

Taglich Brothers, Inc.

The Standard of Excellence in the Microcap Market

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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

LWAY \$12.85 - (NasdaqNM)

September 12, 2003

	FYE (12/00)	FYE (12/01)	FYE (12/02)	FYE (12/03) E*	FYE (12/04) E
Revenues (in millions)	\$9.2	\$10.7	\$12.2	\$14.7	\$17.1
Earnings per share (diluted)	\$0.21	\$0.28	\$0.36	\$0.53	\$0.65

52week range	\$15.25 – \$5.01	Fiscal year ends:	December
Shares outstanding	4.22 million	Revenue/shares (TTM)	\$3.16
Trading float	1.18 million	Price/Sales (TTM)	4.07X
Insider and institutional ownership	72.0%	Price/Sales (2004)	3.21X
Tangible Book value/shr <small>a/o 06-60-03</small>	\$3.30	Price/Earnings (TTM)*	29.9X
Price/Book	3.89X	Price/Earnings (2004)	19.8X

* Excludes a \$0.14 per share gain from the sale of assets and a one-time loss from sale of marketable securities

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 approximately 45 employees. Web site address is: www.kefir.com

Key investment considerations:

We are maintaining our Speculative Buy rating and setting a twelve-month price target of \$15.15 per share based on our earnings estimate for fiscal 2004 and a discounted cash flow analysis. Our previous twelve-month price target was \$11.00 per share.

The Company reported 2003 second quarter revenues of \$3.778 million, which was an increase of 25.8% versus \$3.003 million in the same period last year. Net income was \$0.691 million or \$0.16 per diluted share versus \$0.352 million or \$0.08 per diluted share in the second quarter of 2002.

Based on second quarter results, we are increasing our revenue estimates to \$14.7 million and \$17.1 million in 2003 and 2004, respectively, from our prior 2003 and 2004 expectations of \$13.8 million and \$15.7 million, respectively.

We continue to believe that our revenue forecasts, which call for annual growth in excess of 15%, can be achieved through: 1) The Company's marketing efforts; 2) Increasing acceptance of its organic products; 3) Growth of the La Fruta™ product line for the Hispanic market; and 4) Introduction of new products.

** Please view our disclaimer located on page 8.*

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The Company

Lifeway Foods, Inc. (LWAY) manufactures a cultured dairy beverage called Kefir and also develops Kefir related products at its two manufacturing facilities in Illinois. Distribution of its products in Illinois are through approximately 1,200 local stores including major retail chains (i.e., Jewel Food Stores, Dominick's Finer Foods, and Whole Foods Market), via ten company owned trucks. Also, the Company distributes its products throughout the United States and to some part of Canada.

Danone Foods, Inc. the U.S. subsidiary of Groupe Danone of Paris, France, has a 20% ownership interest in the Company.

On August 19, 2003, the Company announced the expansion of its La Fruta™ product line, which is designed to appeal to Hispanic consumers. In addition to the original four fruit-based varieties, La Fruta will be available in “Horchata” and “Tres Leche” flavors (beginning in September 2003). Also being introduced is a spreadable cheese in the “Tres Leche” flavor. La Fruta is sold nationwide through the Save-a-Lot chain and other retail and specialty grocery stores in Hispanic neighborhoods.

Kefir

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

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

Recent Financials

For the three-month period ended June 30, 2003 versus the same period last year:

- Revenues increased to \$3.778 million versus \$3.003 million;
- Operating expenses increased to \$0.938 million versus \$0.734 million;
- EBITDA increased to \$1.279 million versus \$0.942 million;
- Net income was \$0.691 million or \$0.16 per diluted share versus net income of \$0.194 million or \$0.08 per diluted share.

The year-over-year quarterly revenue increase of 25.8% was primarily attributable to the Company's advertising program for its various Kefir-based products, which led to growth in sales of existing products. In addition, the expansion of its line of sweet cheese spreads under the Sweet Kiss™ brand helped to increase sales.

