Research Report – Update

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

Lifeway Foods, Inc.

Rating: Underperform

Howard Halpern

May 25, 2006

LWAY $10.52 – (NasdaqNM)

	FY (12/04)A	FY (12/05)A	***FY (12/06) E***	***FY (12/07) E***
Revenue (in millions)	$16.32	$20.13	***$25.43***	***$31.50***
Earnings per share (diluted)*	$0.24	$0.30	***$0.37***	***$0.46***

52-Week range	$18.17 – $10.19	Fiscal year ends:	December
Shares outstanding a/o 05/08/06	8.397 million	Revenue/shares (TTM)	$2.56
Trading float	2.197 million	Price/Sales (TTM)	4.11X
Insider and 5%owners	73.8%	Price/Sales (2007)E	2.82X
Tangible Book value/shr a/o 03-31-06	$2.51	Price/Earnings (TTM)	31.9X
Price/Book	4.19X	Price/Earnings (2007)E	22.9X

* All per share figures reflect the 2-1 stock split effective March 9, 2004.

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 maintaining our Underperform rating on Lifeway Foods, Inc. (NasdaqNM: LWAY). We continue to believe its shares remain fairly valued based on our current revenue, EBITDA, and EPS estimates.

On May 5, 2006, Lifeway Foods filed an 8-K with the SEC regarding its entry into a forth extension of a stockholders' agreement with Danone Foods, Inc. According to the filing, on May 3, 2006, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the forth extension of the stockholders', standstill, and non-compete agreement, which will expire on December 31, 2006. According to SEC filings, as of May 8, 2006, Danone owned approximately 20.5% of LWAY's common shares.

Lifeway Foods reported first quarter 2006 revenue of $6.003 million, which was an increase of 28.9% versus $4.657 million in the same period last year. Net income was $0.895 million or $0.11 per diluted share versus $0.725 million or $0.09 per diluted share in the first quarter of 2005.

Based on first quarter results, we are maintaining our 2006 revenue estimate of $25.428 million. Given our revenue estimate and improved cost structure during Q1 of 2006, we are increasing our 2006 forecast for net income to $3.100 million or $0.37 per diluted share from $2.893 million or $0.34 per diluted share.

Our initial forecast for 2007 calls for revenue of $31.5 million and net income of $3.915 million or $0.46 per diluted share.

**** Please view our disclaimer located on page 10.***

The Company

Lifeway Foods, Inc. (NasdaqNM: 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 fifteen 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 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.

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 May 5, 2006, Lifeway Foods filed an 8-K with the SEC regarding the entry into a forth extension of the stockholders' agreement with Danone Foods, Inc. According to the filing, on May 3, 2006, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the forth extension of the stockholders', standstill, and non-compete agreements, which will expire on December 31, 2006. According to the filing, all Lifeway shares held by Danone Foods, Inc., were transferred to DS Waters on November 10, 2005. As part of the non-compete provision of the agreement, a specific exclusion was included for Stonyfield Farms, Inc., an affiliate of Danone Foods, Inc. and DS Waters. Stonyfield Farm, Inc. is a manufacturer of natural and organic yogurts and ice cream and according to its Web-site is the largest organic yogurt producer in the world.

Investors should be aware that as of May 8, 2006, Danone Foods, Inc., the U.S. subsidiary of Groupe Danone of Paris, France, has a 20.5% ownership interest in Lifeway Foods, Inc.

Recent Financials

For the three-months ended March 31, 2006, versus the three-months ended March 31, 2005:

- Revenue increased to $6.003 million versus $4.657 million;
- Gross margin increased to 46.48% versus 44.64%;
- Operating expenses increased to $1.384 million versus $1.155 million;
- EBITDA increased to $1.550 million versus $1.064 million; and
- Net income was $0.895 million or $0.11 per diluted share versus net income of $0.458 million or $0.09 per diluted share.

The year-over-year revenue increase of 28.9% was primarily attributable to increased awareness of the Company's existing drinkable dairy products (i.e., La Fruta and its flagship Kefir product). Also, the Company's LFI Enterprises subsidiary (formed in 1992) contributed $0.260 million to total revenue, which included $0.126 from the sale of gourmet cream cheese products (related to the 2004 acquisition of Ilya's Farms, Inc.), as well as, $0.134 million in sales from the distribution of Lifeway's Kefir and Farmer Cheese products in the tri-state area of PA, NJ, and NY.

