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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: Neutral

Howard Halpern
September 18, 2006

LWAY $7.01 – (NasdaqGM)

	FY (12/04)A	FY (12/05)A	*FY (12/06) E*	*FY (12/07) E*
Revenue (in millions)	$16.32	$20.13	***$27.57***	***$37.85***
Earnings per share (diluted)*	$0.12	$0.15	***$0.18***	***$0.27***

52-Week range*	$7.79 – $5.06	Fiscal year ends:	December
Shares outstanding a/o 08/08/06*	16.793 million	Revenue/shares (TTM) *	$1.31
Trading float*	4.587 million	Price/Sales (TTM) *	5.35X
Insider and 5%owners*	72.69%	Price/Sales (2007)E*	3.16X
Tangible Book value/shr a/o 06-30-06*	$1.26	Price/Earnings (TTM) *	43.8X
Price/Book*	5.56X	Price/Earnings (2007)E*	26.0X

* 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 upgrading shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) to Neutral from Underperform. Our upgrade is based on the Company's recent announcement on July 31, 2006, that it acquired Helios Nutrition Limited. We believe it is prudent to step back and see how Management over the next two quarters (or so) is able to integrate and leverage the assets of Helios into LWAY's operations.

On July 31, 2006, Lifeway announced it acquired Helios Nutrition Limited for $8.0 million, which includes $2.5 million in cash, a $4.2 million note to be paid off-quarterly over four years, and $1.3 million of LWAY's treasury shares. According to the press release, Helios generated revenues of approximately $4.6 million in 2005 and for the first six months of 2006 generated revenues of approximately $2.7 million. According to the Company's 8-K filing, the pro-forma financial results of Helio will not be filed with the SEC until 10/19/06.

Lifeway Foods reported second quarter 2006 revenue of $6.367 million, which was an increase of 25.5% versus $5.073 million in the same period last year. Net income was $0.750 million or $0.04 per diluted share versus $0.557 million or $0.03 per diluted share in the second quarter of 2005.

Based on first half results and limited information regarding Helios, we are increasing our 2006 revenue estimate for 2006 to $27.570 million from our prior estimate of $25.428 million. Given our revenue estimate and assumption that LWAY's cost structure should initially increase due to the acquisition, we are tweaking our 2006 forecast for net income to $3.109 million or $0.18 per share from $3.100 million or $0.18 per share.

Based on trend analysis and a full year of revenue from Helios, our forecast for 2007 now calls for revenue of $37.845 million and net income of $4.645 million or $0.27 per share versus our prior revenue forecast of $31.5 million and net income of $3.915 million or $0.23 per share.

**** 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 fifteen 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 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.

Kefir

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

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

Recent Developments

On September 1, 2006, the Company announced that Oksana Baiul will promote its Lifway Kefir product. According to the press release, Oksana (the Olympic Gold Medal winner in figure skating for the Ukrainian national team) will be promoting Lifeway Kefir in various trade shows and events, as well as in print ads.

On July 31, 2006, Lifeway Foods announced in a press release that it acquired Helios Nutrition Limited, its top competitor in the Kefir market. According to the press release, 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. According to the Company's second quarter 10-Q filing, on August 3, 2006, it executed a stock purchase agreement with George Economy, Amani Holdings, LLC and other shareholders of the capital stock of Helios Nutrition, Ltd. and Pride Main Street Dairy, L.L.C. pursuant to which LWAY will purchase all of the issued and outstanding stock of Helios from the stockholders for a combination of an aggregate amount of $1.3 million in LWAY's common stock, $2.5 million in cash, and a $4.2 million promissory note to be paid off-quarterly over four years that bears interest at the floating prime rate per annum as published from time to time in the Wall Street Journal. The stock payment, the cash payment, and promissory note are subject to adjustment under certain circumstances in accordance with the terms of the stock purchase agreement.

According to the July 31, 2006, press release, Helios generated revenues of approximately $4.6 million in 2005 and for the first six months of 2006 generated revenues of approximately $2.7 million. Management stated that this 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. **According to the Company's 8-K filing, the pro-forma financial results of Helio will not be filed with the SEC until October 19, 2006.**

In the near term, Helios brand Kefir will continue to be manufactured under Lifeway's direction from Helios' existing 25,000-square foot facility in Sauk Cente, Minnesota. Also, all of Helios' employees will be retained and its managers will be employed as consultants. Lifeway expects to transition the manufacturing of the Helio organic kefir line into its main Illinois facility by the end of 2006.

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

On June 8, 2006, the Company's Board of Directors approved a two-for-one split of LWAY's common stock, as well as an amendment to its charter to increase the number of common shares authorized from 10 million to 20 million. As a result of the stock split, each shareholder of record at the close of business on July 19, 2006 received one additional share of common stock for every one share held on such date. The effective date of the stock split was July 16, 2006, when all per share figures were adjusted (unless otherwise noted, all per share figures in the report reflect the two-for-one stock split).

