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Research Report – Update

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Lifeway Foods, Inc.

Rating: Speculative Buy

Howard Halpern

LWAY $10.87 – (NasdaqGM)

May 29, 2009

	FY (12/07) A	FY (12/08) A	***FY (12/09) E***	***FY (12/10) E***
Sales (in millions)	$38.73	$44.46	***$60.21***	***$72.30***
Earnings per share (diluted)	$0.19	$0.11	***$0.31***	***$0.35***

52-Week range	$15.48 – $5.43	Fiscal year ends:	December
Shares outstanding a/o 04/30/09	16.82 million	Revenue/shares (TTM)	$2.81
Approximate float	4.78 million	Price/Sales (TTM)	3.9X
Market Capitalization	$183 million	Price/Sales (2010)E	2.5X
Tangible Book value/shr	$0.56	Price/Earnings (TTM)	72.5X
Price/Book	19.4X	Price/Earnings (2010)E	31.1X

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

Key investment considerations:

We are maintaining our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY). Our 12-month price target is $12.55 per share (prior 12-month price target was $10.50) based on our sales per share estimate for the next four quarters and historic price-to-sales analysis. The higher price target reflects our increased top line expectations for the next twelve months.

On May 18, 2009, Lifeway Foods reported first quarter 2009 revenue of $13.736 million, which was an increase of 23.5% versus $11.122 million in the same period last year. Contributing to the current period's top line results were sales that amounted to $1.391 million from Fresh Made (which was acquired on February 6, 2009). The Company generated net income of $1.547 million or $0.09 per diluted share versus net income of $0.889 million or $0.05 per diluted share.

Based on Q1'09 results, comments made by Management in the Company's first quarter earnings press release and 10Q filing, the integration of the Fresh Made acquisition, marketing/promotional initiatives that commenced late in 2008, mitigated to some degree by macroeconomic uncertainty, we are adjusting our forecasts for 2009. Our 2009 estimates call for sales of $60.211 million (prior was $59.892 million) and net income of $5.308 million or $0.31 per share (prior was $3.772 million or $0.23 per share).

For 2010, our initial forecast calls for top line results to grow by approximately 20% to $72.295 million and net income to reach $5.885 million or $0.35 per diluted share. Our forecast is based on the continuing organic growth of the Company's flagship Kefir product, its ProBugs™ Organic Kefir for kids, and expansion into the northeastern U.S. through the acquisition of Fresh Made. An indication of the latter was announced on May 18, 2009, with the commencement of shipments of LWAY's products to ShopRite, a chain of 200 stores in the northeast.

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

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The Company

Lifeway Foods, Inc. (NasdaqGM: LWAY) manufactures a cultured dairy beverage called Kefir and also develops Kefir related products at its three manufacturing/production facilities in Illinois (2) and Minnesota (1). The Company's distribution of its Kefir-based product portfolio in Illinois is accomplished through approximately 1,200 local stores including major retail chains (i.e., Jewel Food Stores, Dominick's Finer Foods, Treasure Island Food Marts, Whole Foods, and independent retailers), via twelve company owned trucks. Also, over 40 different assorted cream cheese products are distributed under the Cream Cheese Gourmet brand in the Philadelphia and Tri State Metropolitan area. Lifeway's products are also distributed to stores throughout the United States. In addition, the Company distributes its products throughout the United States and to some parts of Canada (Ontario and Quebec), utilizing verbal distribution arrangements with a number of distributors. Management believes that verbal arrangements provide the necessary latitude to expand into new markets and establish new relationships on an ongoing basis.

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

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

During mid-April 2008, the Company launched its Starfruit™ Kefir boutique in Chicago. The boutique offers customers several flavors of frozen Kefir with over 20 toppings, as well as customized Kefir parfaits, and smoothie-style Kefir drinks. On March 31, 2009, Company held an earnings conference call, in which Management indicated that it was nearing the end of the process that would allow for franchising to take place; however, no definite franchising plan has been announced as of the end of May 2009.

On February 6, 2009, LWAY acquired Fresh Made, Inc., a Philadelphia based dairy, which was the nation's second largest Kefir manufacturer. Terms of the acquisition consisted of $8.050 million in cash paid at closing, a promissory note in the principal amount of $2.735 million due on February 6, 2011, 128,948 shares of common stock valued at approximately $0.980 million, and $2.0 million paid for 1.1355 acres of land in Philadelphia, PA as part of the acquisition of Fresh Made. Management indicated its belief that the synergies between the LWAY and Fresh Made provide a natural benefit to shareholders, as LWAY serves the same customers, share the same shelf space, and purchase the same raw materials. It also provides enhanced distribution access to the northeast region of the U.S. According to the announcement, Fresh Made Inc. generated total sales of approximately $10 million in 2008, which was an increase from $8.5 million generated in 2007. From February 7, 2009 to March 31, 2009, Fresh Made contributed approximately $1.390 million to top line results.

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 18, 2009, Lifeway announced it begun to ship its products direct to ShopRite, a chain of about 200 stores primarily in the northeast region of the U.S. Investors should recognize that this is a good indication that the Fresh Made acquisition is paying dividends by providing the opportunity to expand beyond the mid west region of the U.S.

As of May 15, 2009, the Company announced that it had paid down approximately $1.5 million in debt that it borrowed in order to finance the acquisition of Fresh Made. We estimate, based on information gleaned from the first quarter 10Q filing, that the Company financed approximately $11.322 million of the Fresh Made acquisition (as of March 31, 2009).

