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

June 11, 2007

LWAY $10.08 – (NasdaqGM)

	FY (12/05)A	FY (12/06) A	*FY (12/07) E*	*FY (12/08) E*
Revenue (in millions)	$20.13	$27.72	***$37.78***	***$47.82***
Earnings per share (diluted)*	$0.15	$0.17	***$0.26***	***$0.36***

52-Week range*	$10.85 – $6.005	Fiscal year ends:	December
Shares outstanding a/o 04/27/07*	16.89 million	Revenue/shares (TTM) *	$1.82
Approximate float*	4.40 million	Price/Sales (TTM) *	5.5X
Market Capitalization	$170 million	Price/Sales (2008)E*	3.6X
Tangible Book value/shr	$1.47	Price/Earnings (TTM) *	56.0X
Price/Book*	6.9X	Price/Earnings (2008)E*	28.8X

* 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 setting a twelve-month price target of $11.50 per share based on our sales and earnings per share estimates for 2008. Our prior twelve-month price target was $10.65 per share.

Our rating is primarily based on momentum that is occurring from the Helios acquisition, a growing awareness of Lifeway's flagship Kefir line, its kids Kefir drink, called Probugs™, as well as securing its first foodservice distribution contract (which occurred on May 18, 2007).

On May 14, 2007, Lifeway Foods reported first quarter 2007 revenue of $9.022 million, which was an increase of 50.3% versus $6.003 million in the same period last year. Top line results included sales from the Helios acquisition that amounted to $1.320 million. Net income was $1.135 million or $0.07 per share versus $0.895 million or $0.05 per share in the first quarter of 2006.

Based on first quarter 2007 results, trend analysis of LWAY's base business, and the historic numbers of Helios, we are adjusting slightly our 2007 revenue forecast to $37.777 million (prior forecast was $37.786 million). Our revised net income forecast is $4.411 million or $0.26 per share (prior forecast was $2.651 million or $0.16 per share). The increase in our bottom line forecast is primarily due to improved gross margin prospects that occurred in the first quarter of 2007, which we believe will continue since Helio production should continued to be shifted to LWAY's own manufacturing facility.

Our initial forecast for 2008 calls for revenue of $47.815 million and net income of $6.145 million or $0.36 per share. We believe the year-over-year growth should continue to occur based on current trends, increased consumer awareness, and gross margin expansion that should continue to occur throughout 2008.

**** Please view our disclaimer located on page 12.***

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 twelve Kefir-based products in Illinois is accomplished through approximately 1,200 local stores including major retail chains (i.e., Jewel Food Stores, Dominick's Finer Foods, Treasure Island Food Marts, Whole Foods, and independent retailers), via twelve company owned trucks. Also, over 40 different assorted cream cheese products are distributed under the Cream Cheese Gourmet brand in the Philadelphia 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.

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. LWAY purchased all of the issued and outstanding stock of Helios from the stockholders for a combination of an aggregate amount of $1.300 million in LWAY's common stock (approximately 202,650 shares), $2.526 million in cash, and a $4.200 million promissory note (according to the Company's earnings conference call on April 3, 2007, Management believes it will paid down approximately $1.3 million of the note by the end of 2007) that bears interest at the floating prime rate per annum as published from time to time in the Wall Street Journal.

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. In addition, it is expected to provide cost efficiencies by pooling the purchase of raw materials. Based on Management's public statements the cost efficiencies should become evident as the quarters unfold throughout 2007.

During the final quarter of 2006, approximately 25% of Helios production was moved to the Company's facility in Morton Grove, Illinois. During the first quarter of 2007, approximately 30% of Helios production occurred in LWAY's main production facility in Morton Grove, Illinois. This should translate into improving gross margins in future periods. In the near term, the remaining 70% of the Helios brand Kefir will continue to be manufactured (under Lifeway's direction) from Helios' existing 25,000-square foot facility in Sauk Cente, Minnesota.

Helios Nutrition, based in Sauk Centre, Minnesota, founded in 1997 by George Economy, produces 5 flavors of organic reduced fat Kefir, as well as a line of fluid rBGH-free and organic milk that is distributed throughout central Minnesota and the Twin Cities.

<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 Developments

On May 18, 2007, Lifeway Foods announced that it secured a distribution agreement with U.S. Foodservice that will expand its footprint to restaurants, schools, hotels, and other institutional sites. During the second quarter of 2007, the Midwest division of U.S. Foodservice will make 10 Lifeway products available to customers in the Chicagoland area (including independent and multi-unit restaurants, educational institutions, and healthcare and hospitality facilities). The product mix includes three flavors of Probugs™ and seven 8-oz. single-serve natural and organic Kefir.

Also, Lifeway hired a sales representative dedicated to the away from home market and will exhibit at the National Restaurant Association Show in Chicago (May 20 – 22, 2007) as part of the Company's strategy to penetrate the foodservice area.

