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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 16, 2010

LWAY $11.29 – (NasdaqGM)

	2007A	2008A	2009A	*2010E*	*2011E*
Sales (in millions)	$38.7	$44.5	$58.1	***$67.5***	***$78.3***
Earnings per share (diluted)	$0.19	$0.11	$0.33	***$0.38***	***$0.44***

52-Week range	$14.94 – $7.90	Fiscal year ends:	December
Shares outstanding a/o 03/01/09	16.8 million	Revenue/shares (TTM)	$3.46
Approximate float	4.9 million	Price/Sales (TTM)	3.3X
Market Capitalization	$190 million	Price/Sales (2011)E	2.4X
Tangible Book value/shr	$0.75	Price/Earnings (TTM)	34.2X
Price/Book	15.1X	Price/Earnings (2011)E	25.7X

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 or www.lifeway.net

Key investment considerations:

We are maintaining our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY), but reducing our 12-month price target to $13.00 per share from $15.30. Our price target is based on our sales per share estimate for 2010 and three-year historic price-to-sales multiple 3.2X.

The company's increased brand awareness spending and continued penetration into the Northeastern and Western regions of the US should drive sales growth. But spending on these efforts is likely to narrow operating margins by at least 100 basis points in 2010.

For 2010, we project sales growth of 16.2% to $67.5 million (prior was $67.1 million) and EPS of $0.38 (prior was $0.44 per share). Our reduced EPS forecast is due in part to gross margin compression to 35.9% from our prior forecast of 38.6%.

For 2011, we project sales of $78.3 million and net income of $7.4 million or $0.44 per share. We believe the brand awareness spending will build an expanding loyal customer base.

On April 7, 2010, the company reported preliminary 1Q10 revenue of nearly $16 million. LWAY's brand awareness spending drove its weekly revenue run rate over the final 11 weeks of 1Q10 to $1.35 million, which is the highest level in the company's history.

On March 31, 2010, LWAY reported 2009 revenue increased by 30.7% to $58.1 million, with the Fresh Made acquisition contributing $7.9 million. EPS increased to $0.33 vs. $0.11 per diluted share. While FY09 revenue was in line with our forecast, EPS fell short by $0.06, due to increased spending in order to drive brand awareness.

Please view our Disclosures pages 12 - 14

Recommendation

We are maintaining our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) but reducing our 12-month price target to $13.00 per share from $15.30. We believe that investors are likely to accord this stock a lower valuation as commodity prices (i.e., milk costs) are forecast by the futures market (as of March 2010) to average $15.60 in 2010, up from a current price of $14.90. Also, investors might view in the short term the trend of higher spending in order to drive brand awareness as a potentially negative factor. The three-year price-to-sales multiple has contracted to 4X from 4.8X (prior to applying a discount factor) over the last three months.

We are valuing the company's shares using a historical approach the takes into consideration stock price fluctuations over the past three-years. Our valuation model (discounted by 20% to account for microcap risk and company specific risks) applies the three-year average historic price-to-sales multiple for the company's stock to our sales per share estimate for 2010 of $4.02 per share. The three-year average price-to-sales multiple for LWAY is 4X (prior was 4.8X).

On December 31, 2009, Lifeway Foods again extended 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 eighth extension of the stockholders', standstill, and non-compete agreements, which will now expire on December 31, 2010. As of December 31, 2009, Danone owned approximately 20.6% of LWAY's common shares. If Danone sold its stake in Lifeway Foods, it would most likely have a negative effect of the company's stock price.

The Company

Lifeway Foods, Inc. (NasdaqGM: LWAY) manufactures a cultured dairy beverage called Kefir and also develops Kefir related products at its four-manufacturing/production facilities in Illinois (2), Pennsylvania (1), and Minnesota (1). Its Kefir-based product portfolio is distributed in Illinois through approximately 1,200 local stores including major retail chains (i.e., Jewel Food Stores, Dominick's Finer Foods, Whole Foods, and independent retailers), via thirteen company owned trucks. Also, over 40 different assorted cream cheese products are distributed under the Cream Cheese Gourmet brand in the Philadelphia and New York metropolitan areas. Lifeway's products are also distributed to stores throughout the US (Costco Midwest, Stop & Shop Northeast, and Kroger and Ralphs – Midwest and West, respectively).

LWAY distributes its products in some parts of Canada (Ontario and Quebec). However, in order to make a meaningful sales impact in Canada, the company intends to setup (via a purchase) a small manufacturing facility within Canada. Timing of the purchase and setup has yet to be determined. In the US, verbal distribution agreements are used since they provide latitude to expand into new markets and establish new relationships on an ongoing basis. The developments in the table are ones we consider building blocks that should support future growth.