Recent Financials

For the three-months ended March 31, 2009, versus the three-months ended March 31, 2008:

- Sales increased to $13.736 million versus $11.122 million. Taglich Brothers' estimate called for sales of $13.742 million;
- Gross margin increased to 40.18% versus 31.39%. Taglich Brothers' estimate was 22.68%;
- Operating expenses increased to $2.976 million versus $2.124 million;
- EBITDA improved to $2.931 million versus $1.636 million; and
- Net income was $1.547 million or $0.09 per share versus net income of $0.889 million or $0.05 per share. In comparison, Taglich Brothers' estimate called for net income of $0.542 million or $0.03 per share.

The year-over-year revenue increase of approximately 23.5% was attributable to higher sales and awareness of Lifeway's flagship product, Kefir and Probugs Organic Kefir for kids. Sales for its historic brands (including Helios Organic Kefir) grew by 11% on a year-over-year basis. Also contributing to the top line results was the Fresh Made acquisition, which from February 7, 2009 to March 31, 2009, generated sales of approximately $1.391 million.

Gross margin improved by 879 basis points versus the same period last year. The improvement in gross margin was directly related to:

- Lower cost of conventional milk, the Company's largest raw material;
- Reduced transportation costs; and
- Lower petroleum based production supplies.

On a year-over-year basis, operating expenses increased in the aggregate by approximately $0.852 million, which was primarily the result of legal and professional fees related to the February 6, 2009 acquisition of Fresh Made, and an increase in amortization expense (a non-cash item) of approximately $0.091 million (or an 114% increase) related to the Fresh Made acquisition. According to the first quarter 2009 10Q filing, many of the acquisition related professional fees are non recurring expenses; however, the Company did not publicly disclose the aggregate. As a percentage of revenue, operating expenses increased to 21.66% versus 19.09% in the first quarter of 2008. The year-over-year percentage increase was primarily attributable to the non-recurring expenses related to the acquisition of Fresh Made.

Total other expense for the three-month period ended March 31, 2009 was approximately $0.233 million, compared to income of $0.080 million in the same period last year. This increase was primarily attributable to higher interest expense related to the February 6, 2009 Fresh Made acquisition. Interest expense during the first quarter 2009 was approximately $0.154 million, which included approximately a $0.055 million pre-payment penalty on one of Lifeway's real estate mortgages related to the financing of the acquisition (this is a non-recurring expense). Additionally, interest income decreased by approximately $0.041 million during the first quarter 2009 versus the same period last year due to lower overall interest rates.

Balance Sheet as of March 31, 2009

The Company had cash and cash equivalents of $0.607 million and marketable securities of $4.286 million. This compares to cash and cash equivalents of $0.277 million and marketable securities of $5.262 million as of December 31, 2008. Working capital decreased to $5.323 million versus $11.095 million at the end of 2008. This was the result of short-term financing related to the Fresh Made acquisition. As of March 31, 2009, the Company increased its current maturities of notes payable by approximately $6.054 million. According to the first quarter 2009 10Q filing, the current maturities of notes payable is due by March 31, 2010. The Company's long-term liabilities (notes payable) stood at $8.376 million, which was an increase from $3.108 million at the end of 2008. Investors should note that approximately $7.516 million of the long-term notes payable is not due until February 6, 2014.

The Company's portfolio mix of marketable securities (at fair value as of March 31, 2009) consisted of:

- 56.4% fixed income type securities (government agency obligations & Bonds - corporate/municipal); and
- 43.6% in equities, mutual funds, preferred securities, and limited partnerships.

At March 31, 2009, the Company had total unrealized losses of $1.166 million. Also, proceeds from the sale of marketable securities were approximately $2.319 million and $1.865 million, respectively, for the three months ended March 31, 2009 and 2008.

We believe that LWAY will be able to fund its sales growth from cash on hand and internally generated funds. Management is not aware of any circumstances or trends other than the February 6, 2009 acquisition of Fresh Made, Inc., which would negatively affect liquidity in 2009. Also, Management is unaware of any potential negative impact upon future sales or earnings and that there have been no material fluctuations in the standard seasonal variation of the Company's business. Investors should be aware that Management continues to explore additional acquisition opportunities in order to increase sales, leverage the Company's distribution system, and expand its geographic reach across the U.S.

Market Comment

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

Investors should be cognizant that the two primary drivers for the growth in the Functional Foods Market are 1) changing trends in consumer diets towards healthier foods; and 2) growing proportion of aging populations.

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

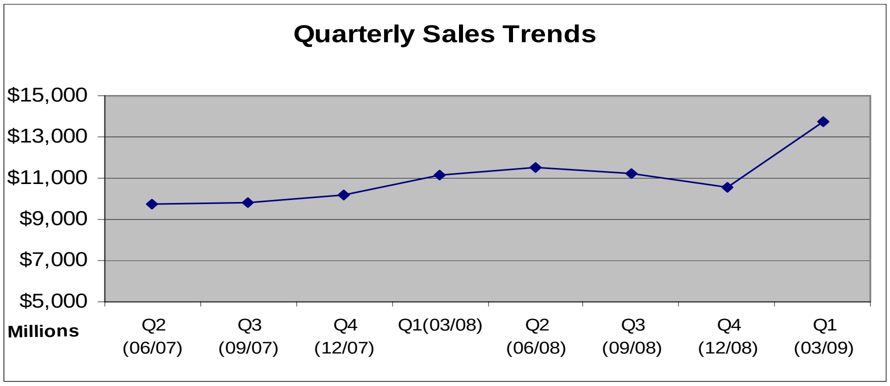
- During the global economic downturn, functional foods and beverages that provide a benefit consumers can actually feel will be best placed to weather the financial storm, according to a January 2009 article entitled How Functional Foods can Ride the Recession. Also, the article points out that digestive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

