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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 $8.47 – (NasdaqGM)

April 20, 2009

	FY (12/06) A	FY (12/07) A	FY (12/08) A	*FY (12/09) E*
Sales (in millions)	$27.72	$38.73	$44.46	***$59.92***
Earnings per share (diluted)*	$0.17	$0.19	$0.11	***$0.23***

52-Week range	$15.48 – $5.43	Fiscal year ends:	December
Shares outstanding a/o 03/02/09	16.72 million	Revenue/shares (TTM)	$2.65
Approximate float	4.78 million	Price/Sales (TTM)	3.2X
Market Capitalization	$142 million	Price/Sales (2009)E	2.4X
Tangible Book value/shr	$1.07	Price/Earnings (TTM)	77.0X
Price/Book	7.9X	Price/Earnings (2009)E	36.8X

* All per share figures reflect the 2-1 stock split effective 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 or www.lifeway.net

Key investment considerations:

We are maintaining our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY). Our 12-month price target is $10.50 per share based on our sales per share estimate for the next four quarters and historic price-to-sales analysis (prior 12-month price target was $8.45). The higher price target reflects our increased top line expectations for the next twelve months.

On February 6, 2009, LWAY acquired Fresh Made, Inc., a Philadelphia based dairy, which was the nation's second largest Kefir manufacturer. Terms of the acquisition consisted of $8.050 million in cash paid at closing, a promissory note in the principal amount of $2.735 million due on February 6, 2011, 128,948 shares of LWAY's common stock valued at $0.980 million, and $2.0 million paid for 1.1355 acres of land in Philadelphia, PA as part of the acquisition of Fresh Made.

On March 31, 2009, Lifeway Foods reported fourth quarter 2008 revenue of $10.576 million, which was an increase of slightly less than 4% versus $10.174 million in the same period last year. The Company experienced a net loss of $0.743 million or ($0.04) per share versus net income of $0.153 million or $0.01 per share in same period last year. It should be noted that during Q4'08 the Company recognized an impairment to marketable securities totaling $0.688 million (on a pre-tax basis). No such impairment was taken in 2007.

Based on comments made by Management during the Company's fourth quarter earnings conference call, the acquisition of Fresh Made, marketing/promotional initiatives that commenced during the fourth quarter, mitigated to some degree by the economic uncertainty as it relates to the consumer, we are adjusting our forecasts for 2009. Our 2009 estimates call for sales of $59.892 million (prior was $51.965 million) and net income of $3.772 million or $0.23 per share (prior was $4.110 million or $0.24 per share).

**** 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 three manufacturing/production facilities in Illinois (2) and Minnesota (1). 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. Lifeway's products are also distributed to stores throughout the United States. 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.

In August 2006, Lifeway Foods acquired Helios Nutrition Limited (including Pride Main Street Dairy, LLC), its top competitor in the Kefir market at that time. Also, the Company introduced in 2006, a children's line of organic Kefir products called ProBugs™, which is packaged in a patented no spill spout pouches designed as cartoon bug characters Peter, Polly and Penelope. This product is offered in kid-friendly flavors (i.e., Orange Creamy Crawler, Sublime Slime Lime, and Goo-Berry Pie). According to the Company's 2008 financial results, year-over-year sales for ProBugs™ grew by 124%.

LWAY believe that its 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 during 2006 a product called La Fruta, which is a yogurt like drink similar to a milkshake or smoothie that is specifically formulated to accommodate the Hispanic market. It comes in strawberry, mango, pina colada, banana-strawberry, horchata, and tres leches. On March 6, 2009, the Company announced expanded distribution of this offering to about 150 Supercenter stores in California (i.e., Super A). Additionally, shipments commenced to the 99 Cents Only chain, which operates about 100 stores in the California region.

During mid-April 2008, the Company launched its Starfruit™ Kefir boutique in Chicago. The boutique offers customers several flavors of frozen Kefir with over 20 toppings, as well as customized Kefir parfaits, and smoothie-style Kefir drinks. During the Company's fourth quarter earnings conference call, Management indicated it was nearing the end of the process that would allow for franchising to take place; however, no definite franchising plan was announced.

On February 6, 2009, LWAY acquired Fresh Made, Inc., a Philadelphia based dairy, which was the nation's second largest Kefir manufacturer. Terms of the acquisition consisted of $8.050 million in cash paid at closing, a promissory note in the principal amount of $2.735 million due on February 6, 2011, 128,948 shares of common stock valued at approximately $0.980 million, and $2.0 million paid for 1.1355 acres of land in Philadelphia, PA as part of the acquisition of Fresh Made. Management indicated its belief that the synergies between the LWAY and Fresh Made provide a natural benefit to shareholders, as LWAY serves the same customers, share the same shelf space, and purchase the same raw materials. It also provides enhanced distribution access to the Northeast. According to the announcement, Fresh Made Inc. generated total sales of approximately $10 million in 2008, which was an increase from $8.5 million generated in 2007.

<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 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 April 7, 2009, Lifeway announced that Fresh Made Inc., for the seven weeks from February 9, 2009 (date of the acquisition) to March 31, 2009, generated revenue of approximately $1.391 million. Given the increased cash flow derived from the acquisition, the Company was able to begin aggressively paying down the debt related to the financing of the acquisition (according to Management specific details of the debt financing will be made public when first quarter 2009 earnings results are release on or about May 15, 2009). As of April 7, 2009, LWAY had paid down approximately $1 million of debt related to the acquisition of Fresh Made Inc.

