

Taglich Brothers, Inc.

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Research Report Update

Lifeway Foods, Inc.

Rating: Speculative Buy

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LWAY \$7.45 - (NasdaqNM)

August 23, 2001

	FYE (12/98)	FYE (12/99)	FYE (12/00)	FYE (12/01)	FYE (12/02)
Revenues (in millions)	\$6.8	\$7.9	\$9.2	\$11.1	\$12.9
Earnings per share (diluted)	\$0.20	\$0.17	\$0.21	\$0.26	\$0.32
52week range	8.00 – 4.25		Fiscal year ends:	December	
Shares outstanding	4.32 million		Revenue/shares (TTM)	\$2.32	
Trading float	2.03 million		Price/Sales (TTM)	3.2X	
Insider ownership	53%		Price/Sales (2002)	2.5X	
Tangible Book value/shr <small>a/o 6-30-01</small>	\$2.62		Price/Earnings (2001)	28.7X	
Price/Book	2.8X		Price/Earnings (2002)	23.3X	

Lifeway Foods, Inc., based in Morton Grove, Illinois 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. They currently have about 45 employees. Web-site address is: www.kefir.com

Key investment considerations:

- **We are maintaining coverage of Lifeway Foods, Inc. (LWAY) with a Speculative Buy recommendation and a fifteen-month price target of \$10.63 per share. We believe this equity has solid upside potential based on our 2002 earnings estimate and discounted cash flow model.**
- **Lifeway's primary products are functional foods. The functional food market, depending on the definition, ranges from annual sales of \$15 to \$130 billion. We believe the functional foods market, which is likely to expand, provides the Company with excellent growth opportunities over the next three to five years.**
- **For the second quarter ended June 30, 2001, revenues increased by 20% to \$2.75 million and net income increased by 26% to \$0.232 million or \$0.05 per fully diluted share. In comparison, Taglich Brothers' estimates called for second quarter revenues of \$2.8 million and net income of \$0.300 million or \$0.07 per fully diluted share.**
- **We expect revenues to grow by approximately 20.8% to \$11.1 million in 2001 and in 2002 LWAY's revenues should grow to \$12.9 million. We believe this revenue growth will be achieved through increased marketing and the rollout of its organic product line in the second half of 2001.**
- **Net income should reach \$1.1 million or \$0.26 per share in 2001 and increase to \$1.4 million or \$0.32 per share in 2002. Earnings growth for 2002 should be achieved through operating margin improvements.**

* Please view our disclaimer located at the end of the text portion of this report.

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The Company

Lifeway Foods, Inc. (LWAY) was founded in 1986 and is based in Morton Grove, Illinois. The Company manufactures a cultured dairy beverage called kefir and also develops kefir related products at its two manufacturing facilities. The Company's 50,000-square foot facility is the largest kefir manufacturing facility in the United States.

LWAY distributes its products to over 8,000 stores throughout the United States and in its home state of Illinois; the Company owns and operates nine trucks that distribute Lifeway products directly to 1,200-plus stores, including major retail chains such as Jewel Food Stores, Dominick's Finer Foods, Wild Oats Markets, Treasure Island Food Marts, Whole Foods, Cub Foods and Butera Food Stores. Additionally, the Company distributes its products internationally by exporting to Canada and Russia.

Recent Financials

The Company reported that revenues for the second quarter of 2001 increased by approximately 20% to \$2.75 million, versus \$2.29 million in the second quarter of 2000. The increase was primarily attributable to the Company's marketing program for its various Kefir-based products and SoyTreat™ product. EBITDA for the second quarter increased by 92.7% to \$0.528 million versus \$0.274 million in the second quarter of 2000.

Net income for the quarter increased by 26% to \$0.232 million or \$0.05 per fully diluted share, versus \$0.184 million or \$0.04 per fully diluted share. However, net income was shy of our estimate of \$0.300 million or \$0.07 per fully diluted share. The primary reason for the shortfall was a lower gross margin of 40.2% versus our estimate of 40.9% and higher SG&A costs of \$0.773 million versus our estimate of \$0.715 million. The increase in cost of goods sold for the quarter was the result of higher freight, raw materials, and utility costs.

At the end of the second quarter, cash, cash equivalents and marketable securities were approximately \$6.37 million and working capital was \$7.2 million. The Company's long-term liabilities have decreased to \$0.516 million from \$1.19 million in the prior year. The decrease in long-term liabilities is the result of the reclassification of a mortgage note payable in November 2001 to current liabilities. The Company intends to refinance the note before it matures. We believe that the Company will be able to fund its sales growth from internal operations for the foreseeable future.

