TAGLICH BROTHERS

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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

LWAY $9.24 – (NasdaqGM)

April 19, 2007

	FY (12/04)A	FY (12/05)A	FY (12/06) A	***FY (12/07) E***
Revenue (in millions)	$16.32	$20.13	$27.72	***$37.79***
Earnings per share (diluted)*	$0.12	$0.15	$0.17	***$0.16***

52-Week range*	$10.85 – $5.06	Fiscal year ends:	December
Shares outstanding a/o 03/01/07*	16.90 million	Revenue/shares (TTM) *	$1.65
Approximate float*	4.40 million	Price/Sales (TTM) *	5.6X
Market Capitalization	$156 million	Price/Sales (2007)E*	4.1X
Tangible Book value/shr	$1.40	Price/Earnings (TTM) *	54.4X
Price/Book*	6.6X	Price/Earnings (2007)E*	57.8X

* 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 upgrading shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) to Speculative Buy from Neutral and setting a twelve-month price target of $10.65 per share based on our sale per share estimate for 2007.

Our upgrade is primarily based on top line sales momentum that is occurring from the third quarter 2006 acquisition of Helios Nutrition Ltd., a growing awareness of Lifeway's existing flagship Kefir line, as well as Lifeway's new kids Kefir drink, called Probugs™.

On April 2, 2007, Lifeway Foods reported full year 2006 revenue of $27.721 million, which was an increase of 37.7% versus $20.132 million in 2005. Top line results included five months of sales from Helios that amounted to $2.174 million. Net income was $2.896 million or $0.17 per share versus $2.548 million or $0.15 per share in 2005.

On April 3, 2007, the Company announced that first quarter 2007 top line results should come in at approximately $9.021 million or a 50% increase versus $6.003 million in the same period last year.

Based on estimated first quarter 2007 top line results, trend analysis of LWAY's base business, and the historic numbers of Helios, we are increasing our 2007 revenue forecast to $37.786 million (prior forecast was $35.000 million). Our revised net income forecast is $2.651 million or $0.16 per share (prior forecast was $4.150 million or $0.24 per share). The reduction in our bottom line forecast is primarily due to increased expenses from the continued integration of the Helios acquisition and approximately $1.0 million of capital expenditures. According to Management, capital expenditures in 2007 will accomplish a doubling of production capacity (to $100 million in revenue potential) by the start of 2008.

**** Please view our disclaimer located on page 12.***

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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 twelve Kefir-based products 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.

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. LWAY purchased all of the issued and outstanding stock of Helios from the stockholders for a combination of an aggregate amount of $1.300 million in LWAY's common stock (approximately 202,650 shares), $2.526 million in cash, and a $4.200 million promissory note (according to the Company's earnings conference call on April 3, 2007, Management believe it will paid down approximately $1.3 million of the note by the end of 2007) that bears interest at the floating prime rate per annum as published from time to time in the Wall Street Journal.

According to SEC filings, Helios generated revenues of $4.505 million in 2005 and for the first six months of 2006 generated revenues of approximately $2.601 million. During the five months under LWAY's management, Helios generated total revenue of $2.174 million. Management stated that this 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. In addition, it is expected to provide cost efficiencies by pooling the purchase of raw materials. Based on Management's public statements the cost efficiencies should become evident as the quarters unfold throughout 2007.

During the final quarter of 2006, approximately 25% of Helios production was moved to the Company's facility in Morton Grove, Illinois. In the near term, the remaining 75% of the Helios brand Kefir will continue to be manufactured (under Lifeway's direction) from Helios' existing 25,000-square foot facility in Sauk Cente, Minnesota.

Helios Nutrition, based in Sauk Centre, Minnesota, founded in 1997 by George Economy, produces 5 flavors of organic reduced fat Kefir, as well as a line of fluid rBGH-free and organic milk that is distributed throughout central Minnesota and the Twin Cities.