Gross margins increased to 54.1% versus 41.4% in the same period last year. The improvement in gross margins resulted from a decrease in raw material costs. Operating expenses, as a percentage of revenues, increased to 24.9% versus 24.5% in the second quarter of 2002. The increase in operating expenses, on a percentage basis, was due to increased advertising expenses and a one-time undisclosed charge.

In comparison to the results reported by the Company, Taglich Brothers' estimates called for second quarter revenues of \$3.375 million and net income of \$0.450 million or \$0.11 per diluted share.

Balance Sheet as of June 30, 2003

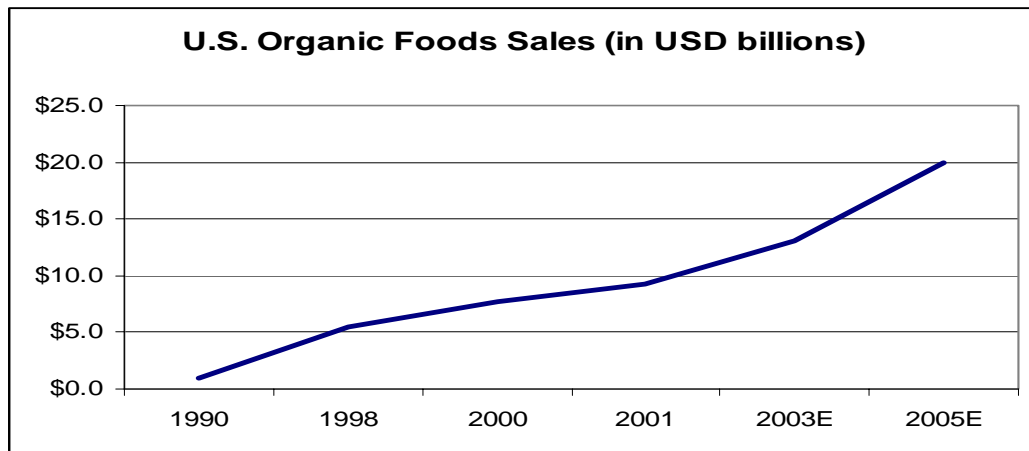
The Company had cash and cash equivalents of \$3.6 million and short-term marketable securities of \$6.303 million. This compares to cash and cash equivalents of \$2.73 million and short-term marketable securities of \$4.17 million as of December 31, 2002. Working capital was \$11.22 million versus \$8.56 million in 2002.

The Company's long-term liabilities stood at \$0.49 million. We believe that LWAY will be able to fund its sales growth from internally generated funds.

Industry and Competition

It is estimated that Lifeway Foods' target market in the functional and probiotic foods segment of the Food Industry has grown annual sales from \$16 billion in 1999 to approximately \$23 billion in 2002. The Nutrition Business Journal (NBJ) predicts that by 2010, the U.S. Functional Food Market will double in size to \$34 billion, representing 5.5% of the total Food Market. Currently, NBJ estimates that the Functional Food Market represents 3.3% of the total U.S. Food Market.

In addition, the Company's organic products are targeting a market that generated approximately \$9.3 billion of sales in 2001, according to Rabobank International's Food & Agribusiness Research Industry Note of May 2002. The chart below indicates the growth potential for this segment:



Source: Organic Trade Association; Natural Marketing Institute; Rabobank International, Food & Agribusiness Research

Outlook

We believe annual revenue growth will exceed 15%; therefore, revenues should reach \$14.7 million in 2003 and \$17.1 million in 2004, from \$12.212 million in 2002. Our revenue forecasts are based on:

- Consumers increased acceptance of the Company's products;
- Marketing initiatives such as:
 - Educating consumers about the potential beneficial uses of Kefir in the replenishment of 'good' bacteria in a person's intestinal system, especially after taking antibiotics or consuming alcohol;
 - Advertising in local newspapers (i.e., primarily in the Chicago area) and in national magazines (i.e., Self, Shape, and Men's Fitness); and
 - Sponsoring and participating in various local sporting events around the country and exhibiting at trade shows (ex: The Fancy Food Show held in New York during July 2003);
- The Company building on its current distribution channel, which includes regional supermarket chains and/or regional super-center type stores;
- Introduction of new packaging for the Company's non-fat Kefir products; and
- Expansion of its La Fruta Product line.