Gross margin improved to 46.48% versus 44.64% in the same period last year. The increase in gross margin was directly related to the declining cost of milk. According to the Company, the average cost of milk, its largest component of cost of goods sold, decreased approximately 15% during the three-months ended March 31, 2006, as compared to the same period last year.

Operating expenses in the quarter increased by $0.229 million, primarily due to higher utility, transportation, and certain raw materials costs. On a percentage of revenue, operating expenses decreased to 23.06% versus 24.81% in the first quarter of 2005, primarily due to the Company's revenue growth and increased overall operating efficiencies.

In comparison, Taglich Brothers' estimates called for revenue of $6.003 million and net income of $0.833 million or $0.11 per diluted share.

Balance Sheet as of March 31, 2006

The Company had cash and cash equivalents of $3.818 million and short-term marketable securities of $8.338 million. This compares to cash and cash equivalents of $4.354 million and short-term marketable securities of $7.479 million as of December 31, 2005. Working capital was $16.114 million versus $14.474 million in 2005. The Company's long-term liabilities stood at $2.888 million, which was a slight decrease from $2.903 million at the end of 2005.

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

- 31.7% fixed income securities; and

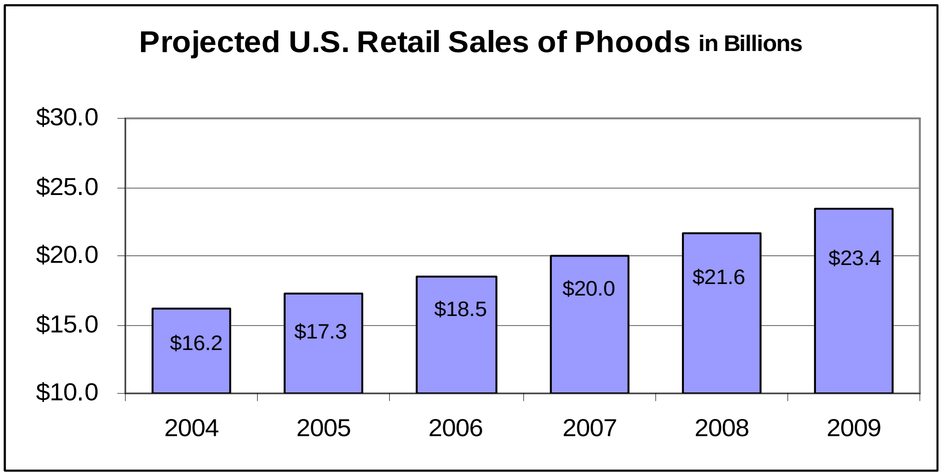
- 68.3% in equities, mutual funds, and preferred securities.

According to the Company's first quarter 10-Q filing, Lifeway has net unrealized gains on marketable securities of $0.263 million as of March 31, 2006. Management anticipates realizing approximately $0.200 million of those gains in the second quarter of 2006, as a result of rebalancing its portfolio. However, at this point in time, our estimates do not include this anticipated amount since they may or may not be offset by future unrealized losses (given the recent market decline in May 2006).

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 potential acquisition opportunities in order to boost sales, while leveraging the Company's distribution system that potentially could lower costs.

Market Comment

It is estimated that Lifeway Foods' target market, the functional and probiotic foods segment of the Food Industry, generates annual revenue in excess of $20 billion. In addition, according to an article (January 2005) in the Chemical Market Reporter magazine (a trade publication provides business information for the global chemical market), the U.S. retail sales of phoods and bepherages (terms used for foods and drinks with health benefits) was approximately $16.2 billion in 2004 and is forecast to reach $20 billion by 2007 (stats were from a research report published by Packaged Facts, a provider of authoritative consumer market research). The following offers some prospective as to the potential future sales trends:



Source: Packaged Facts

In addition, Marketresearch.com (an aggregator of global business intelligence) predicts that by the end of the decade, the U.S. Functional Food Market will approach $30 billion. This would represent approximately 5.5% of the total Food Market. The Nutrition Business Journal (research, publishing and consulting company serving the nutrition, natural products and alternative health care industries) estimates that the Functional Food Market currently represents 3.8% of the total U.S. Food Market.