Kefir

Kefir, which originated centuries ago in Eastern Europe, is a cultured milk drink with a slightly acidic taste and has a consistency very similar to that of a milkshake. It is made with probiotic cultures obtained from the kefir grain, which is a complex and specific mixture of bacteria. Kefir is similar to, but distinct from, yogurt because the fermentation process produces a less sour tasting product and less sugar is required. Therefore, the end product contains fewer calories.

Lifeway Kefir contains seven 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). It is highly digestible due to its acidity and enzymes.

A full description of Lifeway's products are detailed in our previous reports or can be viewed on the Company's Web site – www.kefir.com.

Industry and Competition

Functional and probiotic foods form a segment within the food industry that has been growing in popularity. Foods in this segment include natural functional foods (i.e. cranberry juice, green tea, etc.), foods and ingredients for specific health use, formulas for infants and the elderly, medical foods, nutraceuticals and drug foods. The market is estimated to be approximately \$130 billion. An alternative definition offered by the American Dietetic

Association is that a functional food is a modified food or ingredient that provides health benefits beyond the nutrition it contains. Using this definition, the annual market for foods designed to provide specific medical benefits is estimated to be \$15 billion. Therefore, depending on the definition, Lifeway Foods' target market ranges from \$15 billion to \$130 billion.

The functional food segment continues to be the fastest growing area of the food industry. Some of the factors driving this growth are:

- The perception of nutrition as a tool for disease prevention and the self-treatment of various health concerns;
- An aging population;
- An increase in disposable income.

Supermarket chains have created a store within a store concept to make it easier for consumers to find health foods. This trend should be helpful to Lifeway Foods as the Company can position its products in the health food section of national or regional supermarket chains.

The Company faces very little direct competition in the United States for its drinkable kefir product, although the Company's kefir-based products are subject to competition from other yogurt and dairy products. Many producers of yogurt and other dairy products are well established and have greater financial resources than Lifeway Foods.

Outlook

Lifeway Foods has expanded its line of products through the introduction of its new organic kefir products at the Natural Products Expo in California. The Lifeway Organic™ kefir and cheese product line builds upon the Company's non-dairy SoyTreat™ products, thus allowing the Company the opportunity to broaden its customer base. We believe the rollout of this new product line will begin to impact revenues late in the third quarter of 2001.

Lifeway should continue to grow revenues through its marketing program and distribution channels. The Company's marketing program relies on advertising in local newspapers, primarily in the Chicago area, and in magazines such as *Self*, in order to educate consumers about the health benefits of Kefir. In addition, the Company participates in trade shows and consumer sampling shows in order to introduce its products to distributors. During the second week of July 2001, Lifeway presented its product offerings at the Fancy Food Show in New York City, which brings together food companies and distributors from around the world.

The most significant development for the Company's distribution channel was the addition of Jelian Foods, Inc. of Canada. Jelian Foods will distribute the Company's SoyTreat™ product in Canada and will also have the opportunity to distribute other products made by Lifeway Foods. Jelian Foods distributes natural and specialty products to over 500 stores in Canada, including mainstream grocery store chains.

We believe that revenues should grow to \$11.1 million in 2001 and \$12.9 million in 2002, from \$9.2 million in 2000, primarily due to the Company's new organic product line and continued marketing efforts. Also, revenue growth will depend on increasing shelf space in the United States and the acceptance of the SoyTreat™ product line in Canada.

Other Considerations

Danone Foods, Inc. the U.S. subsidiary of Groupe Danone of Paris, France, has a 20% ownership interest in the Company. A support agreement was entered into stating that each party would not compete with each other during the term of the agreement and for three years after termination of the agreement with respect to certain yogurt, cheese and kefir products.

An equity-specific concern relates to liquidity. Based on our calculations, since the beginning of 2001, the average daily-volume has been approximately 2,000 shares. Investors need to be aware that by nature, a thinly traded equity can have significant price volatility.

Conclusion

We are maintaining our coverage of Lifeway Foods, Inc., with a Speculative Buy recommendation and fifteen-month price target of \$10.63. Our price target is based on an average valuation using our earnings per share estimate for 2002 and a discounted cash flow model using EBITDA as a proxy for cash flow. It should be noted that the Company's EBITDA will not be impacted by FASB's new accounting rule for goodwill amortization since they do not have any goodwill related to acquisitions.

