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

September 5, 2007

LWAY $16.82 – (NasdaqGM)

	FY (12/05)A	FY (12/06) A	*FY (12/07) E*	*FY (12/08) E*
Revenue (in millions)	$20.13	$27.72	***$38.64***	***$48.91***
Earnings per share (diluted)*	$0.15	$0.17	***$0.27***	***$0.38***

52-Week range*	$17.50 – $6.50	Fiscal year ends:	December
Shares outstanding a/o 08/03/07*	16.82 million	Revenue/shares (TTM) *	$2.02
Approximate float*	4.85 million	Price/Sales (TTM) *	8.3X
Market Capitalization	$283 million	Price/Sales (2008)E*	5.8X
Tangible Book value/shr	$1.52	Price/Earnings (TTM) *	76.5X
Price/Book*	11.1X	Price/Earnings (2008)E*	44.3X

* 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 increasing our twelve-month price target of $19.20 per share based on our sales per share estimate for 2008. Our prior twelve-month price target was $16.65 per share.

Our rating is primarily based on momentum that is occurring from the Helios acquisition, growing awareness of Lifeway's flagship Kefir line, its kids Kefir drink, called Probugs™, securing its first foodservice distribution contract (which occurred on May 18, 2007), distribution in Mexico, as well as introduction of a new smoothie drink called Lifeway Lassi, which is aimed at South Asian consumers in the U.S.

On August 14, 2007, Lifeway Foods reported second quarter 2007 revenue of $9.715 million, which was an increase of 52.6% versus $6.367 million in the same period last year. Top line results included sales from the Helios acquisition that amounted to $1.434 million. Net income was $1.396 million or $0.08 per share versus $0.750 million or $0.04 per share in the second quarter of 2006.

Based on first half results, trend analysis of LWAY's base business, and the historic numbers of Helios, as well as increased distribution and new product offering, we are maintaining our 2007 revenue forecast of $38.642 million. Our revised net income forecast is $4.561 million or $0.27 per share (prior forecast was $4.536 million or $0.27 per share).

We are maintaining our forecast for 2008, which calls for revenue of $48.910 million and net income of $6.410 million or $0.38 per share. We believe the year-over-year growth should continue to occur based on current trends, increased consumer awareness, and gross margin expansion.

**** Please view our disclaimer located on page 11.***

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. The key group of consumers for the Company's products includes children, women, baby boomers, and Hispanics. With respect to the Hispanic market the Company developed and has had success with its La Fruita product.

In early August 2006, Lifeway Foods acquired Helios Nutrition Limited (including Pride Main Street Dairy, LLC), its top competitor in the Kefir market. Helios held the number two position (versus LWAY's number one position) in terms of the Kefir market and the top position in the organic category. Management has publicly stated that the acquisition is expected to strengthen LWAY's presence in the rapidly growing market for **organic dairy products, as well as provide a steady supply of organic milk through Helios' organic dairy subsidiary.** In addition, it is expected to provide cost efficiencies by pooling the purchase of raw materials. Based on Management's public statements after the acquisition occurred, cost efficiencies should become evident. The cost efficiencies have materialized as year-over-year gross margin has improved during the first half of 2007 versus the first half of 2006.

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

According to the June 28, 2007 press release, the Asian Indian community in the U.S. has grown from under 1 million in 1990 to more than 2.3 million in 2005. This growth translated into one of the highest growth rates for any Asian community. Lassi is a smoothie-like drink dating back 6,000 years to its origins as a thirst quencher to combat the heat of the Indian subcontinent. Its association with Ayurvedic health practices (defined as an ancient system of health care that is native to the Indian subcontinent) and healthy eating also aligns with Lifeway's emphasis on the nutritional value of its products.

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

For the three-months ended June 30, 2007, versus the three-months ended June 30, 2006:

- Revenue increased to $9.715 million versus $6.367 million. Taglich Brothers' estimates called for revenue of $9.715 million;
- Gross margin declined to 39.41% versus 40.52%;
- Operating expenses increased to $2.068 million versus $1.650 million;
- EBITDA increased to $2.029 million versus $1.078 million; and
- Net income was $1.396 million or $0.08 per share versus net income of $0.750 million or $0.04 per share. In comparison, Taglich Brothers' estimates called for net income of $1.313 million or $0.08 per share.

