

# Taglich Brothers, Inc.

The Standard of Excellence in the Microcap Market

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## Research Report Update

**Lifeway Foods, Inc.**

**Rating: Speculative Buy**

Howard Halpern

**LWAY \$7.12- (NasdaqNM)**

May 24, 2002

	FYE (12/99)	FYE (12/00)	FYE (12/01)	FYE (12/02)	FYE (12/03)
Revenues (in millions)	\$7.9	\$9.2	\$10.7	<b>\$12.3</b>	<b>\$14.2</b>
Earnings per share (diluted)	\$0.17	\$0.21	\$0.28	<b>\$0.37</b>	<b>\$0.44</b>

52week range	\$8.00 – \$5.55	Fiscal year ends:	December
Shares outstanding	4.27 million	Revenue/shares (TTM)	\$2.54
Trading float	1.20 million	Price/Sales (TTM)	2.81X
Insider and institutional ownership	71.8%	Price/Sales (2003)	2.17X
Tangible Book value/shr <small>a/o 3-31-02</small>	\$2.58	Price/Earnings (TTM)	23.0X
Price/Book	2.76X	Price/Earnings (2003)	16.2X

*Lifeway Foods, Inc., based in Morton Grove, Illinois is a manufacturer of cultured, probiotic and functional food products in the health food industry, and is America's leading supplier of the cultured dairy product known as Kefir. Their products are sold to health conscious consumers through health food stores and to the mass-market consumers through supermarkets. They currently have about 45 employees. Web-site address is: [www.kefir.com](http://www.kefir.com)*

### **Key investment considerations:**

- We are maintaining coverage of Lifeway Foods, Inc. (LWAY) with a Speculative Buy recommendation and have an eighteen-month price target of \$13.65 per share. Our previous twenty-one month price target was \$11.11 per share. We believe this equity is undervalued based on our 2003 earnings estimate and discounted cash flow model.***
- The Company reported first quarter revenues increased by approximately 10% to \$2.888 million versus \$2.636 million in the first quarter of 2001. Net income increased by 36.27% to \$0.448 million or \$0.10 per diluted share versus \$0.329 million or \$0.08 per diluted share the same period last year.***
- Lifeway's primary products are positioned to take advantage of the \$18.5 billion estimated to be spent annually on functional and probiotic foods. We believe this market provides the Company with excellent potential for growth over the next three to five years.***
- We anticipate revenues will grow by approximately 15% to \$12.3 million in 2002 and reach \$14.2 million in 2003. This growth should be achieved through the Company's marketing efforts, increased customer acceptance of its organic products, and the recently introduced La Fruta™ product line for the Hispanic market.***
- We believe that net income will be \$1.6 million or \$0.37 per diluted share in 2002 and increase to \$1.9 million or \$0.44 per diluted share in 2003.***

*\* Please view our disclaimer located at the end of the text portion of this report.*

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## ***The Company***

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

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

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

Danone Foods, Inc. the U.S. subsidiary of Groupe Danone of Paris, France, has a 20% ownership interest in the Company. A support agreement was entered into stating that each party would not compete with each other during the term of the agreement and for three years after termination of the agreement with respect to certain yogurt, cheese and Kefir products.

## ***Recent Financials***

For the period ended March 31, 2002, versus the period ended March 31, 2001:

- Revenues increased to \$2.89 million versus \$2.64 million;
- EBITDA increased to \$0.92 million versus \$0.61 million;
- Net income was \$0.478 million or \$0.10 per diluted share, versus net income of \$0.329 million or \$0.08 per diluted share.

The revenue increase for the year was primarily attributable to the Company's marketing program for its various Kefir-based products, the rollout of its organic product during the second half of 2001, and the introduction of its La Fruita™ yogurt-like drink for the Hispanic market during the first quarter of 2002.

Net income for the quarter exceeded our estimate of \$0.307 million or \$0.07 per diluted share. The primary reasons why net income exceeded our expectations were higher than anticipated revenues (approximately \$113,000 more than our estimate) and lower than anticipated SG&A expenses as a percentage of revenues. The Company reported SG&A expenses as a percentage of revenues of 22.5% versus our estimate of 25.2%.