2006	Acquired Helios Nutrition Limited (including Pride Main Street Dairy)
	Introduced ProBugs™ product line for kids. It is packaged in patented no spill spout pouches designed as cartoon bug characters
	Developed La Fruta, a yogurt like drink formulated to accommodate the Hispanic market
2008	Launched Starfruit™ Kefir boutique in Chicago. Starfruit offers several flavors of frozen Kefir (over 20 toppings), customized Kefir parfaits, and smoothie-style Kefir drinks
2009	Acquired Philadelphia based Fresh Made, Inc., which was the nations second largest Kefir manufacturer. In 2008, Fresh Made generated sales of approximatley $10 million. In 2009, Fresh Made contributed $7.9 million to LWAY's sales.

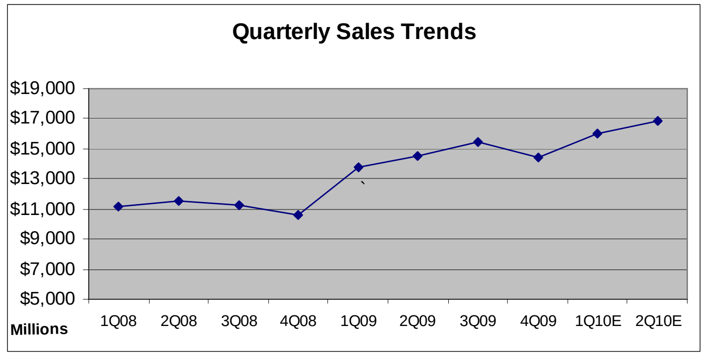
<u>Kefir</u>

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 source of calcium, protein, minerals, and B-complex vitamins, and is highly digestible due to its acidity and enzymes. Kefir is similar to, but distinct from, yogurt due to the fermentation process which produces a less sour taste. Less sugar is required so it 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.

Outlook

The acquisition of Fresh Made and 2H09 spending on raising brand awareness has resulted in a positive trend reversal in quarterly sales. The graph (to the right) illustrates the sequential declines in 2008 and the trend reversal in sales (except for the seasonal decline in 4Q09 sales vs. 3Q09).



LWAY was able to generate weekly average revenues of $1.1 million during 2009. For 1Q10 the weekly sales run rate should approach $1.2 million. For 2010 the weekly run rate should average $1.3 million (compared to $1.1 million last year) and expand to $1.5 million in 2011.

Expectations of strong weekly run rate gains over the next two years should be supported by:

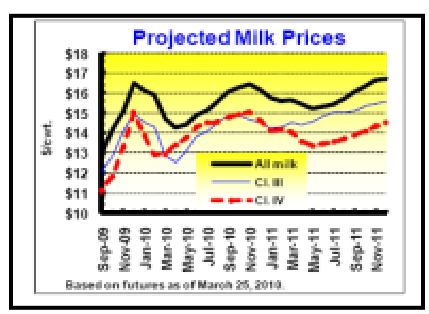
- Programs to build brand awareness, such as product sampling and demonstration activities, use of coupons, and other promotional initiatives that drive penetration of the Northeast, West, and Southeastern regions of the US.
- Gaining new distribution outlets. The biggest potential exists with Costco, which has in the past rotated LWAY's products to different divisions throughout the year. The company announced that Costco intends to make permanent its purchase of product from LWAY for their warehouses in the Midwest. LWAY believes that distribution to the northeast and west will occur on a rotational basis.

  LWAY's 8oz Grab n' Go bottles, Probugs™, and Wellness Bar products have just begun distribution to 275 7-Eleven convenience stores in the Chicago area. If successful, the company is prepared to expand the distribution nationwide after 2Q10.
- In September 2009, Lifeway expanded distribution of its two most popular Kefir products to 280 of the Albertsons grocery stores in California and select stores in Nevada.
- Developing consistent distribution outlets (supermarkets) in the northeast region of the US. In 2009, Lifeway commenced shipments of its products direct to ShopRite, a chain of about 200 stores primarily in the northeast. Based on personal observation, it appears that some of Lifeway's products are being sold at Stop & Shop, Wild by Nature, and Whole Foods locations on Long Island, NY.
- Continuing to expand distribution of its ProBugs offering.
- Obtaining new distribution of its Probiotic Wellness Bars. The Wellness Bar has been approved for distribution at Kroger Stores and Whole Foods.
- Expanding distribution of La Fruita. In 2009 distribution began to 150 Supercenter stores in California (i.e., Super A) and the 99 Cents Only chain, which operates about 100 stores in the California region.

<u>*Milk Price Perspective*</u>

The March 2010 Dairy Market Report from the National Milk Producers Federation observed the following:

- The continued growth in milk production is reversing last fall's milk price gains;
- Demand is lackluster even though exports are up; however, exports are nowhere near the levels of 2008.
- Milk production was up in February as dairy heard numbers grew for a second month in a row. The chart graphically illustrates projections of prices through November 2011 (Source: March 2010 Dairy Market Report page 4). The trend for the second half of 2010 appears to be up.



The March 2010 Dairy Market Report from the National Milk Producers Federation stated that March 2010 revised all-milk price (defined as the milk-to-feed price ratio) was $14.90, down $1.00 from February 2010. The futures market is projecting the all-milk prices should average $15.60 in 2010 (three-months ago, the projection was $16.65) and $15.90 in 2011. For prices to meet the average for 2010, they would need to increase above the $15.60 level in the 2H10.