The year-over-year revenue increase of 52.6% was attributable to higher sales for the existing Lifeway Foods line, which experienced growth of 30.0% 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 $1.434 million, consisting of $1.198 million from the Helios brand and $0.236 million from its subsidiary Pride of Main Street Dairy.

Gross margin declined by 111 basis points versus the same period last year. The decrease in gross margin was primarily related to the increased cost of conventional milk, (the Company's largest raw material). According to the second quarter 10-Q filing, the cost of conventional milk was approximately 60% higher in the current period as compared to the same quarter in 2006. However, the Company's gross margin decline was very modest relative to the increase in conventional milk prices. The reason for the modest decline was due primarily to Management's continuing efforts to leverage LWAY's Helios Organic Kefir line by moving production to the main facility in Morton Grove Illinois (which is highly-automated); therefore, taking advantage of economies of scale. Also, the cost of organic milk used in both Lifeway Organic Kefir, and Helios Kefir line was approximately the same in the current period as compared to the same period in 2006.

Operating expenses in the second quarter of 2007 increased by $0.418 million, primarily due to the higher advertising and marketing expenses to build brand awareness. As a percentage of revenue, operating expenses decreased to 20.91% versus 25.90% in the second quarter of 2006. The year-over-year percentage improvement was due to higher top line results, as well as increased operating synergies gained by the consolidation of the Helios acquisition into the Company's overall operations.

Total other income for the three month period ended June 30, 2007 was approximately $0.438 million, compared with approximately $0.287 million during the same period in 2006. This increase was primarily attributable to a higher gain on the sale of marketable securities in 2007.

Balance Sheet as of June 30, 2007

The Company had cash and cash equivalents of $1.014 million and marketable securities of $8.425 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 $14.608 million versus $13.812 million at the end of 2006. The Company's long-term liabilities stood at $4.843 million, which was a decrease from $5.747 million at the end of 2006. 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 half of 2007.

The Company's portfolio mix of marketable securities (at fair value as of June 30, 2007) consisted of:

- 23.6% fixed income type securities; and
- 76.4% in equities, mutual funds, preferred securities, and private investments.

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

Market Comment

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

AC Nielsen issued a report entitled "What's Hot around the Globe – Insights on Growth in Food & Beverage Products", in which 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.

In the June 11, 2007, issue of Brandweek.com an article entitled "Probiotics Growth Spurt Continues in New Categories", it was stated that the hottest word in food marketing is now probiotics. In the article, Euromonitor International (a provider of market intelligence on industries, countries and consumers) stated that the overall probiotic yogurt category accounted for $294 million in U.S. sales (in 2006) and is projected to grow to $500 million by 2010. Globally, sales doubled during the past half-decade, making probiotic yogurt a $1 billion category.

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

We anticipate that the Company is likely to experience a weekly sales run rate on its core business (excluding Helios – which should have a weekly run rate of approximately $0.115 million) of approximately $0.648 million for the third quarter of 2007, which will be 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 and second quarters of 2007 of $0.592 million and $0.637 million, respectively.

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, new foodservices contract, as well as the introduction of a new product (Lifeway Lassi). Lifeway continues to market its products through local radio station, newspaper, and magazines advertisements, as well as gaining additional exposure through the Internet, catalog advertising and promotion, in store demonstration throughout the U.S., and participation in various trade shows.

Additionally, top line results will continue to 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, reiterated in its first quarter earnings press release, and second quarter 10-Q filing, 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 sequential contribution from Helios to bottom line results throughout 2007.

One final note, the Company's CFO publicly commented in the second quarter press release, that Management was proud of the results to date in 2007. Despite historically high conventional milk prices, organic milk prices have been beneficial since they have been stable over the last year. Since organic milk prices have remained stable, the Company has been able to benefit from leveraging the acquisition of the Helios Organic Kefir line into its overall operation. Additionally, Lifeway's own Orgnic Kefir lines continue to outpace its conventional Kefir line in growth, especially in light of the focus on such products as Probugs™ Organic Kefir for kids. Lastly, going forward, the Company's CFO believes that the focus on Organic Kefir will help mitigate the effects of historically high conventional milk prices on input costs.

