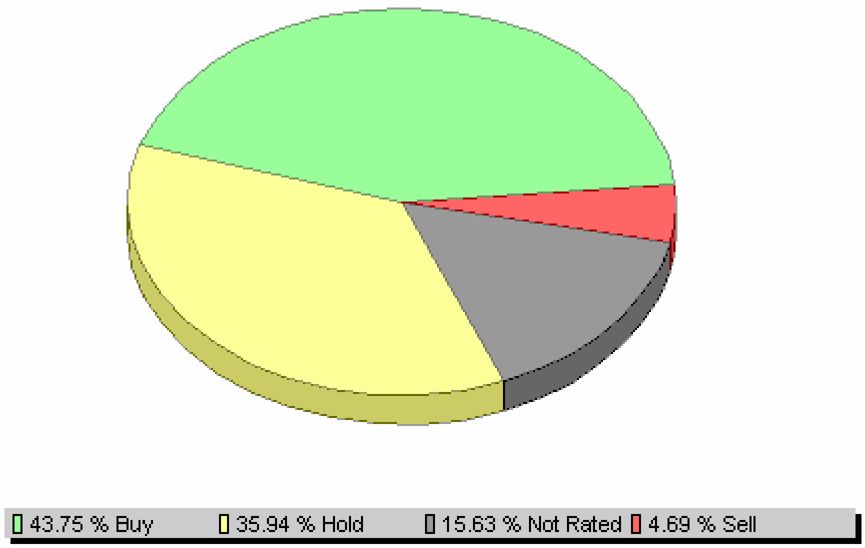
We obtained our price target from the following valuation model, discounted by 15% to account for microcap risk and Company specific risks mentioned earlier:

- A 4.7X price to sales multiple, which is the Company's current trailing-twelve month multiple, applied to our net sales estimate of $2.88 per share for 2008.

Investors need to be aware that during December 2007, Lifeway Foods was able to enter into a sixth extension of the stockholders' agreement with Danone Foods, Inc. According to the SEC filing, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the fifth extension of the stockholders', standstill, and non-compete agreements, which will now expire on December 31, 2008.



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months		
Rating	#	%
Buy	0	0
Hold	2	9.52%
Sell	0	0
Not Rated	0	0

Meaning of Ratings

Buy

We believe the Company is undervalued relative to its market and peers. We believe its risk reward ratio strongly advocates purchase of the stock relative to other stocks in the marketplace. Remember, with all equities there is always downside risk.

Speculative Buy

We believe that the long run prospects of the Company are positive. We believe its risk reward ratio advocates purchase of the stock. We feel the investment risk is higher than our typical “buy” recommendation. In the short run, the stock may be subject to high volatility and continue to trade at a discount to its market.

Neutral

We will remain neutral pending certain developments.

Underperform

We believe that the Company may be fairly valued based on its current status. Upside potential is limited relative to investment risk.

Sell

We believe that the Company is significantly overvalued based on its current status. The future of the Company's operations may be questionable and there is an extreme level of investment risk relative to reward.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.

Public Companies mentioned in this report:

Groupe Danone (NYSE: DA)

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All research issued by Taglich Brothers, Inc. is based on public information. Since December 2000, the company pays a monthly monetary fee of $1,500 (USD) to Taglich Brothers, Inc. for the creation and dissemination of research reports.

I, Howard Halpern, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this report.

Lifeway Foods, Inc.
Consolidated Balance Sheets
(in thousands)

	Dec. 2005 Year End	Dec. 2006 Year End	Mar. 2007 1st Qtr End	Jun. 2007 2nd Qtr End	Sept. 2007 3rd Qtr End
ASSETS					
Current assets:					
Cash and cash equivalents	$ 4,354	$ 1,548	$ 1,013	$ 1,014	$ 1,625
Marketable securities	7,479	8,491	8,561	8,425	6,558
Investment, at cost	-	-	-	-	500
Accounts receivable, net	2,518	3,943	4,588	4,602	4,846
Other receivables	56	71	50	40	46
Inventories	1,717	2,522	2,883	3,511	4,061
Prepaid income taxes	12	268	159	73	126
Prepaid expenses and other assets	9	12	10	13	13
Deferred income taxes	143	32	-	-	226
Total current assets	**16,287**	**16,887**	**17,264**	**17,679**	**18,000**
Property, plant and equipment, net	7,751	8,581	8,555	8,819	9,176
Total assets	**$ 24,465**	**$ 32,999**	**$ 33,270**	**$ 33,874**	**$ 34,471**
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Current maturities of notes payable	532	1,131	1,129	1,130	1,435
Accounts payable	426	1,463	1,239	1,527	1,865
Accrued expenses	355	480	341	387	441
Taxes payable	-	-	31	32	-
Total current liabilities	**1,314**	**3,074**	**2,740**	**3,076**	**3,741**
Long-term liabilities	2,903	5,747	5,202	4,843	4,424
Deferred income taxes	349	450	454	467	510
Stockholders' equity:					
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509	6,509	6,509
Paid-in capital	91	1,081	1,081	1,087	1,104
Stock subscription receivable	-	-	-	-	-
Retained earnings	14,423	17,319	18,454	19,850	20,318
Accumulated other comprehansive income, net of tax	(100)	154	241	127	(53)
Treasury stock, at cost	(1,025)	(1,334)	(1,411)	(2,086)	(2,082)
Total stockholders' equity	**19,899**	**23,728**	**24,874**	**25,488**	**25,796**
Total liabilities and stockholders' equity	**$ 24,465**	**$ 32,999**	**$ 33,270**	**$ 33,874**	**$ 34,471**