Market Comment

Lifeway Foods' product portfolio includes cultured dairy products known as Kefir, which includes probiotic functional cultures. There are no publicly traded direct Kefir competitors and with LWAY acquiring Kefir producers Helios and Fresh Made, in 2006 and 2009, respectively, they become the dominant producer in the US. We believe Dannon's Activia yogurt is the closest competitive product, which generated sales growth of 15% during the first 2-1/2 months of 2010. Over the long-term Danone's goal is to double per capita consumption of Activa in the US within the next four years. As acceptance of Activia increases, it should assist LWAY's growth through the acceptance by consumers of probiotic dairy products.

The company's target markets, health conscious consumers and the growing elderly US population, are driving the growth of the functional and probiotic foods segment of the food industry.

The following factors should benefit the company's product portfolio as we are equating cultured yogurt sales as a proxy for growing kefir acceptance:

– Functional foods and beverages provide a potential health benefit consumers can see results from. LWAY's beverage offerings target digestive health, which is a growing segment for health conscious consumers. According to market research firm Aarkstore Enterprise, the global probiotics market is estimated to reach $31.2 billion in 2014, which is a compounded annual growth rate of 11.7% from 2009.

– In the November 2009 issue of Dairy Foods magazine the Chicago-based Information Resources Inc. reported that yogurt is a market leader within the cultured products market. As of August 2009, cultured yogurt sales had growth of 3.3% (for the 52 week period ending August 9, 2009). A Mintel Group (a consulting firm) survey observed that the primary gains in functional dairy products came from yogurt with a pro-health positioning, accounting for a 10% market share in 2009. Yogurts with organic and natural claims had a 12% increase in sales. The table to the right shows the top 10 yogurt brands and aggregate category sales $3.8 billion.

Top 10 Brands of Yogurt

Brand	Dollar Sales (millions)	% change vs. yago	Unit Sales (millions)	% change vs. yago
Total Category	3,826.5	3.3	3,804	2.0
Private Label	415.4	5.3	678.2	7.2
Yoplait Original	399.2	-1.7	551.9	-3.9
Yoplait Light	384.8	11.6	573.4	9.9
Dannon Light & Fit	243.6	5.9	305.9	9.7
Dannon Activia	210.1	-0.4	71.8	2.3
Stonyfield Farm	143.1	-4.4	87	-9.8
Dannon Activia Light	117	19.8	41.2	16.6
Yoplait Go Gurt	112	-1.8	38.2	-3.3
Yoplait Trix	88.3	4.8	32.6	2.9
Dannon Fruit on Bottom	77	-3.0	131.2	2.3

52 weeks ended 8/9/09 Source: Information Resources Inc.

– The report Dairy Wholesaling in the US (IBISWorld February 2010) stated that domestic demand for dairy products will continue to depend on disposable income growth, population growth, and consumer preferences. The US population is forecast to grow at a marginal rate of 1.0% per annum over the five years to 2014, which will aid some volume growth. Real disposable income is forecast to grow at a relatively strong rate over the five years to 2014, which will support purchases of more expensive dairy foods. Consumers' concern about health and nutritional claims should drive demand for functional dairy products with probiotics, increased calcium, and organic varieties.

Projections

<u>Operations</u>

For 2010, we project sales of $67.5 million (prior was $67.1 million), a year-over-year increase of 16.2%. We project net income for 2010 of $6.4 million or $0.38 per share (prior was $7.5 million or $0.44 per share). Our forecast is based on organic growth of the company's flagship Kefir product, its ProBugs™ Organic Kefir for kids, and further penetration into the Northeast, West coast, the continual shipment to Costco in the Midwest, and rotational shipments to Costco for the Northeast and Western regions of the US. We project organic product sales of $23.6 million (35% of total) and non organic sales of $43.9 million. The company has never broken out individual product sales, but based on our own observations, its original Kefir (pictured to the right) is the sales leader, followed by its organic product offerings, and ProBugs for kids.

Our reduced profit forecast, is based in part on gross margin contraction. We project gross margin of 35.9% from our prior forecast of 38.6%. The contraction is due to the portion of the company's increased brand awareness spending the will be recorded as cost of good sold. The lower than forecasted milk prices in the 1H10 will not offset the gross margin contraction stemming from brand awareness spending.

For 2011, we project sales of $78.3 million with net income of $7.4 million or $0.44 per share. The 15.9% sales growth should occur through continued market penetration supported by its spending on brand awareness and organic sales of $31.3 million or approximately 40% of total sales. With stable gross margin of 35.8% and a an improvement in operating margin to 14.5% from 2010's forecast of 14.3%, the driving force for net income growth of 16.2% should be increased sales.