We believe the Company will earn \$0.26 per fully diluted share, on revenues of \$11.1 million for 2001 and \$0.32 per fully diluted share on revenues of \$12.9 million for 2002. Our revenue estimate for 2002 represents a compounded annual growth rate of 16.6% based on the \$7.9 million in revenues that the Company reported in 1999. Based on our model, we expect EBITDA to be \$2.37 million in 2001 and \$2.9 million in 2002. We expect EBITDA to grow at a compounded annual rate of approximately 15% through 2004.

We believe Lifeway Foods is undervalued based on our earnings for 2002 and discounted cash flow model. In our opinion, the primary reason for the Company's undervaluation is the lack of Wall Street coverage and lack of investor knowledge about Kefir. Until consumers and investors are educated about the potential benefits of kefir and kefir based products, the Company is likely to remain undervalued.

We obtained our price target by averaging the following valuation models:

- A 25.3X P/E (based on the trailing twelve month average for the Food Processing Industry) applied to our 2002 earnings per share estimate of \$0.32. This provides a valuation of \$8.10 per share;
- Our discounted cash flow model, using EBITDA as a proxy for cash flow and an 9.4% discount factor using the estimated five year growth rate for the food processing industry. This provides a valuation of \$13.16 per share.



** 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 change in figures or our views. This is not a solicitation of any order to buy or sell. Taglich Brothers, Inc. is not a market maker and does not sell to or buy from customers on a principal basis. 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. 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. 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 and was not a manager or co-manager of any offering for the company within the last three years. 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.*

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

	Dec. 1998 Full Year	Dec. 1999 Full Year	Dec. 2000 Full Year	Mar. 2001 First Quarter	Mar. 2001 Second Quarter
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 628	\$ 4,641	\$ 1,437	\$ 1,832	\$ 918
Marketable securities	340	1,564	4,850	4,279	5,454
Accounts receivable, net	847	966	1,182	1,437	1,315
Other receivables	16	57	-	5	23
Inventories	852	844	920	795	924
Prepaid expenses and other assets	12	-	-	-	-
Deferred income taxes	37	52	167	169	133
Total current assets	<u>2,732</u>	<u>8,124</u>	<u>8,556</u>	<u>8,518</u>	<u>8,766</u>
Property, plant and equipment, net	4,148	4,528	5,020	5,028	5,008
Intangible assets, net	10	5	-	-	-
Total assets	<u>\$ 6,890</u>	<u>\$ 12,658</u>	<u>\$ 13,575</u>	<u>\$ 13,546</u>	<u>\$ 13,774</u>
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Current maturities of notes payable	85	92	706	688	667
Accounts payable	514	480	518	594	577
Accrued expenses	166	192	242	175	192
Taxes payable	-	-	65	93	124
Total current liabilities	<u>765</u>	<u>764</u>	<u>1,531</u>	<u>1,550</u>	<u>1,560</u>
Long-term liabilities	1,315	1,234	529	523	517
Deferred income taxes	172	248	376	382	383
Stockholders' equity:					
Common stock, no par value; authorized 10,000,000 shares	1,427	6,509	6,509	6,509	6,509
Stock subscription receivable	-	(15)	(15)	(15)	(15)
Retained earnings	3,241	3,924	4,851	5,180	5,412
Accumulated other comprehensive income, net of tax	(12)	(7)	(205)	(583)	(591)
Treasury stock, at cost	(19)	-	-	-	-
Total stockholders' equity	<u>4,638</u>	<u>10,411</u>	<u>11,140</u>	<u>11,091</u>	<u>11,315</u>
Total liabilities and stockholders' equity	<u>\$ 6,889</u>	<u>\$ 12,657</u>	<u>\$ 13,575</u>	<u>\$ 13,546</u>	<u>\$ 13,774</u>
SHARES OUT	3,786	4,318	4,318	4,318	4,318