## ***Balance Sheet as of March 31, 2002***

Cash and cash equivalents grew to \$1.16 million versus \$0.94 million as of December 31, 2001. Short-term marketable securities stood at \$5.2 million with working capital of \$8.29 million. The Company has long-term liabilities of \$0.96 million. We believe that LWAY will be able to fund its sales growth from internally generated funds in the foreseeable future.

## ***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 because the fermentation process produces a less sour tasting product and because less sugar is required 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 suggest fermented dairy products that contain probiotic cultures are healthful.

### ***Industry and Competition***

It is estimated that annually the nutrition industry generates sales of approximately \$49 billion. We believe that Lifeway Foods' target market in the functional and probiotic foods segment of the food industry generates at least \$18.5 billion in annual sales. Also, the Company's organic products are targeting a market that generated approximately \$5.8 billion of sales in 2000, according to the Nutrition Business Journal's market research. We project that the organic food market could reach \$6.75 billion in sales by the end of 2002. It is estimated that organic non-dairy beverages comprise approximately 5% of the total market.

It is our view that the primary factors driving growth in sales of functional, probiotic, and organic foods are:

- The perception that nutrition is an effective tool for disease prevention; and
- An aging population.

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

### ***Recently Introduced Product Lines***

#### ***La Fruita™***

The Company in 2002, expanded distribution of a new cultured beverage product called La Fruita™. This product line is intended for the Hispanic market across the Country. La Fruita™ is a yogurt-like drink similar to a milkshake or smoothie and is being sold through retail chains and specialty grocery stores in Hispanic neighborhoods in four fruit-based flavors.

It is our opinion that based on the following statistics, the Hispanic market should provide significant growth opportunities for Lifeway Foods. According to:

1. The U.S. Census Bureau, the Hispanic population currently comprises approximately 35 million or 12.4% of the U.S. population, growing some 60% over the past decade.
2. Santiago Valdez Solutions, Hispanic purchasing power will increase to \$630 billion in 2002 versus \$561 billion in 2001.