Projections

Based on public comments made by Management in the Company's press releases and SEC filings, first half results, second quarter results that were in line with our expectations, and a full year contribution from Helios, we are maintaining our 2007 revenue estimate of $38.642 million. If our top line estimate is achieved it would translate into year-over-year growth of 39.40%. Given our revenue estimate and first half results that fell in line with our expectation of improved gross margin prospects (primarily based on Helio production continuing to be shifted to LWAY's own manufacturing facility), we are only tweaking our 2007 forecast for net income to $4.561 million or $0.27 per diluted share from our prior forecast of $4.536 million or $0.27 per diluted share.

We are reiterating our forecast for 2008, which calls for revenue of $48.910 million and net income of $6.415 million or $0.38 per share. We believe the year-over-year growth should continue to occur based on current trends, increased consumer awareness, new product introductions such as its Lifeway Lassi product, as well as gross margin expansion that should continue to occur throughout 2008.

Our forecast for 2007 and 2008 incorporates the following:

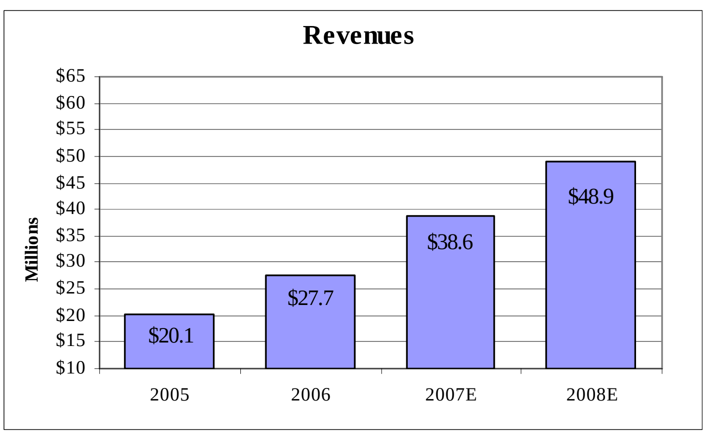
- Distribution agreements with Ralph's Grocery stores in Southern California and ACME Grocery in the Philadelphia and Tri-state area. Shipments of four flavors of Lowfat Kefir and ProBugs™ began during the middle of the fourth quarter of 2006 and reorder rates appears to be at record levels at the end of the second quarter of 2007;
- The continued rollout across the U.S. of it ProBugs™ offering. Management stated in the July 5, 2007 press release, that Probugs™ had its best ever quarterly revenue performance. This was reiterated by Management's public statements at the Longbow Research conference on July 11, 2007;
- Distribution of Lifeway Kefir in Mexico. According to the July 5, 2007 press release, for the first time ever, in a variety of new, upscale supermarkets, through a distributor in Texas the entrance into Mexico occurred. Management stated that while this is by no means the Company's largest account, it is a first step into an important market;
- Completing the integration of the Helios acquisition;
- Initial impact from the May 18, 2007, announcement of its first foodservice distribution contract, as well as the hiring of a professional dedicated to growing this potential revenue stream;

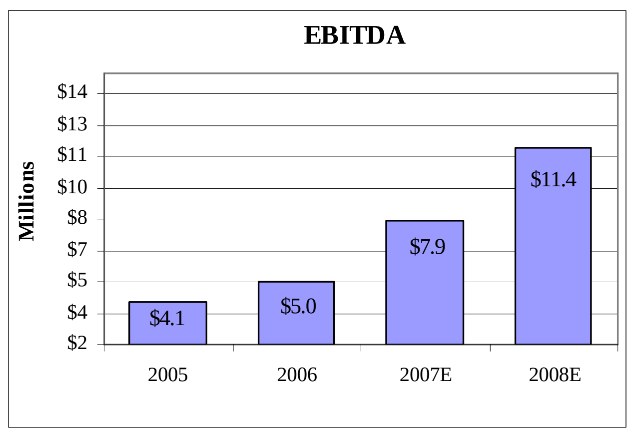
- Increased interest expense for 2007. We anticipate interest expense for 2007 of $0.419 million versus $0.346 million in 2006, primarily due to the acquisition of Helios. In 2008, we estimate interest expense should be reduced to approximately $0.360 million;
- Relatively high energy and raw material cost of resin for its containers and packaging, which we anticipate being offset by improved gross margin;
- Increased capital expenditures that will ultimately 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. During the first six months of 2007, nearly $0.600 million of capital expenditures have occurred, as compared to $0.269 million in the same period last year; 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 margin in 2007 to 38.51% from 38.32%. 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 and second quarter 2007 experienced gross margin of 39.60% and 39.41, respectively. We are using the results from the fourth quarter of 2006 and improvement seen in the first and second quarters of 2007 as evidence that improvement should occur (on a year-over-year basis) as the final two quarter progress (primarily 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 2008 forecast for gross margin remains unchanged at 39.56%; and
- SG&A expenses, as a percentage of revenues, in 2007 to 20.79% from 20.06%. Our revised forecast for 2008 calls for SG&A expenses, as a percentage of revenues to 18.51% versus our prior expectation of 18.40%. 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% and 21.28% for the first and second quarters 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. (the terms of the non-compete period and standstill period of the stockholders' agreement expire on December 31, 2007, 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. **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.