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

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

Outlook

Based on the Company's first quarter 2009 results and the February 6, 2009 acquisition of Fresh Made, it appears that the sequential quarterly sales declines that occurred during the second half of 2008 have abated. The following chart below graphically illustrates the sequential decline and also shows the rebound in sales for the first quarter of 2009:



Source: SEC filings

To provide some prospective on the positive progress being made in top line results, Management publicly stated that during the first quarter of 2009, LWAY recorded six $1 million-plus revenue generating weeks out of thirteen. Our current forecast calls for a weekly run-rate (for LWAY's core brands during the second quarter of 2009) of approximately $0.966 million. This would be an increase from $0.950 million for Q1'09 and $0.814 million reported in Q4'08. In addition to the weekly run-rate for its core brands, we are also forecasting that the Fresh Made acquisition should contribute approximately $0.154 million per week during the second quarter of 2009 (for an aggregate $2.0 million).

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

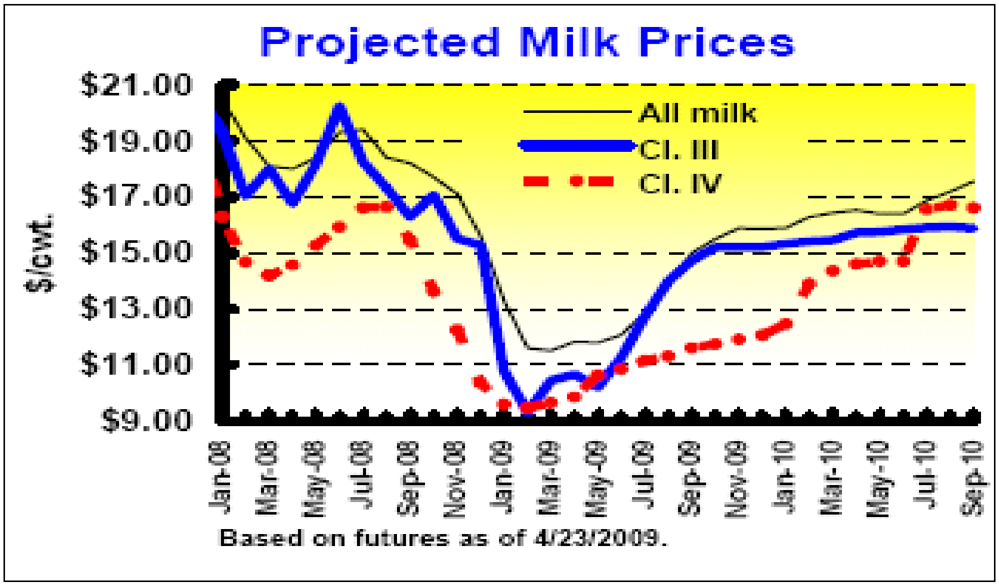
- Increasing product sampling and demonstration activities, use of coupons, and other promotional initiatives that commenced during the fourth quarter 2008 and will continue throughout 2009;
- Gaining new distribution outlets at Costco Wholesale, King Soopers, and Shop'n Save. Investors should be aware that Costco tends to rotate products to different divisions throughout the year. The Company believes that it can distributed its product in at least two divisions of Costco at any particular time;
- Developing consistent distribution outlets (supermarkets) in the northeast region of the U.S. On May 18, 2009, Lifeway announced it begun to ship its products direct to ShopRite, a chain of about 200 stores primarily in the northeast region of the U.S. Investors should recognize that this is a good indication that the Fresh Made acquisition is meeting its intended goal of providing the opportunity to expand beyond the mid west region of the U.S;
- Continuing to expand distribution of it ProBugs offering. ProBugs expansion is occurring in Whole Foods, Jewl-Osco, Publix, and Unfi (an independent national distributor of natural, organic and specialty foods and related products); and
- Obtaining new distribution of its Probiotic Wellness Bars that was launched during 2008. The Wellness Bar has been approved for new distribution at Kroger (certain locations), Jewel-Osco, and Whole Foods. This offering has been mentioned on LivelyWomen and mommygocrazy blogs.

Investors should also be cognizant that the February 2009 acquisition of Fresh Made should positively impact 2009 results (it already began benefiting first quarter results – see recent financials for details). According to Management, the acquisition should provide natural benefits to LWAY, since Fresh Made served the same customers, shared the same shelf space, purchased the same raw materials, and exhibit at the same trade shows. This transaction will enhance Lifeway's purchasing power, increase its ability to target the market category, and alleviate some competitive pressures.

Milk Price Perspective and Potential Impact(s)

The April 2009 Dairy Market Report from the National Milk Producers Federation (an organization that provides a forum through which dairy farmers and their cooperatives formulate policy on national issues that effect milk production and marketing) offers the following comments:

- Current prices have dipped, but futures prices have retained some strength for several months out and beyond;
- USDA projects a decline in average daily milk production of 0.9% in 2009; and
- The following chart graphically shows a projection of future price levels:



Source: April 2009 Dairy Market Report page 4.

The April 2009 Dairy Market Report from the National Milk Producers Federation stated that March's 2009 revised all-milk price was $11.50, the lowest all-milk price since August 2003. April was projected to be up to $11.80. Also, the futures markets are projecting the all-milk price to average $13.40 in 2009 (a month ago, the projection was $14.00) and $16.90 in 2010.

Investors should be aware that gross margin reported during Q1'09 was approximately 40.2%. We believe that level of gross margin could contract during the reaming nine months of 2009. However, on a year-over-year basis, gross margin is likely to see improvement since conventional milk prices are likely to remain lower then last year. Also, Management stated in the Company's first quarter earnings press release that organic milk prices, which have been at the same levels for several years, have begun to decline in price starting in mid-May. Investors should note that approximately 30% of LWAY's total sales come from organic product offerings.