Outlook/Projections

Management stated in the Company's first quarter earnings press release on May 15, 2006, that this quarter was another record in terms of top line results. We believe this continues to mean that public interest for Lifeway's Kefir product reached an all time high, as well as becoming more accepted by the mainstream market as a healthy product. In addition, at the end of 2005, the Company's CEO saw gains in distribution outlets across the country and new product introductions (i.e., ProBugs™ and Greek Style Kefir). The Company's CFO commented that he was pleased to see improved first quarter gross margins partly due to lower raw material costs (i.e., milk, which was at its lowest level since late 2004).

We anticipate that the Company is likely to experience a weekly sales run rate of approximately $0.480 million for the second quarter of 2006, which would be just below the upper end of Taglich Brothers' expected range of $0.450 million to $0.490 million. Taglich Brothers' weekly sale run rate is based primarily on increased orders from existing customers, as well as expanded distribution opportunities. In addition, Management believes the Company's packaging has improved 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. Also, a new warehouse facility purchased in 2005, gives the Company added flexibility and the opportunity to expand its product line to include more nonperishable food items.

Based on first quarter results and comments made in the Company's first quarter 10-Q filing, we are maintaining our 2006 revenue estimate of $25.428 million. Given our revenue estimate, public statements made by Management, and the potential for productivity improvements made through investments in automation, we are increasing our 2006 forecast for net income to $3.100 million or $0.37 per diluted share from $2.893 million or $0.34 per diluted share. Our forecast incorporates the following:

– A distribution agreement with Target stores;

– A limited test market of LowFat Plain Kefir to Costco stores in the Midwest region of the U.S;

– The average price of milk declining by approximately 15% on a year over year basis according to U.S. government forecasts;

– Investments made to improve productivity through the automation process;

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

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

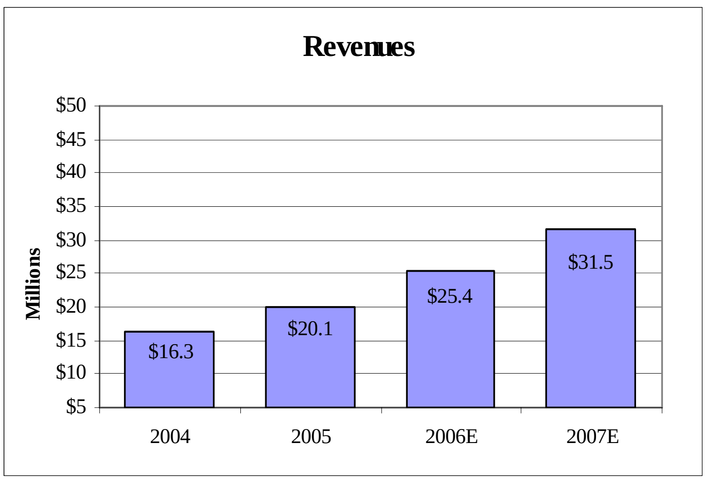
We have adjusted the following from our prior forecast, based on the previously discussed operating trends:

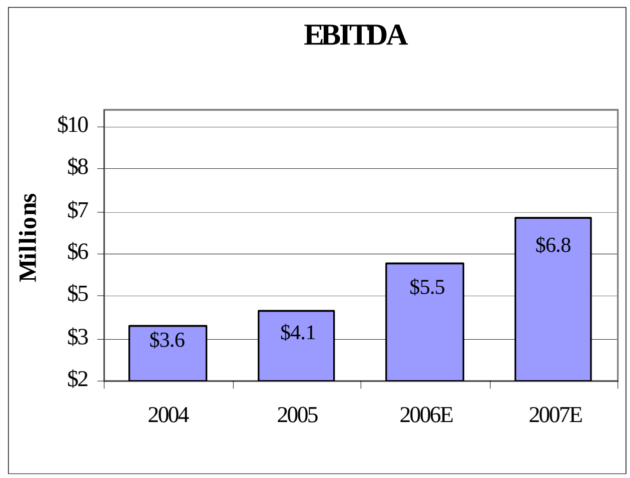
– Gross margins to 43.81% from 42.50%; and

– SG&A expenses, as a percentage of revenues, to 24.61% from 25.03%.