Our forecasts for 2010 and 2011 are predicated on LWAY:

- Maximizing distribution agreements (both existing and new).
- Expanding the distribution of its Kefir Wellness Snack Bar. Even with expanded distribution, the sales impact is likely to be minimal. The key to expanding distribution is increased acceptance and brand awareness.
- Completing the manufacturing realignment of Fresh Made.
- Expanding sales within Canada by the end of 2010. We anticipate LWAY should purchase a small manufacturing facility and have it running before the end of 2010. If the time line is met, sales from Canada in 2011 could reach at least $1 million. With proper execution, the company's Canadian sales could be three-quarters of US sales by 2014.
- Keeping interest expense in check. If the company maintains an accelerated debt repayment program (it has already paid down over $4 million in 2009) we anticipate interest expense for 2010 and 2011 of $400,000 and $300,000 million, respectively, versus $433,000 in 2009.

Our forecasts do not include the franchising potential of its Starfruit Café concept. No franchising plan has been announced as of this writing.

<u>Finances</u>

For 2010, we project cash earnings of $8.6 million (versus $8.1 million in 2009) and a $1.6 million increase in working capital. Cash from operations of $7.1 million (versus $7.6 million) should enable the company to continue paying down the debt incurred to finance the Fresh Made acquisition ($4.0 million) and fund the purchase of a facility in Canada ($2 million). Cash at the end of 2010 should increase to $1.2 million from $0.6 million at December 31, 2009.

Projected cash earnings of $9.2 million for 2011 should cover an increase of approximately $1.6 million in working capital and repayment of approximately $6.0 million of debt obligations. Our year-end cash forecast for 2011 is approximately $2 million, up approximately $800,000 from our 2010 forecast.

Recent Financials

For 2009, versus 2008:

- Sales increased to $58.1 million from $44.5 million. Our estimate was $58.9 million.
- Gross margin increased to 36.0% from 28.7%.
- Operating expenses increased to $12.0 million from $8.6 million.
- Net income was $5.6 million or $0.33 per share versus net income of $1.9 million or $0.11 per share. Our estimate was $6.5 million or $0.39 per share.

2009 revenue increased by nearly 30.6% to $58.1 million (from $44.5 million) driven by the acquisition of Fresh Made (which contributed $7.9 million) and the increased acceptance of the company’s flagship Kefir product and Probugs Organic Kefir for kids. Sales for its historic brands (excluding Fresh Made) grew by 12.8% on a year-over-year basis.

Gross margin for 2009 increased sharply due to:

- Lower cost of conventional milk, the company’s largest raw material
- Reduced transportation costs
- Lower petroleum-based production supplies.

Gross margin for the year was lower than the 40.2% we anticipated (by 420 basis points) due to the portion of costs from increased activity associated with product sampling and in-store demonstrations, increased use of coupons. Gross margin was also affected by a 10% increase in the cost of organic milk. 35% of the company’s sales in 2009 consisted of organic milk products. All these events occurred in the 4Q09, causing gross margin for the year to contract to 20.6% versus our forecast of 37.7%.

Operating expenses increased by approximately $3.4 million due to legal and professional fees related to the February 2009 acquisition of Fresh Made, and an increase in amortization expense (a non-cash item) of approximately $357,340, related to the Fresh Made acquisition. Many of the acquisition-related professional fees were non-recurring expenses and had an estimated negative impact of at least $0.03 per share. For 2009, the operating expense margin increased to 20.6% versus 19.3%. The year-over-year percentage increase was primarily attributable to the non-recurring expenses related to the acquisition of Fresh Made.

Total other expense in 2009 was $489,716 compared to $640,051 in 2008 (excluding an impairment charge of $958,619 related to marketable securities). The decrease excluding the impairment charge was due to a lower loss on sale of marketable securities of $455,173. Offsetting the decline was higher interest expense related to the Fresh Made acquisition, lower interest and rental income.

Finances

The company’s debt to equity ratio of 0.4% versus 2.3% for the industry shows that LWAY is significantly less leveraged than other dairy product companies.

In 2009, cash earnings and cash from operations totaled $8.1 million and $7.6 million, respectively, compared to $4.4 million and $4.7 million, respectively, in 2008. Working capital needs increased by $0.5 million to support sales growth. The cash from operations allowed the company to increase cash by $350,000, pay down over $4 million of debt incurred from the Fresh Made acquisition, and repurchase 900,000 of the company’s common shares. At December 31, 2009, cash was $630,000 compared to $277,000 at the same time last year.

Debt
Debt totals $11.7 million, of which $4.8 million is short-term. Total debt at December 31, 2009 consisted of a note payable to Private Bank ($7.1 million, matures February 2014), a line of credit with Private Bank ($0.5 million, matures February 2011), a line of credit with Morgan Stanley ($2.5 million, no maturity date), and subordinated notes payable to Ilya Mandel and Michael Edelson ($1.6 million, matures February 2011).

Marketable Securities
The company's portfolio of marketable securities (at fair value as of December 31, 2009) consisted of:

- 62.6% fixed income type securities (government agency obligations and bonds - corporate/municipal); and

- 37.4% in equities, mutual funds, preferred securities, and limited partnerships.

At December 31, 2009, the company had total unrealized losses of $0.3 million. Also, proceeds from the sale of marketable securities were approximately $6.9 million and $5.3 million, respectively, for 2009 and 2008, respectively.

