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 28, 2008

LWAY $12.93 – (NasdaqGM)

	FY (12/06) A	FY (12/07) A	*FY (12/08) E*	*FY (12/09) E*
Revenue (in millions)	$27.72	$38.73	***$49.80***	***$60.72***
Earnings per share (diluted)*	$0.17	$0.19	***$0.27***	***$0.37***

52-Week range*	$20.75 – $9.25	Fiscal year ends:	December
Shares outstanding a/o 03/31/08*	16.84 million	Revenue/shares (TTM) *	$2.42
Approximate float*	4.80 million	Price/Sales (TTM) *	5.3X
Market Capitalization	$218 million	Price/Sales (2009)E*	3.6X
Tangible Book value/shr	$1.53	Price/Earnings (TTM) *	76.1X
Price/Book*	8.5X	Price/Earnings (2009)E*	34.9X

* All per share figures reflect the 2-1 stock split effective March 9, 2004 and August 16, 2006.

Lifeway Foods, Inc. is a manufacturer of cultured, probiotic and functional food products in the health food industry, and is America's leading supplier of the cultured dairy product known as Kefir. Their products are sold to health conscious consumers through health food stores and to the mass-market consumers through supermarkets. Web site address is: www.kefir.com

Key investment considerations:

We are reiterating our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) and raising our 12-month price target to $15.55 per share based on our sales and free cash flow per share estimates and relative analysis (prior target was $13.65). The higher price target reflects our increasing expectations for the next twelve months.

Our rating is primarily based on top line growth expectations, increasing awareness of LWAY's Kefir line, its kids Probugs™ Kefir drink, obtaining foodservice distribution contracts, as well as the 2007 introduction of its smoothie drink called Lifeway Lassi, and 2008 launch of its Starfruit™ Kefir boutique café concept.

On May 15, 2008, Lifeway Foods reported first quarter 2008 revenue of $11.122 million, which was an increase of 23.3% versus $9.022 million in the same period last year. Net income was $0.889 million or $0.05 per share versus $1.135 million or $0.07 per share in the first quarter of 2007.

Based on Management's public statements in the Company earnings press release, current trends (a sales run rate that is approximately $1.0 million a week and a moderation of milk prices), and increased consumer awareness of LWAY's offerings, we are adjusting our forecasts for 2008. Our 2008 estimates call for revenue of $49.797 million (prior was $49.935 million) and net income of $4.569 million or $0.27 per share (prior was $4.120 million or $0.24 per share). Investors should note that we continue to expect second half results to improve over first half results.

Our initial forecast for 2009 calls for revenue of $60.720 million and net income of $6.205 million or $0.37 per share. Our forecast is based on continued growth trends and a stabilization of milk prices.

**** Please view our disclaimer located on page 13.***

The Company

Lifeway Foods, Inc. (NasdaqGM: LWAY) manufactures a cultured dairy beverage called Kefir and also develops Kefir related products at its two manufacturing facilities in Illinois. The Company's distribution of its Kefir-based product portfolio in Illinois is accomplished through approximately 1,200 local stores including major retail chains (i.e., Jewel Food Stores, Dominick's Finer Foods, Treasure Island Food Marts, Whole Foods, and independent retailers), via twelve company owned trucks. Also, over 40 different assorted cream cheese products are distributed under the Cream Cheese Gourmet brand in the Philadelphia and Tri State Metropolitan area. In addition, the Company distributes its products throughout the United States and to some parts of Canada (Ontario and Quebec), utilizing verbal distribution arrangements with a number of distributors. Management believes that verbal arrangements provide the necessary latitude to expand into new markets and establish new relationships on an ongoing basis.

The Company introduced in 2006, a series of innovative new products such as pomegranate Kefir, Greek-style Kefir, and a children's line of organic Kefir products called ProBugs™ in a no-spill pouch in kid-friendly flavors (i.e., Orange Creamy Crawler and Sublime Slime Lime), as well as a line of organic whole milk Kefir. The key group of consumers for the Company's products includes children, women, baby boomers, and Hispanics. With respect to the Hispanic market, the Company developed and has had success with its La Fruita product.

In early August 2006, Lifeway Foods acquired Helios Nutrition Limited (including Pride Main Street Dairy, LLC), its top competitor in the Kefir market. Helios held the number two position (versus LWAY's number one position) in terms of the Kefir market and the top position in the organic category. Management has publicly stated that the acquisition is expected to strengthen LWAY's presence in the rapidly growing market for **organic dairy products, as well as provide a steady supply of organic milk through Helios' organic dairy subsidiary.**

At the end of June 2007, the Company announced the expansion of its product portfolio to include a new smoothie drink called Lifeway Lassi. This product is designed for Lifeway's core natural and health food markets, people who are familiar with Lassi from Indian restaurants, and the immigrant population from India (where it is a beverage staple). Lifeway Lassi (in mango and strawberry flavors) will be available to consumers in 8-oz 'Grab and Go' containers and distributed through select natural, specialty, and ethnic food stores nationwide. According to Management, Lifeway plans to promote this product through its traditional channels, as well as by sampling it at yoga studios, conferences, and similar events.

During mid-April 2008, the Company launched its Starfruit™ Kefir boutique in Chicago. The boutique offers customers several flavors of frozen Kefir with over 20 toppings, as well as customized Kefir parfaits, and smoothie-style Kefir drinks. According to Management, the intent of the Starfruit boutique is to capitalize on the renewed popularity of frozen yogurt shops while offering a healthier alternative with all the probiotic benefits of Kefir. Also, Management believes that this is a promising diversification that can help to leverage the Company's leadership in the Kefir market, by continuing the education process for a group of consumers that have yet to experience Kefir, as well as teach existing customers new ways to consume the product, and over time potentially provide a new revenue stream.

<u>*Kefir*</u>

Lifeway Kefir contains ten active "friendly" microorganisms and is probiotic[*] in nature because it promotes the growth of those microorganisms naturally. The product is a good source of calcium, protein, minerals, and vitamins (i.e. B-complex vitamins) and is highly digestible due to its acidity and enzymes. Kefir is similar to, but distinct from, yogurt. The fermentation process produces a less sour tasting product. Also, less sugar is required; therefore, the product contains fewer calories.