Our initial forecast for 2007 calls for revenue of $31.5 million and net income of $3.915 million or $0.46 per diluted share. Our forecast incorporates expansion of existing distribution agreements, the average price of milk remaining fairly steady, leveraging the investments made to improve productivity through the automation process, and continued high energy and raw material costs (i.e., resin). We also anticipate gross margin of 44.05% and SG&A expenses, as a percentage of revenues of 24.52%

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 May 5, 2006, the Company entered into a forth extension of the stockholders' agreement with Danone Foods, Inc., which was originally entered into on October 1 1999. In the filing, on May 3, 2006, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the forth 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 fourth extension, the terms of the non-compete period and standstill period of the stockholders' agreement expire on December 31, 2006.

According to SEC filings, as of May 8, 2006, Danone owned approximately 20.5% 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 2005, 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 20% annually. As a result, the Company will need to meet the challenges associated with growth, such as management of raw materials and increased production staff. If Lifeway Foods is not successful in meeting these challenges, revenue growth may slow in future periods.

Management Control

Ludmila Smolyansky, who is Chairperson of the Board of Directors of Lifeway Foods, beneficially owns or controls approximately 47.3% 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 March 31, 2006, the fair value of the Company's marketable securities available for sale was $8.338 million. In the Company's 10-K filing, Management stated its belief that LWAY can offset a portion of the oil related costs that have been incurred over the last twelve months, by making prudent investments in energy related securities, which will show up in other income. Investors should be aware that investments in energy related securities can be volatile and could have a negative impact on its portfolio if energy prices were to decline.

Federal Reserve
Investors should be aware that if the Federal Reserve continues increasing interest rates (over the last sixteen meetings it has increased rates 25 basis points each time), 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 the first four months of 2006, average daily volume has declined to 12,938 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 Underperform rating on Lifeway Foods, Inc. (NasdaqNM: LWAY). We continue to believe its shares remain fairly valued based on our current revenue, EBITDA, and EPS estimates.

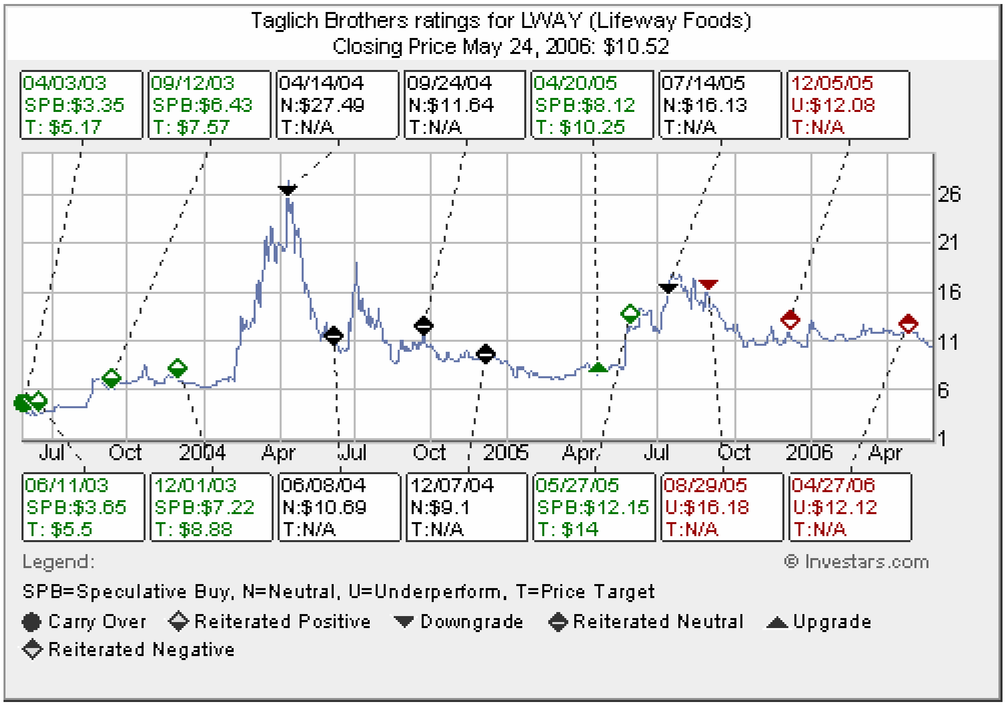
Our valuation model is as follows:

- A 1.43X price to sales multiple, which is the trailing twelve month industry multiple from Reuters as of May 25, 2006, applied to our revenue per share estimate of $3.74 for 2007;

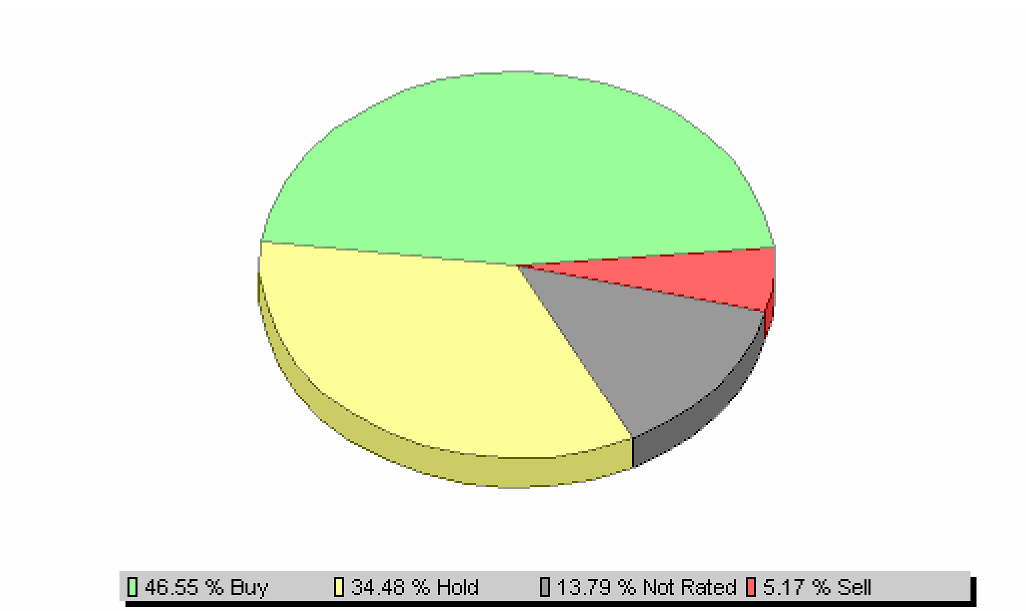
- A 22.7X P/E based on the Company's earnings per share compound annual growth rate between 2000 and 2007 ($0.11 per share to $0.46 per share, respectively), applied to our earnings per share estimate of $0.46 for 2007; and

- A discounted cash flow model, using EBITDA as a proxy for cash flow (see chart on page 5), a 16.1% discount factor using the capital asset pricing model, and a terminal value of 13.5X (which is the trailing twelve month price to cash flow multiple from Reuters as of May 25, 2006).

Investors need to be aware that in early May 2006, Lifeway Foods was able to enter into a forth 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 forth extension of the stockholders', standstill, and non-compete agreements, which will now expire on December 31, 2006.



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	0	0
Hold	0	0
Sell	0	0
Not Rated	1	8.33%

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)

