Taglich Brothers, Inc.
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Research Report – Update

Lifeway Foods, Inc.

Rating: Speculative Buy

Howard Halpern

LWAY $6.70 - (NasdaqNM)

April 3, 2003

	FYE (12/00)	FYE (12/01)	FYE (12/02)	***FYE (12/03) E***	***FYE (12/04) E***
Revenues (in millions)	$9.2	$10.7	$12.2	***$13.8***	***$15.7***
Earnings per share (diluted)	$0.21	$0.28	$0.36	***$0.48***	***$0.56***

52week range	$7.50 – $4.95	Fiscal year ends:	December
Shares outstanding	4.27 million	Revenue/shares (TTM)	$2.86
Trading float	1.20 million	Price/Sales (TTM)	2.34X
Insider and institutional ownership	71.8%	Price/Sales (2003)	2.08X
Tangible Book value/shr a/o 12-31-02	$2.70	Price/Earnings (TTM)	18.6X
Price/Book	2.48X	Price/Earnings (2003)	14.0X

Lifeway Foods, Inc., based in Morton Grove, Illinois 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. They currently have approximately 45 employees. Web site address is: www.kefir.com

Key investment considerations:

We are reiterating our Speculative Buy recommendation and setting a twelve-month price target of $10.34 per share, based on our 2003 earnings estimate and a discounted cash flow analysis. Our previous twelve -month price target was $11.50 per share. The lower price target is primarily a reflection of a decline in industry multiples.

The Company reported record revenues of $12.212 million in 2002, which was an increase of 14.3% versus $10.684 million in 2001. Net income increased by 25.2% to $1.529 million or $0.36 per diluted share versus $1.221 million or $0.28 per diluted share in 2001.

The year-over-year improvement in results is due to the increasing awareness of the probiotic health-related benefits of the Company's products and expansion of its products in traditional stores and specialty markets.

We are adjusting our revenue estimate for 2003 to $13.8 million from our prior forecast of $13.6 million. Our newly introduced revenue forecast for 2004 is $15.7 million.

We believe that our revenue forecasts calling for annual growth in excess of 13%, can be achieved through – 1) The Company's marketing efforts; 2) Increasing acceptance of its organic products; 3) Growth of the La Fruta™ product line for the Hispanic market; and 4) New eye-catching packaging for non-fat Kefir products.

We are maintaining for 2003 of $2.04 million or $0.48 per diluted share. For 2004, our net income estimate is $2.43 million or $0.56 per diluted share.

**** Please view our disclaimer located on page 8***

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The Company

Lifeway Foods, Inc. (LWAY) manufactures a cultured dairy beverage called Kefir and also develops Kefir related products at its two manufacturing facilities in Illinois.

1. A 50,000-square foot facility, which is the largest Kefir manufacturing facility in the United States; and
2. A smaller 12,000-square foot Kefir manufacturing facility.

LWAY distributes its products in Illinois directly to approximately 1,200 local stores including major retail chains (i.e., Jewel Food Stores, Dominick's Finer Foods, and Whole Foods Market), via ten company owned trucks. In the United States, the Company distributes its products to over 10,000 stores. Also, the Company’s products are distributed internationally to Canada.

Danone Foods, Inc. the U.S. subsidiary of Groupe Danone of Paris, France, has a 20% ownership interest in the Company.

Kefir

Lifeway Kefir contains ten active "friendly" microorganisms and is probiotic[*] in nature because it promotes the growth of those microorganisms naturally. The product is a good source of calcium, protein, minerals, and vitamins (i.e. B-complex vitamins) and is highly digestible due to its acidity and enzymes. Kefir is similar to, but distinct from, yogurt. The fermentation process produces a less sour tasting product. Also, less sugar is required therefore the product contains fewer calories.

[*] Probiotics are defined as live cultures consumed for a health benefit. These cultures are comprised of one or more types of bacteria. Probiotic cultures have recently undergone controlled scientific investigations. The results lend some credence to the old folklore that suggests fermented dairy products that contain probiotic cultures are healthful.