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 45.05% of common shares outstanding, as of August 3, 2007.

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 June 30, 2007, the fair value of the Company's marketable securities available for sale was $8.425 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.

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

Trading Volume
Liquidity has the potential to be a concern. Based on our calculations average daily-volume during 2003 increased to 4,451 shares from 1,943 shares in 2002. During 2004, average volume increased significantly to 154,399 shares traded a day. In 2005, average volume declined to 43,400 shares traded a day. During 2006, average daily volume has declined to 30,756 shares traded a day and rebounded during the first eight months of 2007 to 42,022 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

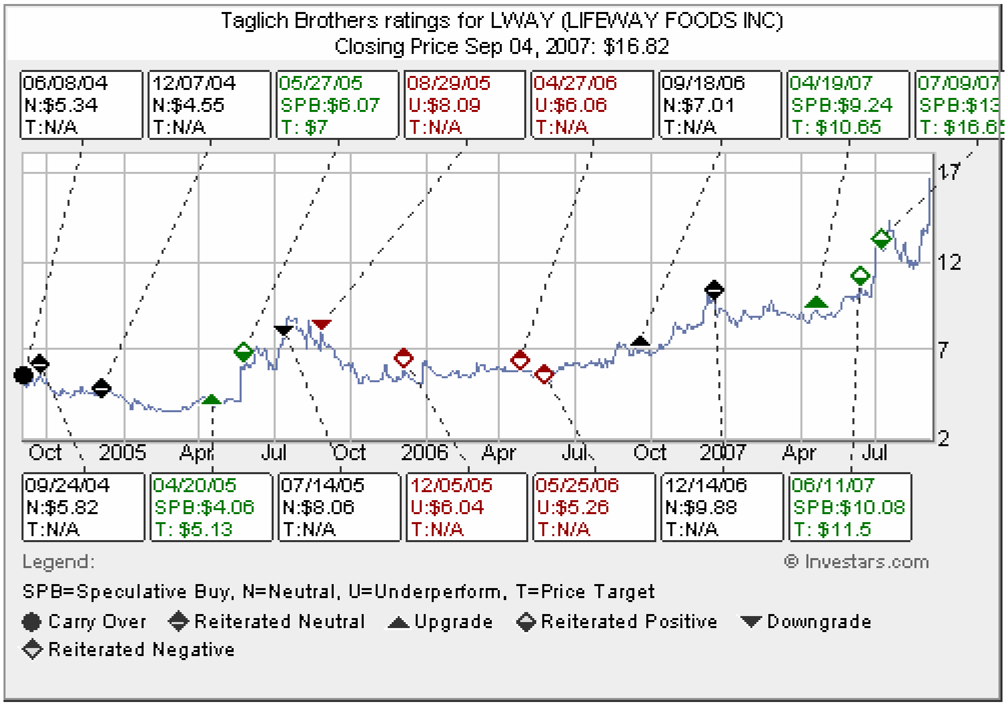
We are reiterating our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) and setting a twelve-month price target of $19.20 per share based on our sales per share estimates. Our prior twelve-month price target was $16.65.

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™, securing its first foodservice distribution contract (which occurred on May 18, 2007), and distribution in Mexico, as well as introduction of a new smoothie drink called Lifeway Lassi, which is aimed at South Asian consumers in the U.S.