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 Developments

On March 2, 2007, Lifeway Foods announced that it would showcase its low-fat Kefir at the International Restaurant and Foodservcie Show of New York in early March 2007. Management's intent at the show was to introduce Lifeway's products in order to encourage the use of its health yogurt-style beverage products in restaurants, hotels, and other foodservice locations. The Company's CEO stated that foodservice is an untapped market for Lifeway Foods; therefore, participation in this show will expose a whole new group of customer to the world of Kefir.

On January 8, 2007, the Company announced it was a product sponsor (LowFat Kefir and Producgs ™) at The Access Hollywod "STUFF YOU MUST…" Lounge in celebration of The Golden Globe® Awards. Lifeway's CEO believes that reaching out to celebrities through gift lounges is an extremely useful way to enhance the Company's brand awareness.

On December 15, 2006, Lifeway Foods announced its Board of Directors authorized a stock repurchase program of up to 75,000 shares. Under the program, the Company may repurchase up to 75,000 share of common stock through the open market within a period of one year from the date of the first purchase. According to Management, LWAY will use its available cash resources to fund the program.

Recent Financials *(All per share figures reflect the 2-1 stock split effective August 16, 2006)*

For the twelve-months ended December 31, 2006, versus the twelve-months ended December 31, 2005:

- Revenue increased to $27.721 million versus $20.132 million;
- Gross margin declined to 38.38% versus 39.78%;
- Operating expenses increased to $6.409 million versus $4.607 million;
- EBITDA increased to $4.990 million versus $4.052 million; and
- Net income was $2.896 million or $0.17 per share versus net income of $2.548 million or $0.15 per share.

The year-over-year revenue increase of 37.7% was attributable to higher sales for the existing Lifeway Foods line, which experienced growth of 26.9% and five month contribution from Helios Nutrition. 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 new Probugs™ Kefir drink designed specifically for kids). The five month of sales from Helios Nutrition and its subsidiary, Pride of Main Street Dairy was $2.174 million, consisting of $1.856 million from the Helios brand and $0.318 million from its subsidiary Pride of Main Street Dairy.

Gross margin declined by 140 basis points versus the same period last year. The decrease in gross margin was primarily related to the acquisition of Helios Nutrition and its subsidiary, Pride of Main Street Dairy, on August 3, 2006. Gross margin for Helios and its subsidiary was approximately 30.0% for the period following the acquisition. According to the 2006 10-K filing, Management believes as the integration process of Helios continues results will reflect the consolidation of raw material purchases, transportation costs, and production operations, which should help improve gross margins in future periods.

Operating expenses in 2006 increased by $1.802 million, primarily due to legal and regulatory expenses related to the stock split and Helios acquisition. As a percentage of revenue, operating expenses increased to 23.12% versus 22.89% in 2005.

In comparison, Taglich Brothers' estimates called for revenue of $27.802 million and net income of $3.115 million or $0.18 per share.

Balance Sheet as of December 31, 2006

The Company had cash and cash equivalents of $1.548 million and marketable securities of $8.491 million. This compares to cash and cash equivalents of $4.354 million and marketable securities of $7.479 million as of

December 31, 2005. Working capital was $13.812 million versus $14.474 million in 2005. The Company's long-term liabilities stood at $5.747 million, which was an increase from $2.903 million at the end of 2005; however it was a decrease from $6.192 million at September 30, 2006. The year-over-year changes in cash, working capital, and long-term liabilities resulted from the August 2006 acquisition of Helios Nutrition.

The Company's portfolio mix of marketable securities (at fair value as of December 31, 2006) consisted of:

- 30.8% fixed income securities; and
- 69.2% in equities, mutual funds, and preferred securities.

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. An example is the Helios acquisition, which included an initial cash outlay of $2.5 million.

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.

The Nutrition Business Journal (NBJ is a research, publishing and consulting company serving the nutrition, natural products and alternative health care industries) estimates that the Functional Food Market was worth $72 billion in 2005. NBJ estimates the global Functional Food Market could reach $500 billion by 2010. However, other leading market research firms (Deloitte and AC Nielsen) estimate that the global market might only reach $167 billion by 2010.