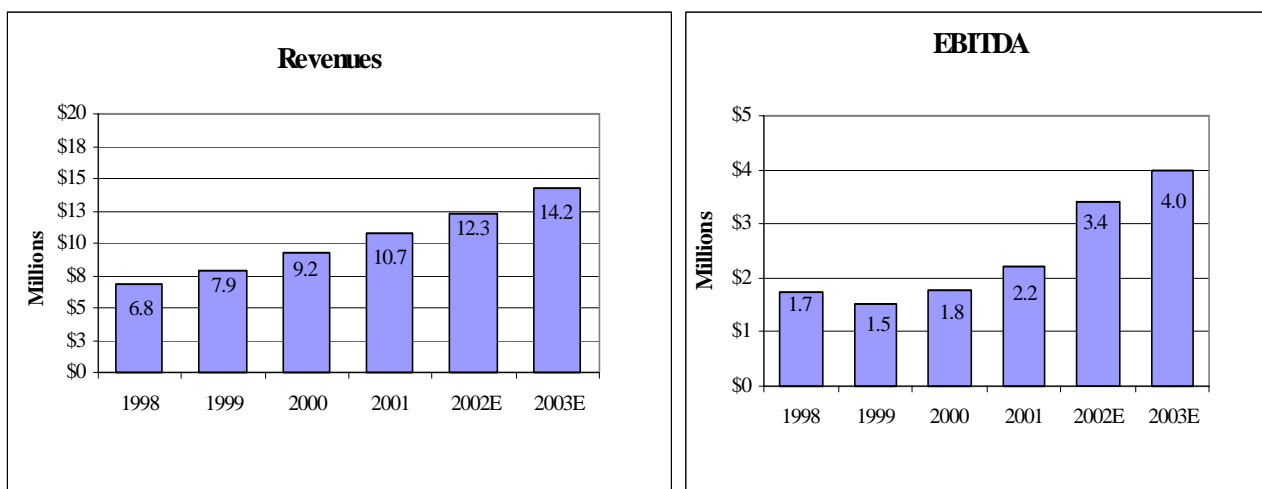
### ***Outlook***

Lifeway continues to grow revenues through the introduction of new product lines (i.e., the La Fruita™ beverage), its marketing program(s), and distribution channels in the United States and Canada. The Company's marketing program relies on advertising in local newspapers, primarily in the Chicago area, and in national magazines such as *Self*, *Shape*, and *Health*, in order to educate consumers about the health benefits of Kefir. Also, the Company is sponsoring and participating in various local sporting events around the country, such as the Y-Me Race against Breast Cancer in Chicago.

We believe that revenues should grow to \$12.29 million in 2002 and \$14.22 million in 2003, from \$10.68 million in 2001, primarily due to the Company's:

- Organic product line;
- The La Fruita™ product line, which continues to gain acceptance within the Hispanic market;
- Marketing that includes educating consumers about the potential beneficial uses of Kefir in the replenishment of 'good' bacteria in a person's intestinal system especially after taking antibiotics or consuming alcohol;
- Efforts to build on its current distribution channel, which may include regional supermarket chains and/or regional super-center type stores, and assisting local distributors with product sales.

The following chart shows the Company's historic revenue and EBITDA trend and our estimates through 2003:



### ***Other Considerations***

The Company closed its Russian theme restaurant and supper club facility. Management believes that the decision to close the restaurant should allow them to focus on its core Kefir manufacturing business. Also, the Company is involved in a pending “eminent domain” lawsuit regarding the property upon which this restaurant resides. The resolution of the lawsuit could result in a monetary gain or an exchange of property.

### ***Risks***

During the fourth quarter of 2001, Fresh Made, Inc. amended a previously filed lawsuit against Lifeway Foods in regard to abuse of process, restraint of trade, unfair competition, and interference with business relationships, etc. The Company believes this lawsuit is without merit and is in retaliation to Lifeway's efforts to enforce its rights under a settlement agreement, which the two parties entered into in connection with a prior trademark infringement lawsuit filed against Fresh Made.

The Company's products use raw materials, such as milk, sugar and fruit, from unaffiliated suppliers, and is not limited or contractually bound to any one. The raw and packaging materials purchased by the Company are considered commodity items and are widely available on the open market. If the price of those commodity products were to unexpectedly rise in price it could negatively margins for a short period of time.

The Company's financial results and equity values are subject to other risks and uncertainties known and unknown, including but not limited to competitive, operating, financial market, governmental on the State and Federal level, and event risks. These risks may cause actual results to differ from expected results.

An equity-specific concern relates to liquidity. Based on our calculations average daily-volume during the first four months of 2002 was approximately 1,400 shares, a decrease from 2,570 for the full year 2001. Investors need to be aware that by nature, a thinly traded equity can have significant price volatility.

### ***Conclusion***

We are maintaining our coverage of Lifeway Foods, Inc., with a Speculative Buy recommendation and have set an eighteen month price target of \$13.65 per share. Our previous twenty-one month price target was \$11.11 per share. Our price target is based on our earnings per share estimate for 2003 and EBITDA as a proxy for cash flow. It should be noted that the Company's EBITDA will not be impacted by FASB's new accounting rule for goodwill amortization since they do not have any goodwill related to acquisitions.

## Lifeway Foods, Inc.

We believe the Company will earn \$0.37 per diluted share, on revenues of \$12.3 million for 2002 and \$0.44 per diluted share on revenues of \$14.2 million for 2003. Our revenue estimate for 2003 represents a compounded annual growth rate of 15.8% based on the \$7.9 million in revenues that the Company reported in 1999. Based on our model, we expect EBITDA to be \$3.4 million in 2002 and \$3.98 million in 2003. We expect EBITDA to grow at a compounded annual rate of approximately 17% through 2004. We believe as a result of the revenue growth, the Company is able to leverage operating efficiencies at its two owned manufacturing facilities. We estimate that gross margins will improve to 45.6% in 2002 from 39.6% in 2001 and SG&A expenses as a percentage of revenues will decline to 23.0% in 2002 from 26.2% in 2001.

