

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: Underperform

Howard Halpern

December 5, 2005

LWAY \$12.08 - (NasdaqNM)

	FY (12/03)A	FY (12/04)A	FY (12/05) E	FY (12/06) E
Revenue (in millions)	\$14.9	\$16.32	\$20.26	\$25.17
Earnings per share (diluted)*	\$0.26	\$0.24	\$0.27	\$0.32
52-Week range	\$18.17 – \$7.11		Fiscal year ends:	December
Shares outstanding <small>a/o 9/30/05</small>	8.39 million		Revenue/shares (TTM)	\$2.28
Trading float	2.20 million		Price/Sales (TTM)	5.30X
Insider and institutional ownership	73.8%		Price/Sales (2006)E	4.04X
Tangible Book value/shr <small>a/o 09-30-05</small>	\$2.29		Price/Earnings (TTM)	44.7X
Price/Book	5.28X		Price/Earnings (2006)E	37.8X

* All per share figures reflect the 2-1 stock split effective March 9, 2004.

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 maintaining our Underperform rating on Lifeway Foods, Inc. (NasdaqNM: LWAY). We continue to believe its shares remain fairly valued based on our current revenue, EBITDA, and EPS estimates.

Investors need to be aware that the Company's Stockholders' Agreement with Danone runs out on December 30, 2005; therefore, investors should be cognizant that the term of the current non-competition covenant between Lifeway and Danone expires.

Lifeway Foods reported third quarter 2005 revenue of \$5.195 million, which was an increase of 25.5% versus \$4.139 million in the same period last year. Net income was \$0.559 million or \$0.07 per diluted share versus \$0.515 million or \$0.06 per diluted share in the third quarter of 2004.

Based on results for the first nine months of 2005 and comments by Management in the Company's third quarter 10Q filing, we are adjusting our 2005 revenue estimate to \$20.26 million from \$20.64 million. We are also reducing our 2006 revenue forecast to \$25.17 million from our prior estimate of \$26.73 million.

Given our revenue estimate and statements made by Management in the Company's third quarter 10-Q filing regarding increasing cost pressures, we are lowering our 2005 forecast for net income to \$2.262 million or \$0.27 per diluted share from \$2.492 million or \$0.30 per diluted share. Our revised 2006 net income estimate is \$2.660 million or \$0.32 per diluted share versus our prior estimate of \$3.215 million or \$0.38 per diluted share.

** Please view our disclaimer located on page 9.*

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The Company

Lifeway Foods, Inc. (NasdaqNM: 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, 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.

In addition, the Company distributes over 40 different assorted cream cheese products under the Cream Cheese Gourmet brand name in the Philadelphia metropolitan area. Those product offerings resulted from the acquisition of Ilya's Farms, Inc., a Philadelphia based producer of fine gourmet cream cheeses during the third quarter of 2004.

Danone Foods, Inc., the U.S. subsidiary of Groupe Danone of Paris, France, has a 20.5% ownership interest in the Company. According to the Company's SEC filings, Lifeway and Danone Foods, Inc. entered into an extension of an existing Stockholders' Agreement. The extension expires on December 30, 2005.

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-months ended September 30, 2005, versus the three-months ended September 30, 2004:

- Revenue increased to \$5.195 million versus \$4.139 million;
- Operating expenses increased to \$1.359 million versus \$1.158 million;
- EBITDA increased to \$0.930 million versus \$0.901 million; and
- Net income was \$0.559 million or \$0.07 per diluted share versus net income of \$0.515 million or \$0.06 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., La Fruta and Kefir). Also, the Company's acquisition of Ilya's Farms, Inc., contributed \$0.135 million to total revenue from the sale of gourmet cream cheese products, as well as \$0.113 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 margins decreased to 40.84% versus 43.38% in the same period last year. While the average cost of milk (the Company's largest component of cost of goods sold) was similar to the same period last year, the Company was negatively impacted by an 18% increase in the minimum wage in Illinois. According to Management, LWAY intends to offset wage increases by continuing to invest in the automation of its production process. As a consequence of increased shipments of its products, the overall rise in fuel and transportation costs negatively impacted gross margins during the third quarter of 2005.

Operating expenses in the third quarter of 2005 increased by \$0.201 million, primarily due to higher utility and fuel costs, rising insurance and professional fees associated with the Sarbanes-Oxley Act, as well as other

Lifeway Foods, Inc.

regulatory compliance requirements. On a percentage of revenue, operating expenses decreased to 26.16% versus 27.98% in the same period last year, primarily due to the Company's revenue growth.

In comparison, Taglich Brothers' estimates called for revenues of \$5.380 million and net income of \$0.665 million or \$0.08 per diluted share.