Risks

In our view, these are the principal risks underlying the stock:

Commodities
The company's products use conventional and organic raw materials, such as milk, sugar, and fruit from unaffiliated suppliers. Lifeway is not limited or contractually bound to any supplier. If the price of those commodity products were to unexpectedly rise and remain at high levels, it would negatively impact margins.

Regulation
Lifeway is subject to regulation by federal, state and local governmental authorities regarding the distribution and sale of food products. The company believes it is in compliance with all material government permits, licenses, qualifications, and approvals for its operations, as well as all applicable environmental laws. 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. This is why (as previously discussed) the company is seeking to manufacture product within Canada.

Groupe Danone SA Relationship
On December 31, 2009, the company entered into a seventh extension of the stockholders' agreement with Danone Foods, Inc. on December 31, 2009 (the terms of the non-compete period and standstill period of the stockholders' agreement expire on December 31, 2010). As of December 31, 2009, Danone owned approximately 20.6% of LWAY's common shares. If Danone were to sell its stake in Lifeway Foods, the stock price could be adversely affected.

Competition
Lifeway faces a small amount of direct competition in the United States and Canadian markets for its Kefir products. The company competes to a greater extent with other yogurt and dairy products.

Internal Controls
The company identified two material weaknesses in the company's internal controls: 1) an incomplete and undocumented system for tracking current programs for advertising and sales promotions with current customers and 2) not posting monthly activity to the company's general ledger. Management is creating a system for documenting advertising and promotional costs, including analyzing the benefits received from customers, and improving review procedures for posting and updating the monthly financial activity.

Management Control
Ludmila Smolyansky (mother of the company's CEO and CFO), chairperson of the board of directors of Lifeway Foods, beneficially owns or controls approximately 44.8% of common shares outstanding, as of March 12, 2009. The chairperson has the ability to substantially influence matters submitted to stockholders for approval, this could have a negative impact if her interests do not coincide with other shareholders on a particular issue.

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. During 2007, average daily volume was 69,402 shares traded a day. During 2008 average daily volume declined to 35,147 shares traded daily and declined further in 2009 to 23,313 shares traded a day. Average daily volume remains relatively low; therefore, investors need to be aware that by nature a thinly traded equity can have significant price volatility.

Lifeway Foods, Inc.
Consolidated Balance Sheets
2007 – 2011E
(in thousands)

	2007A	2008A	2009A	2010E	2011E
ASSETS					
Current assets:					
Cash and cash equivalents	$ 596	$ 277	$ 630	$ 1,181	$ 1,975
Marketable securities	6,989	5,262	5,044	5,000	4,900
Accounts receivable, net	4,210	4,766	6,000	7,129	8,483
Other receivables	43	40	50	65	75
Inventories	3,507	3,098	3,297	3,685	4,188
Prepaid income taxes	241	356	1,309	2,000	2,500
Prepaid expenses and other assets	21	23	41	54	67
Deferred income taxes	312	920	251	150	650
Total current assets	**15,919**	**14,742**	**16,622**	**19,263**	**22,837**
Property, plant and equipment, net	9,679	11,063	14,282	16,000	16,750
Other assets	500	500	500	500	500
Intangible assets, net	8,671	8,351	20,066	20,000	20,000
Total assets	**$ 34,768**	**$ 34,656**	**$ 51,470**	**$ 55,763**	**$ 60,087**
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Current maturities of notes payable	1,136	928	4,842	2,000	1,000
Checks written in excess of bank balances	-	-	343		
Accounts payable	1,594	2,260	2,764	3,308	3,908
Accrued expenses	414	458	614	736	905
Total current liabilities	**3,144**	**3,647**	**8,564**	**6,044**	**5,813**
Long-term liabilities -- notes payable	4,097	3,108	6,890	4,890	2,890
Deferred income taxes	1,713	1,607	3,445	2,300	1,900
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	1,121	1,202	1,966	1,966	1,966
Retained earnings	20,471	22,384	27,953	34,323	41,728
Accumulated other comprehensive income, net of	(209)	(499)	(10)	3,577	3,127
Treasury stock, at cost	(2,078)	(3,302)	(3,847)	(3,847)	(3,847)
Total stockholders' equity	**25,814**	**26,294**	**32,571**	**42,529**	**49,484**
Total liabilities and stockholders' equity	**$ 34,768**	**$ 34,656**	**$ 51,470**	**$ 55,763**	**$ 60,087**