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

Recent Development

On May 16, 2008, Lifeway Foods announced a clarification of a recent FDA enforcement for its Pennsylvania facility. According to Management, all of its production facilities remain open and fully operational. The only product line temporary affected is the cream cheese spreads, which are produced only in Pennsylvania by its LFI Enterprises subsidiary. According to the Company's CFO, Lifeway will continue to produce and ship all of its products including its Kefir, farmer's cheese, and spreadable cheese products without any interruption. Investors should also note that cream cheese spreads account for 0.5%-1% of the Company's total sales.

Recent Financials

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

- Revenue increased to $11.122 million versus $9.022 million. Taglich Brothers' estimates called for revenue of $11.100 million;
- Gross margin decreased to 31.39% versus 39.60%;
- Operating expenses increased to $2.124 million versus $1.771 million;
- Free cash flow (defined as net income plus D&A less working capital changes and capital expenditures) was $0.629 million versus $0.044 million;
- EBITDA decreased to $1.636 million versus $2.047 million; and
- Net income was $0.889 million or $0.05 per share versus net income of $1.135 million or $0.07 per share. In comparison, Taglich Brothers' estimates called for net income of $0.420 million or $0.02 per share.

The year-over-year revenue increase of 23.3% was attributable to higher sales for the existing Lifeway Foods line, which experienced growth of 23.2% and a contribution from Helios of $1.635 million versus $1.320 million in the first quarter of 2007. The organic growth was primarily attributable to increased awareness of the Company's existing drinkable dairy products (i.e., its flagship Kefir product and its Probugs™ Kefir drink designed specifically for kids). Sales from Helios Nutrition and its subsidiary, Pride of Main Street Dairy was $1.635 million, consisting of $1.207 million from the Helios brand and $0.428 million from Pride of Main Street Dairy.

Gross margin declined by 821 basis points versus the same period last year. The plunge in gross margin was primarily related to the increased cost of milk (the Company's largest raw material), which was approximately 30% higher during the quarter as compared to the first quarter of 2007. Also, the cost of transportation was a contributing factor to the decline in gross margin. According to the Company's first quarter 10Q filing, the price of milk during the months of April and May 2008 was approximately 10% lower when compared to the average cost during the first quarter of 2008.

On a year-over-year basis, operating expenses increased in the aggregate by $0.353 million, which was primarily the result of higher selling and advertising expenses (in order to continue building brand awareness), as well as one-time expenses related to Sarbanes Oxley 404 compliance (approximately $0.065 million). As a percentage of revenue, operating expenses decreased to 19.09% versus 19.63% in the first quarter of 2007.

Total other income for the three-month period ended March 31, 2008 was approximately $0.080 million, compared to $0.020 million in the same period last year. This increase was primarily attributable to a higher interest and dividend income, as well as increase in the gain on the sale of marketable securities.

Balance Sheet as of March 31, 2008

The Company had cash and cash equivalents of $0.393 million and marketable securities of $6.791 million. This compares to cash and cash equivalents of $0.596 million and marketable securities of $6.989 million as of December 31, 2007. Working capital was nearly unchanged at $12.696 million versus $12.775 million at the end of 2007. The Company's long-term liabilities stood at $3.814 million, which was a decrease from $4.097 million at the end of 2007.

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

- 26.5% fixed income type securities (government agency obligations & Bonds - corporate/municipal); and
- 73.5% in equities, mutual funds, preferred securities, and limited partnerships.

At March 31, 2008, the Company had total unrealized losses of $0.848 million.

We believe that LWAY will be able to fund its sales growth from cash on hand and internally generated funds. Management is not aware of any circumstances or trends, which would have a negative impact upon future sales or earnings and that there have been no material fluctuations in the standard seasonal variation of the Company's business. Investors should be aware that Management continues to explore additional acquisition opportunities in order to increase sales and leverage the Company's distribution system.

Market Comment

Lifeway Foods' product portfolio includes cultured dairy products know as Kefir, which includes probiotic functional cultures. The Company's target market is health conscious consumers that are the driving force behind the functional and probiotic foods segment of the Food Industry.

On April 14, 2008, SRI Consulting (a leading business research service for the global chemical industry) issued a press release regarding their 2008 Nutraceutical Ingredients Report. SRI's report stated that U.S. sales of probiotic foods are projected to grow from $698 million in 2007 by an average annual growth rate of 10% and expected to reach $1.1 billion by 2012.

In a December 2007 article entitled America Wakes Up to Probiotics – But What's the Best Delivery System? By Julian Mellentin, it was stated that 2006 was the year that America woke up to the possibility of a market for probiotic foods and beverages for digestive health. According to the article, 2008 will be the year when we see if American companies have learnt from experiences of the long-established probiotics markets in Asia, Europe, and South American. The U.S. probiotic dairy market was worth approximately $400 million at retail for the year ending June 2007, and 80% of that was controlled by Danone. The article concludes by stating that the future of probiotics in America is about dairy drinks and yogurts and perhaps some other beverages in second place.

Investors should be cognizant that the two primary drivers for the growth in the Functional Foods Market are:

1) Changing trends in consumer diets towards healthier foods; and
2) Growing proportion of aging populations.

Outlook

Based on the Company's 2008 first quarter earnings, we anticipate that the Company could experience a weekly sales run-rate of approximately $0.925 million for the thirteen weeks ended June 30, 2008. This would continue the trend of sequential growth of a weekly sales run-rate of $0.856 million during the first quarter of 2008 and $0.783 million during the fourth quarter of 2007. On average, the weekly sales run-rate for all of 2007 was $0.745 million. The weekly sales run-rate incorporates the operation of Helios that was acquired at the beginning of August 2006.