Recent Financials *(All per share figures reflect the 2-1 stock split effective August 16, 2006)*

For the three-months ended March 31, 2007, versus the three-months ended March 31, 2006:

- Revenue increased to $9.022 million versus $6.003 million. Taglich Brothers' estimates called for revenue of $9.021 million;
- Gross margin declined to 39.60% versus 44.93%;
- Operating expenses increased to $1.771 million versus $1.291 million;
- EBITDA increased to $2.047 million versus $1.550 million; and
- Net income was $1.135 million or $0.07 per share versus net income of $0.895 million or $0.05 per share. In comparison, Taglich Brothers' estimates called for net income of $0.551 million or $0.03 per share. The Company's bottom line beat our expectations primarily due to much better than anticipated gross margins versus our estimate for the first quarter of 2007 (investors should note we anticipated a 1,477 basis point reduction in gross margins and actual results only declined by 533 basis points).

The year-over-year revenue increase of 50.3% was attributable to higher sales for the existing Lifeway Foods line, which experienced growth of 28.3% and a contribution from Helios Nutrition, which was not present in the same period last year. The organic growth was primarily attributable to increased awareness of the Company's existing drinkable dairy products (i.e., its flagship Kefir product, Organic Kefir, La Fruta, as well as its Probugs™ Kefir drink designed specifically for kids). Sales from Helios Nutrition and its subsidiary, Pride of Main Street Dairy was $1.320 million, consisting of $1.139 million from the Helios brand and $0.181 million from its subsidiary Pride of Main Street Dairy.

Gross margin declined by 533 basis points versus the same period last year. The decrease in gross margin was primarily related to the increased cost of milk, (the Company's largest raw material), and the cost of freight, its second largest cost of goods sold component. According to the Company's quarterly SEC filing:

- The cost of milk was approximately 10% higher in the first quarter of 2007, as compared to the same period last year;

- Transportation costs were higher by approximately 55% in the first quarter of 2007, as compared to the first quarter of 2006.

Of note, products produced at Helios' facility have a lower gross margin then product produced at LWAY's facility.

Management stated in the Company's earnings press release, that even though the cost trend for conventional milk is increasing, the cost trend for organic milk is flat and supply even seems to be outpacing demand, so as more and more of the Company's revenues come from organic Kefir, which includes the recently acquired Helios brand, the expectation is that increased cost for conventional milk will have less of an impact going forward.

Operating expenses in the first quarter of 2007 increased by $0.480 million, primarily due to the higher advertising and marketing expenses to build brand awareness, which grew by approximately 33% on a year-over-year basis. As a percentage of revenue, operating expenses decreased to 19.63% versus 25.90% in the first quarter of 2006.

Balance Sheet as of March 31, 2007

The Company had cash and cash equivalents of $1.013 million and marketable securities of $8.561 million. This compares to cash and cash equivalents of $1.548 million and marketable securities of $8.491 million as of December 31, 2006. Working capital was $14.524 million versus $13.812 million at the end of 2006. The Company's long-term liabilities stood at $5.202 million, which was a decrease from $5.747 million at the end of 2005. The year-over-year changes in cash, working capital, and long-term liabilities resulted from the August 2006 acquisition of Helios Nutrition, as well as profitable operations during the first quarter of 2007.

The Company's portfolio mix of marketable securities (at fair value as of March 31, 2007) consisted of:

– 28.3% fixed income securities; and

– 71.7% in equities, mutual funds, and preferred securities.

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. An example is the Helios acquisition, which included an initial cash outlay of $2.5 million.

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.

In a December 2006 report issued by AC Nielsen entitled "What's Hot around the Globe – Insights on Growth in Food & Beverage Products", their analysis concluded that drinkable yogurt topped the list in terms of value growth of 18%, fueled by single-serving products and health trends toward probiotics. This healthy beverage was a strong performer, with double-digit growth in four of the five regions AC Nielsen studied. See chart below (source: December 2006 AC Nielsen report Insights on Growth in Food & Beverage Products):

Fastest Growing Category	Product Area	Number of Markets Growing/ Measured	Category Growth Rate	Private Label Growth Rate
Drinkable Yogurt	Non-Alcoholic Beverages	40 of 45	18%	N/A*
Fresh Soup/ Bouillon/ Stock	Ready-To-Eat Meals	11 of 13	18%	24%
Fresh Herbs/ Spices	Cooking Basics	6 of 7	17%	28%
Fresh Fish/ Shellfish/ Seafood	Meat, Fish & Eggs	10 of 10	12%	16%
Alcoholic Cider	Alcoholic Beverages	9 of 18	11%	7%
Fresh Ready to Eat Salads	Fruits & Vegetables	14 of 14	10%	12%
Frozen Meal Starters	Fruits & Vegetables	3 of 4	10%	15%
Baby Formula	Baby Food	48 of 55	10%	17%
Dairy Based Drinks (flavored/unflavored)	Non-Alcoholic Beverages	32 of 42	10%	N/A*

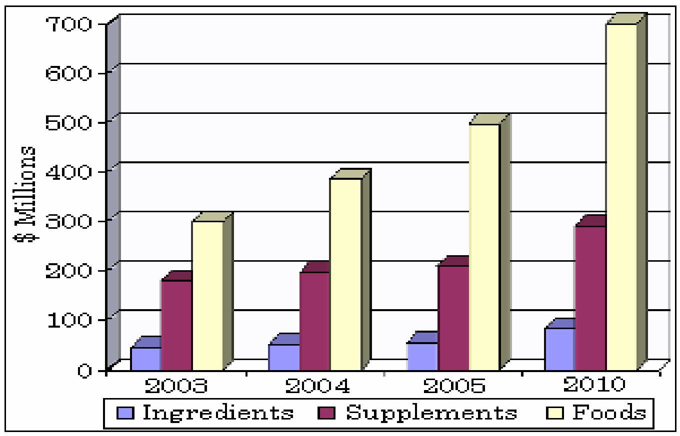
= Categories over US $1 billion globally

* Private Label data was collected for the combination of Dairy-Based Drinks, Dairy Substitute Drinks and Drinkable Yogurt and cannot be separated into categories for this study.

