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Research Report – Update

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

Lifeway Foods, Inc.

Rating: Speculative Buy

Howard Halpern
April 14, 2008

LWAY $12.32 – (NasdaqGM)

	FY (12/05)A	FY (12/06) A	FY (12/07) A	***FY (12/08) E***
Revenue (in millions)	$20.13	$27.72	$38.73	***$49.94***
Earnings per share (diluted)*	$0.15	$0.17	$0.19	***$0.24***

52-Week range*	$20.75 – $8.83	Fiscal year ends:	December
Shares outstanding a/o 03/03/08*	16.81 million	Revenue/shares (TTM) *	$2.30
Approximate float*	4.80 million	Price/Sales (TTM) *	5.4X
Market Capitalization	$203 million	Price/Sales (2008)E*	4.1X
Tangible Book value/shr	$1.52	Price/Earnings (TTM) *	64.8X
Price/Book*	7.9X	Price/Earnings (2008)E*	51.3X

* 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 raising our 12-month price target to $13.65 per share based on our sales per share estimate for 2008 (prior target was $11.50). The higher price target reflects our increasing top line expectation for 2008.

Our rating is primarily based on top line growth expectations, increasing awareness of LWAY's Kefir line, its kids Probugs™ Kefir drink, obtaining foodservice distribution contracts, as well as the 2007 introduction of its smoothie drink called Lifeway Lassi, which is aimed at South Asian consumers in the U.S.

On April 1, 2008, LWAY pre-announced first quarter 2008 revenue of $11.1 million, which is an expected increase of 23% versus $9.0 million in the same period last year. Also, Management indicated in the press release that the Company is getting close to a weekly sales run rate of $1.0 million.

On March 31, 2008, Lifeway Foods reported 2007 revenue of $38.729 million, which was an increase of 39.7% versus $27.721 million in the same period last year. Top line results included sales from the Helios acquisition that amounted to $5.629 million. Net income was $3.153 million or $0.19 per share versus $2.896 million or $0.17 per share in 2006.

Based on Management's public guidance for the first quarter of 2008, current trends (a sales run rate that is approaching $1.0 million a week and a moderation of milk prices), and increased consumer awareness of LWAY's offerings, we are adjusting our forecasts for 2008. Our 2008 estimates call for revenue of $49.935 million (prior was $48.510 million) and net income of $4.120 million or $0.24 per share (prior was $3.800 million or $0.23 per share). Investors should note that we expect second half results to improve over first half results.

**** Please view our disclaimer located on page 14.***

The Company

Lifeway Foods, Inc. (NasdaqGM: LWAY) manufactures a cultured dairy beverage called Kefir and also develops Kefir related products at its two manufacturing facilities in Illinois. The Company's distribution of its Kefir-based product portfolio in Illinois is accomplished through approximately 1,200 local stores including major retail chains (i.e., Jewel Food Stores, Dominick's Finer Foods, Treasure Island Food Marts, Whole Foods, and independent retailers), via twelve company owned trucks. Also, over 40 different assorted cream cheese products are distributed under the Cream Cheese Gourmet brand in the Philadelphia and Tri State Metropolitan area. In addition, the Company distributes its products throughout the United States and to some parts of Canada (Ontario and Quebec), utilizing verbal distribution arrangements with a number of distributors. Management believes that verbal arrangements provide the necessary latitude to expand into new markets and establish new relationships on an ongoing basis.

The Company introduced in 2006, a series of innovative new products such as pomegranate Kefir, Greek-style Kefir, and a children's line of organic Kefir products called ProBugs™ in a no-spill pouch in kid-friendly flavors (i.e., Orange Creamy Crawler and Sublime Slime Lime), as well as a line of organic whole milk Kefir. The key group of consumers for the Company's products includes children, women, baby boomers, and Hispanics. With respect to the Hispanic market the Company developed and has had success with its La Fruita product.

In early August 2006, Lifeway Foods acquired Helios Nutrition Limited (including Pride Main Street Dairy, LLC), its top competitor in the Kefir market. Helios held the number two position (versus LWAY's number one position) in terms of the Kefir market and the top position in the organic category. Management has publicly stated that the acquisition is expected to strengthen LWAY's presence in the rapidly growing market for **organic dairy products, as well as provide a steady supply of organic milk through Helios' organic dairy subsidiary.**

At the end of June 2007, the Company announced the expansion of its product portfolio to include a new smoothie drink called Lifeway Lassi. This product is designed for Lifeway's core natural and health food markets, people who are familiar with Lassi from Indian restaurants, and the immigrant population from India (where it is a beverage staple). Lifeway Lassi (in mango and strawberry flavors) will be available to consumers in 8-oz 'Grab and Go' containers and distributed through select natural, specialty, and ethnic food stores nationwide. According to Management, Lifeway plans to promote this product through its traditional channels, as well as by sampling it at yoga studios, conferences, and similar events.

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 Development

On March 27, 2008, Lifeway Foods announced that it will be opening (before the end of April 2008) its first "kefir boutique" café in Chicago called Starfruit. The boutique will offer customers several flavors of frozen Kefir with over 20 toppings, as well as customized Kefir parfaits, and smoothie-style Kefir drinks. According to Management, the intent of the Starfruit boutique is to capitalize on the renewed popularity of frozen yogurt shops while offering a healthier alternative with all the probiotic benefits of Kefir. Also, Management believes that this is a promising diversification that can help to leverage the Company's leadership in the Kefir market, by continuing the education process for a group of consumers that have yet to experience Kefir, as well as teach existing customers new ways to consume the product, and over time potentially provide a new revenue stream. Management stated in the Company's earnings conference call that the Starfruit boutique is small (approximately

700 square feet), prime location in Chicago with a lot of foot traffic, especially in the nicer weather. Also, the expectation is to gain back their initial investment within two to three months.