On May 15, 2008, Management also indicated in the Company's earnings press release the following:

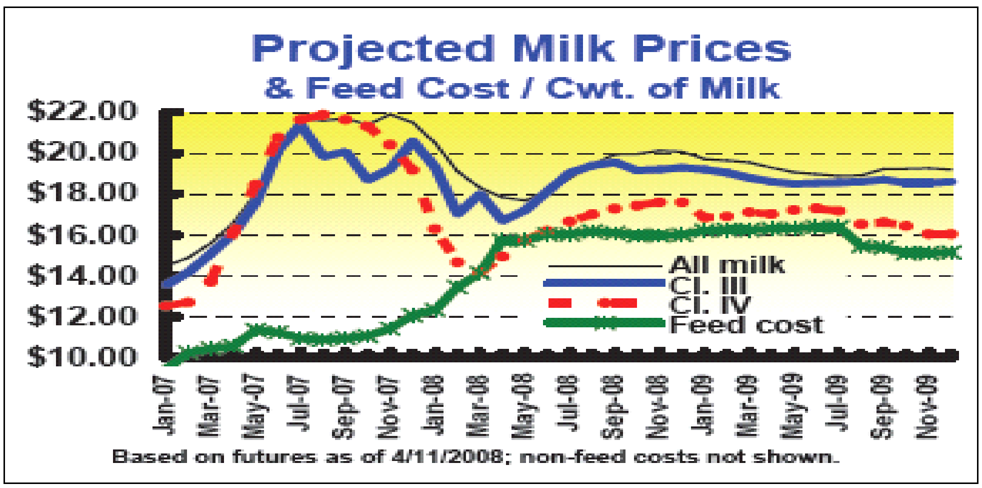
- During the month of April 2008, sales surpassed the $1 million threshold for a couple of weeks;
- Continued to see strength in core drinkable offering; and
- On April 15, 2007, it opened its Starfruit™ Kefir boutique. Early results have surpassed Management's expectations, so LWAY is currently looking for a few more high profile sites in and around Chicago to open additional boutiques.

Our belief is that the weekly run rate will continue to expand is based primarily on increased orders from existing customers, as well as expanded distribution opportunities (that includes food services such as restaurants, hotels, schools, etc.), the continued rollout of its Probugs™ offering, 2007 introduction of Lifeway Lassi, as well as the launch in March 2008 of a Kefir wellness snack bar. Lifeway continues to market its products through local radio station, newspaper, and magazines advertisements, as well as gaining additional exposure through the Internet, catalog advertising and promotion, in store demonstration throughout the U.S., and participation in various trade shows. Also, we believe aiding the marketing effort is the opening of its Starfruit café that should provide additional consumer awareness.

Milk Price Perspective and Potential Impact(s)

The April 2008 Dairy Market Report from the National Milk Producers Federation (an organization that provides a forum through which dairy farmers and their cooperatives formulate policy on national issues that effect milk production and marketing) offers the following comments:

- Milk production growth shows signs of slowing;
- Domestic demand continued to grow near the trend rate in 2007, but there are strong indications of an economic downturn which could curtail growth in 2008;
- A long-term challenge for the industry may be feed costs. Record grain prices could continue this challenge; and
- The following chart graphically shows a projection of future price levels:



Source: April 2008 Dairy Market Report page 4.

The April 2008 Dairy Market Report from the National Milk Producers Federation stated that March 2008 all-milk price was $18.30, down 0.80¢ from February 2008 and down $3.60 from November's 2007 record. However, it was still an increase of $2.70 from the year ago period. According to the report, futures project the price of all milk for the next six months at $19.00, for all of 2008 at $19.15, and 2009 at $19.25.

Investors need to be aware that gross margin is likely to be negatively impacted during the second quarter of 2008, as compared to the same period in 2007. In the Company's 2007 10K filing, Management stated that it expected the price of milk to decline in 2008 from the record high levels experienced in the fourth quarter of 2007. According to the Company's first quarter 10Q filing, the price of milk during the months of April and May 2008 was approximately 10% lower when compared to the average cost during the first quarter of 2008. If that trend continues to occur, it is our belief that while gross margin will improve from the fourth quarter 2007 level during the first half of 2008, investors will not see a year-over-year improvement until the third quarter of 2008. We believe during the second half of 2008 gross margin could improve to the mid-thirty percent area (as long as milk prices remain at current or lower price levels) from the mid-to low twenty percent area experienced during the second half of 2007 (when milk prices set all time record highs).

Also aiding gross margin is the implementation of a price increase of approximately 10-15% on a majority of its products (that began during December 2007). Since it takes time for prices increases to work through the distribution system (maybe two full quarters), by the second quarter of 2008 some of the gross margin improvement should likely occur as related to those increases.

Projections

Based on first quarter results and public comments made by Management in the Company's first quarter 2008 press release and first quarter 10Q filing, we are adjusting slightly our 2008 revenue estimate to $49.797 million (prior was $49.935 million). We believe the year-over-year growth should continue to occur based on current trends, increased consumer awareness, and new product introductions such as its Lifeway Lassi product and Kefir wellness snack bar.

If our top line estimate is achieved it would translate into year-over-year growth of 28.58% (prior was 28.93%). Given our revenue estimate, outlook as described above (which includes relatively high input costs (milk and energy)), positive commentary by Management, and completion of its production capacity expansion project at the main Morton Grove headquarters facility (which should create economies of scale), we are adjusting our 2008 forecast for net income to $4.569 million or $0.27 per diluted share (prior was $4.120 million or $0.24 per diluted share).

Our initial forecast for 2009 calls for revenue of $60.720 million and net income of $6.205 million or $0.37 per share. The initial forecast we are offering is based on a continuation of positive operating trends and relatively stable milk prices.