Lifeway Foods, Inc.
Quarterly Income Statement Model*
For the Years Ended December 31,
(in thousands)

	FY2005A	FY2006A	**FY2007E**	**FY2008E**
Sales	$ 20,132	$ 27,721	**$ 38,725**	**$ 48,510**
Cost of goods sold	12,123	17,082	**26,013**	**33,355**
Gross Profit	8,009	10,639	**12,712**	**15,155**
Gross Margins	39.78%	38.38%	**32.83%**	**31.24%**
Operating Expenses:				
Sales	2,354	3,065	**3,568**	**3,780**
General and administrative	2,253	3,343	**4,531**	**5,170**
Total Operating Expenses	4,607	6,409	**8,098**	**8,950**
EBITDA	4,052	4,990	**5,678**	**7,305**
Operating Income	3,401	4,230	**4,614**	**6,205**
Operating Margin	16.90%	15.26%	**11.91%**	**12.79%**
Other Income (Expense)				
Interest income	323	388	**319**	**240**
Interest expense	(101)	(346)	**(421)**	**(360)**
Gain on sale of marketable securities	445	357	**663**	**-**
Other	14	1	**1**	**-**
Rental income	-	11	**38**	**20**
Total Other Income (Expense)	682	411	**599**	**(100)**
Pre-Tax Income	4,083	4,642	**5,213**	**6,105**
Pre-Tax Margins	20.28%	16.74%	**13.46%**	**12.58%**
Income Tax Expense (Benefit)	1,535	1,745	**1,964**	**2,305**
Tax Rate	37.58%	37.60%	**37.67%**	**37.76%**
Net Income	$ 2,548	$ 2,897	**$ 3,249**	**$ 3,800**
EPS -- Fully Diluted*	$ 0.15	$ 0.17	**$ 0.19**	**$ 0.23**
Avg Shares Out-Fully Diluted*	16,809	16,830	**16,857**	**16,846**
Percent of Revenue				
Cost of Revenues	60.22%	61.62%	67.17%	68.76%
Selling expenses	11.69%	11.06%	9.21%	7.79%
General and Administrative expenses	11.19%	12.06%	11.70%	10.66%
YEAR / YEAR GROWTH				
Total Revenues	23.36%	37.70%	39.70%	25.27%
Net Income	24.19%	13.66%	12.18%	16.94%

*** Adjusted for the 2-1 stock split effective March 9, 2004 and August 16, 2006**

Lifeway Foods, Inc.
Quarterly Income Statement Model*
For the Years Ended December 31, 2006
(in thousands)