In a December 2006 report issued by AC Nielsen entitled "What's Hot around the Globe – Insights on Growth in Food & Beverage Products", their analysis concluded that drinkable yogurt topped the list in terms of value growth of 18%, fueled by single-serving products and health trends toward probiotics. This healthy beverage was a strong performer, with double-digit growth in four of the five regions AC Nielsen studied. See chart below (source: December 2006 AC Nielsen report Insights on Growth in Food & Beverage Products):

Fastest Growing Category	Product Area	Number of Markets Growing/ Measured	Category Growth Rate	Private Label Growth Rate
Drinkable Yogurt	Non-Alcoholic Beverages	40 of 45	18%	N/A*
Fresh Soup/ Bouillon/ Stock	Ready-To-Eat Meals	11 of 13	18%	24%
Fresh Herbs/ Spices	Cooking Basics	6 of 7	17%	28%
Fresh Fish/ Shellfish/ Seafood	Meat, Fish & Eggs	10 of 10	12%	16%
Alcoholic Cider	Alcoholic Beverages	9 of 18	11%	7%
Fresh Ready to Eat Salads	Fruits & Vegetables	14 of 14	10%	12%
Frozen Meal Starters	Fruits & Vegetables	3 of 4	10%	15%
Baby Formula	Baby Food	48 of 55	10%	17%
Dairy Based Drinks (flavored/unflavored)	Non-Alcoholic Beverages	32 of 42	10%	N/A*

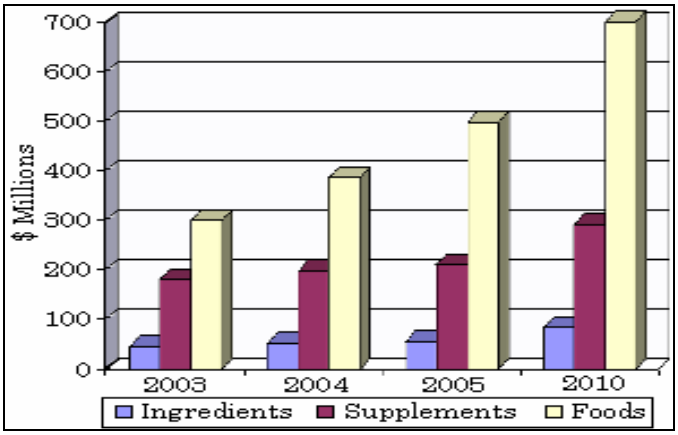
= Categories over US $1 billion globally

* Private Label data was collected for the combination of Dairy-Based Drinks, Dairy Substitute Drinks and Drinkable Yogurt and cannot be separated into categories for this study.

An October 2006 article entitled "Probiotics and Health to drive U.S. Yogurt Market" by Lorraine Heller, the following stats were provided from a research report (Cultured Dairy Products) published by Packaged Facts, a provider of authoritative consumer market research:

- U.S. cultured dairy market, which grow by almost 15% in 2002, only saw growth in 2005 of just 3%.
- Packaged Facts forecasts sales growth of nearly 11% between 2005 and 2010 to $15.4 billion;
- Cultured fluid products are expected to experience the strongest growth, increasing 38% annually. In particular, sales of probiotic shots are forecast to growth by 97% annually; and
- The key targets for this group of consumers are children, women, baby boomers, and Hispanics. Investors should note that Lifeway Foods has developed specific products for children (Probugs™) and the Hispanic market (La Fruita).

According to BCC Research (a technical market research firm), U.S. sales of probiotcs were estimated to be $764 million in 2005 and are expected to grow to over $1.1 billion in 2010. The following graphic shows the breakdown in sales by ingredients, supplements, and foods:



Source: BCC Research

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

Management stated in the Company's April 3, 2007 press release, that the first quarter of 2007 was another record in terms of top line results. Management stated that the first two weeks of 2007 got off to a slow start, but as people returned from their holiday vacations a tremendous increase in orders occurred. That increase translated into order growth each week during the quarter with the last week of the quarter a record. We believe this continues to mean that public interest for Lifeway's Kefir product is still growing and is becoming more accepted by the mainstream market as a healthy product. The Company's CEO reiterated during the fourth quarter conference call that a lot was accomplished in 2006, including the acquisition of Helios Nutrition and its Probugs™ product being featured on "NBC's The Today Show", and "Fox and Friends" during the summer of 2006.