Our forecasts for 2008 and 2009 incorporate the following:

- Maximizing existing distribution agreements (i.e., Ralph's Grocery stores, ACME Grocery, and King Soopers Grocery stores);

- Leveraging new distribution agreements with the Harris Teeter grocery chain in the Southeast and Cub Food Stores in the Midwest;

- Continuing the rollout across the U.S. of its ProBugs™ offering;

- Being able to find new avenues to increase revenue. The introduction of a Kefir Wellness Snack Bar and the launch of its first Kefir Boutique. Management has publicly indicated that it is currently looking for a few more high profile sites in and around Chicago to open additional boutiques. This reinforces our belief that Management will continue to be innovative in driving top line results;

- Having completed in 2007 its production capacity expansion project at their main Morton Grove headquarters facility. The project, nearly doubled Lifeway's existing production capacity and should create greater economies of scale;

- Reducing interest expense for 2008. We anticipate interest expense for 2008 of $0.356 million and 2009 of $0.340 million versus $0.410 million in 2007, primarily due a reduction of debt related to the acquisition of Helios. The Company has been paying down the debt on an accelerated basis from cash generated from operations;

- Moderating of the relatively high energy and raw material cost of resin for its containers and packaging, as well as the cost of milk, the Company's largest raw material expense; and

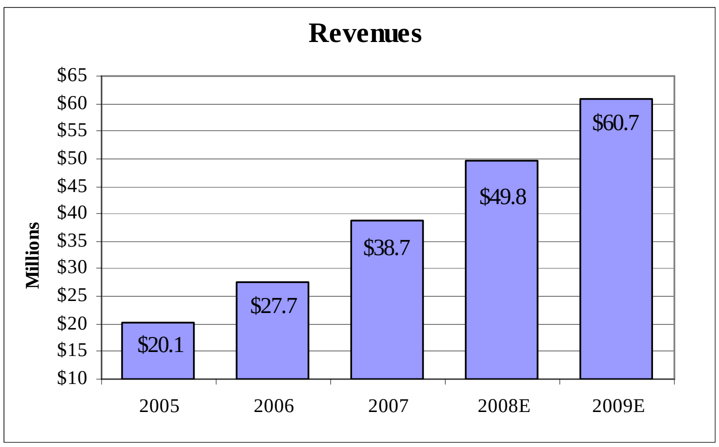
- The continued cost of being a public company (i.e., insurance, legal, and regulatory compliance).

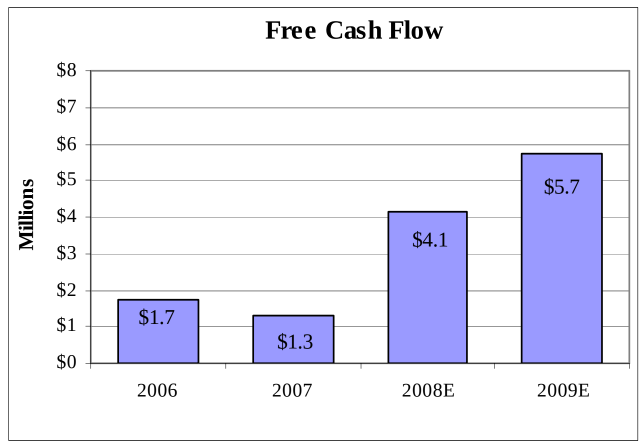
We have adjusted the following from our prior forecast, based on the previously discussed operating trends and offering our initial outlook for 2009:

- Gross margin in 2008 to 34.09% from 32.96%. This compares to 32.07% for all of 2007 and 38.38% for 2006. The increase is primarily due to first quarter results coming in at 31.39% versus our estimate of 26.35%. We anticipate gross margin for the second quarter of 2008 of 31.89%, which will show a year-over-year decline versus the same period in 2007 of 39.41%, this is a consequence of the higher milk and other input costs on a year-over-year basis. However, we believe that the second half should show marked improvement on a year-over-year basis, as milk and other input costs remain fairly stable from the first half of 2008, which means that it should translate into a year-over-year improvement because of the record high price levels experienced during the second half of 2007; and

- SG&A expenses, as a percentage of revenues, in 2008 to 19.21% from 19.45%. This compares to 20.61% in 2007 and 23.12% for 2006. Our revised forecast continues to incorporate higher aggregate selling expenses as the Company will continue its efforts to increase brand awareness, as well as higher aggregate general and administrative expenses in order to run the business. The year-over-year aggregate increase amounts to approximately $1.582 million versus 2007. The increase should continue into 2009. Our initial forecast calls for a SG&A $2.011 million or an aggregate increase of $0.429 million, primarily due to higher selling and marketing expenses that continues to build brand awareness. In total, SG&A expenses, as a percentage of revenues, in 2009 should approximate 19.07%.

The chart below shows our revenue and free cash flow 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 (as demonstrated by results during the second half of 2007, due to the record high price of milk and other input costs, as previously discussed).

Regulation

Lifeway is subject to regulation by federal, state and local governmental authorities regarding the distribution and sale of food products. Management believes that the Company is currently in compliance with all material government permits, licenses, qualifications, and approvals for its operations; however, there can be no assurance that it will be able to maintain its existing licenses and permits. In addition, the Company believes that it is currently in compliance with all applicable environmental laws. Also, the products exported to Canada are subject to strict quotas imposed by the Trade Control Policy Division of the Department of Foreign Affairs and

International Trade of Canada. Management believes that the Company is in compliance with all applicable Canadian regulations.

Groupe Danone SA Relationship

According to the Company's 2007 10-K filing on December 31, 2007, the Company entered into a sixth extension of the stockholders' agreement with Danone Foods, Inc. (the terms of the non-compete period and standstill period of the stockholders' agreement expire on December 31, 2008, which was originally entered into on October 1 1999. In prior SEC filings, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the stockholders' agreement and all Lifeway shares held by Danone Foods, Inc., were transferred to DS Waters on November 10, 2005. Also, included in the agreement was a non-compete provision, with the specific exclusion of Stonyfield Farms, Inc., an affiliate of Danone Foods, Inc. and DS Waters. Investors should be aware that Stonyfield Farms is not in direct competition with LWAY, since it does not produce Kefir. 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. **According to SEC filings, as of December 31, 2007, Danone owned approximately 20.1% of LWAY's common shares. Investors need to be cognizant that if Danone were to sell its stake in Lifeway Foods that it would most likely have a negative effect of the Company's stock price.**

Competition

Lifeway faces a small amount of direct competition in the United States and Canadian markets for its Kefir products; however, they do compete to some degree with other yogurt and dairy products. Investors should realize that many producers of yogurt and other dairy products are well-established and have significantly greater financial resources than LWAY to promote their products.