We believe Lifeway Foods is undervalued based on our earnings for 2003 and discounted cash flow model. In our opinion, the primary reason for the Company's undervaluation is the lack of Wall Street coverage and lack of investor knowledge about Kefir. Until consumers and investors are educated about the potential benefits of Kefir and Kefir based products, the Company is likely to remain undervalued.

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

- A 26.8X P/E (based on the trailing twelve month average for the Food Processing Industry) applied to our 2003 earnings per share estimate of \$0.44. This provides a valuation of \$11.79 per share;
- Our discounted cash flow model, using EBITDA as a proxy for cash flow and a 7.9% discount factor using the estimated five year growth rate for the food processing industry. This provides a valuation of \$15.51 per share.

Lifeway Foods Inc  
as of 23-May-2002



### Public Companies mentioned in this report:

Groupe Danone (NYSE: DA)

\* The information and statistical data contained herein have been obtained from sources, which we believe to be reliable but in no way are warranted by us as to accuracy or completeness. We do not undertake to advise you as to change in figures or our views. This is not a solicitation of any order to buy or sell. Taglich Brothers, Inc. is not a market maker and does not sell to or buy from customers on a principal basis. We, our affiliates, any officer, director or stockholder or any member of their families may from time to time purchase or sell any of the above-mentioned or related securities. The above statement is the opinion of Taglich Brothers, Inc. and is not a guarantee that the target price for the stock will be met or that predicted business results for the company will occur. 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 and was not a manager or co-manager of any offering for the company within the last three years. 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.

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

	Dec. 1998	Dec. 1999	Dec. 2000	Dec. 2001	Mar. 2002
	Full Year	Full Year	Full Year	Full Year	1st Qtr
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ 628	\$ 4,641	\$ 1,437	\$ 937	\$ 1,160
Marketable securities	340	1,564	4,850	5,755	5,156
Accounts receivable, net	847	966	1,182	1,317	1,469
Other receivables	16	57	-	53	58
Inventories	852	844	920	801	859
Prepaid expenses and other assets	12	-	-	34	34
Deferred income taxes	<u>37</u>	<u>52</u>	<u>167</u>	<u>561</u>	<u>719</u>
<b>Total current assets</b>	<b>2,732</b>	<b>8,124</b>	<b>8,556</b>	<b>9,456</b>	<b>9,455</b>
Property, plant and equipment, net	4,148	4,528	5,020	5,021	4,865
Intangible assets, net	10	5	-	-	-
<b>Total assets</b>	<b><u>\$ 6,890</u></b>	<b><u>\$ 12,658</u></b>	<b><u>\$ 13,575</u></b>	<b><u>\$ 14,477</u></b>	<b><u>\$ 14,320</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>					
Current liabilities:					
Current maturities of notes payable	85	92	706	90	74
Margin account	-	-	-	432	198
Accounts payable	514	480	518	543	603
Accrued expenses	166	192	242	164	166
Taxes payable	-	-	65	145	125
<b>Total current liabilities</b>	<b><u>765</u></b>	<b><u>764</u></b>	<b><u>1,531</u></b>	<b><u>1,374</u></b>	<b><u>1,167</u></b>
Long-term liabilities	1,315	1,234	529	1,116	956
Deferred income taxes	172	248	376	436	463
<b>Stockholders' equity:</b>					
Common stock, no par value; authorized 10,000,000 shares	1,427	6,509	6,509	6,509	6,509
Stock subscription receivable	-	(15)	(15)	(15)	(15)
Retained earnings	3,241	3,924	4,851	6,072	6,519
Accumulated other comprehensive income, net of tax	(12)	(7)	(205)	(729)	(959)
Treasury stock, at cost	(19)	-	-	(287)	(319)
<b>Total stockholders' equity</b>	<b><u>4,638</u></b>	<b><u>10,411</u></b>	<b><u>11,140</u></b>	<b><u>11,550</u></b>	<b><u>11,736</u></b>
<b>Total liabilities and stockholders' equity</b>	<b><u>\$ 6,889</u></b>	<b><u>\$ 12,657</u></b>	<b><u>\$ 13,575</u></b>	<b><u>\$ 14,477</u></b>	<b><u>\$ 14,320</u></b>
SHARES OUT	3,786	4,318	4,318	4,269	4,269