Projections

Based on first quarter 2009 results, comments made by Management in the Company's first quarter earnings press release and 10Q filing, the continued integration of the Fresh Made acquisition, marketing/promotional initiatives that commenced late in 2008, mitigated to some degree by macro-economic uncertainty, we are adjusting our forecasts for 2009. Our 2009 estimates call for sales of $60.211 million (prior was $59.892 million) and net income of $5.308 million or $0.31 per share (prior was $3.772 million or $0.23 per share). It should be noted that the primary reason for the increased bottom line forecast is that first quarter 2009 per share results exceeded our expectations by $0.06 per share, which was a direct result of the Company beating our gross margin forecast by approximately 2,228 basis points.

As our forecast indicates, year-over-year top line growth should approximate 35.4%. Management has publicly stated that its top priority during 2009 is growing top line results in order to continue establishing consumer awareness of its product portfolio.

Our initial forecasts for 2010 call for top line results to grow by approximately 20% to $72.295 million and net income to reach $5.885 million or $0.35 per diluted share. Our forecast is based on the continuing organic growth of the Company's flagship Kefir product, its ProBugs™ Organic Kefir for kids, and expansion into the northeast region of the U.S. through the acquisition of Fresh Made.

Our forecasts for 2009 and 2010 incorporate the following:

- Maximizing existing and new distribution agreements;

- Being able to find new avenues to increase revenue. The introduction of a Kefir Wellness Snack Bar and obtaining new distribution channels starting this spring for this offering, as well as opening of its online store (https://onlinestore.lifeway.net/);

- Exploiting its expanded production capacity at the main Morton Grove headquarters facility, which the Company invested approximately $3 million during the end of 2007 to the end of 2008;

- Consolidating the acquisition of Fresh Made. The acquisition should add at least $10 million to the top line on a full year basis, as well as increase EBITDA by approximately $1.0 million. The later will assist the Company in paying down debt. Accordingly, the Company announced that it had begun to aggressively pay down the debt related to the financing of the acquisition and as of May 15, 2009, had paid down approximately $1.5 million of debt. Management believes that this aggressive stance is an important initiative in order to keep LWAY's balance sheet strong.

- Keeping interest expense in check. We anticipate interest expense for 2009 and 2010 of $0.614 million and $540, respectively, versus $0.299 million in 2008, primarily due the debt incurred to acquire Fresh Made Inc. If the Company maintains an accelerated debt repayment program (see prior bullet) our interest expense estimate may need to be adjusted lower;

- Operating with relatively high raw material costs, especially resin for its containers and packaging, as well as organic sugar and fruit; and

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

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

- Gross margin in 2009 and 2010 of 36.1% and 33.1%, respectively. This compares to 28.69% in 2008. The improvement versus 2008 is primarily due the lower conventional milk prices and a moderation of organic milk prices starting in mid-May 2009. However, likely mitigating the improvement is the Company shifting expenses toward cost of goods sold (i.e., product sampling and demonstration activities, couponing, and other promotional initiatives). Initially, we are reducing on a year-over-year basis, gross margin for 2010 primarily due to the expectation of higher milk prices based on the futures market. Also, investors should realize that a wild card for gross margin would be a sharp rise or fall in oil prices. As events occur we will make the necessary adjustments to our forecast; and

- SG&A expenses, as a percentage of sales, in 2009 and 2010 of 21.4% and 19.9%, respectively. This compares to 19.27% in 2008. Our revised forecast incorporates the initial impact of the Fresh Made acquisition for 2009. For 2010, economies of scale should occur from plant utilization and complete integration of the operations of Fresh Made.

Risks

Commodities

The Company's products use conventional and organic raw materials, such as milk, sugar, and fruit from unaffiliated suppliers. Lifeway is not limited or contractually bound to any supplier. The raw and packaging materials purchased by the Company are considered commodity items and are widely available on the open market. If the price of those commodity products were to unexpectedly rise and remain at high levels, it would negatively impact margins.

Regulation

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

Groupe Danone SA Relationship

According to the Company's 2008 10-K filing on January 15, 2009, the Company entered into a seventh extension of the stockholders' agreement with Danone Foods, Inc. (the terms of the non-compete period and standstill period of the stockholders' agreement expire on December 31, 2009, which was originally entered into on October 1 1999. In prior SEC filings, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the stockholders' agreement and all Lifeway shares held by Danone Foods, Inc., were transferred to DS Waters on November 10, 2005. Also, included in the agreement was a non-compete provision, with the specific exclusion of Stonyfield Farms, Inc., an affiliate of Danone Foods, Inc. and DS Waters. Investors should be aware that Stonyfield Farms is not in direct competition with LWAY, since it does not produce Kefir. **According to SEC filings, as of December 31, 2008, Danone owned approximately 20.7% of LWAY's common shares. Investors need to be cognizant that if Danone were to sell its stake in Lifeway Foods that it would most likely have a negative effect of the Company's stock price.**

Competition

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

Legal Issue

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

Sublicense Agreement

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

Integration of Acquisitions
Acquisitions involve numerous risks that include difficulties in the assimilation of the acquired operations (i.e., technology and product(s)), the diversion of Management's attention, entering markets in which the Company has limited or no direct experience, as well as the potential loss of key employees of the acquired company. Achieving and maintaining anticipated benefits of an acquisition will depend in part upon whether the integration of the acquired assets is accomplished in an efficient and effective manner. Therefore, in the event Lifeway makes an acquisition (such as the Helios Nutrition acquisition in 2006 and the Fresh Made acquisition in February 2009), no assurance can be given that it will be successful in terms of improving bottom line results.