Recent Financials

For the twelve-month period ended December 31, 2002 versus the same period last year:

- Revenues increased to $12.212 million versus $10.683 million;
- Operating expenses increased to $2.891 million versus $2.798 million;
- EBITDA increased to $3.385 million versus $2.216 million;
- Net income was $1.529 million or $0.36 per diluted share versus net income of $1.221 million or $0.28 per diluted share.

The 14.3% revenue increase for the year was primarily attributable to the Company’s marketing program for its various Kefir-based products, the growing acceptance of its La Fruta™ yogurt-like drink that was introduced to the Hispanic Market, and the increasing awareness of the probiotic health-related benefits of its products.

In 2002, gross margins improved to 44.78% versus 39.64% last year. The improvement in gross margins resulted from the Company obtaining lower priced vendor contracts for raw materials and production supplies. Operating expenses, as a percentage of revenues, decreased to 23.67% versus 26.19% in 2001. The decrease in operating expenses, on a percentage basis, was due to increased sales and cost saving measures implemented during the second half of 2002 to streamline both production and sales and marketing efforts.

In comparison to the results reported by the Company, Taglich Brothers' estimates called for full year revenues of $12.065 million and net income of $1.641 million or $0.38 per diluted share.

Balance Sheet as of December 31, 2002

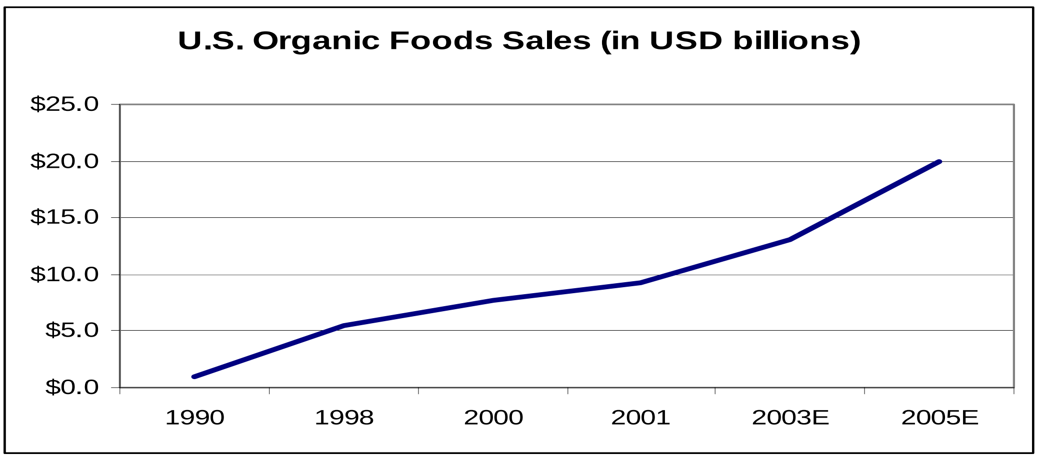
The Company had cash and cash equivalents of $2.739 million and short-term marketable securities of $4.17 million. This compares to cash and cash equivalents of $0.937 million and short-term marketable securities of $5.76 million as of December 31, 2002. Working capital was $8.56 million versus $8.08 million in 2001. The

Company's long-term liabilities stand at $0.50 million. We believe that LWAY will be able to fund its sales growth from internally generated funds.

Industry and Competition

It is estimated that Lifeway Foods' target market in the functional and probiotic foods segment of the Food Industry has grown in terms of annual sales from $16 billion in 1999 to approximately $23 billion in 2002. The Nutrition Business Journal (NBJ) predicts that by 2010, the U.S. Functional Food Market will double in size to $34 billion, representing 5.5% of the total Food Market. Currently, NBJ estimates that the Functional Food Market represents 3.3% of the total U.S. Food Market.

In addition, the Company's organic products are targeting a market that generated approximately $9.3 billion of sales in 2001, according to Rabobank International's Food & Agribusiness Research Industry Note of May 2002. The chart below indicates the growth potential for this segment:



Source: Organic Trade Association; Natural Marketing Institute; Rabobank International, Food& Agribusiness Research

It is estimated that organic beverages comprise approximately 5% of the total U.S. Organic Food Market.

