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

May 25, 2010

LWAY $10.15 – (NasdaqGM)

	2007A	2008A	2009A	*2010E*	*2011E*
Sales (in millions)	$38.7	$44.5	$58.1	***$67.4***	***$78.2***
Earnings per share (diluted)	$0.19	$0.11	$0.33	***$0.39***	***$0.45***

52-Week range	$14.94 – $8.070	Fiscal year ends:	December
Shares outstanding a/o 04/30/10	16.7 million	Revenue/shares (TTM)	$3.60
Approximate float	4.8 million	Price/Sales (TTM)	2.8X
Market Capitalization	$170 million	Price/Sales (2011)E	2.2X
Tangible Book value/shr	$0.85	Price/Earnings (TTM)	29.1X
Price/Book	11.9X	Price/Earnings (2011)E	22.6X

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.

Key investment considerations:

We reiterate our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) and are maintaining our 12-month price target of $13.00 per share. Our price target is based on our sales per share estimate for the next four quarters and a three-year historic trailing price-to-sales multiple of 3.2X.

The company's increased spending on brand awareness programs, continued penetration of the Northeastern and Western regions of the US and permanent distribution to Costco's Midwest warehouse should drive sales growth. During the final 11 weeks of 1Q10, the company announced that its weekly sales run rate reached $1.35 million, the highest in its history. Spending on marketing is likely to narrow operating margins by at least 89 basis points in 2010.

For 2010, we project sales growth of 16.12% to $67.4 million and EPS of $0.39. Our EPS forecast increased by $0.01 per share due to better then anticipated 1Q10 results by $0.04, offset by projected increases in commodity prices for the balance of the year.

For 2011, we project sales of $78.2 million and net income of $7.5 million or $0.45 per share. We believe the brand awareness spending will build an expanding loyal customer base.

On May 17, 2010, LWAY reported 1Q10 revenue increased by 16% to $16 million from $13.7 million, as brand awareness and distribution increased. EPS increased to $0.11 vs. $0.09 in 1Q09. While revenue was in line with our forecast, EPS beat our forecast by $0.04. An improved gross margin offset higher marketing and advertising spending.

Please view our Disclosures pages 12 - 14

Recommendation

We reiterate our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) and are maintaining our 12-month price target of $13.00 per share.

Investors are likely to remain cautious as commodity prices (i.e., milk costs) are forecasted by the futures market to average $16.00 in 2010, up from a current price as reported in April 2010 of $15.50. Also, investors might view in the short term the trend of higher marketing and advertisement spending to drive brand awareness as a potentially negative factor. The three-year trailing price-to-sales multiple has contracted to 4X from 4.8X (prior to applying a discount factor).

We are valuing the company's shares using a historical approach that takes into consideration stock price fluctuations over the past three-years. Our valuation model (discounted by 20% to account for microcap and company specific risks) applies LWAY's three-year average historic price-to-sales multiple to our sales per share estimate for 2010 of $4.18 per share. The three-year average trailing price-to-sales multiple for LWAY is 4X (prior was 4.8X).

On December 31, 2009, Lifeway Foods again extended the stockholders' agreement with Danone Foods, Inc. According to the SEC filing, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the eighth extension of the stockholders', standstill, and non-compete agreements, which will now expire on December 31, 2010. As of December 31, 2009, Danone owned approximately 20.6% of LWAY's common shares. If Danone sold its stake in Lifeway Foods, it would most likely have a negative effect of the company's stock price.

The Company

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

LWAY distributes its products in some parts of Canada (Ontario and Quebec). However, in order to make a meaningful sales impact in Canada, the company intends to set up (via a purchase) a small manufacturing facility within Canada. Timing of the purchase and setup has yet to be determined. Verbal distribution agreements in the US offer latitude to expand into new markets and establish new relationships on an ongoing basis. The developments listed to the right have helped increase brand awareness and distribution opportunities.

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

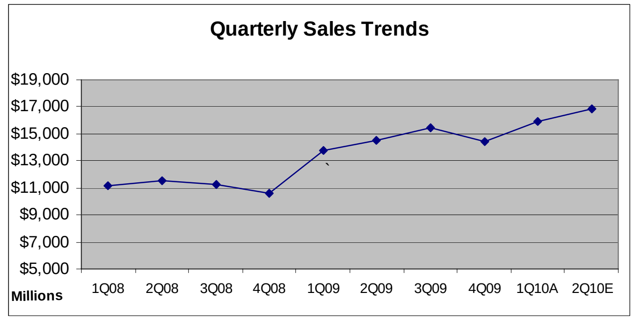
<u>*Kefir*</u>

Lifeway Kefir contains ten active "friendly" microorganisms and is probiotic* in nature because it promotes the growth of those microorganisms naturally. The product is a source of calcium, protein, minerals, and B-complex vitamins, and is highly digestible due to its acidity and enzymes. Kefir is similar to, but distinct from, yogurt due to a different fermentation process which produces a less sour taste. Less sugar is required so it contains fewer calories.