The Company's CFO commented that LWAY absorbed approximately $2.170 million in sales from the Helios acquisition from August 2006 to the end of the year, but also absorbed approximately $2.170 million in costs from the Helios business model (which was not nearly as profitable as Lifeway's). However, Management was able to move about 25% of the Helios production to LWAY's main facility in Illinois, and as 2007 continues, the expectation is it will be able to further consolidate some expenses.

We anticipate that the Company is likely to experience a weekly sales run rate on its core business (excluding Helios) of approximately $0.592 million for the first quarter of 2007, which is a sequential increase from a weekly run rate in the first, second, third, and fourth quarters of 2006, of $0.462 million, $0.490 million, $0.501 million,

and $0.509 million, respectively. Our belief that the weekly run rate will continue to expand is based primarily on increased orders from existing customers, as well as expanded distribution opportunities (that may include food services such as restaurants, hotels, schools, etc.), and the continued rollout of its Probugs™ offering. In addition, Management believes the Company's packaging continues to improve point-of-sale education, as well as heightened visibility among mainstream consumers. While Lifeway continues to market its products through local radio station, newspaper, and magazines advertisements, it also has additional exposure through the Internet, catalog advertising and promotion, in store demonstration throughout the U.S., and participation in various trade shows. The 2005 purchase of a new warehouse continues to give the Company added flexibility and the opportunity to expand its product line to include more nonperishable food items.

During the fourth quarter 2006 earnings conference call, Management indicated approximately $1.0 million of capital expenditures (from internally generated cash) will be spent in order to double the Company's production capacity (to $100 million in revenue potential) by the start of 2008.

Additionally, top line results will reflect the acquisition of Helios, which will positively impact the top line results in 2007. Management publicly stated during the fourth quarter 2006 earning conference call that it will keep the Helios brand and make necessary adjustment in order to bring expenses in line with LWAY's current business model. This should translate into a positive contribution to bottom line results sequentially during 2007.

Projections

Based on results for 2006, public comments made by Management during the Company's fourth quarter earnings conference call, pre-announced top line results for the first quarter of 2007, and a full year contribution from Helios, we are increasing our 2007 revenue estimate to $37.786 million from our prior revenue estimate of $35.000 million. If our top line estimate is achieved it would translate into year-over-year growth of 36.31%. Given our revenue estimate and increased cost structure assumptions, we are adjusting our 2007 forecast for net income to $2.651 million or $0.16 per share from $4.150 million or $0.24 per diluted share. Our forecast incorporates the following:

- Recent distribution agreements with Ralph's Grocery stores in Southern California and ACME Grocery in the Philadelphia and Tri-state area. Shipments of four flavors of Lowfat Kefir and ProBugs™ began during the last week of October 2006 and reorder rates appears to be solid during the first quarter of 2007;

- The continued rollout of it ProBugs™ offering;

- Integration of the Helios acquisition;

- Increased interest expense. We anticipate interest expense for 2007 of $0.560 million versus $0.346 million in 2006, primarily due to the acquisition of Helios.