Legal Issue

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

The Company is a defendant in the following litigation: United States of America v. Lifeway Foods, Inc., et al . The Action was filed by the U.S. Department of Justice Office of Consumer Litigation on behalf of the U.S. Food and Drug Administration (FDA) on April 30, 2008, seeking a permanent injunction against the Company and its principles, for alleged violations of the Federal Food, Drug and Cosmetics Act with regard to certain cream cheese, cream cheese spreads that were allegedly adulterated and/or misbranded within the meaning of the Act. Prior to the filing of the Action, the Company and the FDA had engaged in negotiations to address the alleged violations and ultimately agreed to a Consent Decree that was submitted to the court on May 9, 2008. The Consent Decree provides that the Company will cease the production of certain food products at two locations unless certain requirements are met, to ensure compliance with the Act. The Consent Decree was presented to the Court on May 15, 2008 for approval and entry. On May 14, 2008, the First Amended Complaint for Permanent Injunction was filed and the answer to the same was filed the same day. It was Management's belief that the entry of the Consent Decree will resolve this action.

Sublicense Agreement

In October 1998 Lifeway entered into an agreement with GalaGen for sublicense patent rights of Metagenics for Kefir-based products containing natural immune components exclusively to Lifeway. Under the rights granted, Lifeway manufactures and sells products using the Basics Plus trademark. GalaGen had acquired the primary license for such patent rights in an agreement executed with Metagenics in April 1998. The terms of the sublicense provide that Metagenics will permit Lifeway to continue to have the exclusive patent rights to produce or sell kefir-based products containing natural immune components in the event the original license between GalaGen and Metagenics is terminated (and such termination was not caused by Lifeway). During February 2002, GalaGen filed a petition for bankruptcy, which terminated both its primary license with Metagenics and its participation in the Lifeway sublicense. The license and sublicense were excluded from the sale of assets of GalaGen. According to the 2007 10-K filing, LWAY has not received any indication that Metagenics will not permit Lifeway to continue to have the exclusive patent rights to produce or sell Kefir-based products containing natural immune components. Therefore, Lifeway believes that it continues to have the exclusive patent rights licensed directly from Metagenics (either party may terminate the license agreement for cause). The term of the license agreement expires when the last valid claim of the patent rights expires, which currently is July 2, 2013; however, this term can be extended in accordance with the terms of the license agreement.

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

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.

Internal Controls
According to the Company's 10-K filing, Management has identified a material weakness in the Company's internal control for financial reporting due to incomplete and undocumented financial reporting processes, including an overview of the financial statement disclosure principles, and no documented accounting procedures manual available for employee use. Additionally, there was no requirement to post monthly activity to the Company's general ledger. Management stated that it plans to take corrective action to improve the Company's review procedures for posting and updating the monthly financial activity and has commenced creating an accounting manual for its accounting personnel during 2008. According to the Company's first quarter 10Q filing, there was no change in internal control over financial reporting during the three months ended March 31, 2008 that has materially affected, or is reasonably likely to materially affect LWAY's internal controls over financial reporting.

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 (mother of the Company CEO and CFO), who is Chairperson of the Board of Directors of Lifeway Foods, beneficially owns or controls approximately 44.85% of common shares outstanding, as of April 21, 2008.

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, 2008, the fair value of the Company's marketable securities available for sale was $6.791 million. In the Company's 10Q filing, Management stated investments in equity securities, mutual funds, and corporate bonds consist of investments in common stock and debt securities of companies in various industries.

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

Trading Volume

Liquidity has the potential to be a concern. Based on our calculations average daily-volume during 2003 increased to 4,451 shares from 1,943 shares in 2002. During 2004, average volume increased significantly to 154,399 shares traded a day. In 2005, average volume declined to 43,400 shares traded a day. During 2006, average daily volume has declined to 30,756 shares traded a day and rebounded during 2007 to 69,402 shares traded daily. During the first four months of 2008 average daily volume declined to 43,381 shares traded daily. Average daily volume remains relatively low; therefore, investors need to be aware that by nature a thinly traded equity can have significant price volatility.

Conclusion

We are reiterating our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) and raising our twelve-month price target to $15.55 per share based on our sales and free cash flow per share estimates over the next twelve months. Our prior twelve-month price target was $13.65. The higher price target reflects our increasing expectations over the next twelve months. Investors should take note that our focus on the top line and free cash flow is the result of the steady growth we are expecting during 2008 and 2009.

Our rating and price target is primarily based on momentum that has and should continue to occur from the Helios acquisition, as well as a growing awareness of Lifeway's flagship Kefir line, its kids Kefir drink, called Probugs™, securing its first foodservice distribution contract (which occurred during 2007), introduction in 2007 of its smoothie drink called Lifeway Lassi, which is aimed at South Asian consumers in the U.S.

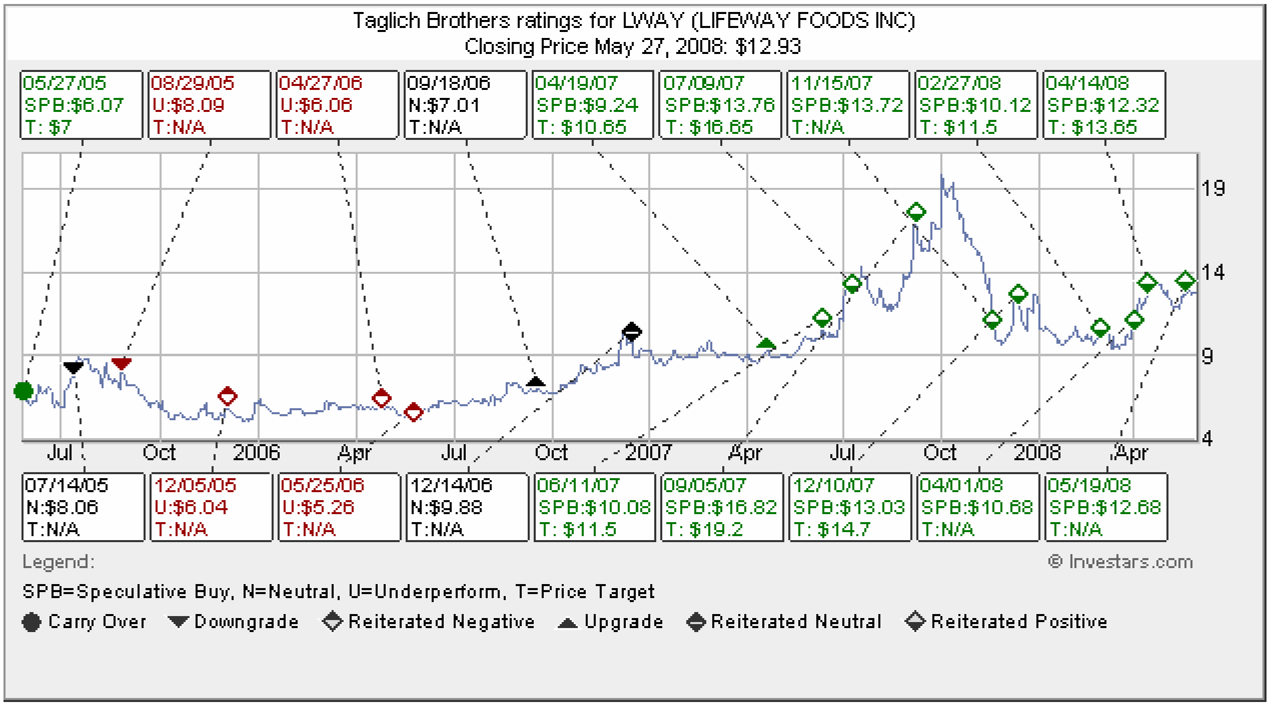
Also supporting our rating was that during the month of April 2008, sales surpassed the $1 million threshold for a couple of weeks. We believe this is a positive indicator of future growth trends.