On March 20, 2008, the Company announced that its ProBugs™ offering for kids, secured new and expanded distribution for all three of its SKU's, in several supermarket chains across the U.S. The ProBugs™ offering is in 160 new stores in the Harris Teeter grocery chain (located in the southeast), 75 new Cub Food Stores (located in the Midwest), and an increase from 30 test stores to about 175 stores at Ralph's, a Kroger owned grocery chain (located in southern California). Additionally, the Company continues to experience growing success of this offering at existing retailers such as Whole Foods, Kroger, and other smaller independent supermarket chains.

On March 14, 2008, Lifeway Foods announced the introduction (during the middle of March 2008) of a line of probiotic Kefir Wellness bars at the 2008 Natural Products Expo West Show (the nation's largest natural and organic food convention). The introduction of this new offering demonstrates that the Company is able to find an alternative way for people to get the benefits of its original Kefir, but in a convenient, on-the-go package. According to the Company, since refrigeration of the bars is recommended, but not required, they can be sold and shipped all over the world, and are especially great for people traveling, or do not otherwise have access to the refrigeration necessary for Company's traditional Kefir beverages.

Recent Financials

For the twelve-months ended December 31, 2007, versus the twelve-months ended December 31, 2006:

- Revenue increased to $38.729 million versus $27.721 million. Taglich Brothers' estimates called for revenue of $38.725 million;
- Gross margin declined to 32.07% versus 38.38%;
- Operating expenses increased to $7.982 million versus $6.409 million;
- EBITDA increased to $5.487 million versus $4.990 million; and
- Net income was $3.153 million or $0.19 per share versus net income of $2.896 million or $0.17 per share. In comparison, Taglich Brothers' estimates called for net income of $3.249 million or $0.19 per share.

The year-over-year revenue increase of 39.7% was attributable to higher sales for the existing Lifeway Foods line, which experienced growth of 29.6% and a contribution from Helios Nutrition of $5.629 million versus $2.174 million in 2006 (Helios only contributed to the top line during the final five months of 2006 as it was acquired August 3, 2006). The organic growth was primarily attributable to increased awareness of the Company's existing drinkable dairy products (i.e., its flagship Kefir product, Organic Kefir, La Fruta, as well as its Probugs™ Kefir drink designed specifically for kids). Sales from Helios Nutrition and its subsidiary, Pride of Main Street Dairy was $5.629 million, consisting of $4.563 million from the Helios brand and $1.066 million from its subsidiary Pride of Main Street Dairy.

Gross margin declined by 631 basis points versus the same period last year. The plunge in gross margin was primarily related to the increased cost of milk (the Company's largest raw material), which was approximately 110% higher during the second half of 2007 as compared to the second half of 2006. According to the Company's full year earnings press release and conference call, the price of milk during the months of October and November 2007, was the highest on record. Also, other input costs (plastic bottles, fuel, freight, etc.) hit record high prices during the second half of 2007. Investors should be aware that the price of milk began to decline and has moved down in price during March 2008 and the beginning of April 2008 to prices not seen since May 2007 (or about a 35% decrease from the fourth quarter of 2007). In addition, negatively impacting gross margin was the July 2007 minimum wage increase in Illinois.

Operating expenses in 2007 increased by $1.573 million, primarily due to the higher advertising and marketing expenses in order to continue building brand awareness. As a percentage of revenue, operating expenses decreased to 20.61% versus 23.12% in 2006. The year-over-year percentage improvement was due to higher top line results, increased operating synergies gained by the consolidation of the Helios acquisition into the Company's overall operations, as well as continuing efforts to maximize efficiencies through capital investments.

Investors should note that included in operating expenses was $0.100 million related to Sarbanes-Oxley compliance work, as well as various one-time leagal and regulatory expenses related to the Helios acquisition.

Total other income for the twelve-month period ended December 31, 2007 was approximately $0.528 million, compared to $0.411 million in 2006. This increase was primarily attributable to a higher gain on the sale of marketable securities in 2007.

Balance Sheet as of December 31, 2007

The Company had cash and cash equivalents of $0.596 million and marketable securities of $6.989 million. This compares to cash and cash equivalents of $1.548 million and marketable securities of $8.491 million as of December 31, 2006. Working capital was $12.775 million versus $13.812 million at the end of 2006. The Company's long-term liabilities stood at $4.097 million, which was a decrease from $5.747 million at the end of 2006. The year-over-year changes in cash, working capital, and long-term liabilities resulted from the August 2006 acquisition of Helios Nutrition, profitable operations in 2007, and completion of its increased production capacity project (cost of approximately $2.5 million) at their main Morton Grove headquarters facility.

The Company's portfolio mix of marketable securities (at fair value as of December 31, 2007) consisted of:

- 21.6% fixed income type securities (Government Agency Obligations & Bonds - Corporate/Municipal); and

- 78.4% in Equities, Mutual Funds, Preferred Securities, and Private Investment LP.

We believe that LWAY will be able to fund its sales growth from cash on hand and internally generated funds. Management is not aware of any circumstances or trends, which would have a negative impact upon future sales or earnings and that there have been no material fluctuations in the standard seasonal variation of the Company's business. Investors should be aware that Management continues to explore additional acquisition opportunities in order to increase sales and leverage the Company's distribution system.

Market Comment

Lifeway Foods' product portfolio includes cultured dairy products know as Kefir, which includes probiotic functional cultures. The Company's target market is health conscious consumers that are the driving force behind the functional and probiotic foods segment of the Food Industry.