We believe that as a result of the revenue growth, the Company will be able to leverage operating efficiencies at its two owned manufacturing facilities. We estimate that gross margins will improve to 49.96% and 50.15% in 2003 and 2004, respectively, from 44.8% in 2002. Also, SG&A expenses, as a percentage of revenues, should approximate 25.38% and 24.12% in 2003 and 2004, respectively.

The following chart shows our revenue and EBITDA projections:



Source: Company Filings and Taglich Brothers Estimates

Based on our expectations for revenues and expenses and excluding the non-recurring gains from asset sales that occurred in the first quarter of 2003, we anticipate net income of \$2.257 million or \$0.53 per diluted share in 2003 and \$2.775 million or \$0.65 per diluted share in 2004.

Risks

Legal Issue

On April 14, 2003, Vera Smolansky (the Aunt of the Lifeway's CEO Julie Smolansky) filed a complaint seeking unspecified damages in the Circuit Court of Cook County, Illinois. The complainant names Lifeway Foods, Inc. as a defendant and alleges breaches of the Uniform Commercial Code, the Magnus-moss Warranty Act, and the Illinois Consumer Fraud Act with respect to the labeling of certain Lifeway products. The Company believes that the lawsuit is without merit and will vigorously defend itself against the claims made.

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 anyone. 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 in price, it could negatively impact margins.

Corporate Governance

Corporate governance may be an issue facing the Company 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.

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 the first seven months of 2003 has decreased to 1,755 shares from 1,943 shares in 2002. Investors need to be aware that liquidity risks in the microcap market are characterized by low trading volume, high volatility of the stock price, and a wide bid-ask spread.

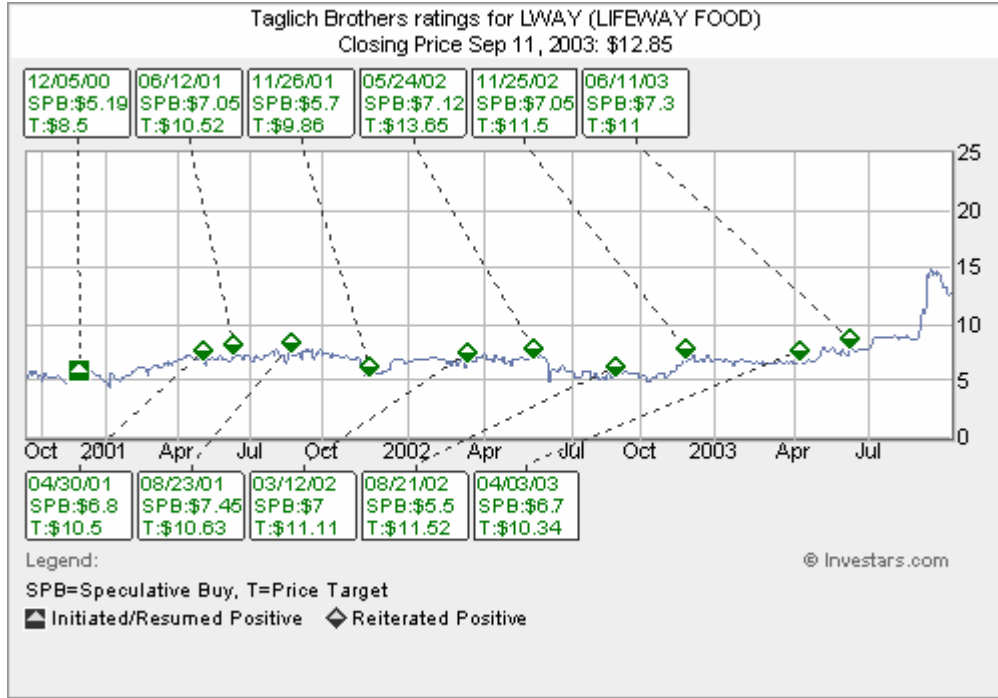
Conclusion

We are maintaining our coverage of Lifeway Foods, Inc. with a Speculative Buy recommendation and setting a twelve-month price target of \$15.15 per share. Our previous twelve-month price target was \$11.00 per share. Our price target is based on our 2004 earnings per share estimate and EBITDA forecasts, which is used as a proxy for cash flow.