On March 20, 2009, the Company announced that it was selected as the exclusive yogurt supplier to Chicago's Lincoln Park Zoo. Under the agreement, effective April 1, 2009, LWAY began selling its Kefir products at multiple zoo concessions, offering samples and coupons at various zoo events, and make its latest Starfruit frozen Kefir boutique an official packet pickup location for the United Run for the Zoo on June 7.

Recent Financials

For the three-months ended December 31, 2008, versus the three-months ended December 31, 2007:

- Sales increased to $10.576 million versus $10.174 million. Taglich Brothers' estimate called for sales of $11.295 million;
- Gross margin decreased to 17.56% versus 22.58%;
- Operating expenses increased to $2.046 million versus $2.004 million;
- EBITDA decreased to $0.082 million versus $0.554 million; and
- Net loss was $0.743 million or ($0.04) per share versus net income of $0.153 million or $0.01 per share. In comparison, Taglich Brothers' estimate called for net income of $0.490 million or $0.03 per share. It should be noted that during Q4'08 the Company recognized an impairment to marketable securities totaling $0.688 million (on a pre-tax basis). No such impairment was taken last year.

The year-over-year revenue increase of approximately 4% was attributable to higher sales and awareness of Lifeway's flagship product, Kefir and Probugs, as well as Lifeway's organic kids Kefir. Sales for its core brand grew by 8% on a year-over-year basis. Mitigating the overall increase was its Helios Organic Kefir brand, which experienced a decline in sales of approximately 14.6% to $0.890 million. The decrease in the Helios brand was primarily attributable to lower demand for higher cost premium organic products, as well as an overall slowdown in demand associated with retailers who primarily sell these products. Management is hopeful that the slowdown experienced in this premium priced food segment is temporary and as macro economic conditions improve, sales should return to more normal levels.

Gross margin contracted by 502 basis points versus the same period last year. The reasons for the decline in gross margin were primarily related to:

- Increased labor costs;
- Higher costs associated with packaging supplies and transportation;
- Remaining at historically high levels was oil related production supplies and fuel surcharges on product deliveries (those did not begin to ease off until the final month of the quarter);
- Increased product sampling and demonstration activities, couponing, and other promotional initiatives; and
- Relatively high cost of organic milk and other organic raw material ingredients (i.e., sugar and fruit), which increased by approximately 10% on a year-over-year basis.

On a year-over-year basis, operating expenses increased slightly in the aggregate by approximately $0.042 million, which was primarily the result of professional fees and expenses paid related to the acquisition of Fresh Made, Inc. As a percentage of revenue, operating expenses decreased to 19.35% versus 19.70% in the fourth quarter of 2007. The year-over-year percentage improvement was primarily attributable to a decrease in selling related expenses and operating synergies gained by the consolidation of the Helios Nutrition acquisition into LWAY's overall operations, as well as the Company's continuing efforts to maximize efficiency through capital investments.

Total other expense for the three-month period ended December 31, 2008 was approximately $1.253 million, compared income of $0.091 million in the same period last year. This increase was attributable to a higher realized loss on the sale of marketable securities in 2008.

During the fourth quarter of 2008, the Company realized losses in the amount of $0.587 million and recognized an impairment of marketable securities in the amount of $0.688 million. During the fourth quarter 2007, the Company realized losses in the amount of $0.124 million and had no impairment charge.

Investors should note that for the full year 2008, the Company increased sales by approximately 15% to $44.461 million versus $38.729 million in 2007. Net income for the year was $1.912 million or $0.11 per share versus $3.159 million or $0.19 per share. Taglich Brothers' forecast called for sales of $45.181 million and net income $3.145 million or $0.19 per share.

Balance Sheet as of December 31, 2008
The Company had cash and cash equivalents of $0.277 million and marketable securities of $5.262 million. This compares to cash and cash equivalents of $0.596 million and marketable securities of $6.989 million as of December 31, 2007. Working capital decreased to $11.095 million versus $12.775 million at the end of 2007. The Company's long-term liabilities stood at $3.108 million, which was a decrease from $4.097 million at the end of 2007.

The Company's portfolio mix of marketable securities (at fair value as of December 31, 2008) consisted of:

- 29.6% fixed income type securities (government agency obligations & Bonds - corporate/municipal); and
- 70.4% in equities, mutual funds, preferred securities, and limited partnerships.

At December 31, 2008, the Company had total unrealized losses of $0.949 million. Also, the Company recorded other than temporary impairments related to investments in marketable securities in certain investments of approximately $0.959 million related to securities with a cost basis of $2.268 million and a fair value of $1.309 million. According to Management, the impairments recognized related to securities that were in an unrealized loss position at December 31, 2008 that were subsequently sold and equity holdings that are considered other than temporarily impaired due to the recent performance of the issuers of those 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 other than the February 6, 2009 acquisition of Fresh Made, Inc., which would negatively affect liquidity in 2009. Also, Management is unaware of any potential 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 known 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.

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. We believe that the following are important points that support the Company's product portfolio:

- During the global economic downturn, functional foods and beverages that provide a benefit consumers can actually feel will be best placed to weather the financial storm, according to a January 2009 article entitled How Functional Foods can Ride the Recession. Also the article points out that digestive health is a key segment and delivering a benefit can provide a marketing advantage.