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

	<u>FY1998</u>	<u>FY1999</u>	<u>FY2000</u>	<u>FY2001</u>	<u>FY2002E</u>	<u>FY2003E</u>
Sales	\$ 6,795	\$ 7,908	\$ 9,177	\$ 10,684	\$ 12,288	\$ 14,220
Cost of goods sold	<u>3,697</u>	<u>4,665</u>	<u>5,308</u>	<u>6,449</u>	<u>6,873</u>	<u>7,735</u>
<b>Gross Profit</b>	3,098	3,243	3,869	4,235	5,415	6,485
<i>Gross Margins</i>	45.59%	41.01%	42.16%	39.64%	44.06%	45.60%
Sales, general and administrative	<u>1,759</u>	<u>2,178</u>	<u>2,707</u>	<u>2,785</u>	<u>2,779</u>	<u>3,270</u>
<i>EBITDA</i>	1,730	1,506	1,772	2,216	3,396	3,975
<b>Operating Income</b>	1,339	1,065	1,162	1,450	2,636	3,215
<i>Operating Margin</i>	19.71%	13.47%	12.66%	13.57%	21.45%	22.61%
Other Income (Expense)						
Interest income	38	110	369	235	142	140
Interest expense	(106)	(112)	(93)	(93)	(80)	(100)
Gain on sale of marketable securities	35	7	15	220	36	-
Total Other Income (Expense)	<u>(33)</u>	<u>5</u>	<u>291</u>	<u>362</u>	<u>98</u>	<u>40</u>
<b>Pre-Tax Income</b>	1,306	1,070	1,453	1,812	2,734	3,255
<i>Pre-Tax Margins</i>	19.22%	13.53%	15.84%	16.96%	22.25%	22.89%
Income Tax Expense (Benefit)	<u>543</u>	<u>387</u>	<u>526</u>	<u>591</u>	<u>1,137</u>	<u>1,350</u>
<i>Tax Rate</i>	41.60%	36.21%	36.21%	32.59%	41.57%	41.47%
<b>Net Income</b>	<u>\$ 763</u>	<u>\$ 682</u>	<u>\$ 927</u>	<u>\$ 1,221</u>	<u>\$ 1,598</u>	<u>\$ 1,905</u>
<b>EPS -- Fully Diluted</b>	<u>\$ 0.20</u>	<u>\$ 0.17</u>	<u>\$ 0.21</u>	<u>\$ 0.28</u>	<u>\$ 0.37</u>	<u>\$ 0.44</u>
Avg Shares Out-Fully Diluted	<u>3,781</u>	<u>3,933</u>	<u>4,318</u>	<u>4,318</u>	<u>4,295</u>	<u>4,350</u>
Percent of Revenue						
Cost of Revenues	54.41%	58.99%	57.84%	60.36%	55.94%	54.40%
Sales, General and Administrative expenses	25.88%	27.54%	29.50%	26.07%	22.61%	23.00%
YEAR / YEAR GROWTH						
Total Revenues	13.99%	16.37%	16.05%	16.42%	15.01%	15.72%
Operating Income	28.80%	-20.49%	9.12%	24.77%	83.41%	21.96%
Pre-Tax Income	10.94%	-18.08%	35.86%	24.67%	50.94%	19.05%
Net Income	8.90%	-10.51%	35.85%	31.75%	30.85%	19.24%

Lifeway Foods, Inc.  
Quarterly Income Statement Model  
For the Years Ended December 31, 2001  
(in thousands)