In a June 2007, issue of Brandweek.com an article entitled "Probiotics Growth Spurt Continues in New Categories", it was stated that the hottest word in food marketing is now probiotics. In the article, Euromonitor International (a provider of market intelligence on industries, countries and consumers) stated that the overall probiotic yogurt category accounted for $294 million in U.S. sales (in 2006) and is projected to grow to $500 million by 2010. Globally, sales doubled during the past half-decade, making probiotic yogurt a $1 billion category.

In a December 2007 article entitled America Wakes Up to Probiotics – But What's the Best Delivery System? By Julian Mellentin, it was stated that 2006 was the year that America woke up to the possibility of a market for probiotic foods and beverages for digestive health. According to the article, 2008 will be the year when we see if American companies have learnt from experiences of the long-established probitocs markets in Asia, Europe, and South American. The U.S. probiotic dairy market was worth approximately $400 million at retail for the year ending June 2007, and 80% of that was controlled by Danone. The article concludes by stating that the future of probiotics in America is about dairy drinks and yogurts and perhaps some other beverages in second place.

Investors should be cognizant that the two primary drivers for the growth in the Functional Foods Market are:

1) Changing trends in consumer diets towards healthier foods; and
2) Growing proportion of aging populations.

Outlook

Based on the Company's pre-announced 2008 first quarter expectations, we anticipate that the Company experienced a weekly sales run-rate of approximately $0.854 million for the thirteen weeks ended March 31, 2008. This continues the trend of sequential growth of a weekly sales run-rate from $0.783 million during the fourth quarter of 2007. On average, the weekly sales run-rate for all of 2007 was $0.745 million. The weekly sales run-rate incorporates the operation of Helios that was acquired at the beginning of August 2006.

On April 1, 2008, Management also indicated in a press release the following:

- The first few weeks of 2008 started out slow as the holiday season wound down;
- Sales picked up tremendously as the first quarter progressed; and
- The Company is getting close to the $1 million dollar a week revenue threshold.

Our belief is that the weekly run rate will continue to expand based primarily on increased orders from existing customers, as well as expanded distribution opportunities (that should include food services such as restaurants, hotels, schools, etc.), the continued rollout of its Probugs™ offering, new foodservices contract, 2007 introduction of Lifeway Lassi, as well as the launch in March 2008 of a Kefir wellness snack bar. 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. Also, we believe aiding the marketing effort is the opening of its Starfruit café that should provide additional consumer awareness.

However, investors need to be aware that gross margin is likely to be negatively impacted during the first and second quarters of 2008, as compared to the same periods in 2007. We have come to that conclusion based on the following comments from other companies that have milk/dairy as an input cost:

- 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.

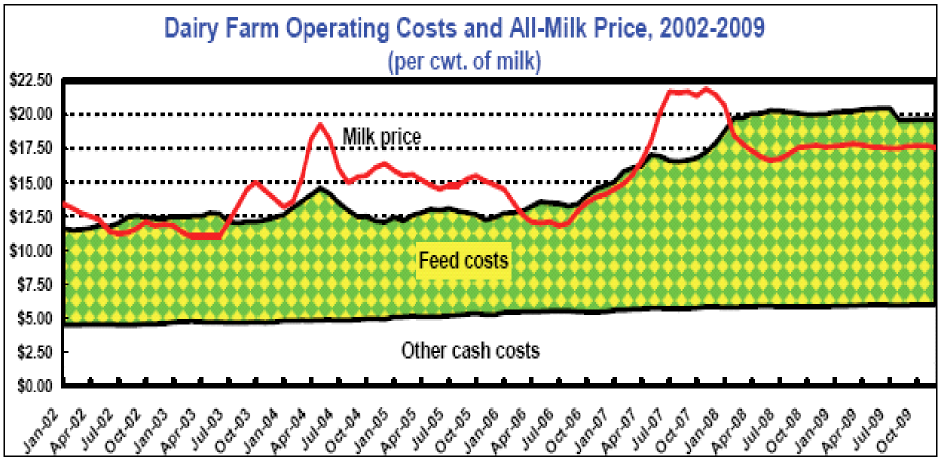
In the Company's 2007 10-K filing, Management stated that it expects the price of milk to decline in 2008 from the record high levels experienced in the fourth quarter of 2007. If that does occur, it is our belief that while gross margin will improve from the fourth quarter 2007 level during the first half of 2008, investors will not see a year-over-year improvement until the third quarter of 2008. We believe during the second half of 2008 gross margin could improve to the mid-thirty percent area (as long as milk prices remain at current or lower price levels) from the mid-to low twenty percent area experienced during the second half of 2007 (when milk prices set all time record highs).

Also aiding gross margin will be the implementation of a price increase of approximately 10-15% on a majority of its products (that began during December 2007). Since it takes time for prices increases to work through the distribution system (maybe two full quarters), by the second quarter of 2008 some of the gross margin improvement should likely occur from those increases. Also making a positive contribution to gross margin should be reduced or stable input costs (i.e., milk prices).