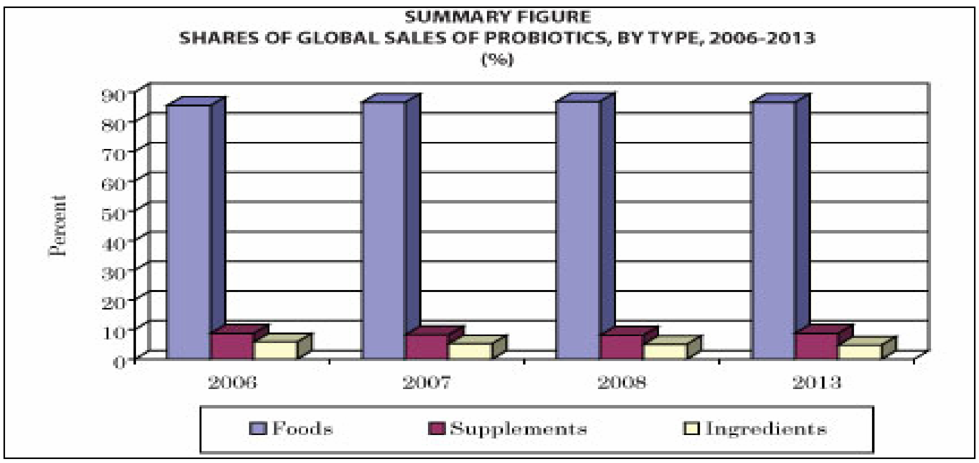
- According to Progressive Grocer's October 2008 Dairy Operations Review, two-thirds of consumers are seeking foods/drinks that address health concerns; forty-one percent want more natural and organic products, twenty-five percent seek fresher products, and twelve percent want more functional items.

- In an article entailed Dairy's New Dynamics by A. Elizabeth Sloan, during December 2008, stated that grocers reported that healthy items equal healthy sales and 79% cited yogurt as the fastest-growing dairy item in 2008. Also, Indian Lassi, Finnish/Russian Kefir, and Greek-style yogurts are gaining traction in the U.S. market.

- According to ACNielsen's LabelTrends (a market research publication), sales of U.S. products carrying a probiotic claim crossed the $1 billion mark in April 2008.

- According to Global Industry Analysts (service that offers one of the world's largest portfolios of research reports in terms of topics covered), the global sales of functional beverages are projected to reach $34 billion by 2010.

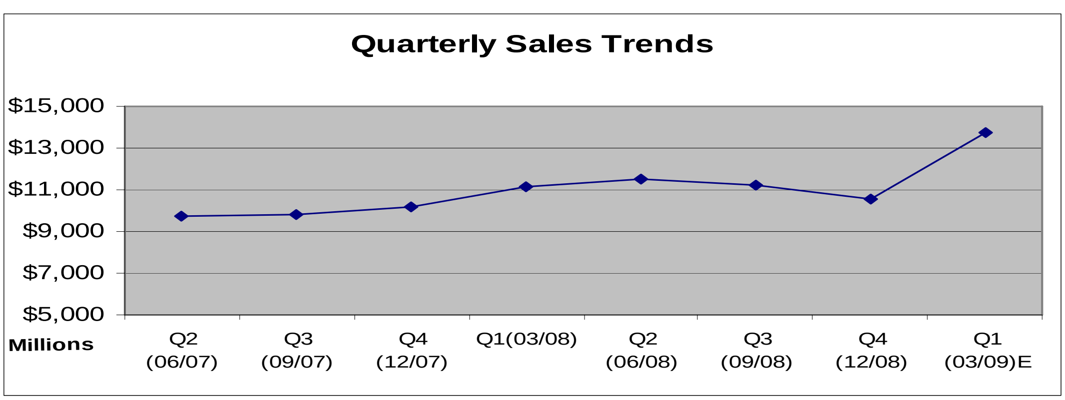
According to BCC Research (a leading information resource producing high-quality market research reports, newsletters, and conferences) in a June 2008 report entitled The Probiotics Market: Ingredients, Supplements, Foods offer the following chart that provides some perspective on future gross potential:



Source: bcc Research at http://www.bccresearch.com/report/fod035b.html

Outlook

Based on the Company's fourth quarter 2008 results, it experienced its second sequential quarterly sales decline, which had not occurred since 2004. The following chart graphic illustrates the sequential decline and also shows a rebound in sales based on pre-announced first quarter 2009 results:



Source: SEC filings

During the Company's fourth quarter earnings conference call, Management stated that during the first quarter of 2009, LWAY recorded six $1 million-plus revenue generating weeks. On April 7, 2009, the Company announced that it expected first quarter 2009 total sales of approximately $13.742 million, which is a 23.6% increase versus $11.122 million reported in the first quarter of 2008. Of that total, Fresh Made Inc., which was acquired on February 9, 2009, contributed approximately $1.391 million for the period ending March 31, 2009. According to LWAY, Fresh Made generated revenues of approximately $10 million during 2008.

Since the Company generated only six $1 million dollar weeks during the first quarter of 2009, our current forecast calls for a weekly run-rate (for the second quarter of 2009) of approximately $0.966 million. This is an increase from $0.950 million for Q1'09 and $0.814 million in Q4'08. Also, our forecast for revenue from Fresh Made is approximately $2.4 million for the second quarter of 2009.

The belief that the weekly run rate should grow even given the state of the economy is primarily based on:

- Increasing product sampling and demonstration activities, use of coupons, and other promotional initiatives during the fourth quarter 2008, which is likely to continue into 2009. Investors should be aware that spending in this area impacts cost of goods sold. Also, the Company's Starfruit™ Kefir boutique is being utilized as an educational and awareness tool;

- Gaining new distribution outlets at Costco Wholesale, King Soopers, and Shop'n Save. Investors should be aware that Costco tends to rotate products to different divisions throughout the year. An example is the purchase by Costco of seven truck loads of its flagship Kefir products in the Northeast region. It may make further purchases for the Northeast later in the year. The Company believes that it can distributed its product in at least two divisions of Costco at any particular time;

- Continuing to expand distribution of it ProBugs offering. As previously noted, this offering grew 127% from 2007 to 2008. Also, expanded distribution of ProBugs is occurring in Whole Foods, Jewl-Osco, Publix, and Unfi (an independent national distributor of natural, organic and specialty foods and related products). In addition, this product has received national publicity in newspapers, magazines, and blogs during 2008 and in 2009; and

- Obtaining new distribution of its Probiotic Wellness Bars that was launched during 2008. The Wellness Bar has been approved for new distribution at Kroger (certain locations), Jewel-Osco, and Whole Foods. This offering has been mentioned on LivelyWomen and mommygocrazy blogs.