Growth Management
Top line growth on a year-over-year basis slowed during 2008. It appears that sequential growth is resuming; therefore, Management will need to meet the challenges associated with managing growth and controlling costs in order to grow EBITDA and bottom line results in order to pay down the debt incurred to acquire Fresh Made. Investors should be watching to see if Management can manage this growth successfully throughout 2009 and beyond.

Internal Controls
As of March 31, 2009 (based on the Company’s 2008 10K filing and first quarter 2009 10Q filing), LWAY carried out an evaluation under the supervision and with the participation of Management, including the CEO and CFO, of the effectiveness of the design and operation of disclosure controls and procedures. Based upon that evaluation, the conclusion was that the Company’s disclosure controls and procedures **were not effective** at the reasonable assurance level as of March 31, 2009 in ensuring that information required to be disclosed under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified under the Exchange Act rules and forms due to the material weaknesses. As a result, LWAY performed additional analysis and other post-closing procedures to ensure the consolidated financial statements were prepared in accordance with generally accepted accounting principles. Accordingly, Management believes the consolidated financial statements included in the 2009 10Q fairly present, in all material respects, the Company’s financial condition, results of operations, and cash flows for the three month period ending March 31, 2009 and 2008.

As of March 31, 2009, there was no change in the material weaknesses in the Company’s internal control for financial reporting. Management plans to take corrective action to improve its review procedures for posting and updating the monthly financial activity and have begun creating an accounting manual for the accounting personnel during 2009. In addition, Management plans on implementing additional controls involving analysis of other than temporary impairment in 2009.

Management Control
Ludmila Smolyansky (mother of the Company CEO and CFO), who is Chairperson of the Board of Directors of Lifeway Foods, beneficially owns or controls approximately 44.76% of common shares outstanding, as of May 20, 2009.

As a result, she has the ability to substantially influence matters submitted to stockholders for approval, including election or removal of a member of the Board of Directors, amendment to the Company’s certificate of incorporation or bylaws, adoption of measures that could delay or prevent a change in control or impede a merger, takeover, or other business combination, and adoption of stock-based compensation plans. Accordingly, this could have a negative impact if her interests do not coincide with other shareholders on a particular issue.

Marketable Securities
At March 31, 2009, the fair value of the Company’s marketable securities available for sale was $4.286 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. During 2006, average daily volume was 30,756 shares traded a day and increased during 2007 to 69,402 shares traded daily. However, during 2008 average daily volume declined to 35,147 shares traded daily. During the first four months of 2009, average daily volume was 16,850 shares traded a day. Average daily volume remains relatively low; therefore, investors need to be aware that by nature a thinly traded equity can have significant price volatility.

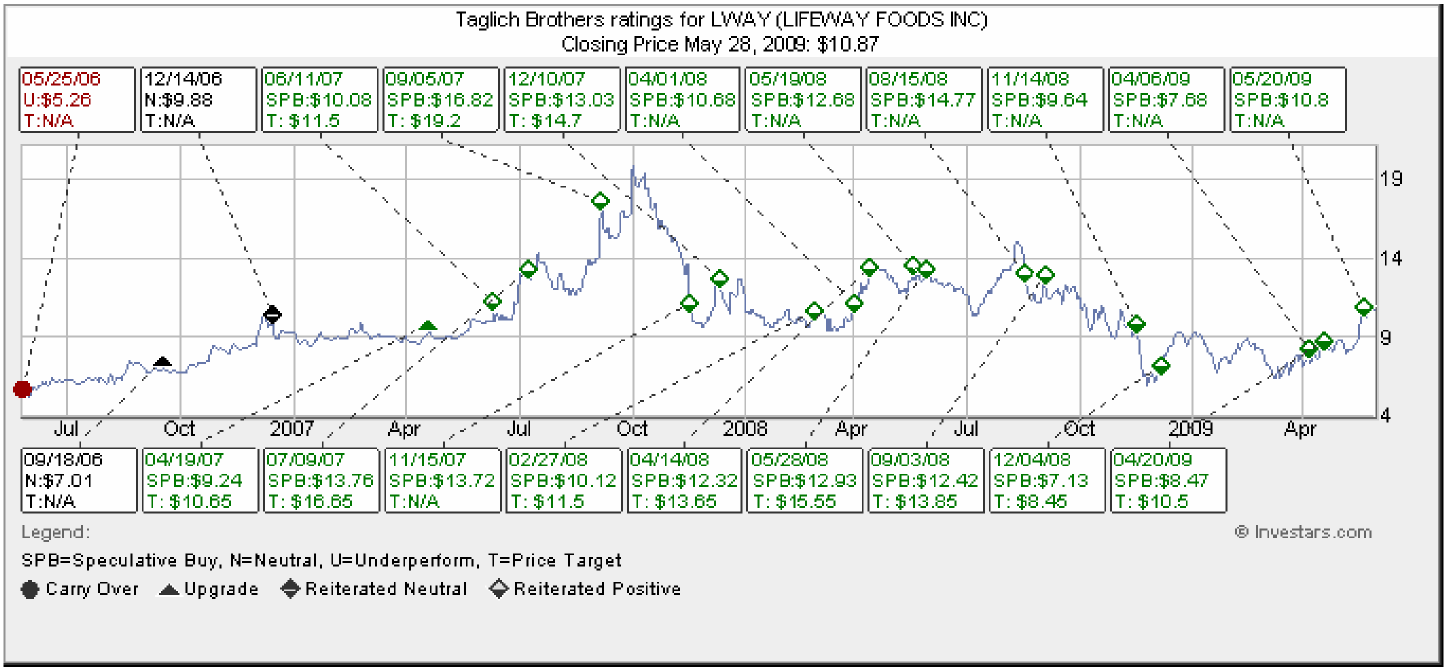
Conclusion

We are maintaining our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY). Our 12-month price target is $12.55 per share based on our sales per share estimate for the next four quarters and historic price-to-sales analysis (prior 12-month price target was $10.50). The higher price target reflects our increased top line expectations for the next twelve months (organic growth of approximately 18% and the expectation of at least $7.4 million from the acquisition of Fresh Made for the balance of 2009).