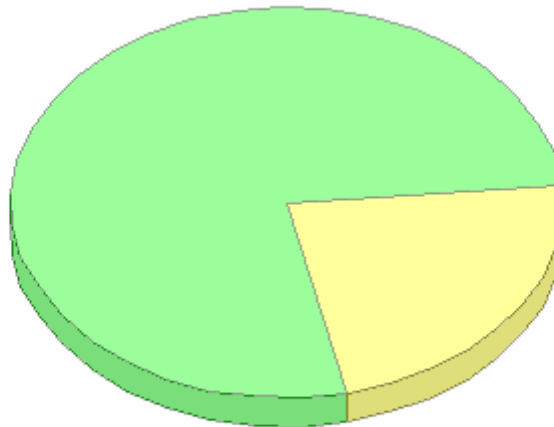
We estimate that the Company will earn \$0.65 per diluted share in 2004. Based on our models, we are forecasting EBITDA of \$4.28 million, \$5.11 million, and \$5.63 million in 2003, 2004, and 2005, respectively.

We obtained our price target by averaging the following valuation models and discounted them by 30% to account for microcap risk and Company specific risks mentioned earlier:

- A 31X P/E based on the Company's EPS growth rate between 2000 and 2002 EPS, applied to our earnings per share estimate of \$0.65 for 2004; and
- A discounted cash flow model, using EBITDA as a proxy for cash flow and a 9.0% discount factor using the estimated five year growth rate for the Food Processing Industry according to multexinvestor.com as of 9/11/03.



Taglich Brothers Current Ratings Distribution



77.08 % Buy 22.92 % Hold

Meaning of Ratings

Buy

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

Speculative Buy

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

Neutral

We will remain neutral pending certain developments.

Underperform

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

Sell

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

Some notable Risks within the Microcap Market

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

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

Public Companies mentioned in this report:

Groupe Danone (NYSE: DA)

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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. 2000 Full Year	Dec. 2001 Full Year	Dec. 2002 Full Year	Mar. 2003 1st Qtr	Jun. 2003 2nd Qtr
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 1,437	\$ 937	\$ 2,732	\$ 2,788	\$ 3,599
Marketable securities	4,850	5,755	4,172	5,644	6,303
Accounts receivable, net	1,182	1,317	1,435	1,731	1,731
Other receivables	-	53	60	58	64
Inventories	920	801	721	774	794
Prepaid expenses and other assets	-	34	1	4	1
Deferred income taxes	<u>167</u>	<u>561</u>	<u>692</u>	<u>440</u>	<u>286</u>
Total current assets	<u>8,556</u>	<u>9,456</u>	<u>9,813</u>	<u>11,438</u>	<u>12,778</u>
Property, plant and equipment, net	5,020	5,021	4,472	3,903	3,906
Total assets	<u>\$ 13,575</u>	<u>\$ 14,477</u>	<u>\$ 14,285</u>	<u>\$ 15,342</u>	<u>\$ 16,684</u>
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Current maturities of notes payable	706	90	31	31	30
Margin account	-	432	-	-	-
Accounts payable	518	543	639	698	649
Accrued expenses	242	164	184	155	183
Taxes payable	<u>65</u>	<u>145</u>	<u>398</u>	<u>250</u>	<u>693</u>
Total current liabilities	<u>1,531</u>	<u>1,374</u>	<u>1,252</u>	<u>1,134</u>	<u>1,555</u>
Long-term liabilities	529	1,116	500	493	486
Deferred income taxes	376	436	453	408	423
Stockholders' equity:					
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509	6,509	6,509
Stock subscription receivable	(15)	(15)	(15)	(15)	(15)
Retained earnings	4,851	6,072	7,600	8,594	9,285
Accumulated other comprehensive income, net of tax	(205)	(729)	(1,335)	(1,101)	(880)
Treasury stock, at cost	<u>-</u>	<u>(287)</u>	<u>(680)</u>	<u>(680)</u>	<u>(680)</u>
Total stockholders' equity	<u>11,140</u>	<u>11,550</u>	<u>12,080</u>	<u>13,307</u>	<u>14,219</u>
Total liabilities and stockholders' equity	<u>\$ 13,575</u>	<u>\$ 14,477</u>	<u>\$ 14,285</u>	<u>\$ 15,342</u>	<u>\$ 16,684</u>
SHARES OUT	4,318	4,269	4,218	4,218	4,218