* Probiotics are defined as live cultures consumed for a health benefit. These cultures are comprised of one or more types of bacteria. Probiotic cultures have recently undergone controlled scientific investigations. The results lend some credence to the old folklore that suggests fermented dairy products that contain probiotic cultures are healthful.

Outlook

Increased spending on raising brand awareness accelerated quarterly sales gains. The graph illustrates the sequential sales declines in 2008, the trend reversal except for the seasonal decline in 4Q09, and resumption of growth in 1Q10.



LWAY generated weekly average sales of $1.1 million during 2009. For 1Q10 the weekly sales run rate was $1.2 million. For 2010 the weekly run rate should average $1.3 million and expand to $1.5 million in 2011.

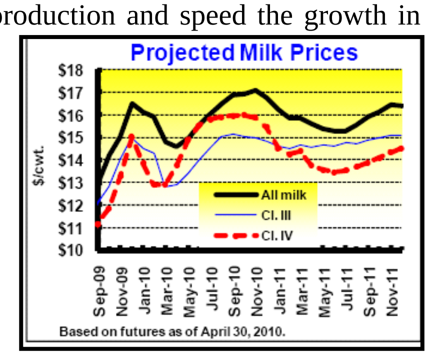
Expectations of strong weekly run rate gains over the next two years are based on:

- Programs to build brand awareness, such as:
  - Product sampling
  - In store demonstrations
  - Use of coupons
- Gaining new distribution outlets, such as:
  - Costco. The Costco Midwest warehouse now purchases LWAY products regularly. Other regional warehouses for the West and Northeast regions will be purchasing product from LWAY on a rotational basis.
  - 275 7-Eleven convenience stores in the Chicago land area began carrying in 1Q10 LWAY's 8oz Grab n' Go bottles of Probugs™ and Wellness Bar products. Expansion nationwide could begin later this year.
- Distribution through supermarkets in the northeast region of the US. In 2009, Lifeway commenced shipments of its products direct to ShopRite, a chain of about 200 stores primarily in the northeast. Based on personal observation, it appears that some of Lifeway's products are being sold at Stop & Shop, Wild by Nature, and Whole Foods locations on Long Island, NY
- Expanding distribution of La Fruita. In 2009 distribution began to 150 Supercenter stores in California (i.e., Super A) and the 99 Cents Only chain, which operates about 100 stores in the California region.

<u>Milk Price Perspective</u>

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

- Dairy markets appear stronger as the global economic recovery seems to have provided hope of a revival in demand
- In the longer-term, selective breeding of larger cows could boost U.S. production and speed the growth in milk per cow



The April 2010 Dairy Market Report from the National Milk Producers Federation stated that the April 2010 revised all-milk price (defined as the milk-to-feed price ratio) was $14.60, down $1.30 from February 2010. The futures market is projecting average all-milk prices of $16.00 in 2010 (in March 2010, the projection was $15.60) and $15.80 in 2011. For prices to meet the average for 2010, they would need to increase to approximately $16.10 through November 2010.

Market Comment

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

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

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

- Functional foods and beverages provide obvious health benefits including for digestive health. As the population ages and people seek healthy alternatives to boost their health, LWAY has positioned its products to take advantage of this trend. According to market research firm Aarkstore Enterprise, the global probiotics market is estimated to reach $31.2 billion in 2014, an annual growth rate of 11.7% from 2009.
- The report Dairy Wholesaling in the US (IBISWorld February 2010) stated that domestic demand for dairy products will continue to depend on disposable income growth, population growth, and consumer preferences. The US population is forecast to grow at a marginal rate of 1.0% per annum over the five years to 2014, which will aid some volume growth. Real disposable income is forecast to grow at a relatively strong rate through 2014, supporting purchases of more expensive dairy foods. Consumers' concern about health and nutritional claims should drive demand for functional dairy products with probiotics, increased calcium, and organic varieties.

Projections

<u>Operations</u>

For 2010, we project sales of $67.4 million, a year-over-year increase of 16.1%. We project net income for 2010 of $6.5 million or $0.39 per share. We had previously forecasted sales of $67.5 million and net income of $6.4 million or $0.38 per share. Our forecast is based on organic growth of the company's flagship Kefir product (pictured to right), its ProBugs™ Organic Kefir for kids, and further penetration into the Northeast, West coast, the permanent shipments to Costco-Midwest, and rotational shipments to Costco in the Northeast and Western regions of the US. We project organic product sales of $23.6 million (35% of total) and non-organic sales of $43.8 million. The company has never broken out individual product sales, but based on our own observations, its original Kefir (pictured to the right) is its sales leader, followed by its organic product offerings, and ProBugs for kids.