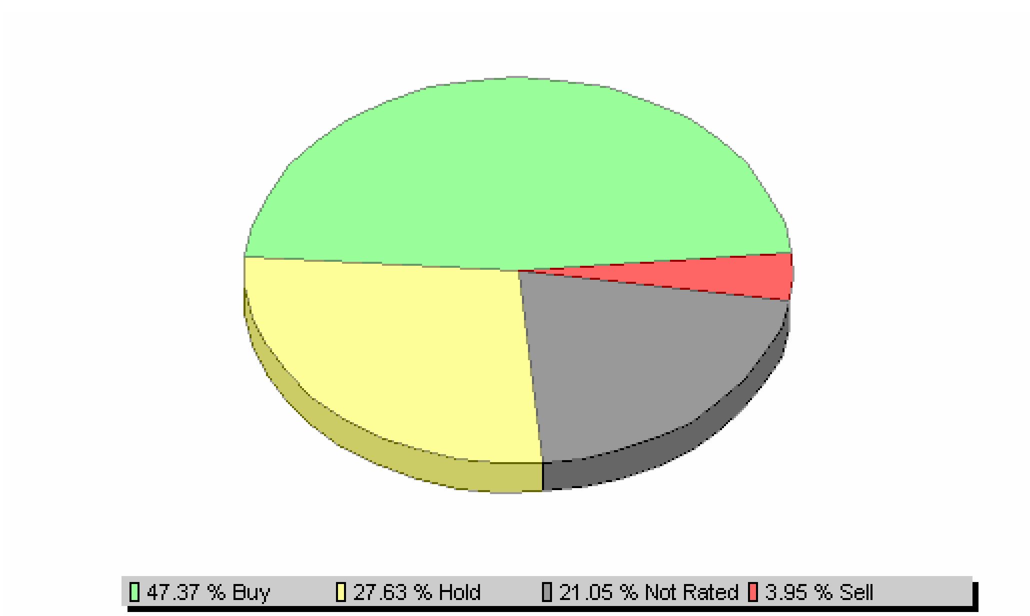
We have chosen to value the Company's shares using a historical approach the takes into consideration its ups and downs over the past 10 years. Therefore, our valuation model (discounted by 15% to account for microcap risk and Company specific risks mentioned earlier) is based on applying the 10 year average historic price-to-sales multiple for the Company's stock to our sales per share estimate over the next four quarters of $3.76 per share. According to MSN Money, the 10 year average price-to-sales multiple for LWAY is 3.92X.

Investors should note that the Company announced on May 18, 2009, it recently begun to ship direct to ShopRite, a chain of about 200 stores primarily in the northeast region of the U.S. We believe that this move into the northeast region of the U.S. is a prime indication that the Fresh Made acquisition is paying dividends by providing the opportunity to expand beyond the mid west region of the U.S.

Investors need to be aware that on January 15, 2009, Lifeway Foods was able to enter into a seventh extension of the stockholders' agreement with Danone Foods, Inc. According to the SEC filing, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the seventh extension of the stockholders', standstill, and non-compete agreements, which will now expire on December 31, 2009.



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months		
Rating	#	%
Buy	2	7.69%
Hold	0	0
Sell	0	0
Not Rated	0	0

<u>Meaning of Ratings</u>

Buy

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

Speculative Buy

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

Neutral

We will remain neutral pending certain developments.

Underperform

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

Sell

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

Some notable Risks within the Microcap Market

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

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

Public Companies mentioned in this report:

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

* 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.

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. 2007 Year End	Dec. 2008 Year End	March 2009 1st Qtr End
ASSETS			
Current assets:			
Cash and cash equivalents	$ 596	$ 277	$ 607
Marketable securities	6,989	5,262	4,286
Investment, at cost	-	-	-
Accounts receivable, net	4,210	4,766	6,062
Other receivables	43	40	27
Inventories	3,507	3,098	3,642
Prepaid income taxes	241	356	73
Prepaid expenses and other assets	21	23	23
Deferred income taxes	312	920	863
Total current assets	**15,919**	**14,742**	**15,584**
Property, plant and equipment, net	9,679	11,063	13,724
Other assets	500	500	500
Intangible assets, net	8,671	8,351	19,019
Total assets	**$ 34,768**	**$ 34,656**	**$ 48,827**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Current maturities of notes payable	1,136	928	6,982
Accounts payable	1,594	2,260	2,369
Accrued expenses	414	458	487
Taxes payable	-	-	-
Total current liabilities	**3,144**	**3,647**	**10,260**
Long-term liabilities -- notes payable	4,097	3,108	8,376
Deferred income taxes	1,713	1,607	1,763
Stockholders' equity:			
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509
Paid-in capital	1,121	1,202	1,886
Stock subscription receivable	-	-	-
Retained earnings	20,471	22,384	23,931
Accumulated other comprehansive income, net of tax	(209)	(499)	(843)
Treasury stock, at cost	(2,078)	(3,302)	(3,057)
Total stockholders' equity	**25,814**	**26,294**	**28,427**
Total liabilities and stockholders' equity	**$ 34,768**	**$ 34,656**	**$ 48,827**
SHARES OUT	16,828	16,724	16,843