An October 2006 article entitled “Probiotics and Health to drive U.S. Yogurt Market” by Lorraine Heller, the following stats were provided from a research report (Cultured Dairy Products) published by Packaged Facts, a provider of authoritative consumer market research:

- U.S. cultured dairy market, which grow by almost 15% in 2002, only saw growth in 2005 of just 3%.
- Packaged Facts forecasts sales growth of nearly 11% between 2005 and 2010 to $15.4 billion;
- Cultured fluid products are expected to experience the strongest growth, increasing 38% annually. In particular, sales of probiotic shots are forecast to growth by 97% annually; and
- The key targets for this group of consumers are children, women, baby boomers, and Hispanics. Investors should note that Lifeway Foods has developed specific products for children (Probugs™) and the Hispanic market (La Fruita).

According to BCC Research (a technical market research firm), U.S. sales of probiotcs were estimated to be $764 million in 2005 and are expected to grow to over $1.1 billion in 2010. The following graphic shows the breakdown in sales by ingredients, supplements, and foods:



Source: BCC Research

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

Management stated in the Company’s May 14, 2007 press release, that the first quarter of 2007 was one of the strongest quarters in its history in terms of top line results. The strong results are a product of work that was done by Management over the past year that included the acquisition of Helios Nutrition and having its Probugs™ product being featured on “NBC’s The Today Show”, and “Fox and Friends” during the summer of 2006. We believe this continues to mean that public interest for Lifeway’s Kefir product is still growing and is becoming more accepted by the mainstream market as a healthy product. Also, the securing of its first foodservice distribution contract (on May 18, 2007) should bode well for future results. The Company’s CEO stated that Americans spend nearly half of every food dollar on meals prepared away from home. That makes the entrance into the foodservice market an important first step in reaching that market and building a new revenue stream for Lifeway.

The Company’s CFO commented that this was the first full quarter where LWAY was producing as much as 30% of the recently acquired Helios Kefir line in its main production facility in Morton Grove, Illinois, which should translate into seeing the real “fruits” of the acquisition. Even though the Company experienced many higher input costs including gas for transportation and the cost of milk, its largest raw material, which was approximately 10% higher on a year-over-year basis, Management was able to offset some of these costs by further maximizing the synergies from the Helios acquisition. The CFO also stated that even though the cost trend for conventional milk is increasing, the cost trend for organic milk is flat and supply even seems to be outpacing demand, so as more and more of LWAY's revenues come from organic Kefir (which includes the recently acquired Helios brand), the feeling is that the increased cost in conventional milk will have less of an impact going forward.

We anticipate that the Company is likely to experience a weekly sales run rate on its core business (excluding Helios) of approximately $0.624 million for the second quarter of 2007, which is a sequential increase from a weekly run rate in the second, third, and fourth quarters of 2006, of $0.490 million, $0.501 million, and $0.509 million, respectively, as well as the first quarter of 2007 of $0.592 million. Our belief 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 may include food services such as restaurants, hotels, schools, etc.), the continued rollout of its Probugs™ offering, and new foodservices contract. In addition, Management believes the Company's packaging continues to improve point-of-sale education, as well as heightened visibility among mainstream consumers. While Lifeway continues to market its products through local radio station, newspaper, and magazines advertisements, it also has additional exposure through the Internet, catalog advertising and promotion, in store demonstration throughout the U.S., and participation in various trade shows.

During the fourth quarter 2006 earnings conference call, Management indicated approximately $1.0 million of capital expenditures (from internally generated cash) will be spent in order to double the Company's production capacity (to $100 million in revenue potential) by the start of 2008.

Additionally, top line results will reflect the acquisition of Helios, which will positively impact the top line results in 2007. Management publicly stated during the fourth quarter 2006 earning conference call and reiterated in its first quarter earnings press release that it will keep the Helios brand and make necessary adjustment in order to bring expenses in line with LWAY's current business model. This should translate into a positive contribution to bottom line results sequentially during 2007.

Projections

Based on public comments made by Management in the Company's press release and SEC filings, first quarter 2007 results, and a full year contribution from Helios, we are tweaking our 2007 revenue estimate to $37.777 million from our prior revenue estimate of $37.786 million. If our top line estimate is achieved it would translate into year-over-year growth of 36.28%. Given our revenue estimate and belief based on first quarter results that indicated improved gross margin prospects should continue as Helio production continues to be shifted to LWAY's own manufacturing facility, we are increasing our 2007 forecast for net income to $4.411 million or $0.26 per diluted share from $2.651 million or $0.16 per diluted share.

Our initial forecast for 2008 calls for revenue of $47.815 million and net income of $6.145 million or $0.36 per share. We believe the year-over-year growth should continue to occur based on current trends, increased consumer awareness, and gross margin expansion.