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

For the three-months ended June 30, 2006, versus the three-months ended June 30, 2005:

- Revenue increased to $6.367 million versus $5.073 million;
- Gross margin declined to 41.29% versus 41.72%;
- Operating expenses increased to $1.699 million versus $1.279 million;
- EBITDA increased to $1.078 million versus $1.015 million; and
- Net income was $0.750 million or $0.04 per diluted share versus net income of $0.557 million or $0.03 per diluted share.

The year-over-year revenue increase of 25.5% was primarily attributable to increased awareness of the Company's existing drinkable dairy products (i.e., its flagship Kefir product, Organic Kefir, and La Fruta). Also, the Company's LFI Enterprises subsidiary (formed in 1992) contributed $0.269 million to total revenue, which included $0.131 from the sale of gourmet cream cheese products (related to the 2004 acquisition of Ilya's Farms, Inc.), as well as $0.138 million in sales from the distribution of Lifeway's Kefir and Farmer Cheese products in the tri-state area of PA, NJ, and NY.

Gross margin declined by 43 basis points versus the same period last year. The decrease in gross margin was primarily related to the introduction of the Company's ProBugs™ line of Kefir for kids during the quarter, which required spending on packaging and graphic design costs. In addition, many raw material and supply costs continue to increase, as well as the continued high cost of oil and gas.

Operating expenses in the quarter increased by $0.420 million, primarily due to the advertising and marketing costs associated with the roll out of the ProBugs™ line of Kefir for kids during the quarter. On a percentage of revenue, operating expenses increased to 26.68% versus 25.21% in the second quarter of 2005.

In comparison, Taglich Brothers' estimates called for revenue of $6.250 million and net income of $0.730 million or $0.04 per diluted share.

<u>*Balance Sheet as of June 30, 2006*</u>

The Company had cash and cash equivalents of $3.622 million and short-term marketable securities of $8.582 million. This compares to cash and cash equivalents of $4.354 million and short-term marketable securities of $7.479 million as of December 31, 2005. Working capital was $16.251 million versus $14.474 million in 2005. The Company's long-term liabilities stood at $2.888 million, which was a slight decrease from $2.903 million at the end of 2005.

The Company's portfolio mix of marketable securities (at fair value as of March 31, 2006) consisted of:

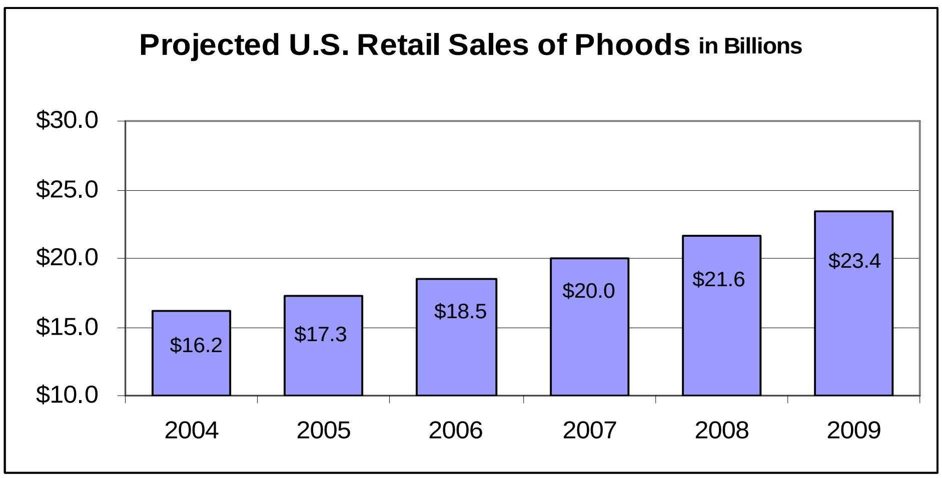
- 32.2% fixed income securities; and

– 67.8% in equities, mutual funds, and preferred securities.

We believe that LWAY will be able to fund its sales growth from cash on hand and internally generated funds. Management is not aware of any circumstances or trends, which would have a negative impact upon future sales or earnings and that there have been no material fluctuations in the standard seasonal variation of the Company's business. Investors should be aware that Management continues to explore additional acquisition opportunities in order to increase sales and leverage the Company's distribution system. An example is the recently completed Helios acquisition, which included an initial cash outlay of $2.5 million.