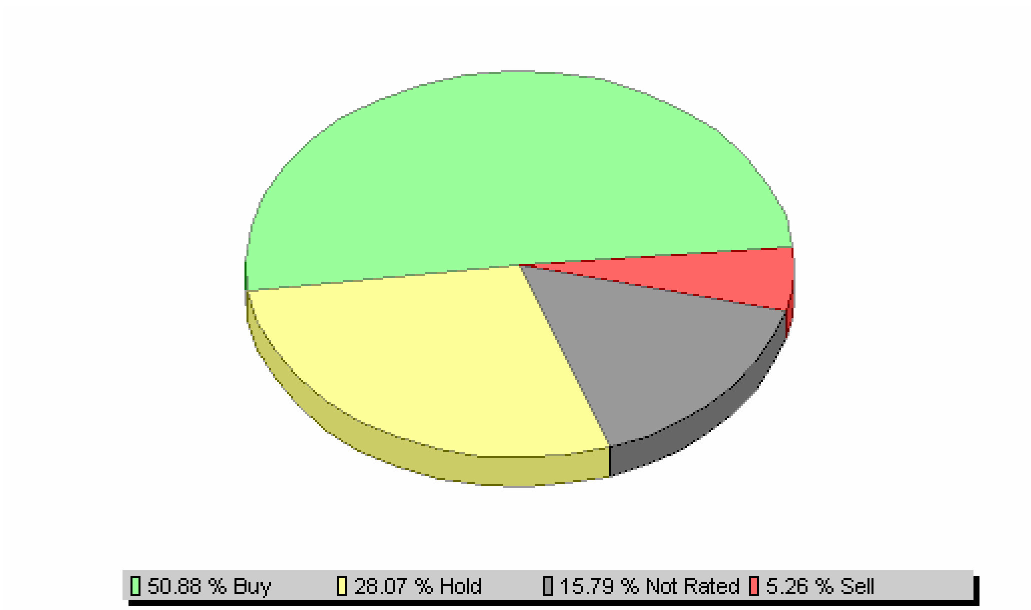
We obtained our price target from the following valuation model, discounted by 20% to account for microcap risk and Company specific risks mentioned earlier:

- An 8.3X price to sales multiple, which is the Company's current trailing-twelve month multiple, applied to our net sales estimate of $2.89 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	3.23%
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.

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:

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	Jun. 2007 2nd Qtr End
ASSETS				
Current assets:				
Cash and cash equivalents	$ 4,354	$ 1,548	$ 1,013	$ 1,014
Marketable securities	7,479	8,491	8,561	8,425
Accounts receivable, net	2,518	3,943	4,588	4,602
Other receivables	56	71	50	40
Inventories	1,717	2,522	2,883	3,511
Prepaid income taxes	12	268	159	73
Prepaid expenses and other assets	9	12	10	13
Deferred income taxes	143	32	-	-
Total current assets	**16,287**	**16,887**	**17,264**	**17,679**
Property, plant and equipment, net	7,751	8,581	8,555	8,819
Total assets	**$ 24,465**	**$ 32,999**	**$ 33,270**	**$ 33,874**
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Current maturities of notes payable	532	1,131	1,129	1,130
Accounts payable	426	1,463	1,239	1,527
Accrued expenses	355	480	341	387
Taxes payable	-	-	31	32
Total current liabilities	**1,314**	**3,074**	**2,740**	**3,076**
Long-term liabilities	2,903	5,747	5,202	4,843
Deferred income taxes	349	450	454	467
Stockholders' equity:				
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509	6,509
Paid-in capital	91	1,081	1,081	1,087
Stock subscription receivable	-	-	-	-
Retained earnings	14,423	17,319	18,454	19,850
Accumulated other comprehansive income, net of tax	(100)	154	241	127
Treasury stock, at cost	(1,025)	(1,334)	(1,411)	(2,086)
Total stockholders' equity	**19,899**	**23,728**	**24,874**	**25,488**
Total liabilities and stockholders' equity	**$ 24,465**	**$ 32,999**	**$ 33,270**	**$ 33,874**
SHARES OUT	16,792	16,898	16,898	16,793