Our forecast for 2007 and 2008 incorporates the following:

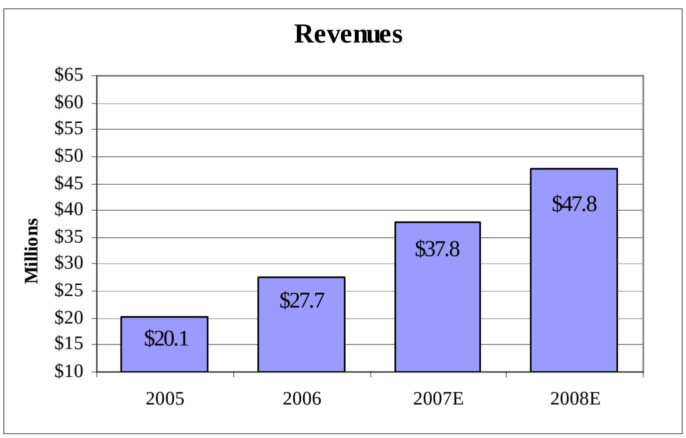
- Recent distribution agreements with Ralph's Grocery stores in Southern California and ACME Grocery in the Philadelphia and Tri-state area. Shipments of four flavors of Lowfat Kefir and ProBugs™ began during the last week of October 2006 and reorder rates appears to be solid during the first quarter of 2007;
- The continued rollout of it ProBugs™ offering;
- Integration of the Helios acquisition;
- Initial impact from the May 18, 2007, announcement of its first foodservice distribution contract;
- Increased interest expense for 2007. We anticipate interest expense for 2007 of $0.415 million versus $0.346 million in 2006, primarily due to the acquisition of Helios. In 2008, we estimate interest expense should be reduced to approximately $0.360 million;

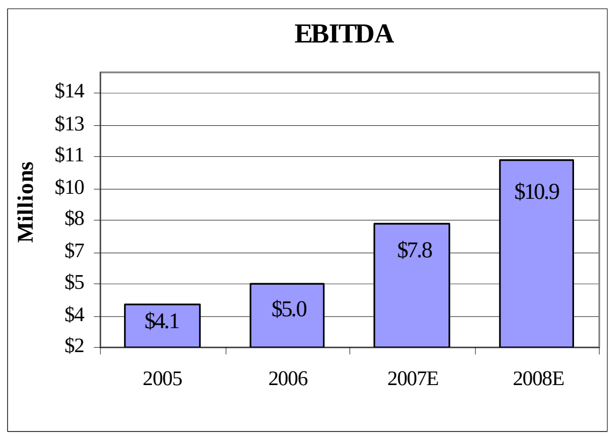
- Relatively high energy and raw material cost of resin for its containers and packaging, which we anticipate being offset by improved gross margins;
- Increased capital expenditures (as discussed earlier) in order to double the Company's production capacity (to approximately $100 million in revenue potential). Investors should note that capital expenditures will occur throughout the year with the intent of having the new capacity in place by the start of 2008; and
- The continued cost of being a public company (i.e., insurance, legal, and regulatory compliance).

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

- Gross margins in 2007 to 38.06% from 31.65%. This compares to 38.38% for all of 2006 and 29.93% for the fourth quarter of 2006 (which includes a full quarter of costs from Helios). Also, first quarter 2007 experienced gross margins of 39.60%. We are using the results from the fourth quarter of 2006 and improvement seen in the first quarter of 2007 as evidence that improvement should occur as the quarter progress due to the integration of the Helios acquisition. Also investors should note that even though milk prices appear to be on the rise, as discussed earlier organic milk prices are stable and as the Company's product mix shifts towards organic, it should mitigate any negative effects of increases in conventional milk costs. Our initial 2008 forecast for gross margins is 39.56%; and
- SG&A expenses, as a percentage of revenues, in 2007 to 19.92% from 19.99%. Our initial forecast for 2008 calls for SG&A expenses, as a percentage of revenues of 18.82%. This compares to 23.12% for all of 2006 and 20.12% for the fourth quarter of 2006 (which includes a full quarter of costs from Helios), as well as 19.54% for the first quarter of 2007.

The chart below shows our revenue and EBITDA projections:





Source: Company Filings and Taglich Brothers Estimates

Risks

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

Regulation
Lifeway is subject to regulation by federal, state and local governmental authorities regarding the distribution and sale of food products. Management believes that the Company is currently in compliance with all material government permits, licenses, qualifications, and approvals for its operations; however, there can be no assurance

that it will be able to maintain its existing licenses and permits. In addition, the Company believes that it is currently in compliance with all applicable environmental laws.

Also, the products exported to Canada are subject to strict quotas imposed by the Trade Control Policy Division of the Department of Foreign Affairs and International Trade of Canada. Management believes that the Company is in compliance with all applicable Canadian regulations.

Groupe Danone SA Relationship

According to an 8-K filed with the SEC on January 3, 2007, the Company entered into a fifth extension of the stockholders' agreement with Danone Foods, Inc., which was originally entered into on October 1 1999. In the filing, on January 3, 2007, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the fifth extension of the stockholders' agreement and all Lifeway shares held by Danone Foods, Inc., were transferred to DS Waters on November 10, 2005. Also, included in the agreement was a non-compete provision, with the specific exclusion of Stonyfield Farms, Inc., an affiliate of Danone Foods, Inc. and DS Waters. Investors should be aware that Stonyfield Farms is not in direct competition with LWAY, since it does not produce Kefir. However, the competitive landscape could increase as yogurt products (especially in the natural and organic categories) could increase the general competitive landscape in the future.