We obtained our twelve-month price target from the following valuation models, discounted by 33% to account for microcap risk and Company specific risks mentioned earlier. Also included in the discount factor above is 13.02%, which we obtained from the capital asset pricing model:

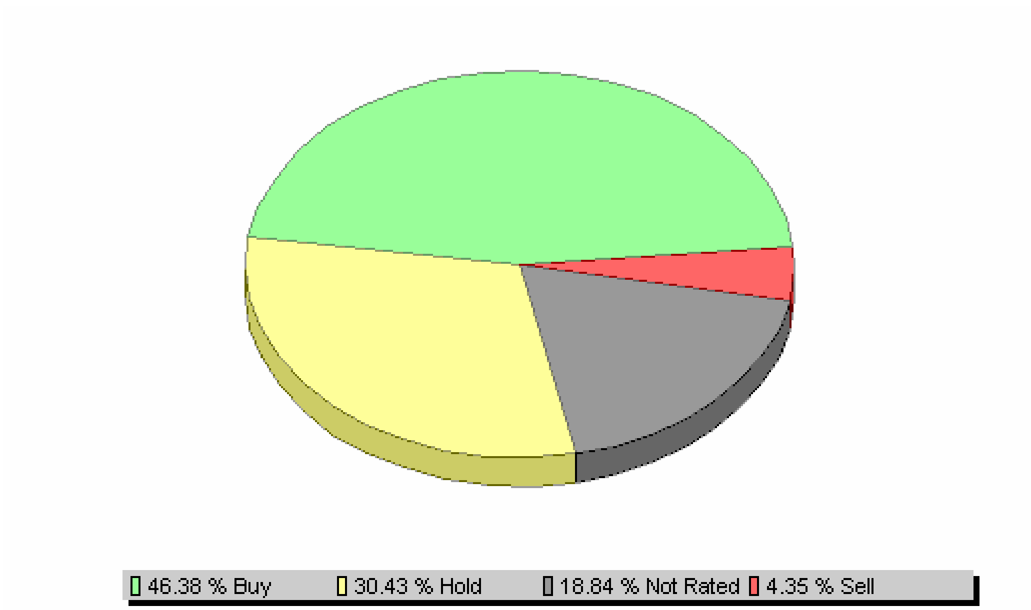
- A 5.3X price-to-sales multiple, which is the Company's current trailing-twelve month multiple, applied to our net sales estimate of $3.60 per share for 2009;

- A 80.4X price-to-free cash flow multiple, which is the trailing twelve-month multiple (as of May 27, 2008) for the Food Processing Industry according to reuters.com, applied to our estimate of free cash flow of $0.34 per share for 2009.

Investors need to be aware that during December 2007, Lifeway Foods was able to enter into a sixth extension of the stockholders' agreement with Danone Foods, Inc. According to the SEC filing, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the fifth extension of the stockholders', standstill, and non-compete agreements, which will now expire on December 31, 2008.



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	0	0
Hold	1	6.67%
Sell	0	0
Not Rated	0	0

Meaning of Ratings

Buy

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

Speculative Buy

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

Neutral

We will remain neutral pending certain developments.

Underperform

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

Sell

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

Some notable Risks within the Microcap Market

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

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

Public Companies mentioned in this report:

Groupe Danone (NYSE: DA)

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As of the date of this report, we, our affiliates, any officer, director or stockholder, or any member of their families do not have a position in the stock of the company mentioned in this report. Taglich Brothers, Inc. does not currently have an Investment Banking relationship with the company mentioned in this report and was not a manager or co-manager of any offering for the company with in the last three years.

All research issued by Taglich Brothers, Inc. is based on public information. Since December 2000, the company pays a monthly monetary fee of $1,500 (USD) to Taglich Brothers, Inc. for the creation and dissemination of research reports.

I, Howard Halpern, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this report.