We continue to view the primary factors driving growth in sales of functional, probiotic, and organic foods as:

- The perception that nutrition is an effective tool for disease prevention;
- An aging population; and
- The expanding participation of conventional manufacturers and retailers in niche food segments.

The Company faces almost no direct competition in the United States for its drinkable Kefir product, although the Company's Kefir-based products are subject to competition from other yogurt and dairy products.

Recent Developments

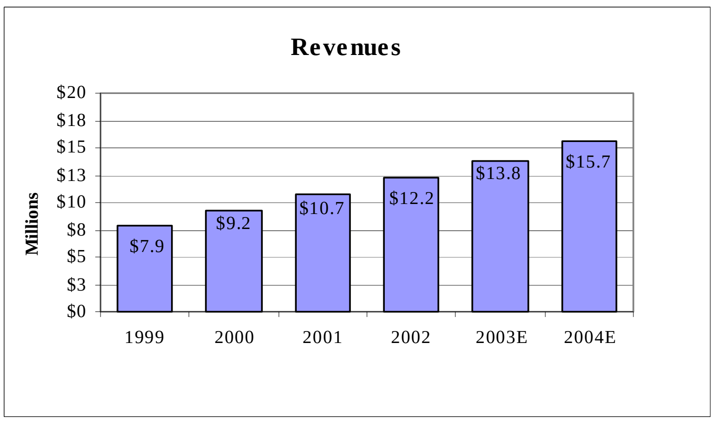
On December 9, 2002, the Company announced it reached a final judgment order with The Niles Park District on the District's condemnation lawsuit that it filed in 2000 to acquire a former dinner club (set on a 2 acre parcel of land) owned by a subsidiary of Lifeway Foods, Inc. The resolution of the litigation occurred when the Park District agreed to a purchase price in the amount of $1.8 million. The Company acquired the parcel of land in 1992 for $0.7 million. Management believes it can utilize various tax strategies to minimize the tax liability created by this sale.

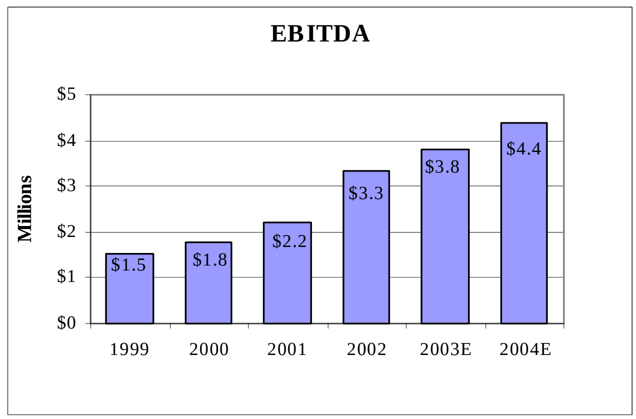
Outlook

We believe annual revenue growth will exceed 13%; therefore, revenues should reach $13.825 million in 2003 and $15.675 million in 2004, from $12.212 million in 2002. Our revenue forecasts are based on:

- Consumers increased acceptance of the Company's organic product line;
- The La Fruta™ product line, which has gained acceptance within the Hispanic Market;
- Marketing initiatives that includes:
  - Educating consumers about the potential beneficial uses of Kefir in the replenishment of 'good' bacteria in a person's intestinal system, especially after taking antibiotics or consuming alcohol;
  - Advertising in local newspapers (i.e., primarily in the Chicago area), and in national magazines (i.e., Self, Shape, and Men's Fitness); and
  - Sponsoring and participating in various local sporting events around the country and exhibiting at trade shows (i.e., Natural Products Expo West in March 2003);
- The Company building on its current distribution channel, which includes regional supermarket chains and/or regional super-center type stores, and to assist local distributors with product sales; and
- Introduction of new eye-catching packaging for the Company's non-fat Kefir products.

The following chart shows our revenue and EBITDA projections:





Source: Company Filings and Taglich Brothers Estimates

Risks

During the fourth quarter of 2001, Fresh Made, Inc. amended a previously filed lawsuit against Lifeway Foods in regard to abuse of process, restraint of trade, unfair competition, and interference with business relationships. The Company believes this lawsuit is without merit and is in retaliation to Lifeway's efforts to enforce its rights under a settlement agreement, which the two parties entered into in connection with a prior trademark infringement lawsuit filed against Fresh Made. On August 8, 2002, an order was entered dismissing 19 of 20 counts made against the Company by Fresh Made, Inc. Lifeway intends to vigorously defend the remaining count.