Market Comment

It is estimated that Lifeway Foods' target market, the functional and probiotic foods segment of the Food Industry, generates annual revenue in excess of $20 billion. In addition, according to an article (January 2005) in the Chemical Market Reporter magazine (a trade publication provides business information for the global chemical market), the U.S. retail sales of phoods and bepherages (terms used for foods and drinks with health benefits) was approximately $16.2 billion in 2004 and is forecast to reach $20 billion by 2007 (stats were from a research report published by Packaged Facts, a provider of authoritative consumer market research). The following offers some prospective as to the potential future sales trends:



Source: Packaged Facts

In addition, Marketresearch.com (an aggregator of global business intelligence) predicts that by the end of the decade, the U.S. Functional Food Market will approach $30 billion. This would represent approximately 5.5% of the total Food Market. The Nutrition Business Journal (research, publishing and consulting company serving the nutrition, natural products and alternative health care industries) estimates that the Functional Food Market currently represents 3.8% of the total U.S. Food Market.

Outlook/Projections

Management stated in the Company's second quarter earnings press release on August 14, 2006, that this quarter was another record in terms of top line results. We believe this continues to mean that public interest for Lifeway's Kefir product reached an all time high, as well as becoming more accepted by the mainstream market as a healthy product.

In the earnings press release, Lifeway's CEO stated that this is an exciting time for the Company as the Helios acquisition has been completed making Lifeway Foods the leader in both in conventional and organic kefir markets. Also, the launch of Lifeway ProBugs™ will continue to be rolled out through the rest of the year. According to the press release, the initial response from retailers and customers alike has been overwhelmingly positive. In addition, this product offering, is slated to be featured in a number of media outlets throughout the United States, according to the Lifeway's CEO.

The Company's CFO commented that even though the Company increased its advertising and marketing expenses related to the roll out of our ProBugs™ Kefir line, in comparison to previous quarters, and in spite of the rising oil related raw material costs, relatively healthy margins were maintained.

We anticipate that the Company is likely to experience a weekly sales run rate on it core business (excluding the acquisition of Helios) of approximately $0.501 million for the third quarter of 2006, which is a sequential increase from a weekly run rate in the first and seconds quarters of 2006, of $0.462 million and $0.490 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, and the continued rollout of its Probugs™ offering (which is geared towards children). In addition, Management believes the Company's packaging continues to improve point-of-sale education, as well as heightened visibility among mainstream consumers. While Lifeway continues to market its products through local radio station, newspaper, and magazines advertisements, it also has additional exposure through the Internet, catalog advertising and promotion, in store demonstration throughout the U.S., and participation in various trade shows. Also, the 2005 purchase of a new warehouse continues to give the Company added flexibility and the opportunity to expand its product line to include more nonperishable food items.

Also, second quarter top line results will reflect the acquisition of Helios, which should positively impact the top line during the second half of August and the full month of September 2006. Given the very limited financial information regarding Helios' operation, we are making a broad assumption that first half results as stated in the July 31, 2006 press release will recur during the second half of 2006. This translates to $0.675 million during the final 1.5 months of the second quarter of 2006, ending September 30, 2006. This also means that the final quarter of 2006 (the three month period consisting of October, November, and December) should benefit from Helios to the tune of $1.35 million. In total, the 4.5 month contribution from Helios may total approximately $2.025 million to Lifeway's top line results in 2006.

Based on first half quarter results, comments made in the Company's second quarter 10-Q filing, and the limited information related to the Helios acquisition, we are increasing our 2006 revenue estimate to $27.570 million from our prior revenue estimate of $25.428 million. Given our revenue estimate and assumption that LWAY's cost structure should initially increase due to the acquisition, we are tweaking our 2006 forecast for net income to $3.109 million or $0.18 per diluted share from $3.100 million or $0.18 per diluted share. Our forecast incorporates the following:

- Distribution agreements – with Target stores and a limited test market of LowFat Plain Kefir to Costco stores in the Midwest region of the U.S;

- The continued rollout of it ProBugs™ offering;

- Integration of the Helios acquisition;

- Relatively high energy and raw material cost of resin for its containers and packaging; and

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

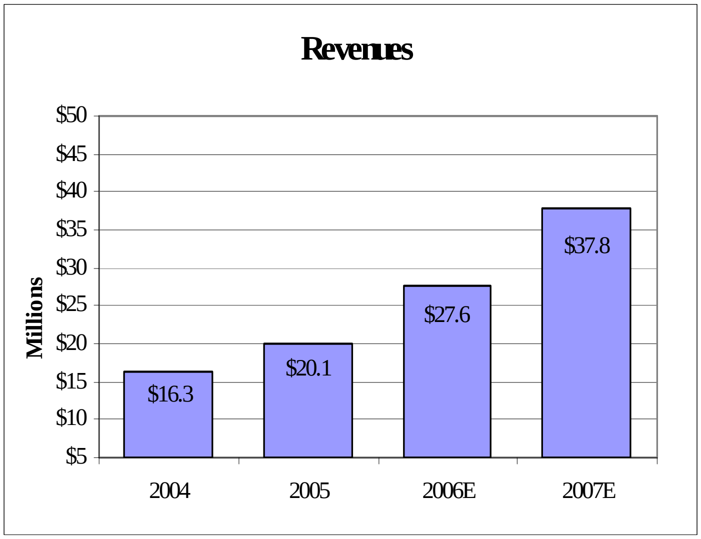
We have adjusted the following from our prior forecast, based on the previously discussed operating trends:

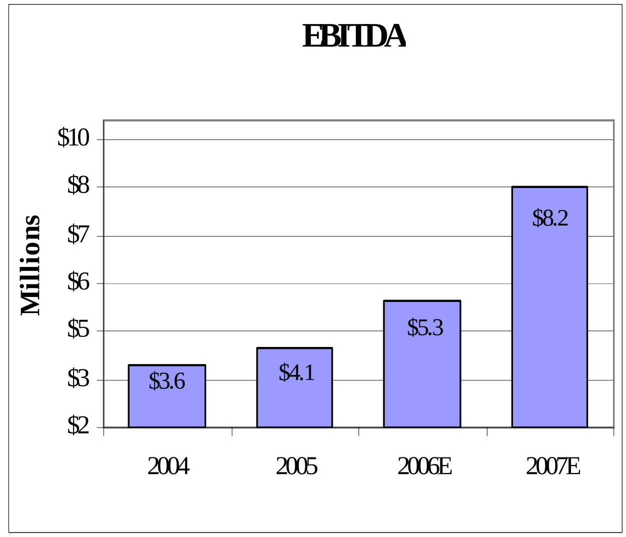
- Gross margins to 42.69% from 43.81%; and

- SG&A expenses, as a percentage of revenues, to 25.78% from 24.61%.

Based on trend analysis of Lifeway's core operations and a baseline assumption that Helios could experience 15% year-over-year growth in revenue, our forecast for 2007 now calls for revenue of $37.845 million and net income of $4.645 million or $0.27 per share versus our prior revenue forecast of $31.5 million and net income of $3.915 million or $0.23 per share. We also anticipate gross margin of $43.59% and SG&A expenses, as a percentage of revenue of 23.91%. Our prior forecast assumed gross margin of 44.05% and SG&A expenses, as a percentage of revenues of 24.52%

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 May 5, 2006, the Company entered into a forth extension of the stockholders' agreement with Danone Foods, Inc., which was originally entered into on October 1 1999. In the filing, on May 3, 2006, LWAY and DS Waters, L.P. an affiliate of Danone Foods, Inc. entered into the forth extension of the stockholders' agreement and all Lifeway shares held by Danone Foods, Inc., were transferred to DS Waters on November 10, 2005. Also, included in the agreement was a non-compete provision, with the specific exclusion of Stonyfield Farms, Inc., an affiliate of Danone Foods, Inc. and DS Waters. Investors should be aware that Stonyfield Farms is not in direct competition with LWAY, since it does not produce Kefir.

However, the competitive landscape could increase as yogurt products (especially in the natural and organic categories) could increase the general competitive landscape in the future.

Under the fourth extension, the terms of the non-compete period and standstill period of the stockholders' agreement expire on December 31, 2006.

According to SEC filings, as of June 8, 2006, Danone owned approximately 20.6% of LWAY's common shares.

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

Customer Concentration
In 2005, Lifeway's largest customer represented approximately 9% of sales and reflected sales in various regions of the United States outside the Chicago, Illinois metropolitan area.

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

Growth Management
LWAY has returned to growing revenues in excess of 20% 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 46.1% of common shares outstanding.

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

Marketable Securities
At June 30, 2006, the fair value of the Company's marketable securities available for sale was $8.582 million. In the Company's 10-K filing, Management stated its belief that LWAY can offset a portion of the oil related costs that have been incurred over the last twelve months, by making prudent investments in energy related securities, which will show up in other income. Investors should be aware that investments in energy related securities can be volatile and could have a negative impact on its portfolio if energy prices were to decline.