Investors should also be cognizant that the February 9, 2009, acquisition of Fresh Made Inc., should positively impact 2009 results. According to Management, the acquisition should provide natural benefits to LWAY, since Fresh Made served the same customers, shared the same shelf space, purchased the same raw materials, and exhibit at the same trade shows. This transaction will enhance Lifeway's purchasing power, increase its ability to target the market category, and alleviate some competitive pressures. More importantly, the acquisition also provides LWAY with enhanced distribution access to the Northeast region. This is an important geographic market that was previously very difficult for Lifeway to target because local retailers were fiercely loyal to the Fresh Made brand. It is very similar to the advantage LWAY has always had in its hometown of Chicago.

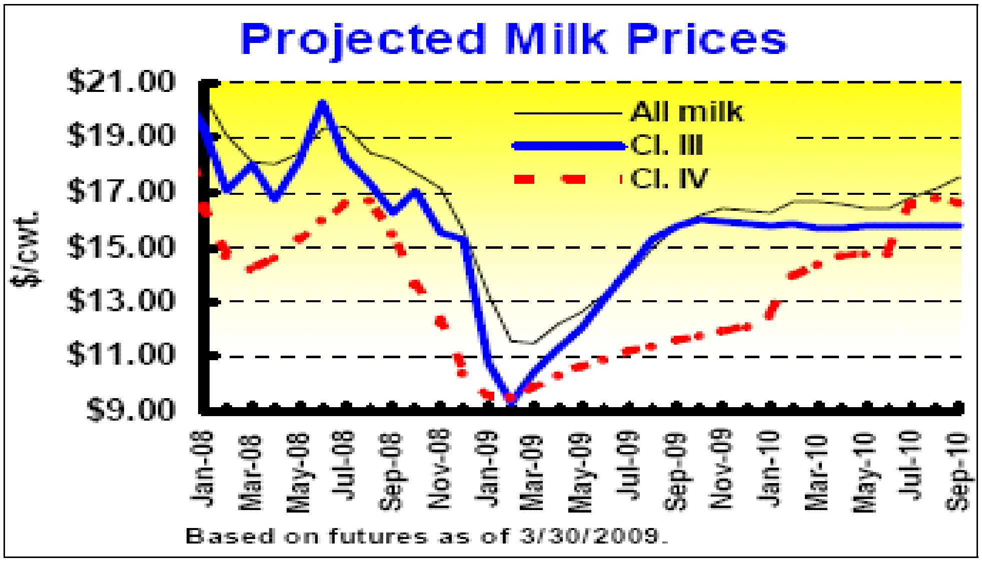
Milk Price Perspective and Potential Impact(s)

The March 2009 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:

- Recent demand is a mix of real consumption and the refilling of pipelines after the bottom was reached to take advantage of low milk and dairy product prices;

- USDA projects a decline in export demand for skim solids equal to 4% of U.S. production, but only a 0.7% decline in production; and

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



Source: March 2009 Dairy Market Report page 1.

The March 2009 Dairy Market Report from the National Milk Producers Federation stated that February's 2009 revised all-milk price was $11.60 and March's was $11.50, the lowest all-milk price since August 2003. April is projected to be up to $12.20. Also, the futures markets are projecting the all-milk price to average $14.00 in 2009 and $16.90 in 2010.

Investors need to be aware that gross margin is likely to remain under pressure throughout 2009, even though conventional milk prices are likely to remain lower then last year. This is due to the fact that approximately 30% of LWAY's total sales come from organic product offerings. According to Management, during the fourth quarter of 2008, the Company experienced a 10% year-over-year increase in organic ingredient costs (i.e., milk, sugar, and fruit). According to the March 2009 Dairy Market Report, organic whole milk and organic fat-reduced milk experienced a year-over-year increase of 23% and 19.7%, respectively, for 2008 versus 2007. Also, if oil prices were to have a sustained move higher that would also negatively impacts gross margin during 2009.

Projections

Based on public comments made by Management during the Company's fourth quarter earnings conference call and slide presentation, the February 2009 acquisition of Fresh Made Inc., and pre-announcement of first quarter 2009 top line results, we are revising our forecasts for 2009. We estimate revenue of $59.892 million (prior was $51.965 million) and net income of $3.772 million or $0.23 per share (prior was $4.110 million or $0.24 per share).

As our forecast indicates, year-over-year top line growth should approximate 34.7%. During the Company's earnings conference call, Management strongly indicated that the top priority during 2009 is growing top line results in order to continue establishing consumer awareness of its product portfolio and growing the bottom line will be a priority in future periods.