- Relatively high energy and raw material cost of resin for its containers and packaging;

- Increased capital expenditures (as discussed earlier) in order to double the Company's production capacity (to approximately $100 million in revenue potential). Investors should note that capital expenditures will occur throughout the year with the intent of having the new capacity in place by the start of 2008; and

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

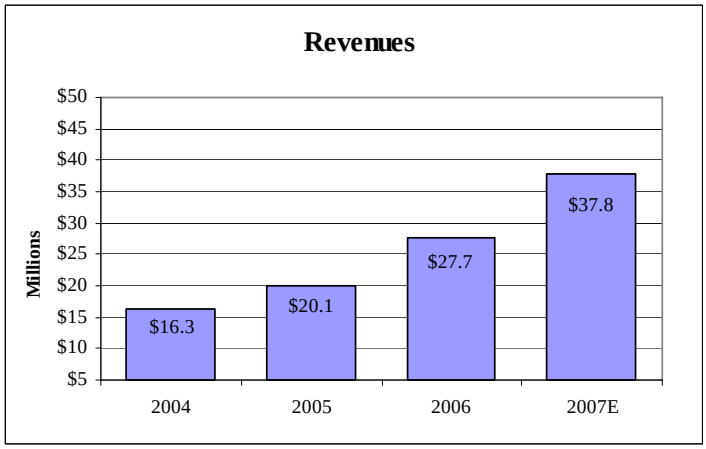
We have adjusted the following from our prior forecast, based on the previously discussed operating trends:

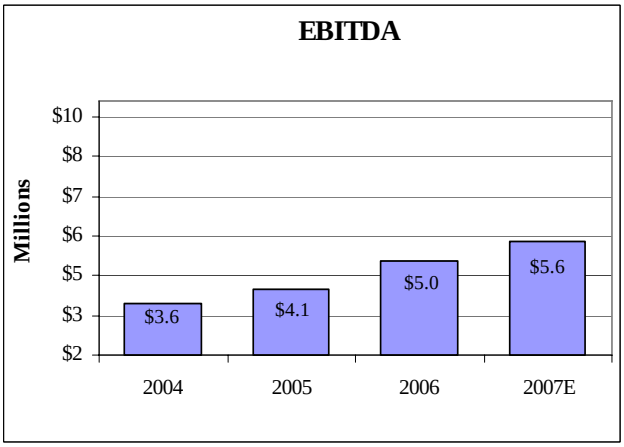
- Gross margins to 31.65% from 43.21%. This compares to 38.38% for all of 2006 and 29.93% for the fourth quarter of 2006 (which includes a full quarter of costs from Helios). We are using the fourth

quarter of 2006 as the starting point and believe that sequential improvement should occur as the quarter progress due to the integration of the Helios acquisition; and

– SG&A expenses, as a percentage of revenues, to 19.99% from 22.87%. This compares to 23.12% for all of 2006 and 20.12% for the fourth quarter of 2006 (which includes a full quarter of costs from Helios).

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.

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

Under the fifth extension, the terms of the non-compete period and standstill period of the stockholders' agreement expire on December 31, 2007.

According to SEC filings, as of December 31, 2006, Danone owned approximately 20.1% of LWAY's common shares.

Legal Issue
Lifeway is from time to time engaged in other litigation matter arising in the ordinary course of business none of which presently is expected to have a material adverse effect on its business results or operations.

Customer Concentration
In 2006, Lifeway's largest customer represented approximately 9% of sales and reflected sales in various regions of the United States outside the Chicago, Illinois metropolitan area.

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

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

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

Management Control
Ludmila Smolyansky, who is Chairperson of the Board of Directors of Lifeway Foods, beneficially owns or controls approximately 45.5% of common shares outstanding.

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, 2006, the fair value of the Company's marketable securities available for sale was $8.491 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.

Federal Reserve
Investors should be aware that if the Federal Reserve were to resume increasing interest rates (during their August, September, October, and December 2006 meetings, as well as January, February, and March 2007 meetings, the Federal Reserve Board of Governors did not increase the federal funds target rate by 25 basis points as it did in its previous seventeen meetings), it is likely to have a negative impact on valuation multiples.