Under the fifth extension, the terms of the non-compete period and standstill period of the stockholders' agreement expire on December 31, 2007.

According to SEC filings, as of December 31, 2006, Danone owned approximately 20.1% of LWAY's common shares.

Legal Issue

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

Customer Concentration

In 2006, Lifeway's largest customer represented approximately 9% of sales and reflected sales in various regions of the United States outside the Chicago, Illinois metropolitan area.

Corporate Governance

Corporate governance may be an issue facing Lifeway Foods in light of new rules and regulation being issued by government regulatory agencies. This could mean that the Company will eventually be required to hire additional management personnel in order to diversify various operational functions.

Growth Management

LWAY has returned to growing revenues in excess of 25% 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.

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.

Management Control

Ludmila Smolyansky, who is Chairperson of the Board of Directors of Lifeway Foods, beneficially owns or controls approximately 45.1% of common shares outstanding.

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

Marketable Securities
At March 31, 2007, the fair value of the Company's marketable securities available for sale was $8.561 million. In the Company's 10-K 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.

Federal Reserve
Investors should be aware that if the Federal Reserve were to resume increasing interest rates (during their August, September, October, and December 2006 meetings, as well as January, February, March, and May 2007 meetings, the Federal Reserve Board of Governors did not increase the federal funds target rate by 25 basis points as it did in its previous seventeen meetings), it is likely to have a negative impact on valuation multiples.

Miscellaneous

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

Trading Volume

Liquidity has the potential to be a concern. Based on our calculations average daily-volume during 2003 increased to 4,451 shares from 1,943 shares in 2002. During 2004, average volume increased significantly to 154,399 shares traded a day. In 2005, average volume declined to 43,400 shares traded a day. During 2006, average daily volume has declined to 30,756 shares traded a day and has dipped during the first four months of 2007 to 25,473 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 setting a twelve-month price target of $11.50 per share based on our sales and earnings per share estimates. Our prior twelve-month price target was $10.65.

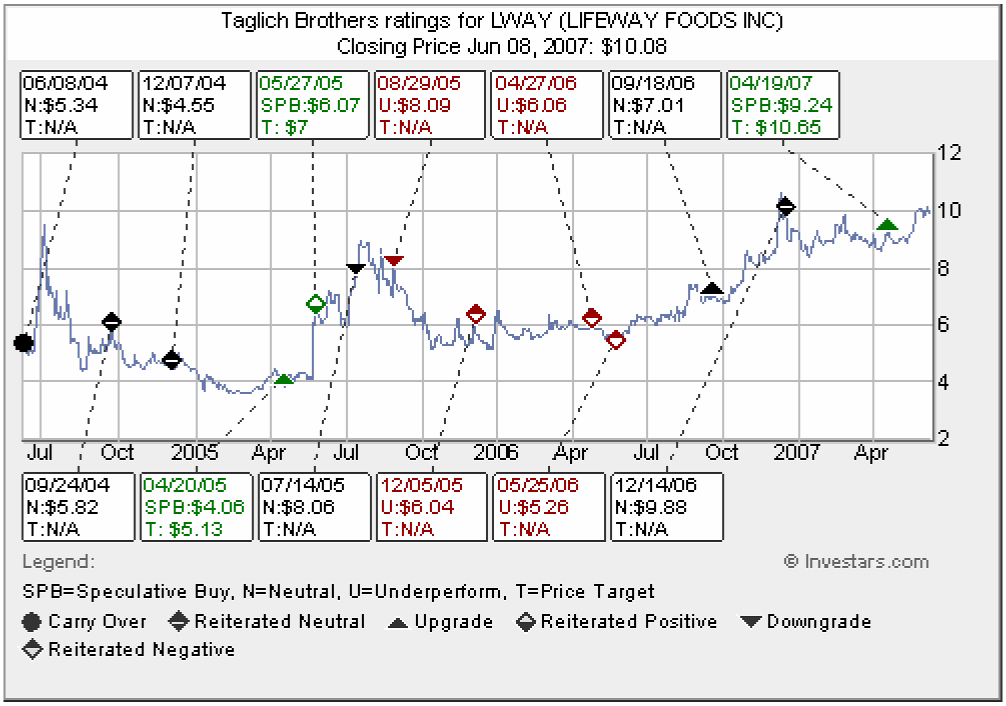
Our rating is primarily based on momentum that is occurring from the Helios acquisition, a growing awareness of Lifeway's flagship Kefir line, its kids Kefir drink, called Probugs™, as well as securing its first foodservice distribution contract (which occurred on May 18, 2007).