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2003
(in thousands)

	<u>FY2000</u>	<u>FY2001</u>	<u>FY2002</u>	<u>FY2003E*</u>	<u>FY2004E</u>
Revenue	\$ 9,177	\$ 10,684	\$ 12,212	\$ 14,709	\$ 17,100
Cost of goods sold	<u>5,308</u>	<u>6,449</u>	<u>6,744</u>	<u>7,360</u>	<u>8,525</u>
Gross Profit	3,869	4,235	5,468	7,350	8,575
<i>Gross Margins</i>	42.16%	39.64%	44.78%	49.96%	50.15%
Sales, general and administrative	<u>2,707</u>	<u>2,785</u>	<u>2,891</u>	<u>3,733</u>	<u>4,125</u>
<i>EBITDA</i>	1,772	2,216	3,385	4,277	5,110
Operating Income	1,162	1,450	2,578	3,617	4,450
<i>Operating Margin</i>	12.66%	13.57%	21.11%	24.59%	26.02%
Other Income (Expense)					
Interest income	369	235	187	140	160
Interest expense	(93)	(93)	(75)	(31)	(40)
Gain on sale of marketable securities	15	220	18	16	-
Other than temporary reduction of marketable securities	-	-	(236)	(347)	-
Gain on sale of assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,246</u>	<u>-</u>
Total Other Income (Expense)	<u>291</u>	<u>362</u>	<u>(105)</u>	<u>1,024</u>	<u>120</u>
Pre-Tax Income	1,453	1,812	2,472	4,641	4,570
<i>Pre-Tax Margins</i>	15.84%	16.96%	20.24%	31.55%	26.73%
Income Tax Expense (Benefit)	<u>526</u>	<u>591</u>	<u>943</u>	<u>1,793</u>	<u>1,795</u>
<i>Tax Rate</i>	36.21%	32.59%	38.16%	38.63%	39.28%
Net Income	<u>\$ 927</u>	<u>\$ 1,221</u>	<u>\$ 1,529</u>	<u>\$ 2,848</u>	<u>\$ 2,775</u>
EPS -- Fully Diluted	<u>\$ 0.21</u>	<u>\$ 0.28</u>	<u>\$ 0.36</u>	<u>\$ 0.67</u>	<u>\$ 0.65</u>
Avg Shares Out-Fully Diluted	<u>4,318</u>	<u>4,318</u>	<u>4,266</u>	<u>4,220</u>	<u>4,270</u>
Percent of Revenue					
Cost of Revenues	57.84%	60.36%	55.22%	50.04%	49.85%
Sales, General and Administrative expenses	29.50%	26.07%	23.67%	25.38%	24.12%
YEAR / YEAR GROWTH					
Total Revenues	16.05%	16.42%	14.30%	20.45%	16.25%
Operating Income	9.12%	24.77%	79.34%	40.32%	23.04%
Pre-Tax Income	35.86%	24.67%	36.47%	87.74%	-1.53%
Net Income	35.85%	31.75%	25.21%	86.33%	-2.58%

* Excluding the \$1.246 million gain on sale of assets and \$0.347 million other than temporary reduction of marketable securities our EPS estimate for 2003 is \$0.53 per fully diluted share.