The Company's products use raw materials, such as milk, sugar and fruit, from unaffiliated suppliers. Lifeway is not limited or contractually bound to anyone. 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 in price it could negatively impact margins for a short period of time.

Corporate governance may be an issue facing the Company 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. To date, the Company has not hired any additional management personnel, which includes the position of Director of Sales and Marketing.

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.

Liquidity has the potential to be a concern. The Company has approximately 4.27 million shares outstanding. Insiders and institutions hold approximately 3 million shares; therefore, the trading float is approximately 1.23 million shares. Based on our calculations average daily-volume during 2002 decreased to 1,943 shares from 2,570 for the full year 2001. Investors need to be aware that liquidity risks in the microcap market are characterized by low trading volume, high volatility of the stock price, and a wide bid-ask spread.

Conclusion

We are maintaining our coverage of Lifeway Foods, Inc., with a Speculative Buy recommendation and setting a twelve-month price target of $10.34 per share. Our previous twelve-month price target was $11.50 per share. Our price target is based on our earnings per share estimate for 2003 and EBITDA as a proxy for cash flow.

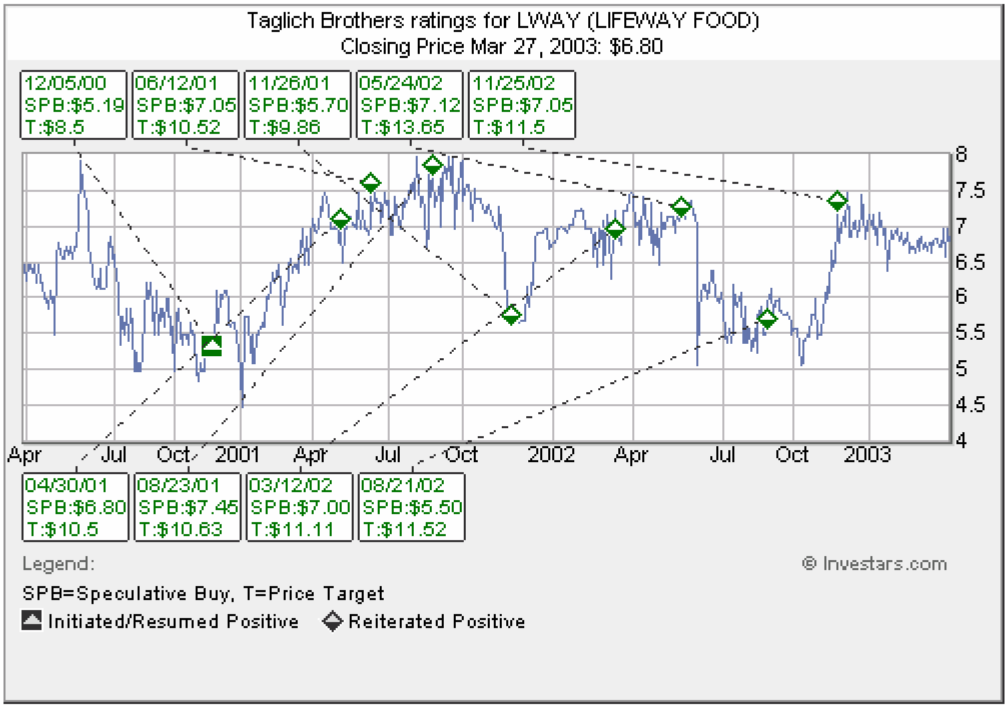
We estimate that the Company will earn $0.48 per diluted share, on revenues of $13.8 million for 2003 and $0.55 per diluted share, on revenues of $15.7 million for 2004. Our revenue estimate for 2004 represents a compounded annual growth rate of 14.7% based on the $7.9 million in revenues that the Company reported in 1999. Based on our models, we are forecasting EBITDA of $3.8 million and $4.4 million in 2003 and 2004, respectively. We believe that as a result of the revenue growth, the Company will be able to leverage operating efficiencies at its two owned manufacturing facilities. We estimate that gross margins will improve to 45.4% and 45.8% in 2003 and 2004, respectively, from 44.8% in 2002. Also, SG&A expenses as a percentage of revenues should decline to 23.5% and 22.8% in 2003 and 2004, respectively, from 23.67% in 2002.