Milk Price Perspective

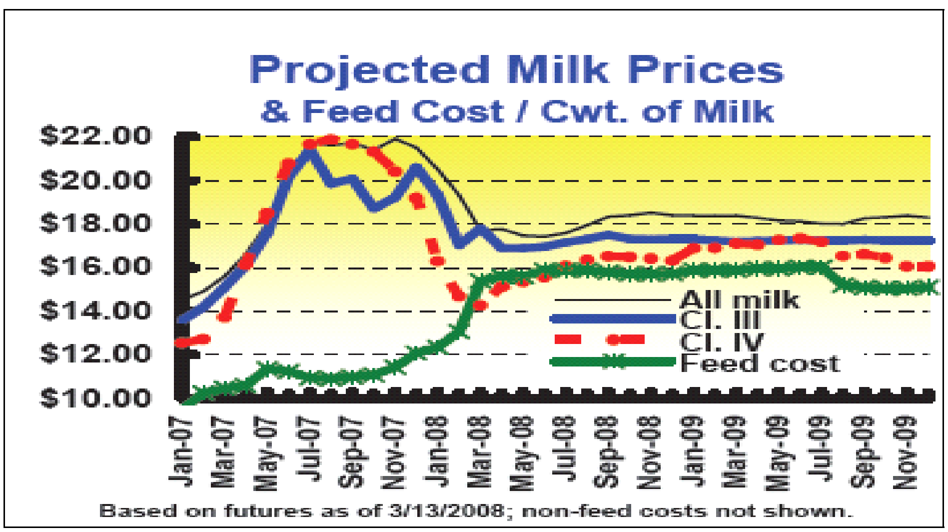
The January 2008 Dairy Market Report from the National Milk Producers Federation (an organization that provides a forum through which dairy farmers and their cooperatives formulate policy on national issues that effect milk production and marketing) offers the following comments:

- The market may be seeing a shift associated with a more limited energy-driven food and feed price inflation;
- Economic growth around the world is driving prices of limited energy, metal, and farm commodities to new highs, including oil near $100 per barrel;
- Dairy farmers, for the foreseeable future, may still be stuck between too-high feed prices and not-high-enough milk prices. See graphic below:



Source: January 2008 Dairy Market Report page 1.

- The following chart graphically shows a projection of future price levels:



Source: March 2008 Dairy Market Report page 4.

The United States Department of Agriculture, in an October 2007 report stated that higher milk production will likely drop prices from 2007 highs. A higher number of milk cows and slightly higher output per cow will be the primary reason for higher milk production for both 2007 and 2008, which in turn should translate into lower milk prices in 2008.

The March 2008 Dairy Market Report from the National Milk Producers Federation stated that Class I milk price in March 2008 was down from February 2008 by $2.98 cwt to $16.70 per cwt (abbreviation for hundred-weight); however, it was up by 17% from the same period last year. According to the report, April's Class I base price should be near $18.40 cwt. Also, the report stated the following Class III milk futures prices for the next six months (April through September 2008) averaged $17.11 per cwt (on March 13, 2008) and projects an average of $17.41 cwt for 2008 and $17.25 for 2009. The United States Department of Agriculture forecasts $15.80 cwt in 2008.

Projections

Based on public comments made by Management in the Company's full year 2007 press release, 2007 10-K filing, earnings conference call, and pre-announcement of first quarter 2008 top line results, we are adjusting our 2008 revenue estimate to $49.935 million (prior was $48.510 million). We believe the year-over-year growth should continue to occur based on current trends, increased consumer awareness, and new product introductions such as its Lifeway Lassi product and Kefir wellness snack bar.

If our top line estimate is achieved it would translate into year-over-year growth of 28.93% (prior was 25.27%). Given our revenue estimate, outlook as described above (which includes relatively high input costs (milk and energy)), positive commentary by Management during the earnings conference call, and completion its production capacity expansion project at their main Morton Grove headquarters facility (which should create economies of scale), we are adjusting our 2008 forecast for net income to $4.120 million or $0.24 per diluted share (prior was $3.800 million or $0.23 per diluted share).

Our forecast for 2008 incorporates the following:

- Maximizing prior 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. Ralph's has increased from 30 test stores to approximately 175 stores;

- Leveraging new distribution agreements with the Harris Teeter grocery chain in the Southeast and Cub Food Stores in the Midwest;

- Continuing the rollout across the U.S. of its ProBugs™ offering. According to the Company's CEO, this offering continues to grow tremendously with each month shipping more product than the previous month. This indicates that this product offering is succeeding in the marketplace;

- Being able to find new avenues to increase revenue. The introduction of a Kefir Wellness Snack Bar and the launch of its first Kefir Boutique Café that will be selling frozen Kefir and Kefir smoothies reinforces our belief that Management will continue to be innovative in driving top line results;

- 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;

- Reducing interest expense for 2008. We anticipate interest expense for 2008 of $0.360 million versus $0.410 million in 2007, primarily due a reduction of debt related to the acquisition of Helios. The Company has been paying down the debt on an accelerated basis from cash generated from operations;

- Moderating of the relatively high energy and raw material cost of resin for its containers and packaging, as well as the cost of milk, the Company's largest raw material expense; and

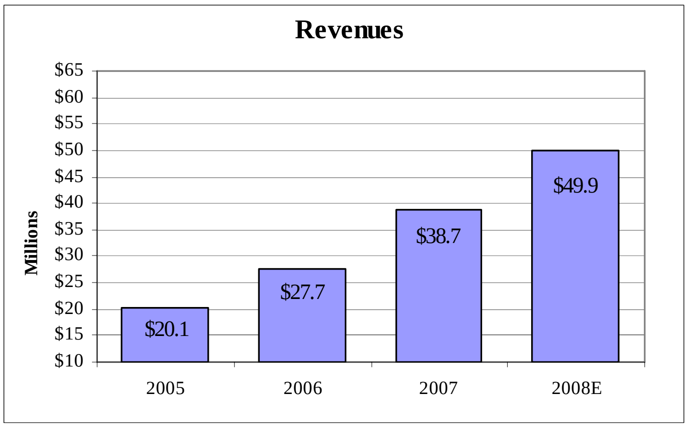
- The continued cost of being a public company (i.e., insurance, legal, and regulatory compliance).