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2003
(in thousands)

	<u>Q1(03/02)</u>	<u>Q2 (06/02)</u>	<u>Q3 (09/02)</u>	<u>Q4 (12/02)</u>	<u>FY2002</u>
Revenue	\$ 2,888	\$ 3,003	\$ 3,075	\$ 3,247	\$ 12,212
Cost of goods sold	<u>1,523</u>	<u>1,761</u>	<u>1,586</u>	<u>1,874</u>	<u>6,744</u>
Gross Profit	1,365	1,242	1,488	1,373	5,468
<i>Gross Margins</i>	47.25%	41.37%	48.41%	42.29%	44.78%
Operating Expenses:					
Sales, general and administrative	649	734	750	758	2,891
Total Operating Expenses	<u>649</u>	<u>734</u>	<u>750</u>	<u>758</u>	<u>2,891</u>
EBITDA	920	707	942	816	3,385
Operating Income	716	508	739	615	2,578
<i>Operating Margin</i>	24.79%	16.92%	24.02%	18.94%	21.11%
Other Income (Expense)					
Interest income	37	53	67	29	187
Interest expense	(20)	(19)	(19)	(16)	(75)
Gain on sale of marketable securities	36	3	(3)	(18)	18
Other than temporary reduction of marketable securities	<u>-</u>	<u>-</u>	<u>-</u>	<u>(236)</u>	<u>(236)</u>
Total Other Income (Expense)	<u>53</u>	<u>37</u>	<u>45</u>	<u>(241)</u>	<u>(105)</u>
Pre-Tax Income	769	545	783	374	2,472
<i>Pre-Tax Margins</i>	26.64%	18.16%	25.48%	11.52%	20.24%
Income Tax Expense (Benefit)	<u>322</u>	<u>194</u>	<u>252</u>	<u>176</u>	<u>943</u>
<i>Tax Rate</i>	41.82%	35.52%	32.18%	47.05%	38.16%
Net Income	<u>\$ 448</u>	<u>\$ 352</u>	<u>\$ 531</u>	<u>\$ 198</u>	<u>\$ 1,529</u>
EPS -- Fully Diluted	<u>\$ 0.10</u>	<u>\$ 0.08</u>	<u>\$ 0.12</u>	<u>\$ 0.05</u>	<u>\$ 0.36</u>
Avg Shares Out-Fully Diluted	<u>4,270</u>	<u>4,269</u>	<u>4,269</u>	<u>4,255</u>	<u>4,266</u>
Percent of Revenue					
Cost of Revenues	52.75%	58.63%	51.59%	57.71%	55.22%
Sales, General and Administrative expenses	22.46%	24.45%	24.39%	23.35%	23.67%
YEAR / YEAR GROWTH					
Total Revenues	9.54%	9.20%	15.51%	23.19%	14.30%
Operating Income	65.75%	53.23%	109.89%	91.06%	79.34%
Pre-Tax Income	36.37%	43.02%	75.31%	-10.77%	36.47%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2003
(in thousands)