Our slightly increased profit forecast reflects 1Q10 results, and higher projected commodity prices (i.e., conventional and organic milk) that will compress gross margin for the balance of the year. We project a gross margin of 39.5% for the final three quarters of the year, down from 43.5% in 1Q10. We also increased our sales expense forecast by $2.5 million, stemming from the company reclassifying on a forward basis more of its product sampling and in-store demonstration programs as a selling expense rather than as a cost of goods sold.

For 2011, we project sales of $78.2 million with net income of $7.5 million or $0.45 per share. The 15.9% sales increase should be driven by continued market penetration, spending on brand awareness and organic sales of $31.3 million or 40% of sales. Sales growth should enable net income to grow by 15.8%, even as gross margin contracts to 37.4% from 40.4% in 2010.

Our forecasts for 2010 and 2011 are predicated on LWAY:

– Maximizing distribution agreements by allowing for entry into all stores in one region or nationally over time.

– Expanding the distribution of its Kefir Wellness Snack Bar. Even with expanded distribution, the sales impact is likely to be minimal, but it should help continue to drive expanding distribution of all their products as consumers see and accept the LWAY brand.

– Expanding sales within Canada by the end of 2010. We anticipate purchase of a small manufacturing facility that will be in operation before the end of 2010. If the time line is met, sales from Canada in 2011 could reach at least $1 million. With proper execution, the company's Canadian sales could be three-quarters of US sales by 2014.

– Keeping interest expense in check. If the company maintains an accelerated debt repayment program (it repaid $4 million in 2009 and $0.5 million so for in 2010) interest expense for 2010 and 2011 should decline to $400,000 and $300,000 million, respectively, versus $433,000 in 2009.

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

Finances

For 2010, we project cash earnings of $9.1 million and a $1.6 million increase in working capital. Cash from operations of $7.5 million should enable the company to continue paying down the debt incurred to finance the Fresh Made acquisition and fund the purchase of a facility in Canada. Cash at the end of 2010 should increase to $1 million from $0.6 million at December 31, 2009.

Projected cash earnings of $9.6 million for 2011 should cover an increase of approximately $1.6 million in working capital and repayment of debt obligations. Our year-end cash forecast for 2011 is approximately $2.8 million, up approximately $1.2 million from our 2010 forecast.

Recent Financials

For 1Q10, versus 1Q09:

- Sales increased to $16 million from $13.7 million. Our estimate was $16 million.
- Gross margin increased to 43.5% from 40.2%.
- Operating expenses increased to $4.2 million from $3.0 million.
- Net income was $1.8 million or $0.11 per share versus net income of $1.5 million or $0.09 per share. Our estimate was $1.2 million or $0.07 per share.

The 1Q10 revenue increase of 16% was due to the growing awareness of Lifeway's flagship line, Kefir and increased distribution of its ProBugs™ Organic Kefir for kids.

Gross margin improved by three percentage points due to a decline in the cost of conventional milk, the company's largest raw material. We had projected a gross margin of 33.4%. The better than anticipated gross margin stemmed from the company reclassifying on a forward basis product sampling and in-store demonstration programs as a selling expense rather than as a cost of goods sold.

For 1Q10, operating expenses increased by $1.2 million to $4.2 million due to higher marketing and advertising expenses. Total other expense fell to $69,458 compared to $232,615 in 1Q09. The decrease was due to higher realized loss on the sale of investments during 1Q09. Additionally, interest expense decreased by $58,441 to $95,941 during the 1Q10 compared to $154,383 in 1Q09.

Finances
The company's debt to equity ratio of 0.3 versus 2.1 for the industry shows that LWAY is significantly less leveraged than other dairy product companies.

In 1Q10, cash earnings and cash from operations totaled $2.2 million and $1.1 million, respectively, compared to $2.1 million and $1.7 million, respectively, in 1Q09. Working capital needs increased by $1.1 million due to increased accounts receivables and higher inventory levels to support sales growth, offset by a higher level of payables. The cash from operations allowed the company to increase cash by $22,000, pay down debt by $500,000, and repurchase $340,000 of common stock. At March 31, 2010, cash was $653,000 compared to $630,000 at the same time last year.

Debt
Debt totals $11.2 million, of which $4.7 million is short-term. Total debt at March 31, 2010 consisted of a note payable to Private Bank ($7 million, matures February 2014), a line of credit with Private Bank ($0.5 million, matures February 2011), a line of credit with Morgan Stanley ($2.5 million, no maturity date), and subordinated notes payable to Ilya Mandel and Michael Edelson ($1.2 million, matures February 2011).