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

	<u>FY1997</u>	<u>FY1998</u>	<u>FY1999</u>	<u>FY2000</u>	<u>FY2001E</u>	<u>FY2002E</u>
Sales	\$ 5,961	\$ 6,795	\$ 7,908	\$ 9,177	\$ 11,086	\$ 12,870
Cost of goods sold	<u>3,435</u>	<u>3,697</u>	<u>4,665</u>	<u>5,308</u>	<u>6,552</u>	<u>7,640</u>
Gross Profit	2,526	3,098	3,243	3,869	4,534	5,230
<i>Gross Margins</i>	42.38%	45.59%	41.01%	42.16%	40.90%	40.64%
Sales, general and administrative	<u>1,486</u>	<u>1,759</u>	<u>2,178</u>	<u>2,707</u>	<u>2,936</u>	<u>3,090</u>
<i>EBITDA</i>	1,316	1,730	1,506	1,772	2,365	2,900
Operating Income	1,040	1,339	1,065	1,162	1,598	2,140
<i>Operating Margin</i>	17.45%	19.71%	13.47%	12.66%	14.42%	16.63%
Other Income (Expense)						
Interest income	47	38	110	369	223	230
Interest expense	(124)	(106)	(112)	(93)	(104)	(80)
Gain on sale of marketable securities	-	35	7	15	164	20
Rental income	214	-	-	-	-	-
Total Other Income (Expense)	<u>137</u>	<u>(33)</u>	<u>5</u>	<u>291</u>	<u>282</u>	<u>170</u>
Pre-Tax Income	1,177	1,306	1,070	1,453	1,880	2,310
<i>Pre-Tax Margins</i>	19.75%	19.22%	13.53%	15.84%	16.96%	17.95%
Income Tax Expense (Benefit)	<u>477</u>	<u>543</u>	<u>387</u>	<u>526</u>	<u>744</u>	<u>910</u>
<i>Tax Rate</i>	40.51%	41.60%	36.21%	36.21%	39.59%	39.39%
Net Income	<u>\$ 700</u>	<u>\$ 763</u>	<u>\$ 682</u>	<u>\$ 927</u>	<u>\$ 1,136</u>	<u>\$ 1,400</u>
EPS -- Fully Diluted	<u>\$ 0.19</u>	<u>\$ 0.20</u>	<u>\$ 0.17</u>	<u>\$ 0.21</u>	<u>\$ 0.26</u>	<u>\$ 0.32</u>
Avg Shares Out-Fully Diluted	<u>3,776</u>	<u>3,781</u>	<u>3,933</u>	<u>4,318</u>	<u>4,318</u>	<u>4,315</u>
Percent of Revenue						
Cost of Revenues	57.62%	54.41%	58.99%	57.84%	59.10%	59.36%
Sales, General and Administrative expenses	24.93%	25.88%	27.54%	29.50%	26.48%	24.01%
YEAR / YEAR GROWTH						
Total Revenues		13.99%	16.37%	16.05%	20.81%	16.09%
Operating Income		28.80%	-20.49%	9.12%	37.55%	33.88%
Pre-Tax Income		10.94%	-18.08%	35.86%	29.38%	22.85%
Net Income		8.90%	-10.51%	35.85%	22.53%	23.24%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2000
(in thousands)

	<u>Q1(03/00)</u>	<u>Q2 (06/00)</u>	<u>Q3 (09/00)</u>	<u>Q4 (12/00)</u>	FY2000
Sales	\$ 2,273	\$ 2,287	\$ 2,284	\$ 2,333	\$ 9,177
Cost of goods sold	<u>1,137</u>	<u>1,288</u>	<u>1,077</u>	<u>1,805</u>	<u>5,308</u>
Gross Profit	1,136	999	1,206	528	3,869
<i>Gross Margins</i>	49.98%	43.67%	52.83%	22.62%	42.16%
Sales, general and administrative	<u>910</u>	<u>883</u>	<u>851</u>	<u>64</u>	<u>2,707</u>
<i>EBITDA</i>	382	274	508	599	1,772
Operating Income	226	116	356	464	1,162
<i>Operating Margin</i>	9.96%	5.08%	15.57%	19.89%	12.66%
Other Income (Expense)					
Interest income	26	86	85	173	369
Interest expense	(25)	(21)	(21)	(25)	(93)
Gain on sale of marketable securities	82	120	61	(248)	15
Total Other Income (Expense)	<u>82</u>	<u>185</u>	<u>125</u>	<u>(100)</u>	<u>291</u>
Pre-Tax Income	308	301	481	364	1,453
<i>Pre-Tax Margins</i>	13.56%	13.15%	21.04%	15.59%	15.84%
Income Tax Expense (Benefit)	<u>119</u>	<u>116</u>	<u>205</u>	<u>86</u>	<u>526</u>
<i>Tax Rate</i>	38.73%	38.73%	42.62%	23.53%	36.21%
Net Income	<u>\$ 189</u>	<u>\$ 184</u>	<u>\$ 276</u>	<u>\$ 278</u>	<u>\$ 927</u>
EPS -- Fully Diluted	<u>\$ 0.04</u>	<u>\$ 0.04</u>	<u>\$ 0.06</u>	<u>\$ 0.06</u>	<u>\$ 0.21</u>
Avg Shares Out-Fully Diluted	<u>4,318</u>	<u>4,318</u>	<u>4,318</u>	<u>4,318</u>	<u>4,318</u>
Percent of Revenue					
Cost of Revenues	50.02%	56.33%	47.17%	77.38%	57.84%
Sales, General and Administrative expenses	40.02%	38.59%	37.26%	2.73%	29.50%
YEAR / YEAR GROWTH					
Total Revenues	22.63%	12.13%	14.10%	15.90%	16.05%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2001
(in thousands)