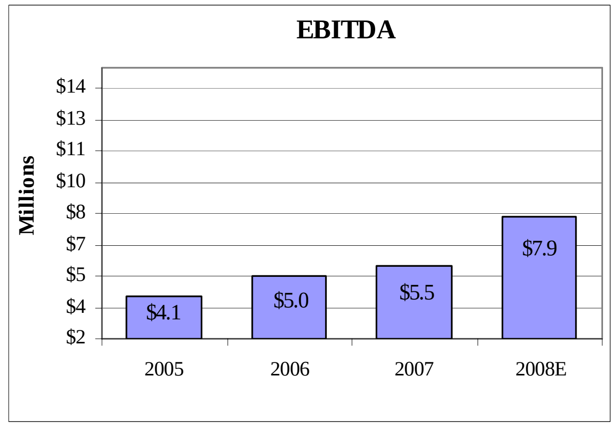
We have adjusted the following from our prior forecast, based on the previously discussed operating trends:

- Gross margin in 2008 to 32.96% from 31.24%. This compares to 32.07% for all of 2007 and 38.38% for 2006. We anticipate gross margin for the first and second quarters of 2008 (26.35% and 31.88%, respectively) will show a year-over-year decline versus the same period in 2007 (39.60% and 39.41%, respectively), this is a consequence of the higher milk and other input costs on a year-over-year basis. However, we believe that the second half should show marked improvement on a year-over-year basis, as milk and other input costs remain fairly stable from the first half of 2008, which means that it should translate into a year-over-year improvement because of the record high price levels experienced during the second half of 2007. We anticipate third and fourth quarter gross margin of 35.58% and 36.81%, respectively. That compares to 2007 third and fourth quarter gross margin of 27.71% and 22.56%, respectively. Also factoring into our forecast is the belief that the price increase starting during December 2007 should help gross margin improve on a sequential basis throughout 2008, as well as economies of scale at the Company's production facility; and

– SG&A expenses, as a percentage of revenues, in 2008 to 19.45% from 18.45%. This compares to 20.61% in 2007 and 23.12% for 2006. Our revised forecast incorporates higher aggregate selling expenses as the Company will continue its efforts to increase brand awareness, as well as higher aggregate general and administrative expenses in order to run the business. The year-over-year aggregate increase amounts to approximately $1.733 million versus 2007.

The chart below shows our revenue and EBITDA projections:





Source: Company Filings and Taglich Brothers Estimates

Risks

Commodities

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 (as demonstrated by results during the second half of 2007, due to the record high price of milk and other input costs, as previously discussed).

Regulation

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 the Company's 2007 10-K filing on December 31, 2007, 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 prior SEC filings, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into 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, 2007, Danone owned approximately 20.1% of LWAY's common shares. Investors need to be cognizant that if Danone were to sell its stake in Lifeway Foods that it would most likely have a negative effect of the Company's stock price.**

Competition

Lifeway faces a small amount of direct competition in the United States and Canadian markets for its Kefir products; however, they do compete to some degree with other yogurt and dairy products. Investors should realize that many producers of yogurt and other dairy products are well-established and have significantly greater financial resources than LWAY to promote their products.

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.

Sublicense Agreement

In October 1998 Lifeway entered into an agreement with GalaGen for sublicense patent rights of Metagenics for Kefir-based products containing natural immune components exclusively to Lifeway. Under the rights granted, Lifeway manufactures and sells products using the Basics Plus trademark. GalaGen had acquired the primary license for such patent rights in an agreement executed with Metagenics in April 1998. The terms of the sublicense provide that Metagenics will permit Lifeway to continue to have the exclusive patent rights to produce or sell kefir-based products containing natural immune components in the event the original license between GalaGen and Metagenics is terminated (and such termination was not caused by Lifeway). During February 2002, GalaGen filed a petition for bankruptcy, which terminated both its primary license with Metagenics and its participation in the Lifeway sublicense. The license and sublicense were excluded from the sale of assets of GalaGen. According to the 2007 10-K filing, LWAY has not received any indication that Metagenics will not permit Lifeway to continue to have the exclusive patent rights to produce or sell Kefir-based products containing natural immune components. Therefore, Lifeway believes that it continues to have the exclusive patent rights licensed directly from Metagenics (either party may terminate the license agreement for cause). The term of the license agreement expires when the last valid claim of the patent rights expires, which currently is July 2, 2013; however, this term can be extended in accordance with the terms of the license agreement.

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.

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.

Internal Controls

According to the Company's 10-K filing, Management has identified a material weakness in the Company's internal control for financial reporting due to incomplete and undocumented financial reporting processes, including an overview of the financial statement disclosure principles, and no documented accounting procedures manual available for employee use. Additionally, there was no requirement to post monthly activity to the Company's general ledger. Management stated that it plans to take corrective action to improve the Company's review procedures for posting and updating the monthly financial activity and has commenced creating an accounting manual for its accounting personnel during 2008.

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.

Management Control
Ludmila Smolyansky (mother of the Company CEO and CFO), who is Chairperson of the Board of Directors of Lifeway Foods, beneficially owns or controls approximately 45.06% of common shares outstanding, as of March 3, 2008.