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. 2003 Year End	Dec. 2004 Year End	Dec. 2005 Year End	Mar. 2006 1st Qtr End
ASSETS				
Current assets:				
Cash and cash equivalents	$ 4,598	$ 5,773	$ 4,354	$ 3,818
Marketable securities	6,303	6,742	7,479	8,338
Accounts receivable, net	1,800	2,024	2,518	3,054
Other receivables	166	72	56	55
Inventories	812	906	1,717	2,024
Prepaid income taxes	306	259	12	40
Prepaid expenses and other assets	1	7	9	15
Deferred income taxes	27	-	143	-
Total current assets	**14,012**	**15,783**	**16,287**	**17,345**
Property, plant and equipment, net	3,733	3,420	7,751	7,775
Total assets	**$ 17,745**	**$ 19,688**	**$ 24,465**	**$ 25,529**
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Current maturities of notes payable	28	9	532	528
Accounts payable	795	642	426	453
Accrued expenses	184	196	355	245
Taxes payable	-	36	-	4
Total current liabilities	**1,007**	**882**	**1,314**	**1,231**
Long-term liabilities	473	464	2,903	2,888
Deferred income taxes	472	424	349	346
Stockholders' equity:				
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509	6,509
Paid-in capital	-	64	91	99
Stock subscription receivable	(15)	-	-	-
Retained earnings	9,822	11,874	14,423	15,318
Accumulated other comprehansive income, net of tax	156	119	(100)	154
Treasury stock, at cost	(680)	(649)	(1,025)	(1,015)
Total stockholders' equity	**15,793**	**17,918**	**19,899**	**21,065**
Total liabilities and stockholders' equity	**$ 17,745**	**$ 19,688**	**$ 24,465**	**$ 25,529**
SHARES OUT	8,437	8,420	8,396	8,397

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

	FY2003A	FY2004A	FY2005A	**FY2006E**	**FY2007E**
Revenue	$ 14,878	$ 16,319	$ 20,132	**$ 25,428**	**$ 31,500**
Cost of goods sold	7,841	9,035	11,664	**14,288**	**17,625**
Gross Profit	7,037	7,284	8,468	**11,140**	**13,875**
Gross Margins	47.30%	44.64%	42.06%	**43.81%**	**44.05%**
Sales, general and administrative	3,558	4,334	5,066	**6,259**	**7,725**
EBITDA	4,167	3,620	4,052	**5,460**	**6,810**
Operating Income	3,479	2,950	3,401	**4,881**	**6,150**
Operating Margin	23.38%	18.08%	16.90%	**19.20%**	**19.52%**
Other Income (Expense)					
Interest income	97	186	323	**341**	**350**
Interest expense	(41)	(31)	(101)	**(215)**	**(210)**
Gain on sale of marketable securities	(1,294)	354	445	**(37)**	**-**
Other than temporary reduction of marketable securities	89	(16)	14	**1**	**-**
Gain on sale of assets	1,246	-	-	**-**	**-**
Total Other Income (Expense)	98	492	682	**90**	**140**
Pre-Tax Income	3,576	3,442	4,083	**4,971**	**6,290**
Pre-Tax Margins	24.04%	21.09%	20.28%	**19.55%**	**19.97%**
Income Tax Expense (Benefit)	1,355	1,390	1,535	**1,871**	**2,375**
Tax Rate	37.89%	40.39%	37.58%	**37.65%**	**37.76%**
Net Income	$ 2,221	$ 2,052	$ 2,548	**$ 3,100**	**$ 3,915**
EPS -- Fully Diluted	$ 0.26	$ 0.24	$ 0.30	**$ 0.37**	**$ 0.46**
Avg Shares Out-Fully Diluted *	8,437	8,439	8,404	**8,410**	**8,425**
Percent of Revenue					
Cost of Revenues	52.70%	55.36%	57.94%	56.19%	55.95%
Sales, General and Administrative expenses	23.92%	26.56%	25.17%	24.61%	24.52%
YEAR / YEAR GROWTH					
Total Revenues	21.83%	9.69%	23.36%	26.31%	23.88%
Operating Income	34.96%	-15.18%	15.28%	43.51%	25.99%
Pre-Tax Income	44.67%	-3.75%	18.62%	21.75%	26.54%
Net Income	45.31%	-7.62%	24.19%	21.63%	26.31%

* Adjusted for the 2-1 stock split effective March 9, 2004

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2004
(in thousands)