	<u>Q1(03/03)*</u>	<u>Q2 (06/03)</u>	<u>Q3 (09/03)E</u>	<u>Q4 (12/03)E</u>	<u>FY2003E*</u>
Revenue	\$ 3,309	\$ 3,776	\$ 3,800	\$ 3,825	\$ 14,709
Cost of goods sold	<u>1,826</u>	<u>1,734</u>	<u>1,875</u>	<u>1,925</u>	<u>7,360</u>
Gross Profit	1,483	2,042	1,925	1,900	7,350
<i>Gross Margins</i>	44.81%	54.08%	50.66%	49.67%	49.96%
Operating Expenses:					
Sales, general and administrative	845	938	965	985	3,733
Total Operating Expenses	<u>845</u>	<u>938</u>	<u>965</u>	<u>985</u>	<u>3,733</u>
EBITDA	803	1,279	1,125	1,080	4,277
Operating Income	638	1,104	960	915	3,617
<i>Operating Margin</i>	19.28%	29.23%	25.26%	23.92%	24.59%
Other Income (Expense)					
Interest income	33	37	35	35	140
Interest expense	(8)	(8)	(8)	(8)	(31)
	-	16	-	-	16
Other than temporary reduction of marketable securities	(347)	-	-	-	(347)
Gain on sale of assets	<u>1,246</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,246</u>
Total Other Income (Expense)	<u>926</u>	<u>45</u>	<u>27</u>	<u>27</u>	<u>1,024</u>
Pre-Tax Income	1,564	1,149	987	942	4,641
<i>Pre-Tax Margins</i>	47.26%	30.42%	25.97%	24.63%	31.55%
Income Tax Expense (Benefit)	<u>570</u>	<u>457</u>	<u>390</u>	<u>375</u>	<u>1,793</u>
<i>Tax Rate</i>	36.47%	39.83%	39.51%	39.81%	38.63%
Net Income	<u>\$ 993</u>	<u>\$ 691</u>	<u>\$ 597</u>	<u>\$ 567</u>	<u>\$ 2,848</u>
EPS -- Fully Diluted	<u>\$ 0.24</u>	<u>\$ 0.16</u>	<u>\$ 0.14</u>	<u>\$ 0.13</u>	<u>\$ 0.67</u>
Avg Shares Out-Fully Diluted	<u>4,218</u>	<u>4,218</u>	<u>4,220</u>	<u>4,225</u>	<u>4,220</u>
Percent of Revenue					
Cost of Revenues	55.19%	45.92%	49.34%	50.33%	50.04%
Sales, General and Administrative expenses	25.53%	24.85%	25.39%	25.75%	25.38%
YEAR / YEAR GROWTH					
Total Revenues	14.57%	25.75%	23.58%	17.81%	20.45%
Operating Income	-10.90%	117.31%	29.99%	48.76%	40.32%
Pre-Tax Income	103.26%	110.61%	25.98%	151.81%	87.74%
Net Income	121.93%	96.52%	12.35%	186.22%	86.33%

* Excluding the \$1.246 million gain on sale of assets and \$0.347 million other than temporary reduction of marketable securities our EPS estimate for the first quarter and full year of 2003 is \$0.10 and \$0.53 per fully diluted share, respectively.

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2004
(in thousands)

	<u>Q1(03/04)E</u>	<u>Q2 (06/04)E</u>	<u>Q3 (09/04)E</u>	<u>Q4 (12/04)E</u>	<u>FY2004E</u>
Revenue	\$ 3,975	\$ 4,275	\$ 4,400	\$ 4,450	\$ 17,100
Cost of goods sold	<u>2,075</u>	<u>2,000</u>	<u>2,175</u>	<u>2,275</u>	<u>8,525</u>
Gross Profit	1,900	2,275	2,225	2,175	8,575
<i>Gross Margins</i>	47.80%	53.22%	50.57%	48.88%	50.15%
Operating Expenses:					
Sales, general and administrative	975	1,025	1,050	1,075	4,125
Total Operating Expenses	<u>975</u>	<u>1,025</u>	<u>1,050</u>	<u>1,075</u>	<u>4,125</u>
<i>EBITDA</i>	1,090	1,415	1,340	1,265	5,110
Operating Income	925	1,250	1,175	1,100	4,450
<i>Operating Margin</i>	23.27%	29.24%	26.70%	24.72%	26.02%
Other Income (Expense)					
Interest income	40	40	40	40	160
Interest expense	<u>(10)</u>	<u>(10)</u>	<u>(10)</u>	<u>(10)</u>	<u>(40)</u>
Total Other Income (Expense)	<u>30</u>	<u>30</u>	<u>30</u>	<u>30</u>	<u>120</u>
Pre-Tax Income	955	1,280	1,205	1,130	4,570
<i>Pre-Tax Margins</i>	24.03%	29.94%	27.39%	25.39%	26.73%
Income Tax Expense (Benefit)	<u>375</u>	<u>500</u>	<u>475</u>	<u>445</u>	<u>1,795</u>
<i>Tax Rate</i>	39.27%	39.06%	39.42%	39.38%	39.28%
Net Income	<u>\$ 580</u>	<u>\$ 780</u>	<u>\$ 730</u>	<u>\$ 685</u>	<u>\$ 2,775</u>
EPS -- Fully Diluted	<u>\$ 0.14</u>	<u>\$ 0.18</u>	<u>\$ 0.17</u>	<u>\$ 0.16</u>	<u>\$ 0.65</u>
Avg Shares Out-Fully Diluted	<u>4,255</u>	<u>4,265</u>	<u>4,275</u>	<u>4,285</u>	<u>4,270</u>
Percent of Revenue					
Cost of Revenues	52.20%	46.78%	49.43%	51.12%	49.85%
Sales, General and Administrative expenses	24.53%	23.98%	23.86%	24.16%	24.12%
YEAR / YEAR GROWTH					
Total Revenues	20.14%	13.22%	15.79%	16.34%	16.25%
Operating Income	44.99%	13.25%	22.40%	20.22%	23.04%
Pre-Tax Income	-38.92%	11.44%	22.09%	19.96%	-1.53%