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

	FY2007A	FY2008A	**FY2009E**	**FY2010E**
Sales	$ 38,729	$ 44,461	**$ 60,211**	**$ 72,295**
Cost of goods sold	26,310	31,704	**38,467**	**48,350**
Gross Profit	12,420	12,758	**21,744**	**23,945**
Gross Margins	32.07%	28.69%	**36.11%**	**33.12%**
Operating Expenses:				
Sales	3,744	4,098	**5,783**	**7,325**
General and administrative	4,238	4,468	**7,073**	**7,025**
Total Operating Expenses	7,982	8,567	**12,856**	**14,350**
EBITDA	5,487	5,284	**10,431**	**11,135**
Operating Income	4,437	4,191	**8,889**	**9,595**
Operating Margin	11.46%	9.43%	**14.76%**	**13.27%**
Other Income (Expense)				
Interest income	350	343	**197**	**210**
Interest expense	(410)	(299)	**(614)**	**(540)**
Gain on sale of marketable securities	540	(734)	**(150)**	**-**
Other	(0)	(959)	-	-
Rental income	48	49	**39**	**40**
Total Other Income (Expense)	528	(1,599)	**(528)**	**(290)**
Pre-Tax Income	4,965	2,592	**8,361**	**9,305**
Pre-Tax Margins	12.82%	5.83%	**13.89%**	**12.87%**
Income Tax Expense (Benefit)	1,813	680	**3,053**	**3,420**
Tax Rate	36.50%	26.23%	**36.52%**	**36.75%**
Net Income	$ 3,153	$ 1,912	**$ 5,308**	**$ 5,885**
EPS -- Fully Diluted*	$ 0.19	$ 0.11	**$ 0.31**	**$ 0.35**
Avg Shares Out-Fully Diluted*	16,856	16,765	**16,853**	**16,873**
Percent of Revenue				
Cost of Revenues	67.93%	71.31%	63.89%	66.88%
Selling expenses	9.67%	9.22%	9.60%	10.13%
General and Administrative expenses	10.94%	10.05%	11.75%	9.72%
YEAR / YEAR GROWTH				
Total Revenues	39.71%	14.80%	35.42%	20.07%
Net Income	8.84%	-39.34%	177.55%	10.88%

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

	Q1(03/08)A	Q2 (06/08)A	Q3 (09/08)A	Q4 (12/08)A	**FY2008A**
Sales	$ 11,122	$ 11,523	$ 11,240	$ 10,576	**$ 44,461**
Cost of goods sold	7,632	7,651	7,703	8,718	**31,704**
Gross Profit	3,491	3,873	3,537	1,857	**12,758**
Gross Margins	*31.39%*	*33.61%*	*31.47%*	*17.56%*	**28.69%**
Operating Expenses:					
Sales	1,059	1,154	958	927	**4,098**
General and administrative	1,065	1,172	1,112	1,119	**4,468**
Total Operating Expenses	2,124	2,326	2,070	2,046	**8,567**
EBITDA	1,636	1,821	1,744	82	**5,284**
Operating Income	1,367	1,546	1,467	(189)	**4,191**
Operating Margin	*12.29%*	*13.42%*	*13.05%*	*-1.79%*	**9.43%**
Other Income (Expense)					
Interest income	103	63	95	82	**343**
Interest expense	(86)	(69)	(72)	(72)	**(299)**
Gain on sale of marketable securities	-	(87)	(381)	(265)	**(734)**
Other	51	-	-	(1,010)	**(959)**
Rental income	12	12	14	12	**49**
Total Other Income (Expense)	80	(82)	(344)	(1,253)	**(1,599)**
Pre-Tax Income	1,447	1,465	1,123	(1,442)	**2,592**
Pre-Tax Margins	*13.01%*	*12.71%*	*9.99%*	*-13.63%*	**5.83%**
Income Tax Expense (Benefit)	558	553	268	(699)	**680**
Tax Rate	*38.57%*	*37.75%*	*23.86%*	*48.47%*	**26.23%**
Net Income	$ 889	$ 912	$ 855	$ (743)	**$ 1,912**
EPS -- Fully Diluted	$ 0.05	$ 0.05	$ 0.05	$ (0.04)	**$ 0.11**
Avg Shares Out-Fully Diluted	16,828	16,765	16,731	16,735	**16,765**
Percent of Revenue					
Cost of Revenues	68.61%	66.39%	68.53%	82.44%	71.31%
Selling expenses	9.52%	10.02%	8.52%	8.76%	9.22%
General and Administrative expenses	9.57%	10.17%	9.89%	10.58%	10.05%
YEAR / YEAR GROWTH					
Total Revenues	23.28%	18.61%	14.49%	3.94%	14.80%
Net Income	-21.73%	-34.68%	82.60%	-584.19%	-39.34%