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

	2007A	2008A	2009A	**2010E**	**2011E**
Sales	$ 38,729	$ 44,461	$ 58,116	**$ 67,535**	**$ 78,305**
Cost of goods sold	26,310	31,704	37,218	**43,300**	**50,250**
Gross Profit	12,420	12,758	20,898	**24,235**	**28,055**
Operating Expenses:					
Sales	3,744	4,098	5,988	**7,800**	**9,450**
General and administrative	4,238	4,468	5,971	**6,615**	**7,200**
Total Operating Expenses	7,982	8,567	11,959	**14,415**	**16,650**
EBITDA	5,487	5,284	10,919	**11,820**	**13,405**
	1,278	1,492	5,090	**5,890**	**6,925**
Operating Income	4,437	4,191	8,939	**9,820**	**11,405**
Other Income (Expense)					
Interest income	350	343	199	**220**	**240**
Interest expense	(410)	(299)	(443)	**(400)**	**(300)**
Gain on sale of marketable securities	540	(734)	(278)	-	-
Other	(0)	(959)	(3)	-	-
Rental income	48	49	35	**20**	**20**
Total Other Income (Expense)	528	(1,599)	(490)	**(160)**	**(40)**
Pre-Tax Income	4,965	2,592	8,449	**9,660**	**11,365**
Income Tax Expense (Benefit)	1,813	680	2,879	**3,290**	**3,960**
Tax Rate	36.50%	26.23%	34.08%	**34.06%**	**34.84%**
Net Income	$ 3,153	$ 1,912	$ 5,570	**$ 6,370**	**$ 7,405**
EPS -- Fully Diluted*	$ 0.19	$ 0.11	$ 0.33	**$ 0.38**	**$ 0.44**
Avg Shares Out-Fully Diluted*	16,856	16,761	16,798	**16,795**	**16,845**
Margins					
Gross Margins	32.1%	28.7%	36.0%	**35.9%**	**35.8%**
Operating Margin	11.5%	9.4%	15.4%	**14.5%**	**14.6%**
Pre-Tax Margins	12.8%	5.8%	14.5%	**14.3%**	**14.5%**
Selling expense	9.7%	9.2%	10.3%	11.5%	12.1%
General and Administrative expense	10.9%	10.1%	10.3%	9.8%	9.2%
YEAR / YEAR GROWTH					
Total Revenues	39.7%	14.8%	30.7%	16.2%	15.9%
Net Income	8.8%	(39.3%)	263.9%	15.5%	15.5%

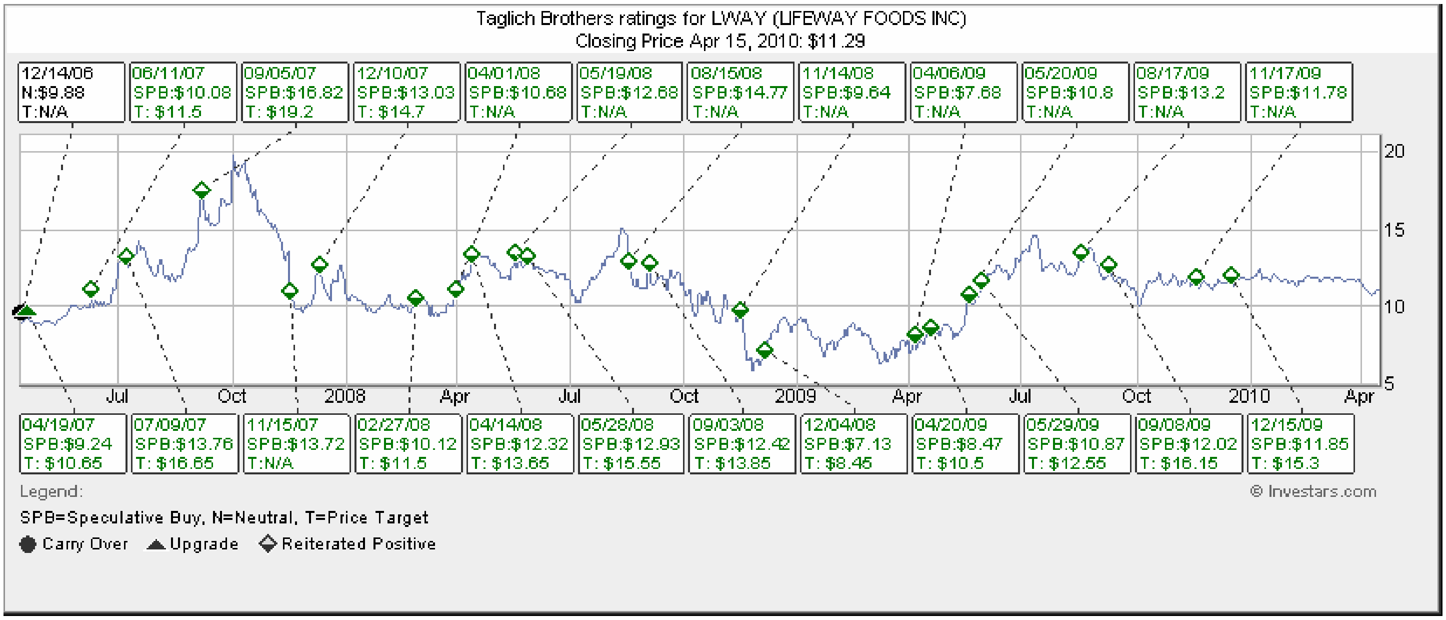
Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ending December 31
(in thousands)