Our forecast for 2009 incorporates the following:

- Maximizing existing distribution agreements;
- Leveraging new distribution agreements;
- Continuing the rollout across the U.S. of its ProBugs™ offering in order to continue its rapid year-over-year growth rate;

- Being able to find new avenues to increase revenue. The introduction of a Kefir Wellness Snack Bar and obtaining new distribution channels starting this spring for this offering, as well as opening of its online store (https://onlinestore.lifeway.net/);
- Exploiting its expanded production capacity at the main Morton Grove headquarters facility, which the Company invested approximately $3 million during the end of 2007 to the end of 2008;
- Consolidating the acquisition of Fresh Made. The acquisition should add at least $10 million to the top line on a full year basis, as well as increase EBITDA by approximately $1.0 million. The later will assist the Company in paying down debt. Accordingly, the Company announced that it had begun to aggressively pay down the debt related to the financing of the acquisition and as of April 7, 2009, had paid down approximately $1 million of debt. Management believes that this aggressive stance is an important initiative in order to keep LWAY's balance sheet strong.
- Keeping interest expense in check. We anticipate interest expense for 2009 of $0.530 million versus $0.299 million in 2008, primarily due the debt incurred to acquire Fresh Made Inc. If the Company maintains an accelerated debt repayment program (see prior bullet) our interest expense estimate may need to be adjusted lower;
- Operating with modestly high energy and relatively high raw material cost of resin for its containers and packaging, as well as organic milk, sugar, and fruit; and
- Continuing 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 2009 to 26.16% from 33.48%. This compares to 28.69% in 2008. The decrease is primarily due the Company shifting expenses toward cost of goods sold (i.e., product sampling and demonstration activities, couponing, and other promotional initiatives). Also, impacting gross margin is likely to be the high cost of organic ingredients, as compared to conventional ingredients. Investors should be aware that approximately 30% of product sales were organic in 2008; and
- SG&A expenses, as a percentage of sales, in 2009 to 15.60% from 21.17%. This compares to 19.27% in 2008. Our revised forecast indicates the shift of promotional expenses towards cost of goods sold, as well as the economies of scale that should occur from the increased plant capacity and the folding in of Fresh Made's operations.

Risks

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. 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 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. 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 2008 10-K filing on January 15, 2009, the Company entered into a seventh 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, 2009, 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. **According to SEC filings, as of December 31, 2008, Danone owned approximately 20.7% 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 acquisition in 2006 and the Fresh Made acquisition in February 2009), no assurance can be given that it will be successful in terms of improving bottom line results.

Growth Management
Top line growth on a year-over-year basis had slowed over the last five quarters. Until sequential growth resumes, the Company will need to meet the challenges associated with managing and controlling costs in order to grow EBITDA and bottom line results. Based on pre-announced first quarter 2009 results, it appears top line growth is posed to resume, especially in light of the acquisition of Fresh Made Inc. Investors need to watch to see if Management can manage this growth successfully throughout 2009 and beyond.

Internal Controls
As of December 31, 2008 (based on the Company's 2008 10K filing), LWAY carried out an evaluation under the supervision and with the participation of Management, including the CEO and CFO, of the effectiveness of the design and operation of disclosure controls and procedures. Based upon that evaluation, the conclusion was that the Company's disclosure controls and procedures **were not effective** at the reasonable assurance level as of December 31, 2008 in ensuring that information required to be disclosed under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified under the Exchange Act rules and forms due to the material weaknesses. As a result, LWAY performed additional analysis and other post-closing procedures to ensure the consolidated financial statements were prepared in accordance with generally accepted accounting principles. Accordingly, Management believes the consolidated financial statements included in the 2008 10K fairly present, in all material respects, the Company's financial condition, results of operations, and cash flows for the twelve month period ending December 31, 2008 and 2007.

The material weaknesses in the Company's internal control for financial reporting is due to an incomplete and undocumented financial reporting process, including an overview of the financial statement disclosure principles; that there is no documented accounting procedures manual available for employee use; and in valuing other than temporary impairment of marketable securities. The Company's independent registered accounting firm identified the need for an impairment of marketable securities that led to a material adjustment at December 31, 2008. Additionally, there was no requirement to post monthly activity to the Company's general ledger. Management plans to take corrective action to improve its review procedures for posting and updating the monthly financial activity and have begun creating an accounting manual for the accounting personnel during 2009. In addition, Management plans on implementing additional controls involving analysis of other than temporary impairment in 2009.

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 45.09% of common shares outstanding, as of March 2, 2009.

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, 2008, the fair value of the Company's marketable securities available for sale was $5.262 million. In the Company's 10K 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.

Investors should note that the Company recorded other than temporary impairments related to investments in marketable securities in certain investments of approximately $0.959 million related to securities with a cost basis of $2.268 million and a fair value of approximately $1.309 million. The impairments recognized relate to securities that were in an unrealized loss position at December 31, 2008 and that were subsequently sold during the first quarter of 2009.

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. In 2005, average volume declined to 43,400 shares traded a day. During 2006, average daily volume declined to 30,756 shares traded a day and rebounded during 2007 to 69,402

shares traded daily. During 2008 average daily volume declined to 35,147 shares traded daily. During the first three months of 2009, average daily volume was 16,277 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.