Federal Reserve

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

Miscellaneous

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

Trading Volume

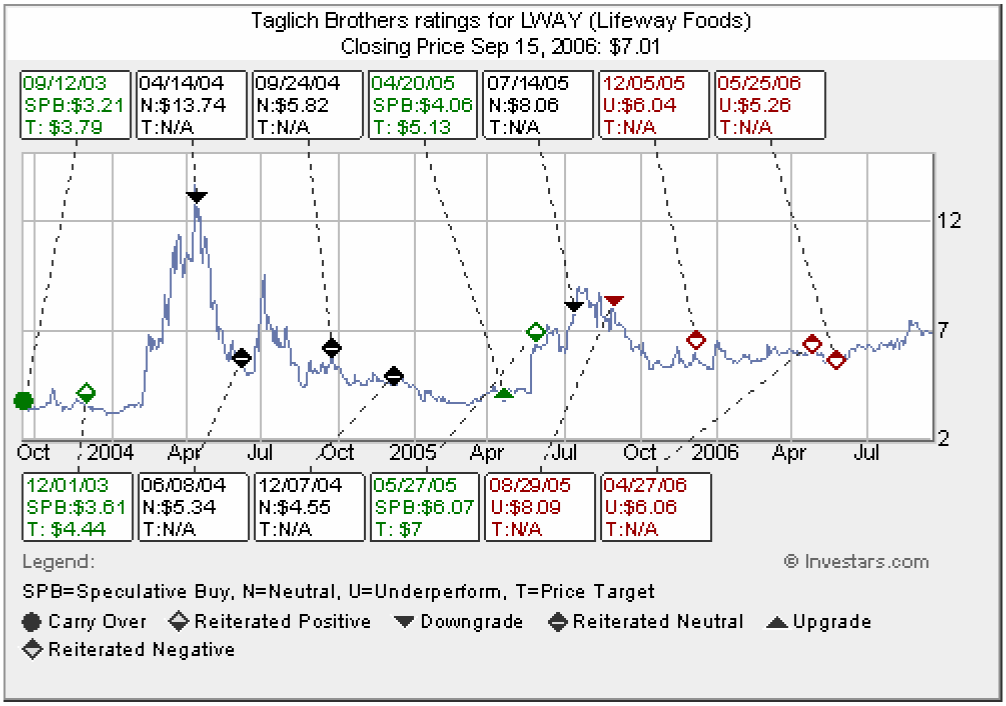
Liquidity has the potential to be a concern. Based on our calculations average daily-volume during 2003 increased to 4,451 shares from 1,943 shares in 2002. During 2004, average volume increased significantly to 154,399 shares traded a day. In 2005, average volume declined to 43,400 shares traded a day. During the first seven months of 2006, average daily volume has declined to 23,667 shares traded a day. Average daily volume remains relatively low; therefore, investors need to be aware that by nature a thinly traded equity can have significant price volatility.

Conclusion

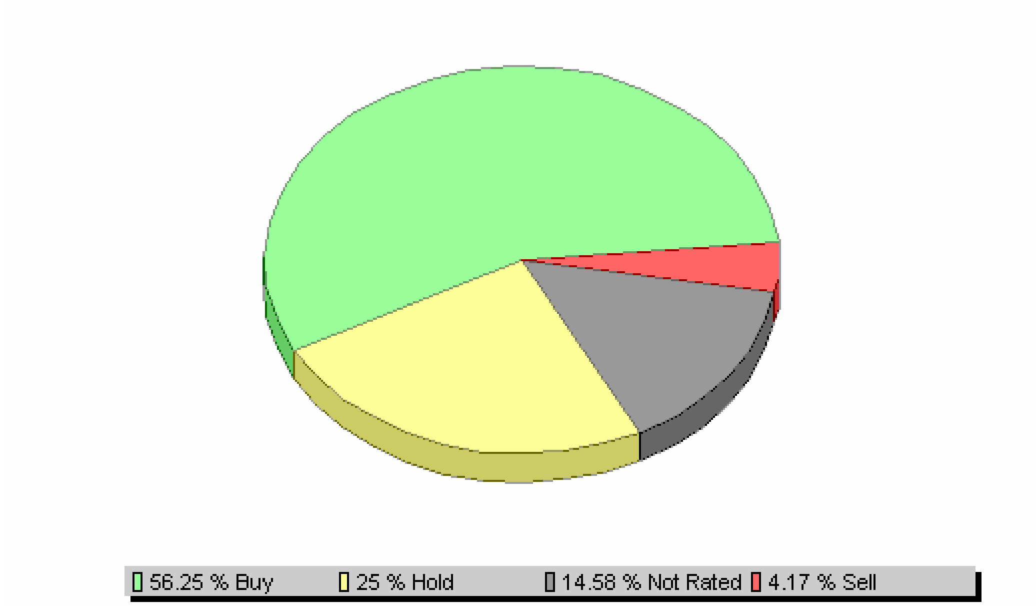
We are upgrading shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) to Neutral from Underperform. Our upgrade is based on the Company's recent announcement on July 31, 2006, that it acquired Helios Nutrition Limited.

We believe it is prudent to step back and see how Management over the next two quarters (or so) is able to integrate and leverage the assets of Helios into LWAY's operations.