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 has dipped during the first three months of 2007 to 26,605 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

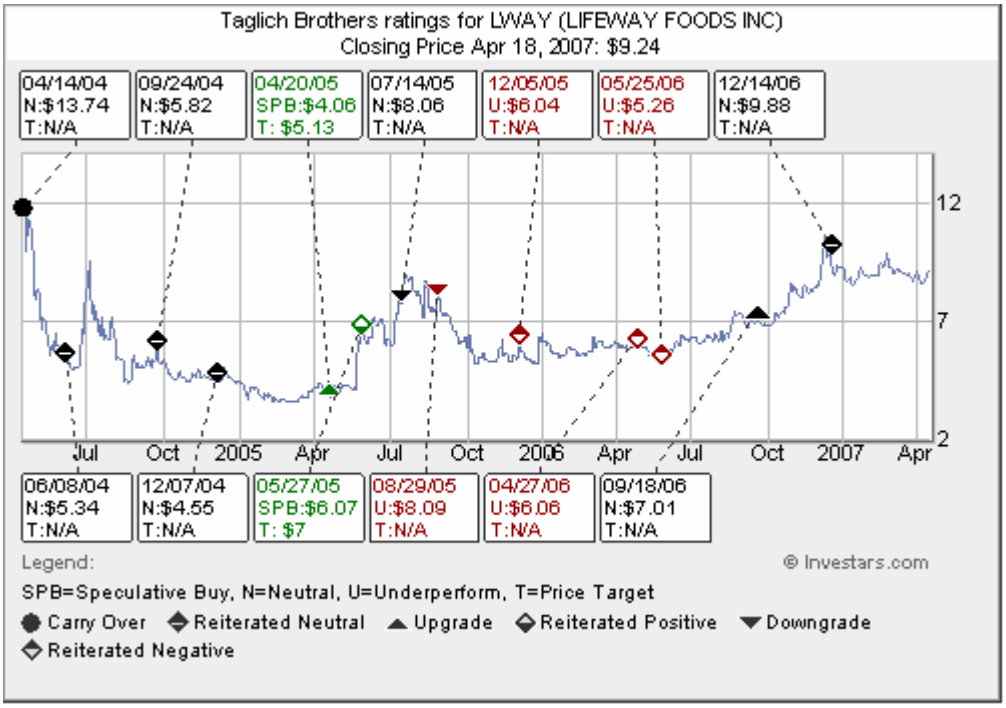
We are upgrading shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) to Speculative Buy from Neutral and setting a twelve-month price target of $10.65 per share based on our sale per share estimate for 2007.

Our upgrade is based on top line sales momentum that is occurring from the third quarter acquisition of Helios Nutrition Ltd., a growing awareness of Lifeway's existing flagship line of Kefir, as well as Lifeway's new kids Kefir drink, Probugs™. On April 3, 2007, the Company announced that first quarter 2007 top line results should come in at approximately $9.021 million or a 50% increase versus $6.003 million in the same period last year. In the press release, Management stated that it feels very confident this trend (in top line sales) will continue for the rest of 2007.

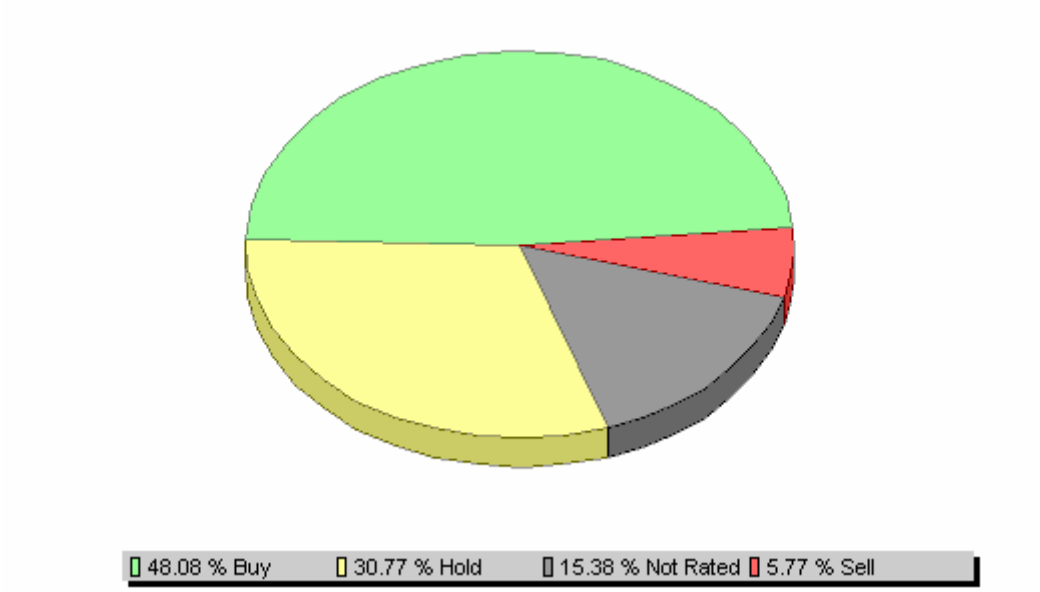
We obtained our price target from the following valuation model, discounted by 15% to account for microcap risk and Company specific risks mentioned earlier:

- A 5.6X price to sales multiple, which is the Company's current trailing-twelve month multiple, applied to our net sales estimate of $2.24 per share for 2007.

Investors need to be aware that during December 2006, Lifeway Foods was able to enter into a fifth 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, 2007.



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	1	3.57%
Hold	0	0
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:

Kroger	(NYSE: KR)
Groupe Danone	(NYSE: DA)

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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. 2004 Year End	Dec. 2005 Year End	Dec. 2006 Year End
ASSETS			
Current assets:			
Cash and cash equivalents	$ 5,773	$ 4,354	$ 1,548
Marketable securities	6,742	7,479	8,491
Accounts receivable, net	2,024	2,518	3,943
Other receivables	72	56	71
Inventories	906	1,717	2,522
Prepaid income taxes	259	12	268
Prepaid expenses and other assets	7	9	12
Deferred income taxes	-	143	32
Total current assets	**15,783**	**16,287**	**16,887**
Property, plant and equipment, net	3,420	7,751	8,581
Total assets	**$ 19,688**	**$ 24,465**	**$ 32,999**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Current maturities of notes payable	9	532	1,131
Accounts payable	642	426	1,463
Accrued expenses	196	355	480
Taxes payable	36	-	-
Total current liabilities	**882**	**1,314**	**3,074**
Long-term liabilities	464	2,903	5,747
Deferred income taxes	424	349	450
Stockholders' equity:			
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509
Paid-in capital	64	91	1,081
Stock subscription receivable	-	-	-
Retained earnings	11,874	14,423	17,319
Accumulated other comprehansive income, net of tax	119	(100)	154
Treasury stock, at cost	(649)	(1,025)	(1,334)
Total stockholders' equity	**17,918**	**19,899**	**23,728**
Total liabilities and stockholders' equity	**$ 19,688**	**$ 24,465**	**$ 32,999**
SHARES OUT	16,840	16,792	16,898

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

	FY2004A	FY2005A	FY2006A	**FY2007E**
Revenue	$ 16,319	$ 20,132	$ 27,721	**$ 37,786**
Cost of goods sold	9,035	11,664	17,082	**25,825**
Gross Profit	7,284	8,468	10,639	**11,961**
Gross Margins	44.64%	42.06%	38.38%	**31.65%**
Sales, general and administrative	4,334	5,066	6,409	**7,555**
EBITDA	3,620	4,052	4,990	**5,606**
Operating Income	2,950	3,401	4,230	**4,406**
Operating Margin	18.08%	16.90%	15.26%	**11.66%**
Other Income (Expense)				
Interest income	186	323	388	**410**
Interest expense	(31)	(101)	(346)	**(560)**
Gain on sale of marketable securities	354	445	357	**-**
Other than temporary reduction of marketable securities	(16)	14	1	**-**
Total Other Income (Expense)	492	682	411	**(150)**
Pre-Tax Income	3,442	4,083	4,642	**4,256**
Pre-Tax Margins	21.09%	20.28%	16.74%	**11.26%**
Income Tax Expense (Benefit)	1,390	1,535	1,745	**1,605**
Tax Rate	40.39%	37.58%	37.60%	**37.71%**
Net Income	$ 2,052	$ 2,548	$ 2,897	**$ 2,651**
EPS -- Fully Diluted	$ 0.12	$ 0.15	$ 0.17	**$ 0.16**
Avg Shares Out-Fully Diluted *	16,877	16,809	16,830	**16,900**
Percent of Revenue				
Cost of Revenues	55.36%	57.94%	61.62%	68.35%
Sales, General and Administrative expenses	26.56%	25.17%	23.12%	19.99%
YEAR / YEAR GROWTH				
Total Revenues	9.69%	23.36%	37.70%	36.31%
Operating Income	-15.18%	15.28%	24.37%	4.16%