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

	FY2005A	FY2006A	**FY2007E**	**FY2008E**
Sales	$ 20,132	$ 27,721	**$ 38,642**	**$ 48,910**
Cost of goods sold	12,123	17,082	**23,761**	**29,560**
Gross Profit	8,009	10,639	**14,881**	**19,350**
Gross Margins	39.78%	38.38%	**38.51%**	**39.56%**
Operating Expenses:				
Sales	2,354	3,065	**3,517**	**3,825**
General and administrative	2,253	3,343	**4,516**	**5,230**
Total Operating Expenses	4,607	6,409	**8,034**	**9,055**
EBITDA	4,052	4,990	**7,900**	**11,395**
Operating Income	3,401	4,230	**6,847**	**10,295**
Operating Margin	16.90%	15.26%	**17.72%**	**21.05%**
Other Income (Expense)				
Interest income	323	388	**384**	**320**
Interest expense	(101)	(346)	**(419)**	**(360)**
Gain on sale of marketable securities	445	357	**454**	**-**
Other	14	1	**-**	**-**
Rental income	-	11	**38**	**20**
Total Other Income (Expense)	682	411	**458**	**(20)**
Pre-Tax Income	4,083	4,642	**7,305**	**10,275**
Pre-Tax Margins	20.28%	16.74%	**18.90%**	**21.01%**
Income Tax Expense (Benefit)	1,535	1,745	**2,744**	**3,865**
Tax Rate	37.58%	37.60%	**37.57%**	**37.62%**
Net Income	$ 2,548	$ 2,897	**$ 4,561**	**$ 6,410**
EPS -- Fully Diluted*	$ 0.15	$ 0.17	**$ 0.27**	**$ 0.38**
Avg Shares Out-Fully Diluted*	16,809	16,830	**16,885**	**16,906**
Percent of Revenue				
Cost of Revenues	60.22%	61.62%	61.49%	60.44%
Selling expenses	11.69%	11.06%	9.10%	7.82%
General and Administrative expenses	11.19%	12.06%	11.69%	10.69%
YEAR / YEAR GROWTH				
Total Revenues	23.36%	37.70%	39.40%	26.57%
Net Income	24.19%	13.66%	57.45%	40.55%

*** 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)A	Q3 (09/07)E	Q4 (12/07)E	**FY2007E**
Sales	$ 9,022	$ 9,715	$ 9,925	$ 9,980	**$ 38,642**
Cost of goods sold	5,450	5,886	6,100	6,325	**23,761**
Gross Profit	3,572	3,829	3,825	3,655	**14,881**
Gross Margins	*39.60%*	*39.41%*	*38.54%*	*36.62%*	**38.51%**
Operating Expenses:					
Sales	770	912	915	920	**3,517**
General and administrative	1,001	1,156	1,160	1,200	**4,516**
Total Operating Expenses	1,771	2,068	2,075	2,120	**8,034**
EBITDA	2,047	2,029	2,020	1,805	**7,900**
Operating Income	1,801	1,761	1,750	1,535	**6,847**
Operating Margin	*19.97%*	*18.13%*	*17.63%*	*15.38%*	**17.72%**
Other Income (Expense)					
Interest income	66	98	105	115	**384**
Interest expense	(110)	(109)	(100)	(100)	**(419)**
Gain on sale of marketable securities	15	439	-		**454**
Rental income	9	10	10	10	**38**
Total Other Income (Expense)	(20)	438	15	25	**458**
Pre-Tax Income	1,781	2,199	1,765	1,560	**7,305**
Pre-Tax Margins	*19.74%*	*22.64%*	*17.78%*	*15.63%*	**18.90%**
Income Tax Expense (Benefit)	646	804	675	620	**2,744**
Tax Rate	*36.26%*	*36.54%*	*38.24%*	*39.75%*	**37.57%**
Net Income	$ 1,135	$ 1,396	$ 1,090	$ 940	**$ 4,561**
EPS -- Fully Diluted	$ 0.07	$ 0.08	$ 0.06	$ 0.06	**$ 0.27**
Avg Shares Out-Fully Diluted	16,895	16,876	16,880	16,890	**16,885**
Percent of Revenue					
Cost of Revenues	60.40%	60.59%	61.46%	63.38%	61.49%
Selling expenses	8.54%	9.39%	9.22%	9.22%	9.10%
General and Administrative expenses	11.09%	11.89%	11.69%	12.02%	11.69%
YEAR / YEAR GROWTH					
Total Revenues	50.29%	52.58%	33.10%	26.43%	39.40%
Net Income	26.90%	86.08%	47.30%	83.57%	57.45%