We obtained our price target from averaging the following valuation models, discounted by 15% to account for microcap risk and Company specific risks mentioned earlier:

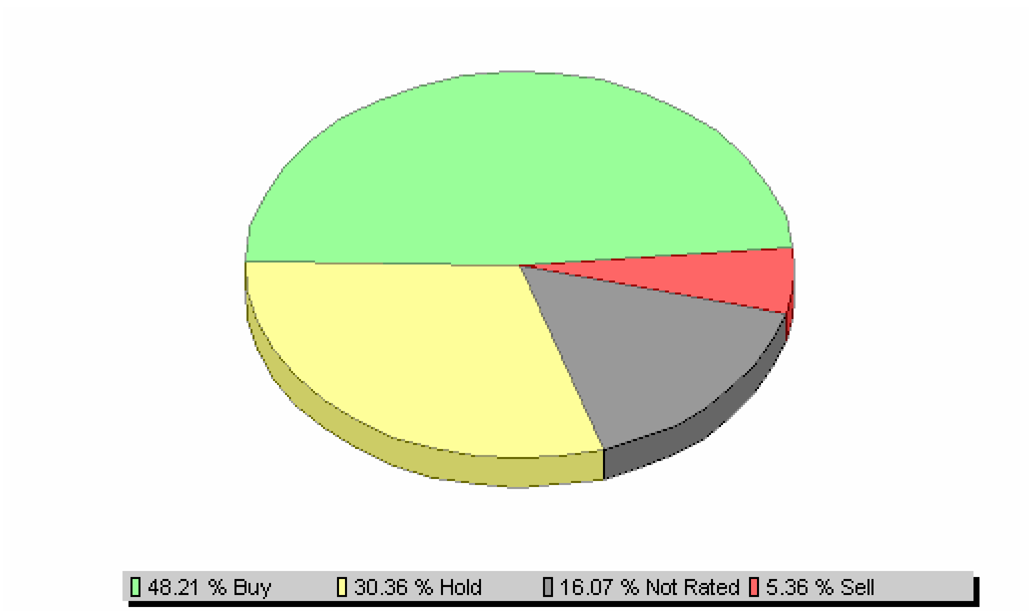
- A 5.5X price to sales multiple, which is the Company's current trailing-twelve month multiple, applied to our net sales estimate of $2.82 per share for 2008; and

- A 31.6X price-to-earnings multiple, which is our projected compounded annual growth rate for net income between 2004 to 2008, applied to our earnings per share estimate of $0.36 per share for 2008.

Investors need to be aware that during December 2006, Lifeway Foods was able to enter into a fifth 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, 2007.



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	1	3.45%
Hold	0	0
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.

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Public Companies mentioned in this report:

Kroger	(NYSE: KR)
Groupe Danone	(NYSE: DA)

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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. 2005 Year End	Dec. 2006 Year End	Mar. 2007 1st Qtr End
ASSETS			
Current assets:			
Cash and cash equivalents	$ 4,354	$ 1,548	$ 1,013
Marketable securities	7,479	8,491	8,561
Accounts receivable, net	2,518	3,943	4,588
Other receivables	56	71	50
Inventories	1,717	2,522	2,883
Prepaid income taxes	12	268	159
Prepaid expenses and other assets	9	12	10
Deferred income taxes	143	32	-
Total current assets	**16,287**	**16,887**	**17,264**
Property, plant and equipment, net	7,751	8,581	8,555
Total assets	**$ 24,465**	**$ 32,999**	**$ 33,270**
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Current maturities of notes payable	532	1,131	1,129
Accounts payable	426	1,463	1,239
Accrued expenses	355	480	341
Taxes payable	-	-	31
Total current liabilities	**1,314**	**3,074**	**2,740**
Long-term liabilities	2,903	5,747	5,202
Deferred income taxes	349	450	454
Stockholders' equity:			
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509
Paid-in capital	91	1,081	1,081
Stock subscription receivable	-	-	-
Retained earnings	14,423	17,319	18,454
Accumulated other comprehansive income, net of tax	(100)	154	241
Treasury stock, at cost	(1,025)	(1,334)	(1,411)
Total stockholders' equity	**19,899**	**23,728**	**24,874**
Total liabilities and stockholders' equity	**$ 24,465**	**$ 32,999**	**$ 33,270**
SHARES OUT	16,792	16,898	16,898

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

	FY2005A	FY2006A	**FY2007E**	**FY2008E**
Sales	$ 20,132	$ 27,721	**$ 37,777**	**$ 47,815**
Cost of goods sold	12,123	17,082	**23,400**	**28,900**
Gross Profit	8,009	10,639	**14,377**	**18,915**
Gross Margins	39.78%	38.38%	**38.06%**	**39.56%**
Operating Expenses:				
Sales	2,354	3,065	**3,190**	**3,770**
General and administrative	2,253	3,343	**4,336**	**5,230**
Total Operating Expenses	4,607	6,409	**7,526**	**9,000**
EBITDA	4,052	4,990	**7,847**	**10,875**
Operating Income	3,401	4,230	**6,852**	**9,915**
Operating Margin	16.90%	15.26%	**18.14%**	**20.74%**
Other Income (Expense)				
Interest income	323	388	**291**	**320**
Interest expense	(101)	(346)	**(415)**	**(360)**
Gain on sale of marketable securities	445	357	**315**	**-**
Other	14	1	-	-
Rental income	-	11	**30**	**20**
Total Other Income (Expense)	682	411	**221**	**(20)**
Pre-Tax Income	4,083	4,642	**7,072**	**9,895**
Pre-Tax Margins	20.28%	16.74%	**18.72%**	**20.69%**
Income Tax Expense (Benefit)	1,535	1,745	**2,661**	**3,750**
Tax Rate	37.58%	37.60%	**37.62%**	**37.90%**
Net Income	$ 2,548	$ 2,897	**$ 4,411**	**$ 6,145**
EPS -- Fully Diluted*	$ 0.15	$ 0.17	**$ 0.26**	**$ 0.36**
Avg Shares Out-Fully Diluted*	16,809	16,830	**16,910**	**16,956**
Percent of Revenue				
Cost of Revenues	60.22%	61.62%	61.94%	60.44%
Selling expenses	11.69%	11.06%	8.44%	7.88%
General and Administrative expenses	11.19%	12.06%	11.48%	10.94%
YEAR / YEAR GROWTH				
Total Revenues	23.36%	37.70%	36.28%	26.57%
Net Income	24.19%	13.66%	52.30%	39.30%