	Q1(03/04)A	Q2 (06/04)A	Q3 (09/04)A	Q4 (12/04)A	**FY2004A**
Revenue	$ 3,935	$ 4,002	$ 4,139	$ 4,243	**$ 16,319**
Cost of goods sold	2,099	2,266	2,240	2,430	**9,035**
Gross Profit	1,836	1,736	1,899	1,813	**7,284**
Gross Margins	*46.65%*	*43.38%*	*45.89%*	*42.73%*	**44.64%**
Operating Expenses:					
Sales, general and administrative	882	1,049	1,158	1,244	**4,334**
Total Operating Expenses	882	1,049	1,158	1,244	**4,334**
EBITDA	1,110	846	901	764	**3,620**
Operating Income	954	687	741	569	**2,950**
Operating Margin	*24.24%*	*17.16%*	*17.91%*	*13.40%*	**18.08%**
Other Income (Expense)					
Interest income	41	34	50	61	**186**
Interest expense	(8)	(8)	(8)	(8)	**(31)**
Total Other Income (Expense)	302	39	70	80	**492**
Pre-Tax Income	1,256	726	811	649	**3,442**
Pre-Tax Margins	*31.91%*	*18.15%*	*19.60%*	*15.29%*	**21.09%**
Income Tax Expense (Benefit)	491	294	296	309	**1,390**
Tax Rate	*39.06%*	*40.50%*	*36.51%*	*47.66%*	**40.39%**
Net Income	$ 765	$ 432	$ 515	$ 340	**$ 2,052**
EPS -- Fully Diluted	$ 0.09	$ 0.05	$ 0.06	$ 0.04	**$ 0.24**
Avg Shares Out-Fully Diluted	8,437	8,438	8,440	8,440	**8,439**
Percent of Revenue					
Cost of Revenues	53.35%	56.62%	54.11%	57.27%	55.36%
Sales, General and Administrative expenses	22.41%	26.22%	27.98%	29.33%	26.56%
YEAR / YEAR GROWTH					
Total Revenues	18.94%	5.99%	7.86%	7.26%	9.69%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2005
(in thousands)

	Q1(03/05)A	Q2 (06/05)A	Q3 (09/05)A	Q4 (12/05)A	**FY2005A**
Revenue	$ 4,657	$ 5,073	$ 5,195	$ 5,208	**$ 20,132**
Cost of goods sold	2,578	2,956	3,073	3,057	**11,664**
Gross Profit	2,079	2,116	2,121	2,151	**8,468**
Gross Margins	*44.64%*	*41.72%*	*40.84%*	*41.31%*	**42.06%**
Operating Expenses:					
Sales, general and administrative	1,155	1,279	1,359	1,273	**5,066**
Total Operating Expenses	1,155	1,279	1,359	1,273	**5,066**
EBITDA	1,064	1,015	930	1,043	**4,052**
Operating Income	924	837	762	878	**3,401**
Operating Margin	*19.84%*	*16.51%*	*14.67%*	*16.86%*	**16.90%**
Other Income (Expense)					
Interest income	65	75	72	110	**323**
Interest expense	(7)	(7)	(37)	(50)	**(101)**
Total Other Income (Expense)	259	44	197	181	**682**
Pre-Tax Income	1,183	881	959	1,059	**4,083**
Pre-Tax Margins	*25.41%*	*17.37%*	*18.47%*	*20.34%*	**20.28%**
Income Tax Expense (Benefit)	458	324	400	352	**1,535**
Tax Rate	*38.69%*	*36.80%*	*41.74%*	*33.24%*	**37.58%**
Net Income	$ 725	$ 557	$ 559	$ 707	**$ 2,548**
EPS -- Fully Diluted	$ 0.09	$ 0.07	$ 0.07	$ 0.08	**$ 0.30**
Avg Shares Out-Fully Diluted	8,433	8,398	8,401	8,404	**8,404**
Percent of Revenue					
Cost of Revenues	55.36%	58.28%	59.16%	58.69%	57.94%
Sales, General and Administrative expenses	24.81%	25.21%	26.16%	24.44%	25.17%
YEAR / YEAR GROWTH					
Total Revenues	18.34%	26.75%	25.52%	22.72%	23.36%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2006
(in thousands)