	03/09A	06/09A	09/09A	12/09 A	**2009A**	03/10E	06/10E	09/10E	12/10E	**2010E**	03/11E	06/11E	09/11E	12/11E	**2011E**
Sales	$ 13,736	$ 14,479	$ 15,434	$ 14,466	**$ 58,116**	$ 15,995	$ 16,870	$ 17,875	$ 16,795	**$ 67,535**	$ 18,570	$ 19,620	$ 20,600	$ 19,515	**$ 78,305**
Cost of goods sold	8,217	8,332	9,181	11,489	**37,218**	10,650	10,850	11,000	10,800	**43,300**	12,300	12,500	13,050	12,400	**50,250**
Gross Profit	5,519	6,148	6,253	2,978	**20,898**	5,345	6,020	6,875	5,995	**24,235**	6,270	7,120	7,550	7,115	**28,055**
Operating Expenses:							12715	12885	13000			14750	15500	15050	
Sales	1,308	1,387	1,231	2,062	**5,988**	1,850	1,865	1,885	2,200	**7,800**	2,100	2,250	2,450	2,650	**9,450**
General and administrative	1,668	1,606	1,783	915	**5,971**	1,625	1,650	1,665	1,675	**6,615**	1,700	1,750	1,900	1,850	**7,200**
Total Operating Expenses	2,976	2,993	3,014	2,977	**11,959**	3,475	3,515	3,550	3,875	**14,415**	3,800	4,000	4,350	4,500	**16,650**
EBITDA	2,982	3,708	3,728	501	**10,919**	2,370	3,005	3,825	2,620	**11,820**	2,970	3,620	3,700	3,115	**13,405**
Operating Income	2,544	3,155	3,239	1	**8,939**	1,870	2,505	3,325	2,120	**9,820**	2,470	3,120	3,200	2,615	**11,405**
Other Income (Expense)															
Interest income	62	49	34	54	**199**	55	55	55	55	**220**	60	60	60	60	**240**
Interest expense	(154)	(110)	(100)	(78)	**(443)**	(100)	(100)	(100)	(100)	**(400)**	(75)	(75)	(75)	(75)	**(300)**
Gain on sale of marketable securities	(150)	54	(178)	(4)	**(278)**	-	-	-	-	**-**	-	-	-	-	**-**
Other	-	(3)	-	-	**(3)**	-	-	-	-	**-**	-	-	-	-	**-**
Rental income	9	12	12	2	**35**	5	5	5	5	**20**	5	5	5	5	**20**
Total Other Income (Expense)	(233)	1	(232)	(26)	**(490)**	(40)	(40)	(40)	(40)	**(160)**	(10)	(10)	(10)	(10)	**(40)**
Pre-Tax Income	2,311	3,156	3,008	(25)	**8,449**	1,830	2,465	3,285	2,080	**9,660**	2,460	3,110	3,190	2,605	**11,365**
Income Tax Expense (Benefit)	763	624	1,637	(145)	**2,879**	600	830	1,135	725	**3,290**	850	1,085	1,125	900	**3,960**
Tax Rate	33.04%	19.77%	54.42%	570.51%	**34.08%**	32.79%	33.67%	34.55%	34.86%	**34.06%**	34.55%	34.89%	35.27%	34.55%	**34.84%**
Net Income	$ 1,547	$ 2,532	$ 1,371	$ 120	**$ 5,570**	$ 1,230	$ 1,635	$ 2,150	$ 1,355	**$ 6,370**	$ 1,610	$ 2,025	$ 2,065	$ 1,705	**$ 7,405**
EPS -- Fully Diluted*	$ 0.09	$ 0.15	$ 0.08	$ 0.01	**$ 0.33**	$ 0.07	$ 0.10	$ 0.13	$ 0.08	**$ 0.38**	$ 0.10	$ 0.12	$ 0.12	$ 0.10	**$ 0.44**
Avg Shares Out-Fully Diluted*	16,847	16,790	16,799	16,755	**16,798**	16,775	16,785	16,800	16,820	**16,795**	16,830	16,840	16,850	16,860	**16,845**
Margins															
Gross Margins	40.2%	42.5%	40.5%	20.6%	**36.0%**	33.4%	35.7%	38.5%	35.7%	**35.9%**	33.8%	36.3%	36.7%	36.5%	**35.8%**
Operating Margin	18.5%	21.8%	21.0%	0.0%	**15.4%**	11.7%	14.8%	18.6%	12.6%	**14.5%**	13.3%	15.9%	15.5%	13.4%	**14.6%**
Pre-Tax Margins	16.8%	21.8%	19.5%	(0.2%)	**14.5%**	16.8%	14.6%	18.4%	12.4%	**14.3%**	16.8%	15.9%	15.5%	13.3%	**14.5%**
Selling expense	9.5%	9.6%	8.0%	14.3%	**10.3%**	11.6%	11.1%	10.5%	13.1%	**11.5%**	11.3%	11.5%	11.9%	13.6%	**12.1%**
General and Administrative expense	12.1%	11.1%	11.5%	6.3%	**10.3%**	10.2%	9.8%	9.3%	10.0%	**9.8%**	9.2%	8.9%	9.2%	9.5%	**9.2%**
YEAR / YEAR GROWTH															
Total Revenues	23.5%	25.7%	37.3%	36.8%	**30.7%**	23.5%	16.5%	15.8%	16.1%	**16.2%**	23.5%	16.3%	15.2%	16.2%	**15.9%**