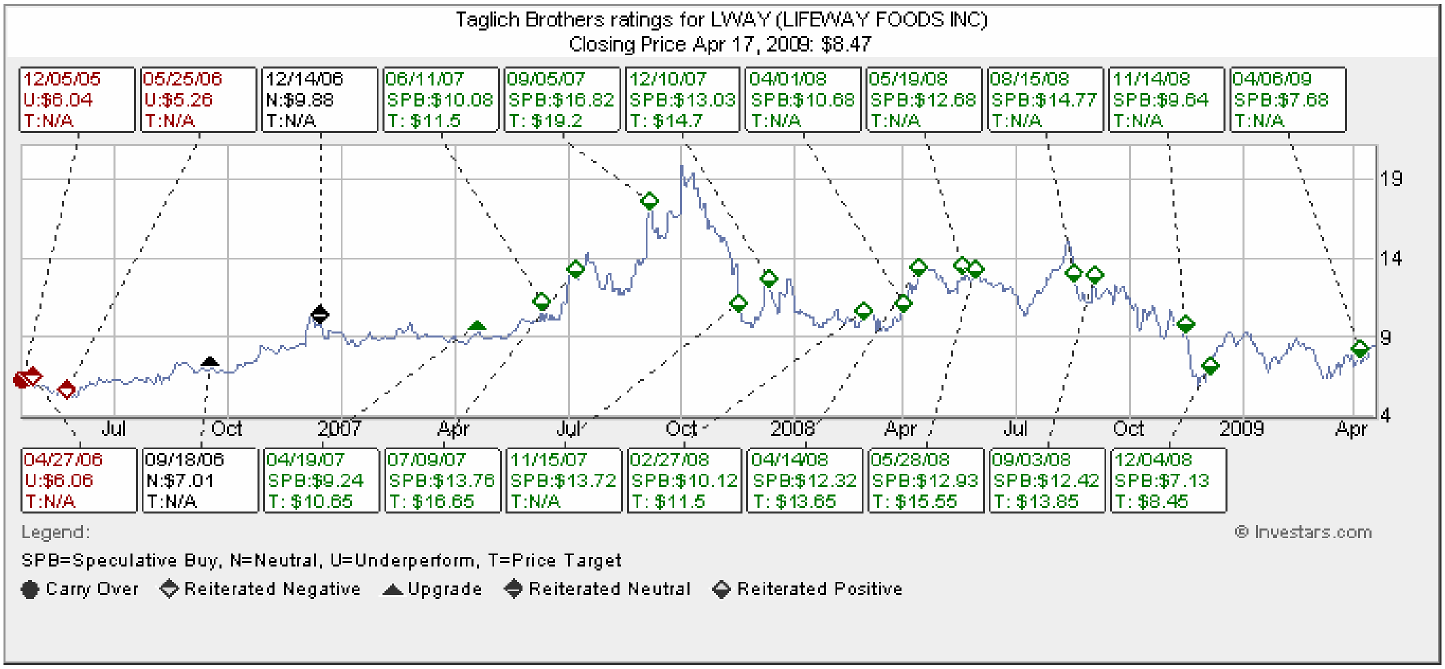
Conclusion

We are maintaining our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY). Our 12-month price target is $10.50 per share based on our sales per share estimate for the next four quarters and historic price-to-sales analysis (prior 12-month price target was $8.45). The higher price target reflects our increased top line expectations for the next twelve months (organic growth of approximately 14% and the expectation of approximately $9.0 million from the February 2009 acquisition of Fresh Made).

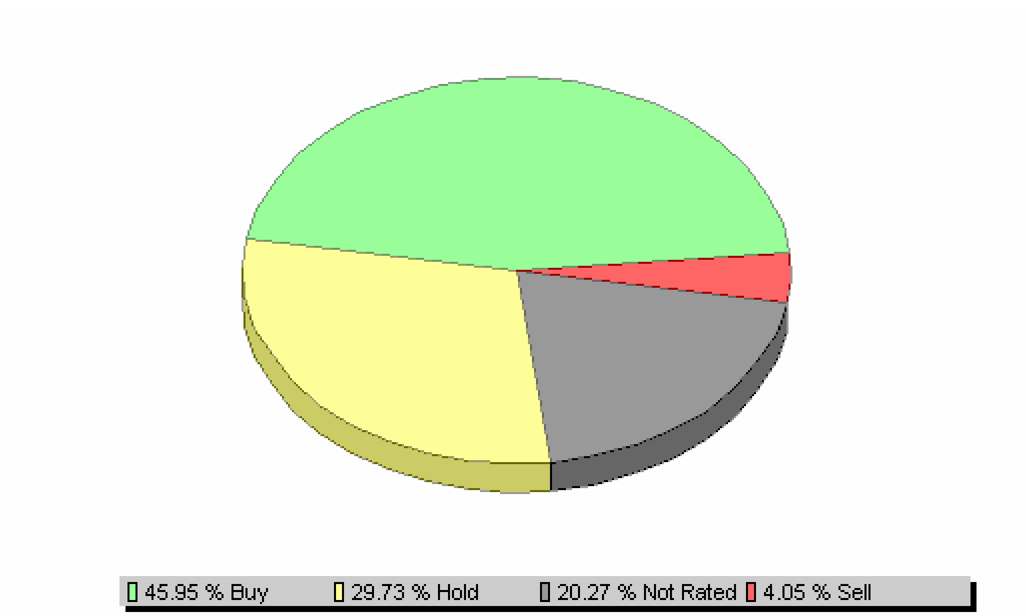
We have chosen to value the Company's shares using a historical approach the takes into consideration its ups and downs over the past 10 years. Therefore, our valuation model (discounted by 25% to account for microcap risk and Company specific risks mentioned earlier) is based on applying the 10 year average historic price-to-sales multiple for the Company's stock to our sales per share estimate over the next four quarters of $3.58 per share. According to MSN Money, the 10 year average price-to-sales multiple for LWAY is 3.92X.

Investors should note that the Company pre-announced first quarter 2009 top line results (as previously discussed) and that excluding the Fresh Made acquisition, year-over-year and sequential growth of just LWAY's offerings grew by 11.2% and 16.8%, respectively. This is an indication that increased promotional activity (as discussed earlier) that occurred during the fourth quarter of 2008 led to increased sales volume. Management has publicly indicated that the promotional activity will continue in 2009, which should translate into continued year-over-year and sequential top line growth. Add in the Fresh Made acquisition and 2009 revenue should grow on a year-over-year basis by approximately 34.7%.