	Q1(03/01)	Q2 (06/01)	Q3 (09/01)	Q4 (12/01)	FY2001
Sales	\$ 2,636	\$ 2,750	\$ 2,662	\$ 2,636	\$ <b>10,684</b>
Cost of goods sold	<u>1,547</u>	<u>1,645</u>	<u>1,618</u>	<u>1,639</u>	<u><b>6,449</b></u>
<b>Gross Profit</b>	1,089	1,105	1,045	996	<b>4,235</b>
<i>Gross Margins</i>	41.31%	40.18%	39.24%	37.80%	<b>39.64%</b>
Sales, general and administrative	<u>657</u>	<u>773</u>	<u>693</u>	<u>662</u>	<u><b>2,785</b></u>
<b>EBITDA</b>	612	528	546	530	<b>2,216</b>
<b>Operating Income</b>	432	331	352	335	<b>1,450</b>
<i>Operating Margin</i>	16.39%	12.05%	13.22%	12.70%	<b>13.57%</b>
Other Income (Expense)					
Interest income	72	51	57	55	<b>235</b>
Interest expense	(25)	(30)	(21)	(18)	<b>(93)</b>
Gain on sale of marketable securities	<u>85</u>	<u>29</u>	<u>58</u>	<u>48</u>	<u><b>220</b></u>
Total Other Income (Expense)	<u>132</u>	<u>50</u>	<u>95</u>	<u>85</u>	<u><b>362</b></u>
<b>Pre-Tax Income</b>	564	381	447	420	<b>1,812</b>
<i>Pre-Tax Margins</i>	21.39%	13.87%	16.79%	15.93%	<b>16.96%</b>
Income Tax Expense (Benefit)	<u>235</u>	<u>149</u>	<u>207</u>	<u>-</u>	<u><b>591</b></u>
<i>Tax Rate</i>	41.72%	39.09%	46.33%	0.00%	<b>32.59%</b>
<b>Net Income</b>	<u>\$ 329</u>	<u>\$ 232</u>	<u>\$ 240</u>	<u>\$ 420</u>	<u>\$ <b>1,221</b></u>
<b>EPS -- Fully Diluted</b>	<u>\$ 0.08</u>	<u>\$ 0.05</u>	<u>\$ 0.06</u>	<u>\$ 0.10</u>	<u>\$ <b>0.28</b></u>
Avg Shares Out-Fully Diluted	<u>4,318</u>	<u>4,318</u>	<u>4,318</u>	<u>4,318</u>	<u><b>4,318</b></u>
Percent of Revenue					
Cost of Revenues	58.69%	59.82%	60.76%	62.20%	60.36%
Sales, General and Administrative expenses	24.93%	28.13%	26.02%	25.10%	26.07%
<b>YEAR / YEAR GROWTH</b>					
Total Revenues	16.00%	20.22%	16.58%	12.97%	16.42%
Operating Income	90.80%	185.42%	-1.04%	-27.87%	24.77%
Pre-Tax Income	82.98%	26.77%	-7.01%	15.38%	24.67%
Net Income	74.05%	26.02%	-13.02%	50.89%	31.75%



Lifeway Foods, Inc.  
Quarterly Income Statement Model  
For the Years Ended December 31, 2002  
(in thousands)