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	$ 12,325	$ 12,605	$ 12,400	**$ 48,910**
Cost of goods sold	6,975	7,425	7,575	7,585	**29,560**
Gross Profit	4,605	4,900	5,030	4,815	**19,350**
Gross Margins	*39.77%*	*39.76%*	*39.90%*	*38.83%*	**39.56%**
Operating Expenses:					
Sales	925	930	975	995	**3,825**
General and administrative	1,225	1,275	1,325	1,405	**5,230**
Total Operating Expenses	2,150	2,205	2,300	2,400	**9,055**
EBITDA	2,730	2,970	3,005	2,690	**11,395**
Operating Income	2,455	2,695	2,730	2,415	**10,295**
Operating Margin	*21.20%*	*21.87%*	*21.66%*	*19.48%*	**21.05%**
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	2,450	2,690	2,725	2,410	**10,275**
Pre-Tax Margins	*21.16%*	*21.83%*	*21.62%*	*19.44%*	**21.01%**
Income Tax Expense (Benefit)	905	995	1,025	940	**3,865**
Tax Rate	*36.94%*	*36.99%*	*37.62%*	*39.00%*	**37.62%**
Net Income	$ 1,545	$ 1,695	$ 1,700	$ 1,470	**$ 6,410**
EPS -- Fully Diluted	$ 0.09	$ 0.10	$ 0.10	$ 0.09	**$ 0.38**
Avg Shares Out-Fully Diluted	16,895	16,900	16,910	16,920	**16,906**
Percent of Revenue					
Cost of Revenues	60.23%	60.24%	60.10%	61.17%	60.44%
Selling expenses	7.99%	7.55%	7.74%	8.02%	7.82%
General and Administrative expenses	10.58%	10.34%	10.51%	11.33%	10.69%
YEAR / YEAR GROWTH					
Total Revenues	28.35%	26.87%	27.00%	24.25%	26.57%
Net Income	36.09%	21.47%	55.94%	56.45%	40.55%

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

	FY2004A	FY2005A	FY2006A	6 Mos.2007A
Cash Flows from Operating Activities				
Net Income	$ 2,052	$ 2,548	$ 2,896	$ 2,531
Depreciation and amortization	670	651	759	513
Amortization of discounts on securities	-	-	-	-
Gain on sale of marketable securities	(354)	(445)	(356)	(453)
Loss on marketable securities classified as trading	16	(14)	(1)	(1)
Issuance of common stock in exchange for services rendered	95	52	29	7
Decrease in allowance for doubtful accounts	-	-	45	(41)
Deferred income taxes	46	(100)	33	(5)
	2,525	2,692	3,405	2,551
Changes In:				
Accounts receivable	(224)	(494)	(1,190)	(619)
Other receivables	94	16	(15)	31
Inventories	(94)	(811)	(586)	(988)
Prepaid income taxes	48	247	(256)	268
Prepaid expenses and other assets	(6)	(2)	35	(1)
Accounts payable	(154)	(215)	639	64
Accrued expenses	12	159	125	(93)
Taxes payable	-	-	-	32
Net Changes in Working Capital	(325)	(1,100)	(1,248)	(1,308)
Net cash Provided by Operations	2,200	1,592	2,158	1,243
Cash Flows from Investing Activities				
Purchase of marketable securities	(6,266)	(6,461)	(7,510)	(3,275)
Sale of marketable securities	6,097	5,810	7,285	3,751
Acquisition of Ilya's Farms, Inc., net of assets acquired	(512)	-	-	-
Acquisition of Helios, net of cash acquired	-	-	(2,552)	-
Purchases of organizational costs	-	-	-	(6)
Purchase of property, plant and equipment	(330)	(4,917)	(680)	(590)
Net cash used in Investing	(1,011)	(5,567)	(3,456)	(120)
Cash Flows from Financing Activities				
Repayment of notes payable	(28)	(37)	(859)	(904)
Proceeds from issuance of common stock	15	-	-	-
Proceeds from note payable	-	3,000	-	-
Purchase of treasury stock	-	(402)	(649)	(753)
Loan costs	-	(7)	-	-
Net cash provided by Financing	(13)	2,555	(1,507)	(1,657)
Net change in Cash	1,175	(1,419)	(2,806)	(533)
Cash Beginning of Period	4,598	5,773	4,354	1,548
Cash End of Period	$ 5,773	$ 4,354	$ 1,548	$ 1,014