We obtained our price target by averaging the following valuation models:

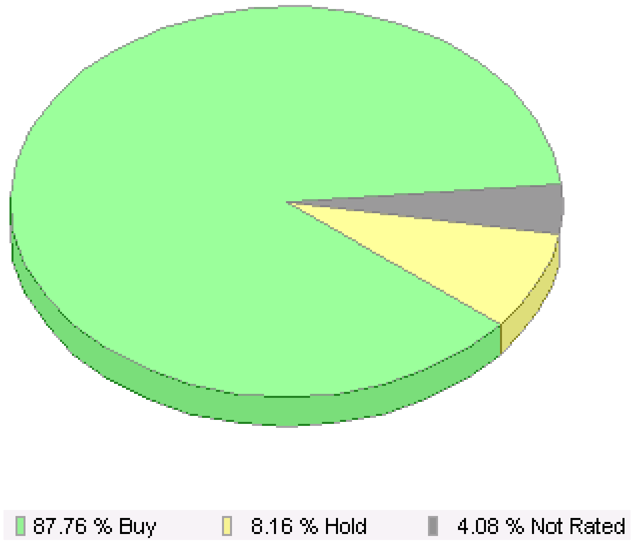
- A 15.95X P/E (based on the trailing twelve month average for the Food Processing Industry of 18.77X*; discounted by 15% to account for microcap risk) applied to our 2003 earnings estimate of $0.48 per share; and

- Our discounted cash flow model, using EBITDA as a proxy for cash flow, a 9.4% discount factor using the estimated five year growth rate for the food processing industry and 15% discount for microcap risk.

* Data from Marketguide a/o 4/03/03



Taglich Brothers Current Ratings Distribution



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 Short

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.

Not rated

There is too much uncertainty in the Company's finances or business model for us to currently form an investment conclusion.

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.

Public Companies mentioned in this report:

Groupe Danone (NYSE: DA)

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

	Dec. 2000 Full Year	Dec. 2001 Full Year	Dec. 2002 Full Year
ASSETS			
Current assets:			
Cash and cash equivalents	$ 1,437	$ 937	$ 2,732
Marketable securities	4,850	5,755	4,172
Accounts receivable, net	1,182	1,317	1,435
Other receivables	-	53	60
Inventories	920	801	721
Prepaid expenses and other assets	-	34	1
Deferred income taxes	167	561	692
Total current assets	**8,556**	**9,456**	**9,813**
Property, plant and equipment, net	5,020	5,021	4,472
Intangible assets, net	-	-	-
Total assets	**$ 13,575**	**$ 14,477**	**$ 14,285**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Current maturities of notes payable	706	90	31
Margin account	-	432	-
Accounts payable	518	543	639
Accrued expenses	242	164	184
Taxes payable	65	145	398
Total current liabilities	**1,531**	**1,374**	**1,252**
Long-term liabilities	529	1,116	500
Deferred income taxes	376	436	453
Stockholders' equity:			
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509
Stock subscription receivable	(15)	(15)	(15)
Retained earnings	4,851	6,072	7,600
Accumulated other comprehansive income, net of tax	(205)	(729)	(1,335)
Treasury stock, at cost	-	(287)	(680)
Total stockholders' equity	**11,140**	**11,550**	**12,080**
Total liabilities and stockholders' equity	**$ 13,575**	**$ 14,477**	**$ 14,285**
SHARES OUT	4,318	4,269	4,218

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2003
(in thousands)