	<u>Q1(03/02)</u>	<u>Q2 (06/02)E</u>	<u>Q3 (09/02)E</u>	<u>Q4 (12/02)E</u>	<u>FY2002E</u>
Sales	\$ 2,888	\$ 3,000	\$ 3,150	\$ 3,250	\$ <b>12,288</b>
Cost of goods sold	<u>1,523</u>	<u>1,700</u>	<u>1,800</u>	<u>1,850</u>	<u><b>6,873</b></u>
<b>Gross Profit</b>	1,365	1,300	1,350	1,400	<b>5,415</b>
<i>Gross Margins</i>	47.25%	43.33%	42.86%	43.08%	<b>44.06%</b>
Operating Expenses:					
Sales, general and administrative	649	665	700	765	<b>2,779</b>
Total Operating Expenses	<u>649</u>	<u>665</u>	<u>700</u>	<u>765</u>	<u><b>2,779</b></u>
<i>EBITDA</i>	920	825	840	825	<b>3,396</b>
<b>Operating Income</b>	716	635	650	635	<b>2,636</b>
<i>Operating Margin</i>	24.79%	21.17%	20.63%	19.54%	<b>21.45%</b>
Other Income (Expense)					
Interest income	37	35	35	35	<b>142</b>
Interest expense	(20)	(20)	(20)	(20)	<b>(80)</b>
Gain on sale of marketable securities	36	-	-	-	<b>36</b>
Rental income					
Total Other Income (Expense)	<u>53</u>	<u>15</u>	<u>15</u>	<u>15</u>	<u><b>98</b></u>
<b>Pre-Tax Income</b>	769	650	665	650	<b>2,734</b>
<i>Pre-Tax Margins</i>	26.64%	21.67%	21.11%	20.00%	<b>22.25%</b>
Income Tax Expense (Benefit)	<u>322</u>	<u>270</u>	<u>275</u>	<u>270</u>	<u><b>1,137</b></u>
<i>Tax Rate</i>	41.82%	41.54%	41.35%	41.54%	<b>41.57%</b>
<b>Net Income</b>	<u>\$ 448</u>	<u>\$ 380</u>	<u>\$ 390</u>	<u>\$ 380</u>	<u><b>\$ 1,598</b></u>
<b>EPS -- Fully Diluted</b>	<u>\$ 0.10</u>	<u>\$ 0.09</u>	<u>\$ 0.09</u>	<u>\$ 0.09</u>	<u><b>\$ 0.37</b></u>
Avg Shares Out-Fully Diluted	<u>4,270</u>	<u>4,285</u>	<u>4,300</u>	<u>4,325</u>	<u><b>4,295</b></u>
Percent of Revenue					
Cost of Revenues	52.75%	56.67%	57.14%	56.92%	55.94%
Sales, General and Administrative expenses	22.46%	22.17%	22.22%	23.54%	22.61%
<b>YEAR / YEAR GROWTH</b>					
Total Revenues	9.54%	9.10%	18.32%	23.31%	15.01%
Operating Income	65.75%	91.57%	84.74%	97.25%	83.41%
Pre-Tax Income	36.37%	70.47%	48.81%	55.03%	50.94%
Net Income	36.15%	63.62%	62.60%	-9.37%	30.85%

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

	<u>Q1(03/03)E</u>	<u>Q2 (06/03)E</u>	<u>Q3 (09/03)E</u>	<u>Q4 (12/03)E</u>	<u>FY2003E</u>
Sales	\$ 3,435	\$ 3,475	\$ 3,635	\$ 3,675	\$ <b>14,220</b>
Cost of goods sold	<u>1,825</u>	<u>1,900</u>	<u>1,985</u>	<u>2,025</u>	<u>7,735</u>
<b>Gross Profit</b>	1,610	1,575	1,650	1,650	<b>6,485</b>
<i>Gross Margins</i>	46.87%	45.32%	45.39%	44.90%	<b>45.60%</b>
Operating Expenses:					
Sales, general and administrative	785	800	835	850	<b>3,270</b>
Total Operating Expenses	<u>785</u>	<u>800</u>	<u>835</u>	<u>850</u>	<u>3,270</u>
<i>EBITDA</i>	1,029	965	1,005	990	<b>3,975</b>
<b>Operating Income</b>	825	775	815	800	<b>3,215</b>
<i>Operating Margin</i>	24.02%	22.30%	22.42%	21.77%	<b>22.61%</b>
Other Income (Expense)					
Interest income	35	35	35	35	<b>140</b>
Interest expense	(25)	(25)	(25)	(25)	<b>(100)</b>
Total Other Income (Expense)	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>40</u>
<b>Pre-Tax Income</b>	835	785	825	810	<b>3,255</b>
<i>Pre-Tax Margins</i>	24.31%	22.59%	22.70%	22.04%	<b>22.89%</b>
Income Tax Expense (Benefit)	<u>350</u>	<u>325</u>	<u>340</u>	<u>335</u>	<u>1,350</u>
<i>Tax Rate</i>	41.92%	41.40%	41.21%	41.36%	<b>41.47%</b>
<b>Net Income</b>	<u>\$ 485</u>	<u>\$ 460</u>	<u>\$ 485</u>	<u>\$ 475</u>	<u>\$ <b>1,905</b></u>
<b>EPS -- Fully Diluted</b>	<u>\$ 0.11</u>	<u>\$ 0.11</u>	<u>\$ 0.11</u>	<u>\$ 0.11</u>	<u>\$ <b>0.44</b></u>
Avg Shares Out-Fully Diluted	<u>4,350</u>	<u>4,350</u>	<u>4,350</u>	<u>4,350</u>	<u>4,350</u>
Percent of Revenue					
Cost of Revenues	53.13%	54.68%	54.61%	55.10%	54.40%
Sales, General and Administrative expenses	22.85%	23.02%	22.97%	23.13%	23.00%
<b>YEAR / YEAR GROWTH</b>					
Total Revenues	18.95%	15.83%	15.40%	13.08%	15.72%
Operating Income	15.22%	22.05%	25.38%	25.98%	21.96%
Pre-Tax Income	8.55%	20.77%	24.06%	24.62%	19.05%
Net Income	8.37%	21.05%	24.36%	25.00%	19.24%