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 December 31, 2007, the fair value of the Company's marketable securities available for sale was $6.989 million. In the Company's 10-K filing, Management stated 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. During the first three months of 2008 average daily volume has declined to 42,148 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 raising our twelve-month price target to $13.65 per share based on our sales per share estimates for 2008. Our prior twelve-month price target was $11.50. The higher price target reflects our increasing top line expectation for 2008. Investors should take note that our focus on the top line in order to value shares of LWAY is due mostly to the margin squeeze (relatively high milk prices) that has caused bottom line results to stagnate, while top line growth has remained robust (increasing by over a 27% compounded annual growth rate between 2003 and 2007).

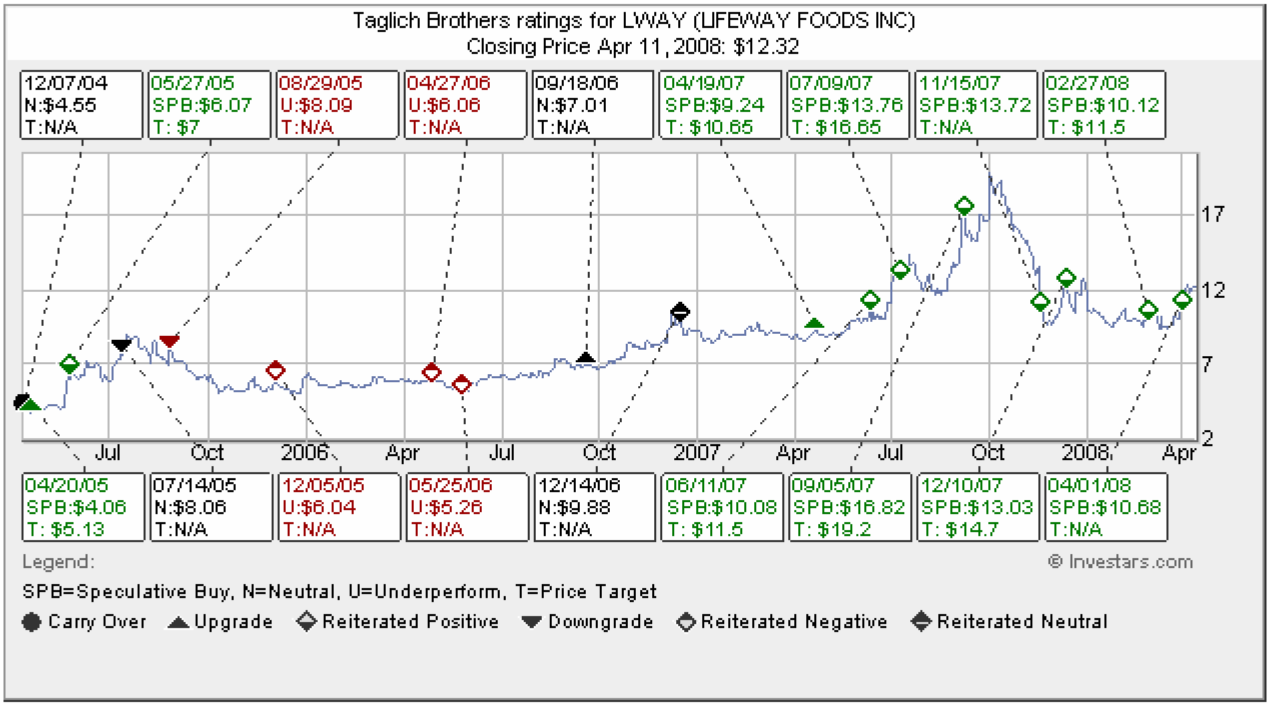
Our rating and price target is primarily based on momentum that has and should continue to occur from the Helios acquisition, as well as a growing awareness of Lifeway's flagship Kefir line, its kids Kefir drink, called Probugs™, securing its first foodservice distribution contract (which occurred during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

Also supporting our rating was the April 2008, pre-announcement of first quarter 2008 revenue of $11.1 million, which is an expected increase of 23% versus $9.0 million in the same period last year. Additionally, Management indicated in the press release that the Company is getting close to a weekly sales run rate of $1.0 million.

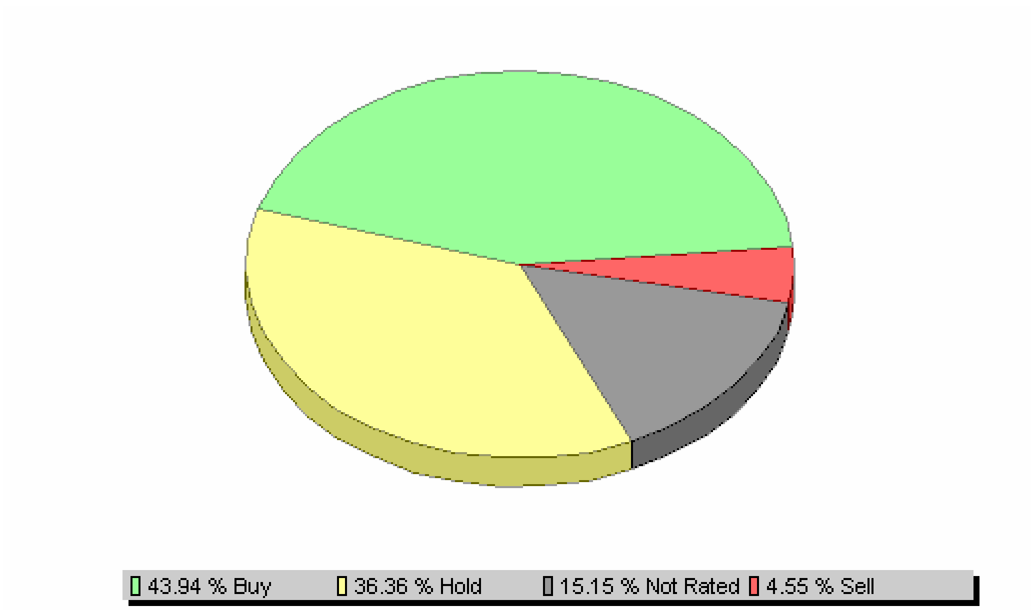
We obtained our price target from the following valuation model, discounted by 15% to account for microcap risk and Company specific risks mentioned earlier:

- A 5.4X price to sales multiple, which is the Company's current trailing-twelve month multiple, applied to our net sales estimate of $2.97 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	10.53%
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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As of the date of this report, we, our affiliates, any officer, director or stockholder, or any member of their families do not have a position in the stock of the company mentioned in this report. Taglich Brothers, Inc. does not currently have an Investment Banking relationship with the company mentioned in this report and was not a manager or co-manager of any offering for the company with in the last three years.