Investors need to be aware that on January 15, 2009, Lifeway Foods was able to enter into a seventh 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 seventh extension of the stockholders', standstill, and non-compete agreements, which will now expire on December 31, 2009.



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months		
Rating	#	%
Buy	2	7.69%
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:

Groupe Danone (NYSE: DA)
99C Only Stores (NYSE: NDN)

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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. 2006 Year End	Dec. 2007 Year End	Dec. 2008 Year End
ASSETS			
Current assets:			
Cash and cash equivalents	$ 1,548	$ 596	$ 277
Marketable securities	8,491	6,989	5,262
Investment, at cost	-	-	-
Accounts receivable, net	3,943	4,210	4,766
Other receivables	71	43	40
Inventories	2,522	3,507	3,098
Prepaid income taxes	268	241	356
Prepaid expenses and other assets	12	21	23
Deferred income taxes	32	312	920
Total current assets	**16,887**	**15,919**	**14,742**
Property, plant and equipment, net	8,581	9,679	11,063
Other assets	-	500	500
Intangible assets, net	7,531	8,671	8,351
Total assets	**$ 32,999**	**$ 34,768**	**$ 34,656**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Current maturities of notes payable	1,131	1,136	928
Accounts payable	1,463	1,594	2,260
Accrued expenses	480	414	458
Taxes payable	-	-	-
Total current liabilities	**3,074**	**3,144**	**3,647**
Long-term liabilities	5,747	4,097	3,108
Deferred income taxes	450	1,713	1,607
Stockholders' equity:			
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509
Paid-in capital	1,081	1,121	1,202
Stock subscription receivable	-	-	-
Retained earnings	17,319	20,471	22,384
Accumulated other comprehansive income, net of tax	154	(209)	(499)
Treasury stock, at cost	(1,334)	(2,078)	(3,302)
Total stockholders' equity	**23,728**	**25,814**	**26,294**
Total liabilities and stockholders' equity	**$ 32,999**	**$ 34,768**	**$ 34,656**
SHARES OUT	16,898	16,828	16,724

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

	FY2006A	FY2007A	FY2008A	**FY2009E**
Sales	$ 27,721	$ 38,729	$ 44,461	**$ 59,892**
Cost of goods sold	17,082	26,310	31,704	**44,225**
Gross Profit	10,639	12,420	12,758	**15,667**
Gross Margins	38.38%	32.07%	28.69%	**26.16%**
Operating Expenses:				
Sales	3,065	3,744	4,098	**3,870**
General and administrative	3,343	4,238	4,468	**5,475**
Total Operating Expenses	6,409	7,982	8,567	**9,345**
EBITDA	4,990	5,487	5,284	**7,762**
Operating Income	4,230	4,437	4,191	**6,322**
Operating Margin	15.26%	11.46%	9.43%	**10.56%**
Other Income (Expense)				
Interest income	388	350	343	**110**
Interest expense	(346)	(410)	(299)	**(530)**
Gain on sale of marketable securities	357	540	(734)	**-**
Other	1	(0)	(959)	**-**
Rental income	11	48	49	**40**
Total Other Income (Expense)	411	528	(1,599)	**(380)**
Pre-Tax Income	4,642	4,965	2,592	**5,942**
Pre-Tax Margins	16.74%	12.82%	5.83%	**9.92%**
Income Tax Expense (Benefit)	1,745	1,813	680	**2,170**
Tax Rate	37.60%	36.50%	26.23%	**36.52%**
Net Income	$ 2,897	$ 3,153	$ 1,912	**$ 3,772**
EPS -- Fully Diluted*	$ 0.17	$ 0.19	$ 0.11	**$ 0.23**
Avg Shares Out-Fully Diluted*	16,830	16,856	16,765	**16,748**
Percent of Revenue				
Cost of Revenues	61.62%	67.93%	71.31%	73.84%
Selling expenses	11.06%	9.67%	9.22%	6.46%
General and Administrative expenses	12.06%	10.94%	10.05%	9.14%
YEAR / YEAR GROWTH				
Total Revenues	37.70%	39.71%	14.80%	34.70%
Net Income	13.66%	8.84%	-39.34%	97.23%