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

	<u>FY1998A</u>	<u>FY1999A</u>	<u>FY2000A</u>	<u>FY2001A</u>	<u>Q1 2002A</u>
<i>Cash Flows from Operating Activities</i>					
Net Income	\$ 763	\$ 682	\$ 927	\$ 1,221	\$ 448
Depreciation and amortization	391	441	610	777	204
Amortization of discounts on securities	-	(7)	-	-	-
Gain on sale of marketable securities	(35)	(7)	(15)	(250)	(36)
Issuance of common stock in exchange for services rendered	31	-	-	-	-
Decrease in allowance for doubtful accounts	(48)	-	-	-	-
Provision for doubtful accounts	-	-	-	15	-
Deferred income taxes	115	54	150	48	(27)
	<u>1,217</u>	<u>1,165</u>	<u>1,672</u>	<u>1,812</u>	<u>588</u>
<i>Changes In:</i>					
Accounts receivable	19	(118)	(216)	(150)	(152)
Other receivables	(1)	(41)	57	(53)	(6)
Inventories	(237)	8	(76)	119	(58)
Prepaid expenses and other assets	(4)	12	-	(34)	0
Accounts payable	119	(34)	(38)	26	60
Accrued expenses	(262)	26	50	(4)	2
Taxes payable	-	-	65	80	(20)
Net Changes in Working Capital	<u>(366)</u>	<u>(148)</u>	<u>(158)</u>	<u>(15)</u>	<u>(174)</u>
<b>Net cash Provided by Operations</b>	<u>850</u>	<u>1,017</u>	<u>1,514</u>	<u>1,797</u>	<u>415</u>
<i>Cash Flows from Investing Activities</i>					
Purchase of marketable securities	(305)	(1,846)	(8,808)	(9,247)	(274)
Sale of marketable securities	218	646	5,202	7,687	574
Change in margin account	-	-	75	357	(49)
Purchase of property, plant and equipment	(593)	(794)	(1,096)	(713)	(234)
<b>Net cash used in Investing</b>	<u>(680)</u>	<u>(1,994)</u>	<u>(4,627)</u>	<u>(1,916)</u>	<u>18</u>
<i>Cash Flows from Financing Activities</i>					
Repayment of notes payable	(92)	(96)	(91)	(94)	(177)
Proceeds from issuance of common stock	-	5,138	-	-	-
Purchase of treasury stock	-	-	-	(287)	(32)
Stock issuance costs	-	(52)	-	-	-
<b>Net cash provided by Financing</b>	<u>(92)</u>	<u>4,990</u>	<u>(91)</u>	<u>(381)</u>	<u>(209)</u>
Net change in Cash	78	4,013	(3,204)	(500)	223
Cash Beginning of Period	<u>551</u>	<u>628</u>	<u>4,641</u>	<u>1,437</u>	<u>936</u>
Cash End of Period	<u>\$ 628</u>	<u>\$ 4,641</u>	<u>\$ 1,437</u>	<u>\$ 936</u>	<u>\$ 1,160</u>