*** 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, 2006
(in thousands)

	Q1(03/06)A	Q2 (06/06)A	Q3 (09/06)A	Q4 (12/06)A	**FY2006A**
Sales	$ 6,003	$ 6,367	$ 7,457	$ 7,894	**$ 27,721**
Cost of goods sold	3,306	3,788	4,616	5,372	**17,082**
Gross Profit	2,697	2,580	2,840	2,521	**10,639**
Gross Margins	*44.93%*	*40.52%*	*38.09%*	*31.94%*	**38.38%**
Operating Expenses:					
Sales	583	850	891	742	**3,065**
General and administrative	708	800	830	1,005	**3,343**
Total Operating Expenses	1,291	1,650	1,721	1,747	**6,409**
EBITDA	1,550	1,078	1,285	1,076	**4,990**
Operating Income	1,406	930	1,119	774	**4,230**
Operating Margin	*23.43%*	*14.61%*	*15.01%*	*9.81%*	**15.26%**
Other Income (Expense)					
Interest income	86	122	86	94	**388**
Interest expense	(50)	(63)	(97)	(136)	**(346)**
Gain on sale of marketable securities	(37)	225	89	79	**357**
Other	1	3	(2)	-	**1**
Rental income		-	-	11	**11**
Total Other Income (Expense)	(0)	287	77	48	**411**
Pre-Tax Income	1,406	1,217	1,196	823	**4,642**
Pre-Tax Margins	*23.42%*	*19.11%*	*16.04%*	*10.42%*	**16.74%**
Income Tax Expense (Benefit)	511	467	456	311	**1,745**
Tax Rate	*36.37%*	*38.36%*	*38.13%*	*37.79%*	**37.60%**
Net Income	$ 895	$ 750	$ 740	$ 512	**$ 2,897**
EPS -- Fully Diluted*	$ 0.05	$ 0.04	$ 0.04	$ 0.03	**$ 0.17**
Avg Shares Out-Fully Diluted*	16,792	16,800	16,860	16,866	**16,830**
Percent of Revenue					
Cost of Revenues	55.07%	59.48%	61.91%	68.06%	61.62%
Selling expenses	9.71%	13.34%	11.94%	9.40%	11.06%
General and Administrative expenses	11.80%	12.56%	11.14%	12.73%	12.06%
YEAR / YEAR GROWTH					
Total Revenues	28.91%	25.53%	43.54%	51.58%	37.70%
Net Income	23.34%	34.70%	32.38%	-27.63%	13.66%

*** 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)E	Q3 (09/07)E	Q4 (12/07)E	**FY2007E**
Sales	$ 9,022	$ 9,440	$ 9,630	$ 9,685	**$ 37,777**
Cost of goods sold	5,450	5,850	5,950	6,150	**23,400**
Gross Profit	3,572	3,590	3,680	3,535	**14,377**
Gross Margins	*39.60%*	*38.03%*	*38.21%*	*36.50%*	**38.06%**
Operating Expenses:					
Sales	770	790	800	830	**3,190**
General and administrative	1,001	1,075	1,095	1,165	**4,336**
Total Operating Expenses	1,771	1,865	1,895	1,995	**7,526**
EBITDA	2,047	1,975	2,035	1,790	**7,847**
Operating Income	1,801	1,725	1,785	1,540	**6,852**
Operating Margin	*19.97%*	*18.27%*	*18.54%*	*15.90%*	**18.14%**
Other Income (Expense)					
Interest income	66	70	75	80	**291**
Interest expense	(110)	(105)	(100)	(100)	**(415)**
Gain on sale of marketable securities	15	300	-		**315**
Rental income	9	8	7	6	**30**
Total Other Income (Expense)	(20)	273	(18)	(14)	**221**
Pre-Tax Income	1,781	1,998	1,767	1,526	**7,072**
Pre-Tax Margins	*19.74%*	*21.17%*	*18.35%*	*15.76%*	**18.72%**
Income Tax Expense (Benefit)	646	750	655	610	**2,661**
Tax Rate	*36.26%*	*37.54%*	*37.07%*	*39.97%*	**37.62%**
Net Income	$ 1,135	$ 1,248	$ 1,112	$ 916	**$ 4,411**
EPS -- Fully Diluted*	$ 0.07	$ 0.07	$ 0.07	$ 0.05	**$ 0.26**
Avg Shares Out-Fully Diluted*	16,895	16,905	16,915	16,925	**16,910**
Percent of Revenue					
Cost of Revenues	60.40%	61.97%	61.79%	63.50%	61.94%
Selling expenses	8.54%	8.37%	8.31%	8.57%	8.44%
General and Administrative expenses	11.09%	11.39%	11.37%	12.03%	11.48%
YEAR / YEAR GROWTH					
Total Revenues	50.29%	48.26%	29.15%	22.69%	36.28%
Net Income	26.90%	66.39%	50.27%	78.97%	52.30%