Marketable Securities
The company's portfolio of marketable securities (at fair value as of March 31, 2010) consisted of:

– 56.5% fixed income type securities (government agency obligations and bonds - corporate/municipal); and

– 43.5% in equities, mutual funds, preferred securities, and limited partnerships.

At March 31, 2010, the company had total unrealized losses of $0.2 million. Also, proceeds from the sale of marketable securities were approximately $0.5 million and $2.3 million, respectively, for 1Q10 and 1Q09, respectively.

Risks

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

Commodities
The price of conventional and organic raw materials such as milk, sugar, and fruit from unaffiliated suppliers can be volatile, causing wide variations in the gross margin.

Regulation
Lifeway is subject to federal, state and local regulation regarding the distribution and sale of food products. Products exported to Canada are subject to strict quotas imposed by the Canadian government. This is why (as previously discussed) the company is seeking to manufacture product within Canada.

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

Internal Controls
The company identified two material weaknesses in the company's internal controls: 1) an incomplete and undocumented system for tracking current programs for advertising and sales promotions with current customers and 2) not posting monthly activity to the company's general ledger. Management is creating a system for

documenting advertising and promotional costs, including analyzing the benefits received from customers, and improving review procedures for posting and updating the monthly financial activity.

Management Control

Ludmila Smolyansky (mother of the company's CEO and CFO), chairperson of the board of directors, beneficially owns or controls approximately 44.9% of common shares outstanding, as of March 12, 2009. The chairperson has the ability to substantially influence matters submitted to stockholders for approval, this could have a negative impact if her interests do not coincide with other shareholders on a particular issue.

Miscellaneous

The company's financial results and equity values are subject to other risks and uncertainties known and unknown, including but not limited to competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Trading Volume

Liquidity has the potential to be a concern. During 2008 average daily volume was 35,147 shares traded daily and declined further in 2009 to 23,313 shares traded a day. During the first five months of 2010, average daily volume fell further to 17,550. Average daily volume remains relatively low; therefore, investors need to be aware that by nature a thinly traded equity can have significant price volatility.

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

	2007A	2008A	2009A	1Q10A	2010E	2011E
ASSETS						
Current assets:						
Cash and cash equivalents	$ 596	$ 277	$ 630	$ 652	$ 1,621	$ 2,828
Marketable securities	6,989	5,262	5,044	4,398	4,000	3,800
Accounts receivable, net	4,210	4,766	6,000	7,726	7,119	8,472
Other receivables	43	40	50	49	65	75
Inventories	3,507	3,098	3,297	3,870	3,420	4,079
Prepaid income taxes	241	356	1,309	477	2,000	2,500
Prepaid expenses and other assets	21	23	41	38	54	66
Deferred income taxes	312	920	251	303	150	650
Total current assets	**15,919**	**14,742**	**16,622**	**18,064**	**18,429**	**22,470**
Property, plant and equipment, net	9,679	11,063	14,282	14,482	16,000	16,750
Other assets	500	500	500	500	500	500
Intangible assets, net	8,671	8,351	20,066	19,890	19,750	19,650
Total assets	**$ 34,768**	**$ 34,656**	**$ 51,470**	**$ 52,936**	**$ 54,679**	**$ 59,370**
LIABILITIES AND STOCKHOLDERS' EQUITY						
Current liabilities:						
Current maturities of notes payable	1,136	928	4,842	4,733	1,845	1,000
Checks written in excess of bank balances	-	-	343	533	-	-
Accounts payable	1,594	2,260	2,764	3,117	3,069	3,807
Accrued expenses	414	458	614	637	683	881
Total current liabilities	**3,144**	**3,647**	**8,564**	**9,021**	**5,598**	**5,688**
Long-term liabilities – notes payable	4,097	3,108	6,890	6,502	4,890	2,890
Deferred income taxes	1,713	1,607	3,445	3,318	3,400	1,900
Stockholders' equity:						
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509	6,509	6,509	6,509
Paid-in capital	1,121	1,202	1,966	1,992	1,995	1,995
Retained earnings	20,471	22,384	27,953	29,722	35,987	41,510
Accumulated other comprehensive income, net of	(209)	(499)	(10)	53	500	3,127
Treasury stock, at cost	(2,078)	(3,302)	(3,847)	(4,182)	(4,200)	(4,250)
Total stockholders' equity	**25,814**	**26,294**	**32,571**	**34,094**	**40,791**	**48,892**
Total liabilities and stockholders' equity	**$ 34,768**	**$ 34,656**	**$ 51,470**	**$ 52,936**	**$ 54,679**	**$ 59,370**
SHARES OUT	16,828	16,724	16,724	16,755	16,724	16,724