Also, investors need to be aware that in early May 2006, Lifeway Foods was able to enter into a forth 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 forth extension of the stockholders', standstill, and non-compete agreements, which will now expire on December 31, 2006.



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	1	3.57%
Hold	0	0
Sell	0	0
Not Rated	1	6.25%

<u>Meaning of Ratings</u>

Buy

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

Speculative Buy

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

Neutral

We will remain neutral pending certain developments.

Underperform

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

Sell

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

Some notable Risks within the Microcap Market

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

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

Public Companies mentioned in this report:

Groupe Danone (NYSE: DA)

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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. 2003 Year End	Dec. 2004 Year End	Dec. 2005 Year End	Mar. 2006 1st Qtr End	Jun. 2006 2nd Qtr End
ASSETS					
Current assets:					
Cash and cash equivalents	$ 4,598	$ 5,773	$ 4,354	$ 3,818	$ 3,622
Marketable securities	6,303	6,742	7,479	8,338	8,582
Accounts receivable, net	1,800	2,024	2,518	3,054	3,561
Other receivables	166	72	56	55	67
Inventories	812	906	1,717	2,024	2,321
Prepaid income taxes	306	259	12	40	-
Prepaid expenses and other assets	1	7	9	15	52
Deferred income taxes	27	-	143	-	117
Total current assets	**14,012**	**15,783**	**16,287**	**17,345**	**18,321**
Property, plant and equipment, net	3,733	3,420	7,751	7,775	7,762
Total assets	**$ 17,745**	**$ 19,688**	**$ 24,465**	**$ 25,529**	**$ 26,476**
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Current maturities of notes payable	28	9	532	528	542
Accounts payable	795	642	426	453	704
Accrued expenses	184	196	355	245	383
Taxes payable	-	36	-	4	441
Total current liabilities	**1,007**	**882**	**1,314**	**1,231**	**2,070**
Long-term liabilities	473	464	2,903	2,888	2,850
Deferred income taxes	472	424	349	346	344
Stockholders' equity:					
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509	6,509	6,509
Paid-in capital	-	64	91	99	104
Stock subscription receivable	(15)	-	-	-	-
Retained earnings	9,822	11,874	14,423	15,318	16,068
Accumulated other comprehansive income, net of tax	156	119	(100)	154	1
Treasury stock, at cost	(680)	(649)	(1,025)	(1,015)	(1,468)
Total stockholders' equity	**15,793**	**17,918**	**19,899**	**21,065**	**21,213**
Total liabilities and stockholders' equity	**$ 17,745**	**$ 19,688**	**$ 24,465**	**$ 25,529**	**$ 26,476**
SHARES OUT	8,437	8,420	8,396	8,397	16,793

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

	FY2003A	FY2004A	FY2005A	**FY2006E**	**FY2007E**
Revenue	$ 14,878	$ 16,319	$ 20,132	**$ 27,570**	**$ 37,845**
Cost of goods sold	7,841	9,035	11,664	**15,801**	**21,350**
Gross Profit	7,037	7,284	8,468	**11,769**	**16,495**
Gross Margins	47.30%	44.64%	42.06%	**42.69%**	**43.59%**
Sales, general and administrative	3,558	4,334	5,066	**7,108**	**9,050**
EBITDA	4,167	3,620	4,052	**5,278**	**8,245**
Operating Income	3,479	2,950	3,401	**4,661**	**7,445**
Operating Margin	23.38%	18.08%	16.90%	**16.91%**	**19.67%**
Other Income (Expense)					
Interest income	97	186	323	**408**	**300**
Interest expense	(41)	(31)	(101)	**(283)**	**(300)**
Gain on sale of marketable securities	(1,294)	354	445	**188**	**-**
Other than temporary reduction of marketable securities	89	(16)	14	**3**	**-**
Gain on sale of assets	1,246	-	-	**-**	**-**
Total Other Income (Expense)	98	492	682	**316**	**-**
Pre-Tax Income	3,576	3,442	4,083	**4,977**	**7,445**
Pre-Tax Margins	24.04%	21.09%	20.28%	**18.05%**	**19.67%**
Income Tax Expense (Benefit)	1,355	1,390	1,535	**1,868**	**2,800**
Tax Rate	37.89%	40.39%	37.58%	**37.53%**	**37.61%**
Net Income	$ 2,221	$ 2,052	$ 2,548	**$ 3,109**	**$ 4,645**
EPS -- Fully Diluted	$ 0.13	$ 0.12	$ 0.15	**$ 0.18**	**$ 0.27**
Avg Shares Out-Fully Diluted *	16,873	16,877	16,809	**16,890**	**17,075**
Percent of Revenue					
Cost of Revenues	52.70%	55.36%	57.94%	57.31%	56.41%
Sales, General and Administrative expenses	23.92%	26.56%	25.17%	25.78%	23.91%
YEAR / YEAR GROWTH					
Total Revenues	21.83%	9.69%	23.36%	36.95%	37.27%
Operating Income	34.96%	-15.18%	15.28%	37.04%	59.73%
Pre-Tax Income	44.67%	-3.75%	18.62%	21.90%	49.58%
Net Income	45.31%	-7.62%	24.19%	22.00%	49.40%