*** 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
Revenue	$ 6,003	$ 6,367	$ 7,457	$ 7,894	$ 27,721
Cost of goods sold	3,213	3,739	4,599	5,531	17,082
Gross Profit	2,790	2,629	2,857	2,362	10,639
Gross Margins	*46.48%*	*41.29%*	*38.32%*	*29.93%*	38.38%
Operating Expenses:					
Sales, general and administrative	1,384	1,699	1,738	1,588	6,409
Total Operating Expenses	1,384	1,699	1,738	1,588	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)
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	53.52%	58.71%	61.68%	70.07%	61.62%
Sales, General and Administrative expenses	23.06%	26.68%	23.31%	20.12%	23.12%
YEAR / YEAR GROWTH					
Total Revenues	28.91%	25.53%	43.54%	51.58%	37.70%

*** Certain 2006 amounts (cost of goods sold and SG&A expenses) will be reclassified and restated to full year 2006 presentation as the first three quarter of 2007 are reported.**

**** 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)E	Q2 (06/07)E	Q3 (09/07)E	Q4 (12/07)E	**FY2007E**
Revenue	$ 9,021	$ 9,450	$ 9,630	$ 9,685	**$ 37,786**
Cost of goods sold	6,300	6,450	6,525	6,550	**25,825**
Gross Profit	2,721	3,000	3,105	3,135	**11,961**
Gross Margins	*30.16%*	*31.75%*	*32.24%*	*32.37%*	**31.65%**
Operating Expenses:					
Sales, general and administrative	1,800	1,865	1,895	1,995	**7,555**
Total Operating Expenses	1,800	1,865	1,895	1,995	**7,555**
EBITDA	1,221	1,435	1,510	1,440	**5,606**
Operating Income	921	1,135	1,210	1,140	**4,406**
Operating Margin	*10.21%*	*12.01%*	*12.56%*	*11.77%*	**11.66%**
Other Income (Expense)					
Interest income	95	100	105	110	**410**
Interest expense	(140)	(140)	(140)	(140)	**(560)**
Total Other Income (Expense)	(45)	(40)	(35)	(30)	**(150)**
Pre-Tax Income	876	1,095	1,175	1,110	**4,256**
Pre-Tax Margins	*9.71%*	*11.59%*	*12.20%*	*11.46%*	**11.26%**
Income Tax Expense (Benefit)	325	420	450	410	**1,605**
Tax Rate	*37.10%*	*38.36%*	*38.30%*	*36.93%*	**37.71%**
Net Income	$ 551	$ 675	$ 725	$ 700	**$ 2,651**
EPS -- Fully Diluted	$ 0.03	$ 0.04	$ 0.04	$ 0.04	**$ 0.16**
Avg Shares Out-Fully Diluted	16,870	16,890	16,915	16,925	**16,900**
Percent of Revenue					
Cost of Revenues	69.84%	68.25%	67.76%	67.63%	68.35%
Sales, General and Administrative expenses	19.95%	19.74%	19.68%	20.60%	19.99%
YEAR / YEAR GROWTH					
Total Revenues	50.27%	48.41%	29.15%	22.69%	36.31%

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

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