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

	Dec. 2006 Year End	Dec. 2007 Year End	Mar. 2008 1st Qtr End
ASSETS			
Current assets:			
Cash and cash equivalents	$ 1,548	$ 596	$ 393
Marketable securities	8,491	6,989	6,791
Investment, at cost	-	-	-
Accounts receivable, net	3,943	4,210	4,926
Other receivables	71	43	134
Inventories	2,522	3,507	3,670
Prepaid income taxes	268	241	-
Prepaid expenses and other assets	12	21	9
Deferred income taxes	32	312	468
Total current assets	**16,887**	**15,919**	**16,391**
Property, plant and equipment, net	8,581	9,679	9,855
Other assets	-	500	500
Intangible assets, net	7,531	8,671	8,591
Total assets	**$ 32,999**	**$ 34,768**	**$ 35,336**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Current maturities of notes payable	1,131	1,136	1,132
Accounts payable	1,463	1,594	1,967
Accrued expenses	480	414	392
Taxes payable	-	-	204
Total current liabilities	**3,074**	**3,144**	**3,695**
Long-term liabilities	5,747	4,097	3,814
Deferred income taxes	450	1,713	1,680
Stockholders' equity:			
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509
Paid-in capital	1,081	1,121	1,138
Stock subscription receivable	-	-	-
Retained earnings	17,319	20,471	21,360
Accumulated other comprehansive income, net of tax	154	(209)	(421)
Treasury stock, at cost	(1,334)	(2,078)	(2,438)
Total stockholders' equity	**23,728**	**25,814**	**26,148**
Total liabilities and stockholders' equity	**$ 32,999**	**$ 34,768**	**$ 35,336**
SHARES OUT	16,898	16,828	16,793

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

	FY2006A	FY2007A	**FY2008E**	**FY2009E**
Sales	$ 27,721	$ 38,729	**$ 49,797**	**$ 60,720**
Cost of goods sold	17,082	26,310	**32,822**	**39,000**
Gross Profit	10,639	12,420	**16,976**	**21,720**
Gross Margins	38.38%	32.07%	**34.09%**	**35.77%**
Operating Expenses:				
Sales	3,065	3,744	**4,819**	**5,925**
General and administrative	3,343	4,238	**4,745**	**5,650**
Total Operating Expenses	6,409	7,982	**9,564**	**11,575**
EBITDA	4,990	5,487	**8,491**	**11,265**
Operating Income	4,230	4,437	**7,412**	**10,145**
Operating Margin	15.26%	11.46%	**14.88%**	**16.71%**
Other Income (Expense)				
Interest income	388	350	**253**	**300**
Interest expense	(346)	(410)	**(356)**	**(340)**
Gain on sale of marketable securities	357	540	**-**	**-**
Other	1	(0)	**51**	**-**
Rental income	11	48	**42**	**40**
Total Other Income (Expense)	411	528	**(10)**	**-**
Pre-Tax Income	4,642	4,965	**7,401**	**10,145**
Pre-Tax Margins	16.74%	12.82%	**14.86%**	**16.71%**
Income Tax Expense (Benefit)	1,745	1,813	**2,833**	**3,940**
Tax Rate	37.60%	36.50%	**38.27%**	**38.84%**
Net Income	$ 2,897	$ 3,153	**$ 4,569**	**$ 6,205**
EPS -- Fully Diluted*	$ 0.17	$ 0.19	**$ 0.27**	**$ 0.37**
Avg Shares Out-Fully Diluted*	16,830	16,856	**16,831**	**16,848**
Percent of Revenue				
Cost of Revenues	61.62%	67.93%	65.91%	64.23%
Selling expenses	11.06%	9.67%	9.68%	9.76%
General and Administrative expenses	12.06%	10.94%	9.53%	9.31%
YEAR / YEAR GROWTH				
Total Revenues	37.70%	39.71%	28.58%	21.93%
Net Income	13.66%	8.84%	44.91%	35.82%

*** Adjusted for the 2-1 stock split effective March 9, 2004 and August 16, 2006**

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2007
(in thousands)

	Q1(03/07)A	Q2 (06/07)A	Q3 (09/07)A	Q4 (12/07)A	**FY2007A**
Sales	$ 9,022	$ 9,715	$ 9,817	$ 10,174	**$ 38,729**
Cost of goods sold	5,450	5,886	7,097	7,877	**26,310**
Gross Profit	3,572	3,829	2,721	2,297	**12,420**
Gross Margins	*39.60%*	*39.41%*	*27.71%*	*22.58%*	**32.07%**
Operating Expenses:					
Sales	770	912	965	1,097	**3,744**
General and administrative	1,001	1,156	1,174	908	**4,238**
Total Operating Expenses	1,771	2,068	2,140	2,004	**7,982**
EBITDA	2,047	2,029	857	554	**5,487**
Operating Income	1,801	1,761	581	293	**4,437**
Operating Margin	*19.97%*	*18.13%*	*5.92%*	*2.88%*	**11.46%**
Other Income (Expense)					
Interest income	66	98	85	101	**350**
Interest expense	(110)	(109)	(102)	(89)	**(410)**
Gain on sale of marketable securities	15	439	209	(123)	**540**
Rental income	9	10	10	20	**48**
Total Other Income (Expense)	(20)	438	202	(91)	**528**
Pre-Tax Income	1,781	2,199	783	202	**4,965**
Pre-Tax Margins	*19.74%*	*22.64%*	*7.97%*	*1.99%*	**12.82%**
Income Tax Expense (Benefit)	646	804	315	49	**1,813**
Tax Rate	*36.26%*	*36.54%*	*40.18%*	*24.11%*	**36.50%**
Net Income	$ 1,135	$ 1,396	$ 468	$ 153	**$ 3,153**
EPS -- Fully Diluted	$ 0.07	$ 0.08	$ 0.03	$ 0.01	**$ 0.19**
Avg Shares Out-Fully Diluted	16,895	16,876	16,825	16,826	**16,856**
Percent of Revenue					
Cost of Revenues	60.40%	60.59%	72.29%	77.42%	67.93%
Selling expenses	8.54%	9.39%	9.83%	10.78%	9.67%
General and Administrative expenses	11.09%	11.89%	11.96%	8.92%	10.94%
YEAR / YEAR GROWTH					
Total Revenues	50.29%	52.58%	31.66%	28.89%	39.71%
Net Income	26.90%	86.08%	-36.73%	-70.02%	8.84%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2008
(in thousands)