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

	2007A	2008A	2009A	**2010E**	**2011E**
Sales	$ 38,729	$ 44,461	$ 58,116	**$ 67,444**	**$ 78,200**
Cost of goods sold	26,310	31,704	37,218	**40,182**	**48,950**
Gross Profit	12,420	12,758	20,898	**27,262**	**29,250**
Operating Expenses:					
Sales	3,744	4,098	5,988	**10,302**	**10,600**
General and administrative	4,238	4,468	5,971	**6,901**	**7,200**
Total Operating Expenses	7,982	8,567	11,959	**17,203**	**17,800**
EBITDA	5,487	5,284	10,919	**12,169**	**13,450**
	1,278	1,492	5,090	**6,002**	**7,025**
Operating Income	4,437	4,191	8,939	**10,058**	**11,450**
Other Income (Expense)					
Interest income	350	343	199	**220**	**240**
Interest expense	(410)	(299)	(443)	**(396)**	**(300)**
Gain on sale of marketable securities	540	(734)	(278)	**(29)**	**-**
Other	(0)	(959)	(3)	**-**	**-**
Rental income	48	49	35	**4**	**20**
Total Other Income (Expense)	528	(1,599)	(490)	**(201)**	**(40)**
Pre-Tax Income	4,965	2,592	8,449	**9,857**	**11,410**
Income Tax Expense (Benefit)	1,813	680	2,879	**3,375**	**3,905**
Tax Rate	36.50%	26.23%	34.08%	**34.24%**	**34.22%**
Net Income	$ 3,153	$ 1,912	$ 5,570	**$ 6,482**	**$ 7,505**
EPS -- Fully Diluted*	$ 0.19	$ 0.11	$ 0.33	**$ 0.39**	**$ 0.45**
Avg Shares Out-Fully Diluted*	16,856	16,761	16,798	**16,749**	**16,710**
Margins					
Gross Margins	32.1%	28.7%	36.0%	**40.4%**	**37.4%**
Operating Margin	11.5%	9.4%	15.4%	**14.9%**	**14.6%**
Pre-Tax Margins	12.8%	5.8%	14.5%	**14.6%**	**14.6%**
Selling expense	9.7%	9.2%	10.3%	15.3%	13.6%
General and Administrative expense	10.9%	10.1%	10.3%	10.2%	9.2%
YEAR / YEAR GROWTH					
Total Revenues	39.7%	14.8%	30.7%	16.1%	15.9%
Net Income	8.8%	(39.3%)	263.9%	16.4%	15.8%

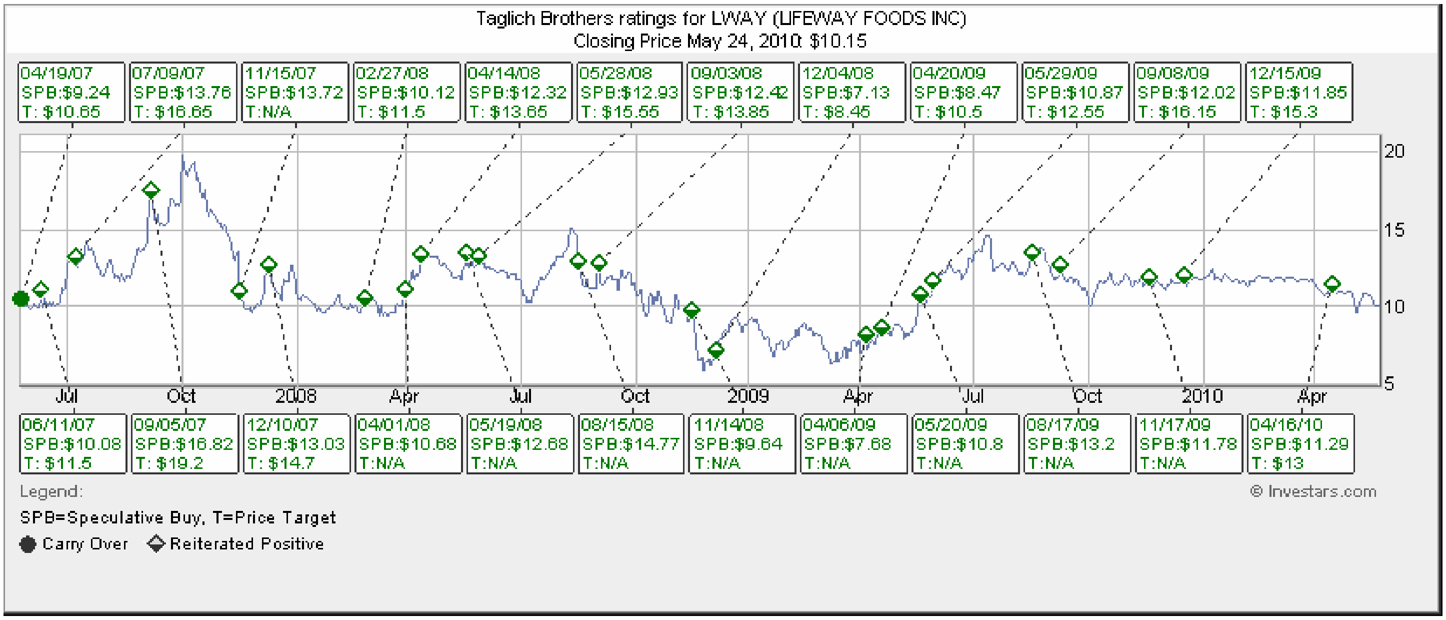
Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ending December 31
(in thousands)