	FY2000	FY2001	FY2002	**FY2003E**	**FY2004E**
Revenue	$ 9,177	$ 10,684	$ 12,212	**$ 13,825**	**$ 15,675**
Cost of goods sold	5,308	6,449	6,744	**7,555**	**8,495**
Gross Profit	3,869	4,235	5,468	**6,270**	**7,180**
Gross Margins	42.16%	39.64%	44.78%	**45.35%**	**45.81%**
Sales, general and administrative	2,707	2,785	2,891	**3,245**	**3,575**
EBITDA	1,772	2,216	3,385	**3,805**	**4,379**
Operating Income	1,162	1,450	2,578	**3,025**	**3,604**
Operating Margin	12.66%	13.57%	21.11%	**21.88%**	**23.00%**
Other Income (Expense)					
Interest income	369	235	187	**285**	**300**
Interest expense	(93)	(93)	(75)	**(60)**	**(50)**
Gain on sale of marketable securities	15	220	18	**-**	**-**
Other than temporary reduction of marketable securities	-	-	(236)	**-**	**-**
Total Other Income (Expense)	291	362	(105)	**225**	**250**
Pre-Tax Income	1,453	1,812	2,472	**3,250**	**3,854**
Pre-Tax Margins	15.84%	16.96%	20.24%	**23.51%**	**24.59%**
Income Tax Expense (Benefit)	526	591	943	**1,210**	**1,430**
Tax Rate	36.21%	32.59%	38.16%	**37.23%**	**37.09%**
Net Income	$ 927	$ 1,221	$ 1,529	**$ 2,040**	**$ 2,425**
EPS -- Fully Diluted	$ 0.21	$ 0.28	$ 0.36	**$ 0.48**	**$ 0.56**
Avg Shares Out-Fully Diluted	4,318	4,318	4,266	**4,275**	**4,300**
Percent of Revenue					
Cost of Revenues	57.84%	60.36%	55.22%	54.65%	54.20%
Sales, General and Administrative expenses	29.50%	26.07%	23.67%	23.47%	22.81%
YEAR / YEAR GROWTH					
Total Revenues	16.05%	16.42%	14.30%	13.21%	13.38%
Operating Income	9.12%	24.77%	79.34%	17.36%	19.15%
Pre-Tax Income	35.86%	24.67%	36.47%	31.47%	18.78%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2003
(in thousands)

	Q1(03/02)	Q2 (06/02)	Q3 (09/02)	Q4 (12/02)	**FY2002**
Revenue	$ 2,888	$ 3,003	$ 3,075	$ 3,247	**$ 12,212**
Cost of goods sold	1,523	1,761	1,586	1,874	**6,744**
Gross Profit	1,365	1,242	1,488	1,373	**5,468**
Gross Margins	*47.25%*	*41.37%*	*48.41%*	*42.29%*	**44.78%**
Operating Expenses:					
Sales, general and administrative	649	734	750	758	**2,891**
Total Operating Expenses	649	734	750	758	**2,891**
EBITDA	920	707	942	816	**3,385**
Operating Income	716	508	739	615	**2,578**
Operating Margin	*24.79%*	*16.92%*	*24.02%*	*18.94%*	**21.11%**
Other Income (Expense)					
Interest income	37	53	67	29	**187**
Interest expense	(20)	(19)	(19)	(16)	**(75)**
Gain on sale of marketable securities	36	3	(3)	(18)	**18**
Other than temporary reduction of marketable securities	-	-	-	(236)	**(236)**
Total Other Income (Expense)	53	37	45	(241)	**(105)**
Pre-Tax Income	769	545	783	374	**2,472**
Pre-Tax Margins	*26.64%*	*18.16%*	*25.48%*	*11.52%*	**20.24%**
Income Tax Expense (Benefit)	322	194	252	176	**943**
Tax Rate	*41.82%*	*35.52%*	*32.18%*	*47.05%*	**38.16%**
Net Income	$ 448	$ 352	$ 531	$ 198	**$ 1,529**
EPS -- Fully Diluted	$ 0.10	$ 0.08	$ 0.12	$ 0.05	**$ 0.36**
Avg Shares Out-Fully Diluted	4,270	4,269	4,269	4,255	**4,266**
Percent of Revenue					
Cost of Revenues	52.75%	58.63%	51.59%	57.71%	55.22%
Sales, General and Administrative expenses	22.46%	24.45%	24.39%	23.35%	23.67%
YEAR / YEAR GROWTH					
Total Revenues	9.54%	9.20%	15.51%	23.19%	14.30%
Operating Income	65.75%	53.23%	109.89%	91.06%	79.34%
Pre-Tax Income	36.37%	43.02%	75.31%	-10.77%	36.47%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2003
(in thousands)