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	Dec. 2007 Year End
ASSETS			
Current assets:			
Cash and cash equivalents	$ 4,354	$ 1,548	$ 596
Marketable securities	7,479	8,491	6,989
Investment, at cost	-	-	-
Accounts receivable, net	2,518	3,943	4,210
Other receivables	56	71	43
Inventories	1,717	2,522	3,507
Prepaid income taxes	12	268	241
Prepaid expenses and other assets	9	12	21
Deferred income taxes	143	32	312
Total current assets	**16,287**	**16,887**	**15,919**
Property, plant and equipment, net	7,751	8,581	9,679
Other assets	-	-	500
Intangible assets, net	426	7,531	8,671
Total assets	**$ 24,465**	**$ 32,999**	**$ 34,768**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Current maturities of notes payable	532	1,131	1,136
Accounts payable	426	1,463	1,594
Accrued expenses	355	480	414
Taxes payable	-	-	-
Total current liabilities	**1,314**	**3,074**	**3,144**
Long-term liabilities	2,903	5,747	4,097
Deferred income taxes	349	450	1,713
Stockholders' equity:			
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509
Paid-in capital	91	1,081	1,121
Stock subscription receivable	-	-	-
Retained earnings	14,423	17,319	20,471
Accumulated other comprehansive income, net of tax	(100)	154	(209)
Treasury stock, at cost	(1,025)	(1,334)	(2,078)
Total stockholders' equity	**19,899**	**23,728**	**25,814**
Total liabilities and stockholders' equity	**$ 24,465**	**$ 32,999**	**$ 34,768**

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

	FY2005A	FY2006A	FY2007A	**FY2008E**
Sales	$ 20,132	$ 27,721	$ 38,729	**$ 49,935**
Cost of goods sold	12,123	17,082	26,310	**33,475**
Gross Profit	8,009	10,639	12,420	**16,460**
Gross Margins	39.78%	38.38%	32.07%	**32.96%**
Operating Expenses:				
Sales	2,354	3,065	3,744	**4,875**
General and administrative	2,253	3,343	4,238	**4,840**
Total Operating Expenses	4,607	6,409	7,982	**9,715**
EBITDA	4,052	4,990	5,487	**7,805**
Operating Income	3,401	4,230	4,437	**6,745**
Operating Margin	16.90%	15.26%	11.46%	**13.51%**
Other Income (Expense)				
Interest income	323	388	350	**200**
Interest expense	(101)	(346)	(410)	**(360)**
Gain on sale of marketable securities	445	357	540	**-**
Other	14	1	(0)	**-**
Rental income	-	11	48	**40**
Total Other Income (Expense)	682	411	528	**(120)**
Pre-Tax Income	4,083	4,642	4,965	**6,625**
Pre-Tax Margins	20.28%	16.74%	12.82%	**13.27%**
Income Tax Expense (Benefit)	1,535	1,745	1,813	**2,505**
Tax Rate	37.58%	37.60%	36.50%	**37.81%**
Net Income	$ 2,548	$ 2,897	$ 3,153	**$ 4,120**
EPS -- Fully Diluted*	$ 0.15	$ 0.17	$ 0.19	**$ 0.24**
Avg Shares Out-Fully Diluted*	16,809	16,830	16,856	**16,831**
Percent of Revenue				
Cost of Revenues	60.22%	61.62%	67.93%	67.04%
Selling expenses	11.69%	11.06%	9.67%	9.76%
General and Administrative expenses	11.19%	12.06%	10.94%	9.69%
YEAR / YEAR GROWTH				
Total Revenues	23.36%	37.70%	39.71%	28.93%
Net Income	24.19%	13.66%	8.84%	30.68%