	Q1(03/06)A	Q2 (06/06)A	Q3 (09/06)A	Q4 (12/06)A	**FY2006A**
Sales	$ 6,003	$ 6,367	$ 7,457	$ 7,894	**$ 27,721**
Cost of goods sold	3,306	3,788	4,616	5,372	**17,082**
Gross Profit	2,697	2,580	2,840	2,521	**10,639**
Gross Margins	*44.93%*	*40.52%*	*38.09%*	*31.94%*	**38.38%**
Operating Expenses:					
Sales	583	850	891	742	**3,065**
General and administrative	708	800	830	1,005	**3,343**
Total Operating Expenses	1,291	1,650	1,721	1,747	**6,409**
EBITDA	1,550	1,078	1,285	1,076	**4,990**
Operating Income	1,406	930	1,119	774	**4,230**
Operating Margin	*23.43%*	*14.61%*	*15.01%*	*9.81%*	**15.26%**
Other Income (Expense)					
Interest income	86	122	86	94	**388**
Interest expense	(50)	(63)	(97)	(136)	**(346)**
Gain on sale of marketable securities	(37)	225	89	79	**357**
Other	1	3	(2)	-	**1**
Rental income		-	-	11	**11**
Total Other Income (Expense)	(0)	287	77	48	**411**
Pre-Tax Income	1,406	1,217	1,196	823	**4,642**
Pre-Tax Margins	*23.42%*	*19.11%*	*16.04%*	*10.42%*	**16.74%**
Income Tax Expense (Benefit)	511	467	456	311	**1,745**
Tax Rate	*36.37%*	*38.36%*	*38.13%*	*37.79%*	**37.60%**
Net Income	$ 895	$ 750	$ 740	$ 512	**$ 2,897**
EPS -- Fully Diluted*	$ 0.05	$ 0.04	$ 0.04	$ 0.03	**$ 0.17**
Avg Shares Out-Fully Diluted*	16,792	16,800	16,860	16,866	**16,830**
Percent of Revenue					
Cost of Revenues	55.07%	59.48%	61.91%	68.06%	61.62%
Selling expenses	9.71%	13.34%	11.94%	9.40%	11.06%
General and Administrative expenses	11.80%	12.56%	11.14%	12.73%	12.06%
YEAR / YEAR GROWTH					
Total Revenues	28.91%	25.53%	43.54%	51.58%	37.70%
Net Income	23.34%	34.70%	32.38%	-27.63%	13.66%

*** Adjusted for the 2-1 stock split effective March 9, 2004 and August 16, 2006**

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2007
(in thousands)

	Q1(03/07)A	Q2 (06/07)A	Q3 (09/07)A	Q4 (12/07)E	**FY2007E**
Sales	$ 9,022	$ 9,715	$ 9,817	$ 10,170	**$ 38,725**
Cost of goods sold	5,450	5,886	7,097	7,580	**26,013**
Gross Profit	3,572	3,829	2,721	2,590	**12,712**
Gross Margins	*39.60%*	*39.41%*	*27.71%*	*25.47%*	**32.83%**
Operating Expenses:					
Sales	770	912	965	920	**3,568**
General and administrative	1,001	1,156	1,174	1,200	**4,531**
Total Operating Expenses	1,771	2,068	2,140	2,120	**8,098**
EBITDA	2,047	2,029	857	745	**5,678**
Operating Income	1,801	1,761	581	470	**4,614**
Operating Margin	*19.97%*	*18.13%*	*5.92%*	*4.62%*	**11.91%**
Other Income (Expense)					
Interest income	66	98	85	70	**319**
Interest expense	(110)	(109)	(102)	(100)	**(421)**
Gain on sale of marketable securities	15	439	209		**663**
Rental income	9	10	10	10	**38**
Total Other Income (Expense)	(20)	438	202	(20)	**599**
Pre-Tax Income	1,781	2,199	783	450	**5,213**
Pre-Tax Margins	*19.74%*	*22.64%*	*7.97%*	*4.42%*	**13.46%**
Income Tax Expense (Benefit)	646	804	315	200	**1,964**
Tax Rate	*36.26%*	*36.54%*	*40.18%*	*44.44%*	**37.67%**
Net Income	$ 1,135	$ 1,396	$ 468	$ 250	**$ 3,249**
EPS -- Fully Diluted	$ 0.07	$ 0.08	$ 0.03	$ 0.01	**$ 0.19**
Avg Shares Out-Fully Diluted	16,895	16,876	16,825	16,830	**16,857**
Percent of Revenue					
Cost of Revenues	60.40%	60.59%	72.29%	74.53%	67.17%
Selling expenses	8.54%	9.39%	9.83%	9.05%	9.21%
General and Administrative expenses	11.09%	11.89%	11.96%	11.80%	11.70%
YEAR / YEAR GROWTH					
Total Revenues	50.29%	52.58%	31.66%	28.84%	39.70%
Net Income	26.90%	86.08%	-36.73%	-51.16%	12.18%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2008
(in thousands)