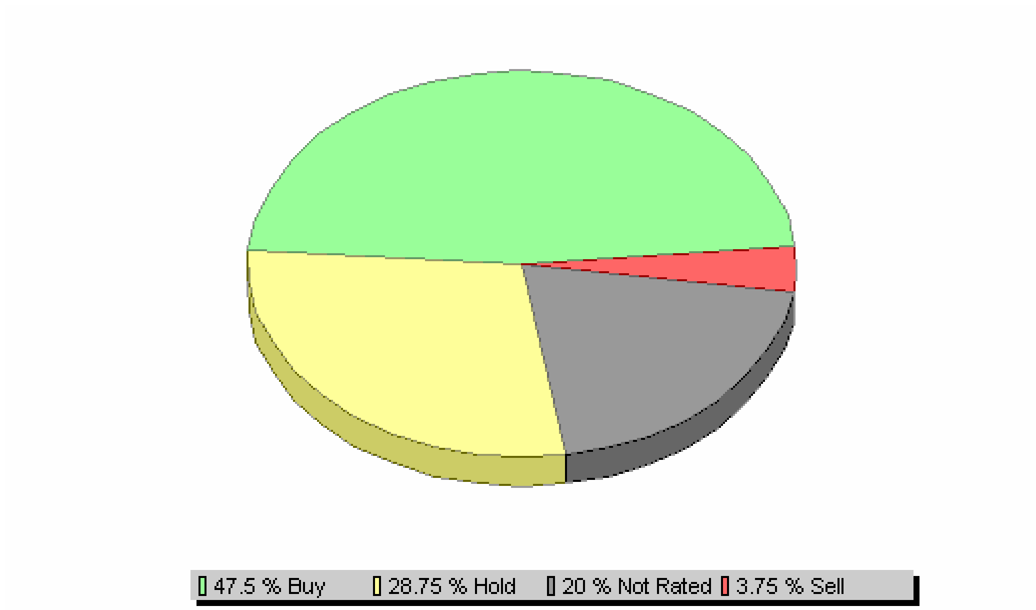
Lifeway Foods, Inc.
Cash Flow Statement
2007 – 2011E
(in thousands)

	2007A	2008A	2009A	2010E	2011E
Cash Flows from Operating Activities					
Net Income	$ 3,153	$ 1,912	$ 5,570	$ 6,370	$ 7,405
Depreciation and amortization	1,050	1,093	1,811	2,000	2,100
Gain on sale of marketable securities	(540)	734	278	-	-
Other than temporary reductions of marketable securities	-	959	-	-	-
Issuance of common stock in exchange for services rendered	49	97	145	150	150
Decrease in allowance for doubtful accounts	(41)	71	(75)	-	-
Deferred income taxes	(224)	(509)	390	101	(500)
	3,447	4,356	8,122	8,621	9,155
Changes In:					
Accounts receivable	(226)	(627)	(613)	(1,129)	(1,354)
Other receivables	28	3	(8)	(15)	(10)
Inventories	(984)	409	173	(388)	(502)
Prepaid income taxes	27	(116)	(476)	(691)	(500)
Prepaid expenses and other assets	(9)	(2)	10	(13)	(13)
Accounts payable	131	666	299	544	601
Accrued expenses	(66)	44	96	122	168
Net Changes in Working Capital	(1,100)	378	(519)	(1,571)	(1,610)
Net cash Provided by Operations	2,347	4,734	7,603	7,050	7,545
Cash Flows from Investing Activities					
Purchase of marketable securities	(5,745)	(5,782)	(6,157)	-	-
Sale of marketable securities	7,168	5,323	6,928	-	-
Acquisition of Fresh Made, net of cash acquired	-	-	(11,043)	-	-
Purchase of property, plant and equipment	(1,825)	(2,157)	(1,766)	(2,000)	(750)
Net cash used in Investing	(901)	(2,616)	(12,037)	(2,000)	(750)
Cash Flows from Financing Activities					
Repayment of notes payable	(1,945)	(1,196)	(4,004)	(4,500)	(6,000)
Proceeds from note payable	300	-	9,354	-	-
Purchase of treasury stock	(753)	(1,239)	(906)	-	-
Checks written in excess of bank balances			343	-	-
Net cash provided by Financing	(2,398)	(2,436)	4,787	(4,500)	(6,000)
Net change in Cash	(952)	(319)	353	550	795
Cash Beginning of Period	1,548	596	277	630	1,181
Cash End of Period	$ 596	$ 277	$ 630	$ 1,181	$ 1,975

Price Chart



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	1	3.57%
Hold	1	3.33%
Sell	0	0
Not Rated	0	0

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Public Companies mentioned in this report:

Groupe Danone	(OTC Other: DANYO)
99C Only Stores	(NYSE: NDN)

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.