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

	Q1(03/09)A	Q2 (06/09)E	Q3 (09/09)E	Q4 (12/09)E	**FY2009E**
Sales	$ 13,736	$ 14,560	$ 15,885	$ 16,030	**$ 60,211**
Cost of goods sold	8,217	9,300	10,350	10,600	**38,467**
Gross Profit	5,519	5,260	5,535	5,430	**21,744**
Gross Margins	*40.18%*	*36.13%*	*34.84%*	*33.87%*	**36.11%**
Operating Expenses:					
Sales	1,308	1,425	1,450	1,600	**5,783**
General and administrative	1,668	1,750	1,780	1,875	**7,073**
Total Operating Expenses	2,976	3,175	3,230	3,475	**12,856**
EBITDA	2,931	2,470	2,690	2,340	**10,431**
Operating Income	2,544	2,085	2,305	1,955	**8,889**
Operating Margin	*18.52%*	*14.32%*	*14.51%*	*12.20%*	**14.76%**
Other Income (Expense)					
Interest income	62	50	45	40	**197**
Interest expense	(154)	(165)	(150)	(145)	**(614)**
Rental income	9	10	10	10	**39**
Total Other Income (Expense)	(233)	(105)	(95)	(95)	**(528)**
Pre-Tax Income	2,311	1,980	2,210	1,860	**8,361**
Pre-Tax Margins	*16.82%*	*13.60%*	*13.91%*	*11.60%*	**13.89%**
Income Tax Expense (Benefit)	763	765	825	700	**3,053**
Tax Rate	*33.04%*	*38.64%*	*37.33%*	*37.63%*	**36.52%**
Net Income	$ 1,547	$ 1,215	$ 1,385	$ 1,160	**$ 5,308**
EPS -- Fully Diluted	$ 0.09	$ 0.07	$ 0.08	$ 0.07	**$ 0.31**
Avg Shares Out-Fully Diluted	16,847	16,850	16,855	16,860	**16,853**
Percent of Revenue					
Cost of Revenues	59.82%	63.87%	65.16%	66.13%	63.89%
Selling expenses	9.52%	9.79%	9.13%	9.98%	9.60%
General and Administrative expenses	12.14%	12.02%	11.21%	11.70%	11.75%
YEAR / YEAR GROWTH					
Total Revenues	23.50%	26.35%	41.32%	51.58%	35.42%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2010
(in thousands)

	Q1(03/10)E	Q2 (06/10)E	Q3 (09/10)E	Q4 (12/10)E	**FY2010E**
Sales	$ 16,825	$ 17,475	$ 18,895	$ 19,100	**$ 72,295**
Cost of goods sold	11,000	11,700	12,750	12,900	**48,350**
Gross Profit	5,825	5,775	6,145	6,200	**23,945**
Gross Margins	*34.62%*	*33.05%*	*32.52%*	*32.46%*	**33.12%**
Operating Expenses:					
Sales	1,650	1,775	1,900	2,000	**7,325**
General and administrative	1,685	1,725	1,765	1,850	**7,025**
Total Operating Expenses	3,335	3,500	3,665	3,850	**14,350**
EBITDA	2,875	2,660	2,865	2,735	**11,135**
Operating Income	2,490	2,275	2,480	2,350	**9,595**
Operating Margin	*14.80%*	*13.02%*	*13.13%*	*12.30%*	**13.27%**
Other Income (Expense)					
Interest income	45	50	55	60	**210**
Interest expense	(135)	(135)	(135)	(135)	**(540)**
Rental income	10	10	10	10	**40**
Total Other Income (Expense)	(80)	(75)	(70)	(65)	**(290)**
Pre-Tax Income	2,410	2,200	2,410	2,285	**9,305**
Pre-Tax Margins	*16.82%*	*12.59%*	*12.75%*	*11.96%*	**12.87%**
Income Tax Expense (Benefit)	885	800	885	850	**3,420**
Tax Rate	*36.72%*	*36.36%*	*36.72%*	*37.20%*	**36.75%**
Net Income	$ 1,525	$ 1,400	$ 1,525	$ 1,435	**$ 5,885**
EPS -- Fully Diluted	$ 0.09	$ 0.08	$ 0.09	$ 0.09	**$ 0.35**
Avg Shares Out-Fully Diluted	16,865	16,870	16,875	16,880	**16,873**
Percent of Revenue					
Cost of Revenues	65.38%	66.95%	67.48%	67.54%	66.88%
Selling expenses	9.81%	10.16%	10.06%	10.47%	10.13%
General and Administrative expenses	10.01%	9.87%	9.34%	9.69%	9.72%
YEAR / YEAR GROWTH					
Total Revenues	23.50%	20.02%	18.95%	19.15%	20.07%

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

	FY2007A	FY2008A	3 Mos.2009A
Cash Flows from Operating Activities			
Net Income	$ 3,153	$ 1,912	$ 1,547
Depreciation and amortization	1,050	1,093	387
Gain on sale of marketable securities	(540)	734	150
Other than temporary reductions of marketable securities	-	959	-
Issuance of common stock in exchange for services rendered	49	97	51
Decrease in allowance for doubtful accounts	(41)	71	-
Deferred income taxes	(224)	(509)	9
	3,447	4,356	2,144
Changes In:			
Accounts receivable	(226)	(627)	(1,136)
Other receivables	28	3	107
Inventories	(984)	409	28
Prepaid income taxes	27	(116)	(155)
Prepaid expenses and other assets	(9)	(2)	(14)
Accounts payable	131	666	402
Accrued expenses	(66)	44	94
Margin payable	-	-	423
Taxes payable	-	-	(198)
Net Changes in Working Capital	(1,100)	378	(449)
Net cash Provided by Operations	2,347	4,734	1,695
Cash Flows from Investing Activities			
Purchase of marketable securities	(5,745)	(5,782)	(1,758)
Sale of marketable securities	7,168	5,323	2,319
Acquisition of Fresh Made, net of cash acquired	-	-	(2,851)
Purchase of property, plant and equipment	(1,825)	(2,157)	(350)
Net cash used in Investing	(901)	(2,616)	(2,640)
Cash Flows from Financing Activities			
Repayment of notes payable	(1,945)	(1,196)	(354)
Proceeds from note payable	300	-	1,730
Purchase of treasury stock	(753)	(1,239)	(102)
Net cash provided by Financing	(2,398)	(2,436)	1,274
Net change in Cash	(952)	(319)	330
Cash Beginning of Period	1,548	596	277
Cash End of Period	$ 596	$ 277	$ 607