	1Q09A	2Q09A	3Q09A	4Q09A	**2009A**	1Q/1A	2Q10E	3Q10E	4Q10E	**2010E**	1Q11E	2Q11E	3Q11E	4Q11E	**2011E**
Sales	$ 13,736	$ 14,479	$ 15,434	$ 14,466	**$ 58,116**	$ 15,964	$ 16,810	$ 17,875	$ 16,795	**$ 67,444**	$ 18,535	$ 19,550	$ 20,600	$ 19,515	**$ 78,200**
Cost of goods sold	8,217	8,332	9,181	11,489	**37,218**	9,022	9,735	10,625	10,800	**40,182**	11,500	12,250	12,650	12,550	**48,950**
Gross Profit	5,519	6,148	6,253	2,978	**20,898**	6,942	7,075	7,250	5,995	**27,262**	7,035	7,300	7,950	6,965	**29,250**
Gross Margins	*40.18%*	*42.46%*	*40.52%*	*20.58%*	**35.96%**	*43.48%*	*42.09%*	*40.56%*	*35.70%*	**40.42%**	*37.96%*	*37.34%*	*38.59%*	*35.69%*	**37.40%**
Operating Expenses:															
Sales	1,308	1,387	1,231	2,062	**5,988**	2,527	2,650	2,725	2,400	**10,302**	2,575	2,700	2,800	2,525	**10,600**
General and administrative	1,668	1,606	1,783	915	**5,971**	1,666	1,685	1,750	1,800	**6,901**	1,700	1,750	1,900	1,850	**7,200**
Total Operating Expenses	2,976	2,993	3,014	2,977	**11,959**	4,193	4,335	4,475	4,200	**17,203**	4,275	4,450	4,700	4,375	**17,800**
EBITDA	2,982	3,708	3,728	501	**10,919**	3,359	3,240	3,275	2,295	**12,169**	3,260	3,350	3,750	3,090	**13,450**
Operating Income	2,544	3,155	3,239	1	**8,939**	2,748	2,740	2,775	1,795	**10,058**	2,760	2,850	3,250	2,590	**11,450**
Operating Margin	*18.52%*	*21.79%*	*20.99%*	*0.01%*	**15.38%**	*17.22%*	*16.30%*	*15.52%*	*10.69%*	**14.91%**	*14.89%*	*14.58%*	*15.78%*	*13.27%*	**14.64%**
Other Income (Expense)															
Interest income	62	49	34	54	**199**	55	55	55	55	**220**	60	60	60	60	**240**
Interest expense	(154)	(110)	(100)	(78)	**(443)**	(96)	(100)	(100)	(100)	**(396)**	(75)	(75)	(75)	(75)	**(300)**
Gain on sale of securities	(150)	54	(178)	(4)	**(278)**	(29)	-	-	-	**(29)**	-	-	-	-	-
Other	-	(3)	-	-	**(3)**	-	-	-	-	-	-	-	-	-	-
Rental income	9	12	12	2	**35**	1	1	1	1	**4**	5	5	5	5	**20**
Total Other Income (Expense)	(233)	1	(232)	(26)	**(490)**	(69)	(44)	(44)	(44)	**(201)**	(10)	(10)	(10)	(10)	**(40)**
Pre-Tax Income	2,311	3,156	3,008	(25)	**8,449**	2,679	2,696	2,731	1,751	**9,857**	2,750	2,840	3,240	2,580	**11,410**
Pre-Tax Margins	*16.82%*	*21.80%*	*19.49%*	*-0.18%*	**14.54%**	*16.82%*	*16.04%*	*15.28%*	*10.43%*	**14.61%**	*16.82%*	*14.53%*	*15.73%*	*13.22%*	**14.59%**
Income Tax Expense (Benefit)	763	624	1,637	(145)	**2,879**	910	915	975	575	**3,375**	945	985	1,075	900	**3,905**
Tax Rate	*33.04%*	*19.77%*	*54.42%*	*570.51%*	**34.08%**	*33.98%*	*33.94%*	*35.70%*	*32.84%*	**34.24%**	*34.36%*	*34.68%*	*33.18%*	*34.88%*	**34.22%**
Net Income	$ 1,547	$ 2,532	$ 1,371	$ 120	**$ 5,570**	$ 1,769	$ 1,781	$ 1,756	$ 1,176	**$ 6,482**	$ 1,805	$ 1,855	$ 2,165	$ 1,680	**$ 7,505**
EPS -- Fully Diluted	$ 0.09	$ 0.15	$ 0.08	$ 0.01	**$ 0.33**	$ 0.11	$ 0.11	$ 0.10	$ 0.07	**$ 0.39**	$ 0.11	$ 0.11	$ 0.13	$ 0.10	**$ 0.45**
Avg Shares	16,847	16,790	16,799	16,755	**16,798**	16,762	16,755	16,745	16,735	**16,749**	16,725	16,715	16,705	16,695	**16,710**
Margins															
Gross Margins	40.2%	42.5%	40.5%	20.6%	36.0%	43.5%	42.1%	40.6%	35.7%	40.4%	38.0%	37.3%	38.6%	35.7%	37.4%
Operating Margin	18.5%	21.8%	21.0%	0.0%	15.4%	17.2%	16.3%	15.5%	10.7%	14.9%	14.9%	14.6%	15.8%	13.3%	14.6%
Pre-Tax Margins	16.8%	21.8%	19.5%	(0.2%)	14.5%	16.8%	16.0%	15.3%	10.4%	14.6%	16.8%	14.5%	15.7%	13.2%	14.6%
Percent of Revenue															
Cost of Revenues	59.8%	57.5%	59.5%	79.4%	64.0%	56.5%	57.9%	59.4%	64.3%	59.6%	62.0%	62.7%	61.4%	64.3%	62.6%
Selling expense	9.5%	9.6%	8.0%	14.3%	10.3%	15.8%	15.8%	15.2%	14.3%	15.3%	13.9%	13.8%	13.6%	12.9%	13.6%
G&A expense	12.1%	11.1%	11.5%	6.3%	10.3%	10.4%	10.0%	9.8%	10.7%	10.2%	9.2%	9.0%	9.2%	9.5%	9.2%
YEAR / YEAR GROWTH															
Total Revenues	23.5%	25.7%	37.3%	36.8%	30.7%	16.2%	16.1%	15.8%	16.1%	16.1%	16.1%	16.3%	15.2%	16.2%	15.9%
Operating Income	86.1%	104.0%	120.8%	(100.6%)	113.3%	8.1%	(13.1%)	(14.3%)	166411.4%	12.5%	0.4%	4.0%	17.1%	44.3%	13.8%
Pre-Tax Income	59.8%	115.5%	167.9%	(98.2%)	226.0%	15.9%	(14.6%)	(9.2%)	(6988.8%)	16.7%	2.7%	5.3%	18.6%	47.3%	15.8%
Net Income	74.1%	177.7%	60.3%	(116.1%)	191.3%	14.3%	(29.7%)	28.1%	883.3%	16.4%	2.1%	4.2%	23.3%	42.9%	15.8%