*** 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, 2004
(in thousands)

	Q1(03/04)A	Q2 (06/04)A	Q3 (09/04)A	Q4 (12/04)A	**FY2004A**
Revenue	$ 3,935	$ 4,002	$ 4,139	$ 4,243	**$ 16,319**
Cost of goods sold	2,099	2,266	2,240	2,430	**9,035**
Gross Profit	1,836	1,736	1,899	1,813	**7,284**
Gross Margins	*46.65%*	*43.38%*	*45.89%*	*42.73%*	**44.64%**
Operating Expenses:					
Sales, general and administrative	882	1,049	1,158	1,244	**4,334**
Total Operating Expenses	882	1,049	1,158	1,244	**4,334**
EBITDA	1,110	846	901	764	**3,620**
Operating Income	954	687	741	569	**2,950**
Operating Margin	*24.24%*	*17.16%*	*17.91%*	*13.40%*	**18.08%**
Other Income (Expense)					
Interest income	41	34	50	61	**186**
Interest expense	(8)	(8)	(8)	(8)	**(31)**
Total Other Income (Expense)	302	39	70	80	**492**
Pre-Tax Income	1,256	726	811	649	**3,442**
Pre-Tax Margins	*31.91%*	*18.15%*	*19.60%*	*15.29%*	**21.09%**
Income Tax Expense (Benefit)	491	294	296	309	**1,390**
Tax Rate	*39.06%*	*40.50%*	*36.51%*	*47.66%*	**40.39%**
Net Income	$ 765	$ 432	$ 515	$ 340	**$ 2,052**
EPS -- Fully Diluted	$ 0.05	$ 0.03	$ 0.03	$ 0.02	**$ 0.24**
Avg Shares Out-Fully Diluted	16,874	16,875	16,880	16,880	**8,439**
Percent of Revenue					
Cost of Revenues	53.35%	56.62%	54.11%	57.27%	55.36%
Sales, General and Administrative expenses	22.41%	26.22%	27.98%	29.33%	26.56%
YEAR / YEAR GROWTH					
Total Revenues	18.94%	5.99%	7.86%	7.26%	9.69%

*** 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, 2005
(in thousands)

	Q1(03/05)A	Q2 (06/05)A	Q3 (09/05)A	Q4 (12/05)A	**FY2005A**
Revenue	$ 4,657	$ 5,073	$ 5,195	$ 5,208	**$ 20,132**
Cost of goods sold	2,578	2,956	3,073	3,057	**11,664**
Gross Profit	2,079	2,116	2,121	2,151	**8,468**
Gross Margins	*44.64%*	*41.72%*	*40.84%*	*41.31%*	**42.06%**
Operating Expenses:					
Sales, general and administrative	1,155	1,279	1,359	1,273	**5,066**
Total Operating Expenses	1,155	1,279	1,359	1,273	**5,066**
EBITDA	1,064	1,015	930	1,043	**4,052**
Operating Income	924	837	762	878	**3,401**
Operating Margin	*19.84%*	*16.51%*	*14.67%*	*16.86%*	**16.90%**
Other Income (Expense)					
Interest income	65	75	72	110	**323**
Interest expense	(7)	(7)	(37)	(50)	**(101)**
Total Other Income (Expense)	259	44	197	181	**682**
Pre-Tax Income	1,183	881	959	1,059	**4,083**
Pre-Tax Margins	*25.41%*	*17.37%*	*18.47%*	*20.34%*	**20.28%**
Income Tax Expense (Benefit)	458	324	400	352	**1,535**
Tax Rate	*38.69%*	*36.80%*	*41.74%*	*33.24%*	**37.58%**
Net Income	$ 725	$ 557	$ 559	$ 707	**$ 2,548**
EPS -- Fully Diluted	$ 0.04	$ 0.03	$ 0.03	$ 0.04	**$ 0.15**
Avg Shares Out-Fully Diluted	16,865	16,795	16,801	16,809	**16,809**
Percent of Revenue					
Cost of Revenues	55.36%	58.28%	59.16%	58.69%	57.94%
Sales, General and Administrative expenses	24.81%	25.21%	26.16%	24.44%	25.17%
YEAR / YEAR GROWTH					
Total Revenues	18.34%	26.75%	25.52%	22.72%	23.36%