*** Adjusted for the 2-1 stock split effective 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)A	Q2 (06/08)A	Q3 (09/08)A	Q4 (12/08)A	**FY2008A**
Sales	$ 11,122	$ 11,523	$ 11,240	$ 10,576	**$ 44,461**
Cost of goods sold	7,632	7,651	7,703	8,718	**31,704**
Gross Profit	3,491	3,873	3,537	1,857	**12,758**
Gross Margins	*31.39%*	*33.61%*	*31.47%*	*17.56%*	**28.69%**
Operating Expenses:					
Sales	1,059	1,154	958	927	**4,098**
General and administrative	1,065	1,172	1,112	1,119	**4,468**
Total Operating Expenses	2,124	2,326	2,070	2,046	**8,567**
EBITDA	1,636	1,821	1,744	82	**5,284**
Operating Income	1,367	1,546	1,467	(189)	**4,191**
Operating Margin	*12.29%*	*13.42%*	*13.05%*	*-1.79%*	**9.43%**
Other Income (Expense)					
Interest income	103	63	95	82	**343**
Interest expense	(86)	(69)	(72)	(72)	**(299)**
Gain on sale of marketable securities	-	(87)	(381)	(265)	**(734)**
Other	51	-	-	(1,010)	**(959)**
Rental income	12	12	14	12	**49**
Total Other Income (Expense)	80	(82)	(344)	(1,253)	**(1,599)**
Pre-Tax Income	1,447	1,465	1,123	(1,442)	**2,592**
Pre-Tax Margins	*13.01%*	*12.71%*	*9.99%*	*-13.63%*	**5.83%**
Income Tax Expense (Benefit)	558	553	268	(699)	**680**
Tax Rate	*38.57%*	*37.75%*	*23.86%*	*48.47%*	**26.23%**
Net Income	$ 889	$ 912	$ 855	$ (743)	**$ 1,912**
EPS -- Fully Diluted	$ 0.05	$ 0.05	$ 0.05	$ (0.04)	**$ 0.11**
Avg Shares Out-Fully Diluted	16,828	16,765	16,731	16,735	**16,765**
Percent of Revenue					
Cost of Revenues	68.61%	66.39%	68.53%	82.44%	71.31%
Selling expenses	9.52%	10.02%	8.52%	8.76%	9.22%
General and Administrative expenses	9.57%	10.17%	9.89%	10.58%	10.05%
YEAR / YEAR GROWTH					
Total Revenues	23.28%	18.61%	14.49%	3.94%	14.80%
Net Income	-21.73%	-34.68%	82.60%	-584.19%	-39.34%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2009
(in thousands)

	Q1(03/09)E	Q2 (06/09)E	Q3 (09/09)E	Q4 (12/09)E	**FY2009E**
Sales	$ 13,742	$ 14,960	$ 15,260	$ 15,930	**$ 59,892**
Cost of goods sold	10,625	11,000	11,250	11,350	**44,225**
Gross Profit	3,117	3,960	4,010	4,580	**15,667**
Gross Margins	*22.68%*	*26.47%*	*26.28%*	*28.75%*	**26.16%**
Operating Expenses:					
Sales	935	950	985	1,000	**3,870**
General and administrative	1,250	1,350	1,375	1,500	**5,475**
Total Operating Expenses	2,185	2,300	2,360	2,500	**9,345**
EBITDA	1,232	2,040	2,030	2,460	**7,762**
Operating Income	932	1,660	1,650	2,080	**6,322**
Operating Margin	*6.78%*	*11.10%*	*10.81%*	*13.06%*	**10.56%**
Other Income (Expense)					
Interest income	35	30	25	20	**110**
Interest expense	(125)	(135)	(135)	(135)	**(530)**
Rental income	10	10	10	10	**40**
Total Other Income (Expense)	(80)	(95)	(100)	(105)	**(380)**
Pre-Tax Income	852	1,565	1,550	1,975	**5,942**
Pre-Tax Margins	*6.20%*	*10.46%*	*10.16%*	*12.40%*	**9.92%**
Income Tax Expense (Benefit)	310	565	570	725	**2,170**
Tax Rate	*36.41%*	*36.10%*	*36.78%*	*36.70%*	**36.52%**
Net Income	$ 542	$ 1,000	$ 980	$ 1,250	**$ 3,772**
EPS -- Fully Diluted	$ 0.03	$ 0.06	$ 0.06	$ 0.07	**$ 0.23**
Avg Shares Out-Fully Diluted	16,740	16,745	16,750	16,755	**16,748**
Percent of Revenue					
Cost of Revenues	77.32%	73.53%	73.72%	71.25%	73.84%
Selling expenses	6.80%	6.35%	6.45%	6.28%	6.46%
General and Administrative expenses	9.10%	9.02%	9.01%	9.42%	9.14%
YEAR / YEAR GROWTH					
Total Revenues	23.55%	29.82%	35.76%	50.63%	34.70%

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

	FY2006A	FY2007A	FY2008A
Cash Flows from Operating Activities			
Net Income	$ 2,896	$ 3,153	$ 1,912
Depreciation and amortization	759	1,050	1,093
Amortization of discounts on securities	-	-	-
Gain on sale of marketable securities	(356)	(540)	734
Loss on marketable securities classified as trading	(1)	-	-
Other than temporary reductions of marketable securities	-	-	959
Issuance of common stock in exchange for services rendered	29	49	97
Decrease in allowance for doubtful accounts	45	(41)	71
Deferred income taxes	33	(224)	(509)
	3,405	3,447	4,356
Changes In:			
Accounts receivable	(1,190)	(226)	(627)
Other receivables	(15)	28	3
Inventories	(586)	(984)	409
Prepaid income taxes	(256)	27	(116)
Prepaid expenses and other assets	35	(9)	(2)
Accounts payable	639	131	666
Accrued expenses	125	(66)	44
Taxes payable	-	-	-
Net Changes in Working Capital	(1,248)	(1,100)	378
Net cash Provided by Operations	2,158	2,347	4,734
Cash Flows from Investing Activities			
Purchase of marketable securities	(7,510)	(5,745)	(5,782)
Sale of marketable securities	7,285	7,168	5,323
Change in margin account	-	-	-
Acquisition of Helios, net of cash acquired	(2,552)	-	-
Purchase of property, plant and equipment	(680)	(1,825)	(2,157)
Net cash used in Investing	(3,456)	(901)	(2,616)
Cash Flows from Financing Activities			
Repayment of notes payable	(859)	(1,945)	(1,196)
Proceeds from note payable	-	300	-
Purchase of treasury stock	(649)	(753)	(1,239)
Net cash provided by Financing	(1,507)	(2,398)	(2,436)
Net change in Cash	(2,806)	(952)	(319)
Cash Beginning of Period	4,354	1,548	596
Cash End of Period	$ 1,548	$ 596	$ 277