	Q1(03/03)E	Q2 (06/03)E	Q3 (09/03)E	Q4 (12/03)E	**FY2003E**
Revenue	$ 3,300	$ 3,375	$ 3,550	$ 3,600	**$ 13,825**
Cost of goods sold	1,815	1,825	1,890	2,025	**7,555**
Gross Profit	1,485	1,550	1,660	1,575	**6,270**
Gross Margins	*45.00%*	*45.93%*	*46.76%*	*43.75%*	**45.35%**
Operating Expenses:					
Sales, general and administrative	775	795	825	850	**3,245**
Total Operating Expenses	775	795	825	850	**3,245**
EBITDA	905	950	1,030	920	**3,805**
Operating Income	710	755	835	725	**3,025**
Operating Margin	*21.52%*	*22.37%*	*23.52%*	*20.14%*	**21.88%**
Other Income (Expense)					
Interest income	70	70	70	75	**285**
Interest expense	(15)	(15)	(15)	(15)	**(60)**
Total Other Income (Expense)	55	55	55	60	**225**
Pre-Tax Income	765	810	890	785	**3,250**
Pre-Tax Margins	*23.18%*	*24.00%*	*25.07%*	*21.81%*	**23.51%**
Income Tax Expense (Benefit)	285	300	335	290	**1,210**
Tax Rate	*37.25%*	*37.04%*	*37.64%*	*36.94%*	**37.23%**
Net Income	$ 480	$ 510	$ 555	$ 495	**$ 2,040**
EPS -- Fully Diluted	$ 0.11	$ 0.12	$ 0.13	$ 0.12	**$ 0.48**
Avg Shares Out-Fully Diluted	4,260	4,270	4,280	4,290	**4,275**
Percent of Revenue					
Cost of Revenues	55.00%	54.07%	53.24%	56.25%	54.65%
Sales, General and Administrative expenses	23.48%	23.56%	23.24%	23.61%	23.47%
YEAR / YEAR GROWTH					
Total Revenues	14.27%	12.40%	15.45%	10.88%	13.21%
Operating Income	-0.84%	48.65%	13.07%	17.87%	17.36%
Pre-Tax Income	-0.55%	48.53%	13.60%	109.84%	31.47%
Net Income	7.25%	45.03%	4.45%	149.88%	33.45%

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

	FY2000A	FY2001A	FY2002A
Cash Flows from Operating Activities			
Net Income	$ 927	$ 1,221	$ 1,529
Depreciation and amortization	610	777	808
Gain on sale of marketable securities	(15)	(250)	(18)
Other than temporary reductions of marketable securities	-	-	236
Provision for doubtful accounts	-	15	-
Deferred income taxes	150	48	(65)
	1,672	1,812	2,490
Changes In:			
Accounts receivable	(216)	(150)	(119)
Other receivables	57	(53)	(8)
Inventories	(76)	119	80
Prepaid expenses and other assets	-	(34)	32
Accounts payable	(38)	26	96
Accrued expenses	50	(4)	20
Taxes payable	65	80	253
Net Changes in Working Capital	(158)	(15)	355
Net cash Provided by Operations	1,514	1,797	2,845
Cash Flows from Investing Activities			
Purchase of marketable securities	(8,808)	(9,247)	(3,316)
Sale of marketable securities	5,202	7,687	4,025
Change in margin account	75	357	(432)
Purchase of property, plant and equipment	(1,096)	(713)	(259)
Net cash used in Investing	(4,627)	(1,916)	17
Cash Flows from Financing Activities			
Repayment of notes payable	(91)	(94)	(675)
Purchase of treasury stock	-	(287)	(393)
Stock issuance costs	-	-	-
Net cash provided by Financing	(91)	(381)	(1,068)
Net change in Cash	(3,204)	(500)	1,795
Cash Beginning of Period	4,641	1,437	936
Cash End of Period	$ 1,437	$ 936	$ 2,731