	<u>Q1(03/01)</u>	<u>Q2 (06/01)</u>	<u>Q3 (09/01)E</u>	<u>Q4 (12/01)E</u>	FY2001E
Sales	\$ 2,636	\$ 2,750	\$ 2,825	\$ 2,875	\$ 11,086
Cost of goods sold	<u>1,547</u>	<u>1,645</u>	<u>1,660</u>	<u>1,700</u>	<u>6,552</u>
Gross Profit	1,089	1,105	1,165	1,175	4,534
<i>Gross Margins</i>	41.31%	40.18%	41.24%	40.87%	40.90%
Sales, general and administrative	<u>657</u>	<u>773</u>	<u>760</u>	<u>745</u>	<u>2,936</u>
<i>EBITDA</i>	612	528	600	625	2,365
Operating Income	432	331	405	430	1,598
<i>Operating Margin</i>	16.39%	12.05%	14.34%	14.96%	14.42%
Other Income (Expense)					
Interest income	72	51	50	50	223
Interest expense	(25)	(30)	(25)	(25)	(104)
Gain on sale of marketable securities	85	29	25	25	164
Total Other Income (Expense)	<u>132</u>	<u>50</u>	<u>50</u>	<u>50</u>	<u>282</u>
Pre-Tax Income	564	381	455	480	1,880
<i>Pre-Tax Margins</i>	21.39%	13.87%	16.11%	16.70%	16.96%
Income Tax Expense (Benefit)	<u>235</u>	<u>149</u>	<u>175</u>	<u>185</u>	<u>744</u>
<i>Tax Rate</i>	41.72%	39.09%	38.46%	38.54%	39.59%
Net Income	<u>\$ 329</u>	<u>\$ 232</u>	<u>\$ 280</u>	<u>\$ 295</u>	<u>\$ 1,136</u>
EPS -- Fully Diluted	<u>\$ 0.08</u>	<u>\$ 0.05</u>	<u>\$ 0.06</u>	<u>\$ 0.07</u>	<u>\$ 0.26</u>
Avg Shares Out-Fully Diluted	<u>4,318</u>	<u>4,318</u>	<u>4,318</u>	<u>4,318</u>	<u>4,318</u>
Percent of Revenue					
Cost of Revenues	58.69%	59.82%	58.76%	59.13%	59.10%
Sales, General and Administrative expenses	24.93%	28.13%	26.90%	25.91%	26.48%
YEAR / YEAR GROWTH					
Total Revenues	16.00%	20.22%	23.71%	23.22%	20.81%
Operating Income	90.80%	185.42%	13.91%	-7.33%	37.55%
Pre-Tax Income	82.98%	26.77%	-5.32%	31.95%	29.38%
Net Income	74.05%	26.02%	1.54%	6.04%	22.53%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2002
(in thousands)