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

	Q1(03/08)E	Q2 (06/08)E	Q3 (09/08)E	Q4 (12/08)E	**FY2008E**
Sales	$ 11,580	$ 11,970	$ 12,230	$ 12,035	**$ 47,815**
Cost of goods sold	6,975	7,200	7,350	7,375	**28,900**
Gross Profit	4,605	4,770	4,880	4,660	**18,915**
Gross Margins	*39.77%*	*39.85%*	*39.90%*	*38.72%*	**39.56%**
Operating Expenses:					
Sales	875	925	975	995	**3,770**
General and administrative	1,225	1,275	1,325	1,405	**5,230**
Total Operating Expenses	2,100	2,200	2,300	2,400	**9,000**
EBITDA	2,745	2,810	2,820	2,500	**10,875**
Operating Income	2,505	2,570	2,580	2,260	**9,915**
Operating Margin	*21.63%*	*21.47%*	*21.10%*	*18.78%*	**20.74%**
Other Income (Expense)					
Interest income	80	80	80	80	**320**
Interest expense	(90)	(90)	(90)	(90)	**(360)**
Rental income	5	5	5	5	**20**
Total Other Income (Expense)	(5)	(5)	(5)	(5)	**(20)**
Pre-Tax Income	2,500	2,565	2,575	2,255	**9,895**
Pre-Tax Margins	*21.59%*	*21.43%*	*21.06%*	*18.74%*	**20.69%**
Income Tax Expense (Benefit)	935	965	975	875	**3,750**
Tax Rate	*37.40%*	*37.62%*	*37.86%*	*38.80%*	**37.90%**
Net Income	$ 1,565	$ 1,600	$ 1,600	$ 1,380	**$ 6,145**
EPS -- Fully Diluted*	$ 0.09	$ 0.09	$ 0.09	$ 0.08	**$ 0.36**
Avg Shares Out-Fully Diluted*	16,935	16,950	16,965	16,975	**16,956**
Percent of Revenue					
Cost of Revenues	60.23%	60.15%	60.10%	61.28%	60.44%
Selling expenses	7.56%	7.73%	7.97%	8.27%	7.88%
General and Administrative expenses	10.58%	10.65%	10.83%	11.67%	10.94%
YEAR / YEAR GROWTH					
Total Revenues	28.35%	26.80%	27.00%	24.26%	26.57%
Net Income	37.85%	28.20%	43.89%	50.65%	39.30%

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

	FY2004A	FY2005A	FY2006A	3 Mos.2007A
Cash Flows from Operating Activities				
Net Income	$ 2,052	$ 2,548	$ 2,896	$ 1,135
Depreciation and amortization	670	651	759	245
Amortization of discounts on securities	-	-	-	-
Gain on sale of marketable securities	(354)	(445)	(356)	(14)
Loss on marketable securities classified as trading	16	(14)	(1)	(1)
Gain on sale of assets	-	-	-	-
Other than temporary reductions of marketable securities	-	-	-	-
Issuance of common stock in exchange for services rendered	95	52	29	-
Decrease in allowance for doubtful accounts	-	-	45	(41)
Provision for doubtful accounts	-	-	-	-
Deferred income taxes	46	(100)	33	7
	2,525	2,692	3,405	1,332
Changes In:				
Accounts receivable	(224)	(494)	(1,190)	(605)
Other receivables	94	16	(15)	21
Inventories	(94)	(811)	(586)	(361)
Prepaid income taxes	48	247	(256)	109
Prepaid expenses and other assets	(6)	(2)	35	2
Accounts payable	(154)	(215)	639	(224)
Accrued expenses	12	159	125	(139)
Taxes payable	-	-	-	-
Net Changes in Working Capital	(325)	(1,100)	(1,248)	(1,197)
Net cash Provided by Operations	2,200	1,592	2,158	135
Cash Flows from Investing Activities				
Purchase of marketable securities	(6,266)	(6,461)	(7,510)	(803)
Sale of marketable securities	6,097	5,810	7,285	896
Sales of Assets	-	-	-	-
Change in margin account	-	-	-	-
Acquisition of Ilya's Farms, Inc., net of assets acquired	(512)	-	-	-
Acquisition of Helios, net of cash acquired	-	-	(2,552)	-
Loan acquisition costs	-	-	-	-
Purchase of property, plant and equipment	(330)	(4,917)	(680)	(139)
Net cash used in Investing	(1,011)	(5,567)	(3,456)	(46)
Cash Flows from Financing Activities				
Repayment of notes payable	(28)	(37)	(859)	(547)
Proceeds from issuance of common stock	15	-	-	-
Proceeds from note payable	-	3,000	-	-
Purchase of treasury stock	-	(402)	(649)	(77)
Loan costs	-	(7)	-	-
Net cash provided by Financing	(13)	2,555	(1,507)	(624)
Net change in Cash	1,175	(1,419)	(2,806)	(535)
Cash Beginning of Period	4,598	5,773	4,354	1,548
Cash End of Period	$ 5,773	$ 4,354	$ 1,548	$ 1,013