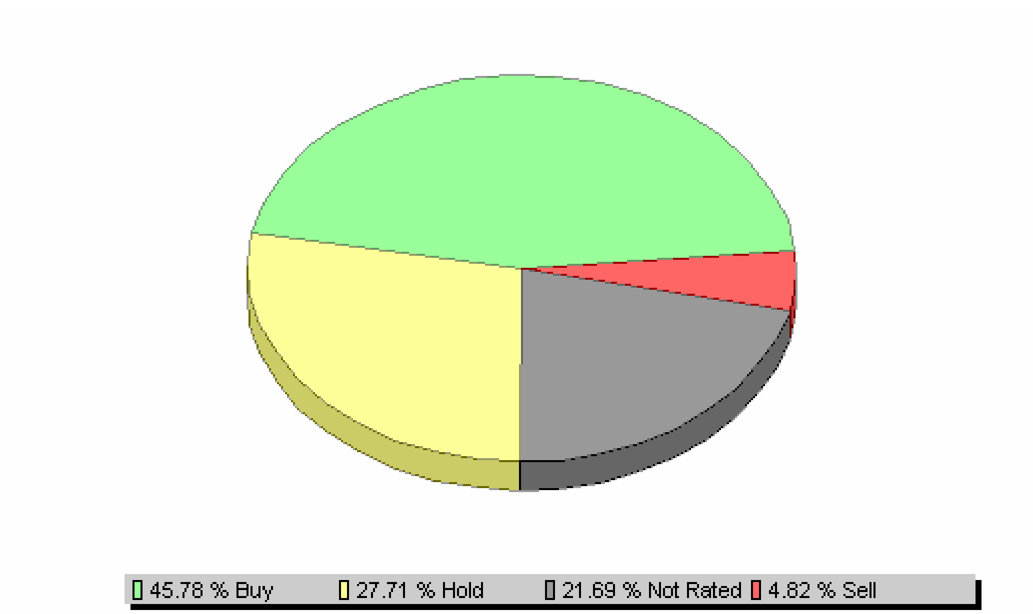
Lifeway Foods, Inc.
Cash Flow Statement
2007 – 2011E
(in thousands)