*** 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)E	Q4 (12/06)E	**FY2006E**
Revenue	$ 6,003	$ 6,367	$ 7,200	$ 8,000	**$ 27,570**
Cost of goods sold	3,213	3,739	4,200	4,650	**15,801**
Gross Profit	2,790	2,629	3,000	3,350	**11,769**
Gross Margins	*46.48%*	*41.29%*	*41.67%*	*41.87%*	**42.69%**
Operating Expenses:					
Sales, general and administrative	1,384	1,699	1,925	2,100	**7,108**
Total Operating Expenses	1,384	1,699	1,925	2,100	**7,108**
EBITDA	1,550	1,078	1,225	1,425	**5,278**
Operating Income	1,406	930	1,075	1,250	**4,661**
Operating Margin	*23.43%*	*14.61%*	*14.93%*	*15.62%*	**16.91%**
Other Income (Expense)					
Interest income	86	122	100	100	**408**
Interest expense	(50)	(63)	(85)	(85)	**(283)**
Total Other Income (Expense)	(0)	287	15	15	**316**
Pre-Tax Income	1,406	1,217	1,090	1,265	**4,977**
Pre-Tax Margins	*23.42%*	*19.11%*	*15.14%*	*15.81%*	**18.05%**
Income Tax Expense (Benefit)	511	467	425	465	**1,868**
Tax Rate	*36.37%*	*38.36%*	*38.99%*	*36.77%*	**37.53%**
Net Income	$ 895	$ 750	$ 665	$ 800	**$ 3,109**
EPS -- Fully Diluted	$ 0.05	$ 0.04	$ 0.04	$ 0.05	**$ 0.18**
Avg Shares Out-Fully Diluted	16,792	16,800	16,930	17,040	**16,890**
Percent of Revenue					
Cost of Revenues	53.52%	58.71%	58.33%	58.13%	57.31%
Sales, General and Administrative expenses	23.06%	26.68%	26.74%	26.25%	25.78%
YEAR / YEAR GROWTH					
Total Revenues	28.91%	25.53%	38.60%	53.61%	36.95%

*** Adjusted for the 2-1 stock split effective March 9, 2004 and August 16, 2006**

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

	FY2003A	FY2004A	FY2005A	6 Mos.2006A
Cash Flows from Operating Activities				
Net Income	$ 2,222	$ 2,052	$ 2,548	$ 1,645
Depreciation and amortization	688	670	651	292
Amortization of discounts on securities	-	-	-	-
Gain on sale of marketable securities	1,294	(354)	(445)	(188)
Loss on marketable securities classified as trading	-	16	(14)	(3)
Gain on sale of assets	(1,246)	-	-	-
Other than temporary reductions of marketable securities	-	-	-	-
Issuance of common stock in exchange for services rendered	-	95	52	29
Decrease in allowance for doubtful accounts	-	-	-	10
Provision for doubtful accounts	-	-	-	-
Deferred income taxes	9	46	(100)	(53)
	2,967	2,525	2,692	1,732
Changes In:				
Accounts receivable	(365)	(224)	(494)	(1,053)
Other receivables	(106)	94	16	(11)
Inventories	(91)	(94)	(811)	(604)
Prepaid income taxes	(306)	48	247	12
Prepaid expenses and other assets	0	(6)	(2)	(43)
Accounts payable	156	(154)	(215)	278
Accrued expenses	0	12	159	28
Taxes payable	(398)	-	-	441
Net Changes in Working Capital	(1,109)	(325)	(1,100)	(953)
Net cash Provided by Operations	1,858	2,200	1,592	779
Cash Flows from Investing Activities				
Purchase of marketable securities	(4,284)	(6,266)	(6,461)	(3,969)
Sale of marketable securities	3,025	6,097	5,810	3,231
Sales of Assets	1,713	-	-	-
Change in margin account	-	-	-	-
Acquisition of Ilya's Farms, Inc., net of assets acquired	-	(512)	-	-
Loan acquisition costs	-	-	-	-
Purchase of property, plant and equipment	(415)	(330)	(4,917)	(269)
Net cash used in Investing	39	(1,011)	(5,567)	(1,007)
Cash Flows from Financing Activities				
Repayment of notes payable	(31)	(28)	(37)	(44)
Proceeds from issuance of common stock	-	15	-	-
Proceeds from note payable	-	-	3,000	-
Purchase of treasury stock	-	-	(402)	(459)
Loan costs	-	-	(7)	-
Net cash provided by Financing	(31)	(13)	2,555	(503)
Net change in Cash	1,866	1,175	(1,419)	(732)
Cash Beginning of Period	2,732	4,598	5,773	4,354
Cash End of Period	$ 4,598	$ 5,773	$ 4,354	$ 3,622