	Q1(03/02)E	Q2 (06/02)E	Q3 (09/02)E	Q4 (12/02)E	FY2002E
Sales	\$ 3,050	\$ 3,150	\$ 3,285	\$ 3,385	\$ 12,870
Cost of goods sold	<u>1,775</u>	<u>1,900</u>	<u>1,965</u>	<u>2,000</u>	<u>7,640</u>
Gross Profit	1,275	1,250	1,320	1,385	5,230
<i>Gross Margins</i>	41.80%	39.68%	40.18%	40.92%	40.64%
Sales, general and administrative	<u>755</u>	<u>775</u>	<u>780</u>	<u>780</u>	<u>3,090</u>
<i>EBITDA</i>	710	665	730	795	2,900
Operating Income	520	475	540	605	2,140
<i>Operating Margin</i>	17.05%	15.08%	16.44%	17.87%	16.63%
Other Income (Expense)					
Interest income	55	55	60	60	230
Interest expense	(20)	(20)	(20)	(20)	(80)
Gain on sale of marketable securities	5	5	5	5	20
Total Other Income (Expense)	<u>40</u>	<u>40</u>	<u>45</u>	<u>45</u>	<u>170</u>
Pre-Tax Income	560	515	585	650	2,310
<i>Pre-Tax Margins</i>	18.36%	16.35%	17.81%	19.20%	17.95%
Income Tax Expense (Benefit)	<u>220</u>	<u>205</u>	<u>230</u>	<u>255</u>	<u>910</u>
<i>Tax Rate</i>	39.29%	39.81%	39.32%	39.23%	39.39%
Net Income	<u>\$ 340</u>	<u>\$ 310</u>	<u>\$ 355</u>	<u>\$ 395</u>	<u>\$ 1,400</u>
EPS -- Fully Diluted	<u>\$ 0.08</u>	<u>\$ 0.07</u>	<u>\$ 0.08</u>	<u>\$ 0.09</u>	<u>\$ 0.32</u>
Avg Shares Out-Fully Diluted	<u>4,315</u>	<u>4,315</u>	<u>4,315</u>	<u>4,315</u>	<u>4,315</u>
Percent of Revenue					
Cost of Revenues	58.20%	60.32%	59.82%	59.08%	59.36%
Sales, General and Administrative expenses	24.75%	24.60%	23.74%	23.04%	24.01%
YEAR / YEAR GROWTH					
Total Revenues	15.69%	14.56%	16.28%	17.74%	16.09%
Operating Income	20.37%	43.30%	33.33%	40.70%	33.88%
Pre-Tax Income	-0.72%	35.06%	28.57%	35.42%	22.85%
Net Income	3.43%	33.48%	26.79%	33.90%	23.24%

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

	<u>FY1998A</u>	<u>FY1999A</u>	<u>FY2000A</u>	<u>Q2 2001A</u>
<i>Cash Flows from Operating Activities</i>				
Net Income	\$ 763	\$ 682	\$ 927	\$ 561
Depreciation and amortization	391	441	610	377
Amortization of discounts on securities	-	(7)	-	-
Gain on sale of marketable securities	(35)	(7)	(15)	(114)
Issuance of common stock in exchange for services rendered	31	-	-	-
Decrease in allowance for doubtful accounts	(48)	-	-	-
Deferred income taxes	115	54	150	41
	<u>1,217</u>	<u>1,165</u>	<u>1,672</u>	<u>866</u>
<i>Changes In:</i>				
Accounts receivable	19	(118)	(216)	(133)
Other receivables	(1)	(41)	57	(23)
Inventories	(237)	8	(76)	(4)
Prepaid expenses and other assets	(4)	12	-	-
Accounts payable	119	(34)	38	59
Accrued expenses	(262)	26	50	(51)
Taxes payable	-	-	65	60
Net Changes in Working Capital	<u>(366)</u>	<u>(148)</u>	<u>(83)</u>	<u>(92)</u>
Net cash Provided by Operations	<u>850</u>	<u>1,017</u>	<u>1,589</u>	<u>774</u>
<i>Cash Flows from Investing Activities</i>				
Purchase of marketable securities	(305)	(1,846)	(8,808)	(5,211)
Sale of marketable securities	218	646	5,202	4,335
Purchase of property, plant and equipment	(593)	(794)	(1,096)	(366)
Net cash used in Investing	<u>(680)</u>	<u>(1,994)</u>	<u>(4,702)</u>	<u>(1,241)</u>
<i>Cash Flows from Financing Activities</i>				
Repayment of notes payable	(92)	(96)	(91)	(52)
Proceeds from issuance of common stock	-	5,138	-	-
Stock issuance costs	-	(52)	-	-
Net cash provided by Financing	<u>(92)</u>	<u>4,990</u>	<u>(91)</u>	<u>(52)</u>
Net change in Cash	78	4,013	(3,204)	(519)
Cash Beginning of Period	<u>551</u>	<u>628</u>	<u>4,641</u>	<u>1,437</u>
Cash End of Period	<u>\$ 628</u>	<u>\$ 4,641</u>	<u>\$ 1,437</u>	<u>\$ 918</u>