	2007A	2008A	2009A	1Q10	2010E	2011E
Cash Flows from Operating Activities						
Net Income	$ 3,153	$ 1,912	$ 5,570	$ 1,769	$ 6,482	$ 7,505
Depreciation and amortization	1,050	1,093	1,811	579	2,316	2,400
Gain on sale of marketable securities	(540)	734	278	29	29	-
Other than temporary reductions of marketable securities	-	959	-	-	-	-
Issuance of common stock in exchange for services rendered	49	97	145	31	150	150
Decrease in allowance for doubtful accounts	(41)	71	(75)	-	-	-
Deferred income taxes	(224)	(509)	390	(223)	101	(500)
	3,447	4,356	8,122	2,185	9,078	9,555
Changes In:						
Accounts receivable	(226)	(627)	(613)	(1,727)	(1,119)	(1,353)
Other receivables	28	3	(8)	1	(15)	(10)
Inventories	(984)	409	173	(573)	(123)	(659)
Prepaid income taxes	27	(116)	(476)	-	(691)	(500)
Prepaid expenses and other assets	(9)	(2)	10	2	(13)	(13)
Accounts payable	131	666	299	353	305	738
Accrued expenses	(66)	44	96	23	69	198
Net Changes in Working Capital	(1,100)	378	(519)	(1,089)	(1,587)	(1,599)
Net cash Provided by Operations	2,347	4,734	7,603	1,096	7,491	7,956
Cash Flows from Investing Activities						
Purchase of marketable securities	(5,745)	(5,782)	(6,157)	(356)	-	-
Sale of marketable securities	7,168	5,323	6,928	531	-	-
Acquisition of Fresh Made, net of cash acquired	-	-	(11,043)	-	-	-
Purchase of property, plant and equipment	(1,825)	(2,157)	(1,766)	(603)	(2,000)	(750)
Net cash used in Investing	(901)	(2,616)	(12,037)	(428)	(2,000)	(750)
Cash Flows from Financing Activities						
Repayment of notes payable	(1,945)	(1,196)	(4,004)	(497)	(4,500)	(6,000)
Proceeds from note payable	300	-	9,354	-	-	-
Purchase of treasury stock	(753)	(1,239)	(906)	(340)	-	-
Checks written in excess of bank balances			343	190	-	-
Net cash provided by Financing	(2,398)	(2,436)	4,787	(647)	(4,500)	(6,000)
Net change in Cash	(952)	(319)	353	22	991	1,206
Cash Beginning of Period	1,548	596	277	630	630	1,621
Cash End of Period	$ 596	$ 277	$ 630	$ 652	$ 1,621	$ 2,828

Price Chart



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	1	3.70%
Hold	0	0
Sell	1	100%
Not Rated	0	0

Important Disclosures

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.

General Disclosures

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 changes in figures or our views. This is not a solicitation of any order to buy or sell. Taglich Brothers, Inc. is fully disclosed with its clearing firm, Pershing, LLC, is not a market maker and does not sell to or buy from customers on a principal basis. 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. There may be instances when fundamental, technical and quantitative opinions contained in this report are not in concert. 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. Analysts and members of the Research Department are prohibited from buying or selling securities issued by the companies that Taglich Brothers, Inc. has a research relationship with, except if ownership of such securities was prior to the start of such relationship, then an Analyst or member of the Research Department may sell such securities after obtaining expressed written permission from the Director of Research.

Analyst Certification

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.

Public Companies mentioned in this report:

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

Meaning of Ratings

Buy

We believe the company is undervalued relative to its market and peers. We believe its risk reward ratio strongly advocates purchase of the stock relative to other stocks in the marketplace. Remember, with all equities there is always downside risk.

Speculative Buy

We believe that the long run prospects of the company are positive. We believe its risk reward ratio advocates purchase of the stock. We feel the investment risk is higher than our typical "buy" recommendation. In the short run, the stock may be subject to high volatility and continue to trade at a discount to its market.

Neutral

We will remain neutral pending certain developments.

Underperform

We believe that the company may be fairly valued based on its current status. Upside potential is limited relative to investment risk.

Sell

We believe that the company is significantly overvalued based on its current status. The future of the company's operations may be questionable and there is an extreme level of investment risk relative to reward.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.