	Q1(03/08)A	Q2 (06/08)E	Q3 (09/08)E	Q4 (12/08)E	**FY2008E**
Sales	$ 11,122	$ 12,025	$ 13,000	$ 13,650	**$ 49,797**
Cost of goods sold	7,632	8,190	8,375	8,625	**32,822**
Gross Profit	3,491	3,835	4,625	5,025	**16,976**
Gross Margins	*31.39%*	*31.89%*	*35.58%*	*36.81%*	**34.09%**
Operating Expenses:					
Sales	1,059	1,160	1,225	1,375	**4,819**
General and administrative	1,065	1,165	1,215	1,300	**4,745**
Total Operating Expenses	2,124	2,325	2,440	2,675	**9,564**
EBITDA	1,636	1,780	2,455	2,620	**8,491**
Operating Income	1,367	1,510	2,185	2,350	**7,412**
Operating Margin	*12.29%*	*12.56%*	*16.81%*	*17.22%*	**14.88%**
Other Income (Expense)					
Interest income	103	50	50	50	**253**
Interest expense	(86)	(90)	(90)	(90)	**(356)**
Rental income	12	10	10	10	**42**
Total Other Income (Expense)	80	(30)	(30)	(30)	**(10)**
Pre-Tax Income	1,447	1,480	2,155	2,320	**7,401**
Pre-Tax Margins	*13.01%*	*12.31%*	*16.58%*	*17.00%*	**14.86%**
Income Tax Expense (Benefit)	558	575	815	885	**2,833**
Tax Rate	*38.57%*	*38.85%*	*37.82%*	*38.15%*	**38.27%**
Net Income	$ 889	$ 905	$ 1,340	$ 1,435	**$ 4,569**
EPS -- Fully Diluted	$ 0.05	$ 0.05	$ 0.08	$ 0.09	**$ 0.27**
Avg Shares Out-Fully Diluted	16,828	16,830	16,832	16,835	**16,831**
Percent of Revenue					
Cost of Revenues	68.61%	68.11%	64.42%	63.19%	65.91%
Selling expenses	9.52%	9.65%	9.42%	10.07%	9.68%
General and Administrative expenses	9.57%	9.69%	9.35%	9.52%	9.53%
YEAR / YEAR GROWTH					
Total Revenues	23.28%	23.77%	32.42%	34.16%	28.58%
Net Income	-21.73%	-35.16%	186.21%	835.19%	44.91%

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

	Q1(03/09)E	Q2 (06/09)E	Q3 (09/09)E	Q4 (12/09)E	**FY2009E**
Sales	$ 13,950	$ 14,500	$ 15,925	$ 16,345	**$ 60,720**
Cost of goods sold	9,250	9,550	9,950	10,250	**39,000**
Gross Profit	4,700	4,950	5,975	6,095	**21,720**
Gross Margins	*33.69%*	*34.14%*	*37.52%*	*37.29%*	**35.77%**
Operating Expenses:					
Sales	1,350	1,425	1,525	1,625	**5,925**
General and administrative	1,325	1,375	1,425	1,525	**5,650**
Total Operating Expenses	2,675	2,800	2,950	3,150	**11,575**
EBITDA	2,305	2,430	3,305	3,225	**11,265**
Operating Income	2,025	2,150	3,025	2,945	**10,145**
Operating Margin	*14.52%*	*14.83%*	*19.00%*	*18.02%*	**16.71%**
Other Income (Expense)					
Interest income	75	75	75	75	**300**
Interest expense	(85)	(85)	(85)	(85)	**(340)**
Rental income	10	10	10	10	**40**
Total Other Income (Expense)	-	-	-	-	**-**
Pre-Tax Income	2,025	2,150	3,025	2,945	**10,145**
Pre-Tax Margins	*14.52%*	*14.83%*	*19.00%*	*18.02%*	**16.71%**
Income Tax Expense (Benefit)	785	835	1,175	1,145	**3,940**
Tax Rate	*38.77%*	*38.84%*	*38.84%*	*38.88%*	**38.84%**
Net Income	$ 1,240	$ 1,315	$ 1,850	$ 1,800	**$ 6,205**
EPS -- Fully Diluted	$ 0.07	$ 0.08	$ 0.11	$ 0.11	**$ 0.37**
Avg Shares Out-Fully Diluted	16,840	16,845	16,850	16,855	**16,848**
Percent of Revenue					
Cost of Revenues	66.31%	65.86%	62.48%	62.71%	64.23%
Selling expenses	9.68%	9.83%	9.58%	9.94%	9.76%
General and Administrative expenses	9.50%	9.48%	8.95%	9.33%	9.31%
YEAR / YEAR GROWTH					
Total Revenues	25.42%	20.58%	22.50%	19.74%	21.93%
Net Income	39.54%	45.30%	38.06%	25.44%	35.82%

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

	FY2006A	FY2007A	3 Mos.2008A
Cash Flows from Operating Activities			
Net Income	$ 2,896	$ 3,153	$ 889
Depreciation and amortization	759	1,050	269
Amortization of discounts on securities	-	-	-
Gain on sale of marketable securities	(356)	(540)	(51)
Loss on marketable securities classified as trading	(1)	-	-
Issuance of common stock in exchange for services rendered	29	49	21
Decrease in allowance for doubtful accounts	45	(41)	-
Deferred income taxes	33	(224)	(39)
	3,405	3,447	1,088
Changes In:			
Accounts receivable	(1,190)	(226)	(716)
Other receivables	(15)	28	(91)
Inventories	(586)	(984)	(163)
Prepaid income taxes	(256)	27	241
Prepaid expenses and other assets	35	(9)	12
Accounts payable	639	131	373
Accrued expenses	125	(66)	(22)
Taxes payable	-	-	204
Net Changes in Working Capital	(1,248)	(1,100)	(164)
Net cash Provided by Operations	2,158	2,347	925
Cash Flows from Investing Activities			
Purchase of marketable securities	(7,510)	(5,745)	(1,977)
Sale of marketable securities	7,285	7,168	1,865
Investment in cost method securities	-	(500)	-
Acquisition of Helios, net of cash acquired	(2,552)	-	-
Purchase of property, plant and equipment	(680)	(1,825)	(365)
Net cash used in Investing	(3,456)	(901)	(477)
Cash Flows from Financing Activities			
Repayment of notes payable	(859)	(1,945)	(287)
Proceeds from note payable	-	300	-
Purchase of treasury stock	(649)	(753)	(363)
Net cash provided by Financing	(1,507)	(2,398)	(650)
Net change in Cash	(2,806)	(952)	(203)
Cash Beginning of Period	4,354	1,548	596
Cash End of Period	$ 1,548	$ 596	$ 393