	Q1(03/06)A	Q2 (06/06)E	Q3 (09/06)E	Q4 (12/06)E	**FY2006E**
Revenue	$ 6,003	$ 6,250	$ 6,525	$ 6,650	**$ 25,428**
Cost of goods sold	3,213	3,550	3,675	3,850	**14,288**
Gross Profit	2,790	2,700	2,850	2,800	**11,140**
Gross Margins	*46.48%*	*43.20%*	*43.68%*	*42.10%*	**43.81%**
Operating Expenses:					
Sales, general and administrative	1,384	1,550	1,625	1,700	**6,259**
Total Operating Expenses	1,384	1,550	1,625	1,700	**6,259**
EBITDA	1,550	1,295	1,370	1,245	**5,460**
Operating Income	1,406	1,150	1,225	1,100	**4,881**
Operating Margin	*23.43%*	*18.41%*	*18.77%*	*16.54%*	**19.20%**
Other Income (Expense)					
Interest income	86	85	85	85	**341**
Interest expense	(50)	(55)	(55)	(55)	**(215)**
Total Other Income (Expense)	(0)	30	30	30	**90**
Pre-Tax Income	1,406	1,180	1,255	1,130	**4,971**
Pre-Tax Margins	*23.42%*	*18.89%*	*19.23%*	*16.99%*	**19.55%**
Income Tax Expense (Benefit)	511	450	475	435	**1,871**
Tax Rate	*36.37%*	*38.12%*	*37.85%*	*38.51%*	**37.65%**
Net Income	$ 895	$ 730	$ 780	$ 695	**$ 3,100**
EPS -- Fully Diluted	$ 0.11	$ 0.09	$ 0.09	$ 0.08	**$ 0.37**
Avg Shares Out-Fully Diluted	8,396	8,410	8,415	8,420	**8,410**
Percent of Revenue					
Cost of Revenues	53.52%	56.80%	56.32%	57.90%	56.19%
Sales, General and Administrative expenses	23.06%	24.80%	24.90%	25.57%	24.61%
YEAR / YEAR GROWTH					
Total Revenues	28.91%	23.22%	25.61%	27.69%	26.31%

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

	FY2003A	FY2004A	FY2005A	3 Mos.2006A
Cash Flows from Operating Activities				
Net Income	$ 2,222	$ 2,052	$ 2,548	$ 895
Depreciation and amortization	688	670	651	143
Amortization of discounts on securities	-	-	-	-
Gain on sale of marketable securities	1,294	(354)	(445)	37
Loss on marketable securities classified as trading	-	16	(14)	(1)
Gain on sale of assets	(1,246)	-	-	-
Other than temporary reductions of marketable securities	-	-	-	-
Issuance of common stock in exchange for services rendered	-	95	52	18
Decrease in allowance for doubtful accounts	-	-	-	10
Provision for doubtful accounts	-	-	-	-
Deferred income taxes	9	46	(100)	(35)
	2,967	2,525	2,692	1,067
Changes In:				
Accounts receivable	(365)	(224)	(494)	(546)
Other receivables	(106)	94	16	1
Inventories	(91)	(94)	(811)	(307)
Prepaid income taxes	(306)	48	247	(29)
Prepaid expenses and other assets	0	(6)	(2)	(6)
Accounts payable	156	(154)	(215)	27
Accrued expenses	0	12	159	(110)
Taxes payable	(398)	-	-	-
Net Changes in Working Capital	(1,109)	(325)	(1,100)	(971)
Net cash Provided by Operations	1,858	2,200	1,592	96
Cash Flows from Investing Activities				
Purchase of marketable securities	(4,284)	(6,266)	(6,461)	(1,424)
Sale of marketable securities	3,025	6,097	5,810	961
Sales of Assets	1,713	-	-	-
Change in margin account	-	-	-	-
Acquisition of Ilya's Farms, Inc., net of assets acquired	-	(512)	-	-
Loan acquisition costs	-	-	-	-
Purchase of property, plant and equipment	(415)	(330)	(4,917)	(150)
Net cash used in Investing	39	(1,011)	(5,567)	(613)
Cash Flows from Financing Activities				
Repayment of notes payable	(31)	(28)	(37)	(20)
Proceeds from issuance of common stock	-	15	-	-
Proceeds from note payable	-	-	3,000	-
Purchase of treasury stock	-	-	(402)	-
Loan costs	-	-	(7)	-
Net cash provided by Financing	(31)	(13)	2,555	(20)
Net change in Cash	1,866	1,175	(1,419)	(536)
Cash Beginning of Period	2,732	4,598	5,773	4,354
Cash End of Period	$ 4,598	$ 5,773	$ 4,354	$ 3,818