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

	<u>FY2000A</u>	<u>FY2001A</u>	<u>FY2002A</u>	<u>6 Mos. 2003A</u>
<i>Cash Flows from Operating Activities</i>				
Net Income	\$ 927	\$ 1,221	\$ 1,529	\$ 1,684
Depreciation and amortization	610	777	808	341
Gain on sale of marketable securities	(15)	(250)	(18)	(1,246)
Other than temporary reductions of marketable securities	-	-	236	-
Provision for doubtful accounts	-	15	-	-
Deferred income taxes	<u>150</u>	<u>48</u>	<u>(65)</u>	<u>57</u>
	1,672	1,812	2,490	1,167
<i>Changes In:</i>				
Accounts receivable	(216)	(150)	(119)	(296)
Other receivables	57	(53)	(8)	(3)
Inventories	(76)	119	80	(74)
Prepaid expenses and other assets	-	(34)	32	0
Accounts payable	(38)	26	96	10
Accrued expenses	50	(4)	20	(1)
Taxes payable	65	80	253	295
Net Changes in Working Capital	<u>(158)</u>	<u>(15)</u>	<u>355</u>	<u>(68)</u>
Net cash Provided by Operations	<u>1,514</u>	<u>1,797</u>	<u>2,845</u>	<u>1,099</u>
<i>Cash Flows from Investing Activities</i>				
Purchase of marketable securities	(8,808)	(9,247)	(3,316)	(4,556)
Sale of marketable securities	5,202	7,687	4,025	2,868
Sales of Assets	-	-	-	1,713
Change in margin account	75	357	(432)	-
Purchase of property, plant and equipment	<u>(1,096)</u>	<u>(713)</u>	<u>(259)</u>	<u>(241)</u>
Net cash used in Investing	<u>(4,627)</u>	<u>(1,916)</u>	<u>17</u>	<u>(216)</u>
<i>Cash Flows from Financing Activities</i>				
Repayment of notes payable	(91)	(94)	(675)	(15)
Purchase of treasury stock	-	(287)	(393)	-
Stock issuance costs	-	-	-	-
Net cash provided by Financing	<u>(91)</u>	<u>(381)</u>	<u>(1,068)</u>	<u>(15)</u>
Net change in Cash	(3,204)	(500)	1,795	868
Cash Beginning of Period	<u>4,641</u>	<u>1,437</u>	<u>936</u>	<u>2,731</u>
Cash End of Period	<u>\$ 1,437</u>	<u>\$ 936</u>	<u>\$ 2,731</u>	<u>\$ 3,599</u>