	Q1(03/08)E	Q2 (06/08)E	Q3 (09/08)E	Q4 (12/08)E	**FY2008E**
Sales	$ 11,365	$ 12,185	$ 12,300	$ 12,660	**$ 48,510**
Cost of goods sold	8,200	8,300	8,375	8,480	**33,355**
Gross Profit	3,165	3,885	3,925	4,180	**15,155**
Gross Margins	*27.85%*	*31.88%*	*31.91%*	*33.02%*	**31.24%**
Operating Expenses:					
Sales	925	930	950	975	**3,780**
General and administrative	1,225	1,280	1,300	1,365	**5,170**
Total Operating Expenses	2,150	2,210	2,250	2,340	**8,950**
EBITDA	1,290	1,950	1,950	2,115	**7,305**
Operating Income	1,015	1,675	1,675	1,840	**6,205**
Operating Margin	*8.93%*	*13.75%*	*13.62%*	*14.53%*	**12.79%**
Other Income (Expense)					
Interest income	60	60	60	60	**240**
Interest expense	(90)	(90)	(90)	(90)	**(360)**
Rental income	5	5	5	5	**20**
Total Other Income (Expense)	(25)	(25)	(25)	(25)	**(100)**
Pre-Tax Income	990	1,650	1,650	1,815	**6,105**
Pre-Tax Margins	*8.71%*	*13.54%*	*13.42%*	*14.33%*	**12.58%**
Income Tax Expense (Benefit)	375	620	625	685	**2,305**
Tax Rate	*37.88%*	*37.58%*	*37.88%*	*37.75%*	**37.76%**
Net Income	$ 615	$ 1,030	$ 1,025	$ 1,130	**$ 3,800**
EPS -- Fully Diluted	$ 0.04	$ 0.06	$ 0.06	$ 0.07	**$ 0.23**
Avg Shares Out-Fully Diluted	16,835	16,840	16,850	16,860	**16,846**
Percent of Revenue					
Cost of Revenues	72.15%	68.12%	68.09%	66.98%	68.76%
Selling expenses	8.14%	7.63%	7.72%	7.70%	7.79%
General and Administrative expenses	10.78%	10.50%	10.57%	10.78%	10.66%
YEAR / YEAR GROWTH					
Total Revenues	25.97%	25.42%	25.29%	24.48%	25.27%
Net Income	-45.84%	-26.21%	118.95%	351.92%	16.94%

Lifeway Foods, Inc.
Cash Flow Statement
(in thousands)

	FY2004A	FY2005A	FY2006A	9 Mos.2007A
Cash Flows from Operating Activities				
Net Income	$ 2,052	$ 2,548	$ 2,896	$ 3,000
Depreciation and amortization	670	651	759	789
Amortization of discounts on securities	-	-	-	-
Gain on sale of marketable securities	(354)	(445)	(356)	(662)
Loss on marketable securities classified as trading	16	(14)	(1)	(2)
Issuance of common stock in exchange for services rendered	95	52	29	28
Decrease in allowance for doubtful accounts	-	-	45	(41)
Deferred income taxes	46	(100)	33	12
	2,525	2,692	3,405	3,125
Changes In:				
Accounts receivable	(224)	(494)	(1,190)	(863)
Other receivables	94	16	(15)	25
Inventories	(94)	(811)	(586)	(1,539)
Prepaid income taxes	48	247	(256)	142
Prepaid expenses and other assets	(6)	(2)	35	(1)
Accounts payable	(154)	(215)	639	402
Accrued expenses	12	159	125	(39)
Taxes payable	-	-	-	-
Net Changes in Working Capital	(325)	(1,100)	(1,248)	(1,873)
Net cash Provided by Operations	2,200	1,592	2,158	1,252
Cash Flows from Investing Activities				
Purchase of marketable securities	(6,266)	(6,461)	(7,510)	(4,408)
Sale of marketable securities	6,097	5,810	7,285	6,653
Investment in cost method securities	-	-	-	(500)
Acquisition of Ilya's Farms, Inc., net of assets acquired	(512)	-	-	-
Acquisition of Helios, net of cash acquired	-	-	(2,552)	-
Purchases of organizational costs	-	-	-	(6)
Purchase of property, plant and equipment	(330)	(4,917)	(680)	(1,143)
Net cash used in Investing	(1,011)	(5,567)	(3,456)	596
Cash Flows from Financing Activities				
Repayment of notes payable	(28)	(37)	(859)	(1,319)
Proceeds from issuance of common stock	15	-	-	-
Proceeds from note payable	-	3,000	-	300
Purchase of treasury stock	-	(402)	(649)	(753)
Loan costs	-	(7)	-	-
Net cash provided by Financing	(13)	2,555	(1,507)	(1,771)
Net change in Cash	1,175	(1,419)	(2,806)	77
Cash Beginning of Period	4,598	5,773	4,354	1,548
Cash End of Period	$ 5,773	$ 4,354	$ 1,548	$ 1,625