*** 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)A	**FY2007A**
Sales	$ 9,022	$ 9,715	$ 9,817	$ 10,174	**$ 38,729**
Cost of goods sold	5,450	5,886	7,097	7,877	**26,310**
Gross Profit	3,572	3,829	2,721	2,297	**12,420**
Gross Margins	*39.60%*	*39.41%*	*27.71%*	*22.58%*	**32.07%**
Operating Expenses:					
Sales	770	912	965	1,097	**3,744**
General and administrative	1,001	1,156	1,174	908	**4,238**
Total Operating Expenses	1,771	2,068	2,140	2,004	**7,982**
EBITDA	2,047	2,029	857	554	**5,487**
Operating Income	1,801	1,761	581	293	**4,437**
Operating Margin	*19.97%*	*18.13%*	*5.92%*	*2.88%*	**11.46%**
Other Income (Expense)					
Interest income	66	98	85	101	**350**
Interest expense	(110)	(109)	(102)	(89)	**(410)**
Gain on sale of marketable securities	15	439	209	(123)	**540**
Rental income	9	10	10	20	**48**
Total Other Income (Expense)	(20)	438	202	(91)	**528**
Pre-Tax Income	1,781	2,199	783	202	**4,965**
Pre-Tax Margins	*19.74%*	*22.64%*	*7.97%*	*1.99%*	**12.82%**
Income Tax Expense (Benefit)	646	804	315	49	**1,813**
Tax Rate	*36.26%*	*36.54%*	*40.18%*	*24.11%*	**36.50%**
Net Income	$ 1,135	$ 1,396	$ 468	$ 153	**$ 3,153**
EPS -- Fully Diluted	$ 0.07	$ 0.08	$ 0.03	$ 0.01	**$ 0.19**
Avg Shares Out-Fully Diluted	16,895	16,876	16,825	16,826	**16,856**
Percent of Revenue					
Cost of Revenues	60.40%	60.59%	72.29%	77.42%	67.93%
Selling expenses	8.54%	9.39%	9.83%	10.78%	9.67%
General and Administrative expenses	11.09%	11.89%	11.96%	8.92%	10.94%
YEAR / YEAR GROWTH					
Total Revenues	50.29%	52.58%	31.66%	28.89%	39.71%
Net Income	26.90%	86.08%	-36.73%	-70.02%	8.84%

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	$ 11,100	$ 12,185	$ 13,000	$ 13,650	**$ 49,935**
Cost of goods sold	8,175	8,300	8,375	8,625	**33,475**
Gross Profit	2,925	3,885	4,625	5,025	**16,460**
Gross Margins	*26.35%*	*31.88%*	*35.58%*	*36.81%*	**32.96%**
Operating Expenses:					
Sales	1,100	1,175	1,225	1,375	**4,875**
General and administrative	1,125	1,200	1,215	1,300	**4,840**
Total Operating Expenses	2,225	2,375	2,440	2,675	**9,715**
EBITDA	965	1,775	2,450	2,615	**7,805**
Operating Income	700	1,510	2,185	2,350	**6,745**
Operating Margin	*6.31%*	*12.39%*	*16.81%*	*17.22%*	**13.51%**
Other Income (Expense)					
Interest income	50	50	50	50	**200**
Interest expense	(90)	(90)	(90)	(90)	**(360)**
Rental income	10	10	10	10	**40**
Total Other Income (Expense)	(30)	(30)	(30)	(30)	**(120)**
Pre-Tax Income	670	1,480	2,155	2,320	**6,625**
Pre-Tax Margins	*6.04%*	*12.15%*	*16.58%*	*17.00%*	**13.27%**
Income Tax Expense (Benefit)	250	555	815	885	**2,505**
Tax Rate	*37.31%*	*37.50%*	*37.82%*	*38.15%*	**37.81%**
Net Income	$ 420	$ 925	$ 1,340	$ 1,435	**$ 4,120**
EPS -- Fully Diluted	$ 0.02	$ 0.05	$ 0.08	$ 0.09	**$ 0.24**
Avg Shares Out-Fully Diluted	16,828	16,830	16,832	16,835	**16,831**
Percent of Revenue					
Cost of Revenues	73.65%	68.12%	64.42%	63.19%	67.04%
Selling expenses	9.91%	9.64%	9.42%	10.07%	9.76%
General and Administrative expenses	10.14%	9.85%	9.35%	9.52%	9.69%
YEAR / YEAR GROWTH					
Total Revenues	23.03%	25.42%	32.42%	34.16%	28.93%
Net Income	-63.01%	-33.73%	186.21%	835.19%	30.68%

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

	FY2005A	FY2006A	FY2007A
Cash Flows from Operating Activities			
Net Income	$ 2,548	$ 2,896	$ 3,153
Depreciation and amortization	651	759	1,050
Amortization of discounts on securities	-	-	-
Gain on sale of marketable securities	(445)	(356)	(540)
Loss on marketable securities classified as trading	(14)	(1)	-
Issuance of common stock in exchange for services rendered	52	29	49
Decrease in allowance for doubtful accounts	-	45	(41)
Deferred income taxes	(100)	33	(224)
	2,692	3,405	3,447
Changes In:			
Accounts receivable	(494)	(1,190)	(226)
Other receivables	16	(15)	28
Inventories	(811)	(586)	(984)
Prepaid income taxes	247	(256)	27
Prepaid expenses and other assets	(2)	35	(9)
Accounts payable	(215)	639	131
Accrued expenses	159	125	(66)
Taxes payable	-	-	-
Net Changes in Working Capital	(1,100)	(1,248)	(1,100)
Net cash Provided by Operations	1,592	2,158	2,347
Cash Flows from Investing Activities			
Purchase of marketable securities	(6,461)	(7,510)	(5,745)
Sale of marketable securities	5,810	7,285	7,168
Investment in cost method securities	-	-	(500)
Acquisition of Ilya's Farms, Inc., net of assets acquired	-	-	-
Acquisition of Helios, net of cash acquired	-	(2,552)	-
Purchases of organizational costs	-	-	-
Purchase of property, plant and equipment	(4,917)	(680)	(1,825)
Net cash used in Investing	(5,567)	(3,456)	(901)
Cash Flows from Financing Activities			
Repayment of notes payable	(37)	(859)	(1,945)
Proceeds from issuance of common stock	-	-	-
Proceeds from note payable	3,000	-	300
Purchase of treasury stock	(402)	(649)	(753)
Loan costs	(7)	-	-
Net cash provided by Financing	2,555	(1,507)	(2,398)
Net change in Cash	(1,419)	(2,806)	(952)
Cash Beginning of Period	5,773	4,354	1,548
Cash End of Period	$ 4,354	$ 1,548	$ 596