Balance Sheet as of September 30, 2005

The Company had cash and cash equivalents of \$4.192 million and short-term marketable securities of \$7.581 million. This compares to cash and cash equivalents of \$5.773 million and short-term marketable securities of \$6.742 million as of December 31, 2004. Working capital was \$14.369 million versus \$14.901 million in 2004. The Company's long-term liabilities stood at \$2.920 million, which is an increase from \$0.464 million at the end of 2004. The increase in long-term liabilities is primarily related to the purchase of a storage and distribution facility. In order to purchase the facility the Company entered into a \$3.0 million five year note at an interest rate of 5.6%.

The Company's portfolio mix of marketable securities (at fair value as of September 30, 2005) consisted of:

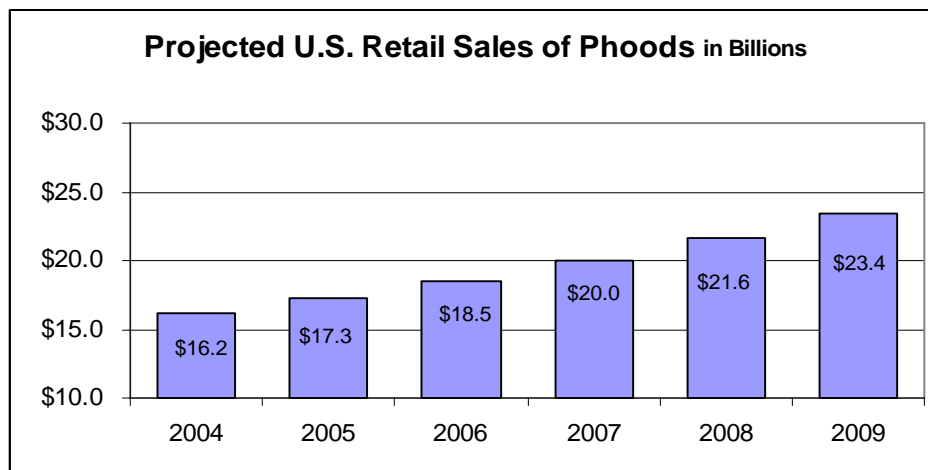
- 44.1% fixed income securities; and
- 55.9% in equities and mutual funds.

In 2004, the Company transitioned away from higher-risk securities towards larger cap value, higher dividend yielding, and tax-advantaged equities.

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.

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, 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). The following offers some prospective as to the potential future sales trends:



Source: Packaged Facts

In addition, Marketresearch.com 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 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 third quarter earnings press release on November 14, 2005, that it was pleased with third quarter sales and that in the coming months new product introductions are likely to occur. The most recent introduction was for the Company's Organic 'It's Pudding', which according to Management met with approval by distributors and some major food chains (i.e., Whole Foods and Wild Oats). In addition, during the fourth quarter a test marketing program is likely to begin at a third club-type outlet that the Company has not previously serviced.

Back on October 3, 2005, Lifeway Foods pre-announced sales for its third quarter ended September 30, 2005, of approximately \$5.195 million. Actual results met those expectations. Overall, third quarter sales translated into a weekly sales run rate of approximately \$0.400 million, which was at the upper end of Taglich Brothers' expected range of \$0.350 million to \$0.400 million. Taglich Brothers' weekly sale run rate was based primarily on increased orders from existing customers, as well as expanded distribution opportunities. In addition, Management believes the Company's new packaging has improved point-of-sale education, as well as heightened visibility among mainstream consumers. Lifeway undertook a new national print campaign featuring its low fat Kefir product in the May issue of Health Magazine and the June issue of Vegetarian Times. Management has publicly stated that more ad placements will be forthcoming into 2006. Also, a new warehouse facility gives the Company added flexibility and the opportunity to expand its product line to include more nonperishable food items.

Based on results for the first nine months of 2005, the factors discussed above, along with increasing cost pressures, we are adjusting our 2005 net income forecast to \$2.262 million or \$0.27 per diluted share based on revenue of \$20.260 million. Our prior forecast was for net income of \$2.492 million or \$0.30 per diluted share based on revenue of \$20.635 million. Our forecast incorporates the following:

- A distribution agreement with Target stores;
- A relationship with Cosi Restaurants;
- The average price of milk remaining stable. During the first quarter of 2005, milk prices increased by approximately 25% versus the first quarter of 2004; however, during the second and third quarters of 2005 the price of milk remained fairly constant versus the same time frame in 2004;
- Higher wage and fuel costs; and
- The continued high cost of being a public company (i.e., insurance, legal, and regulatory compliance).

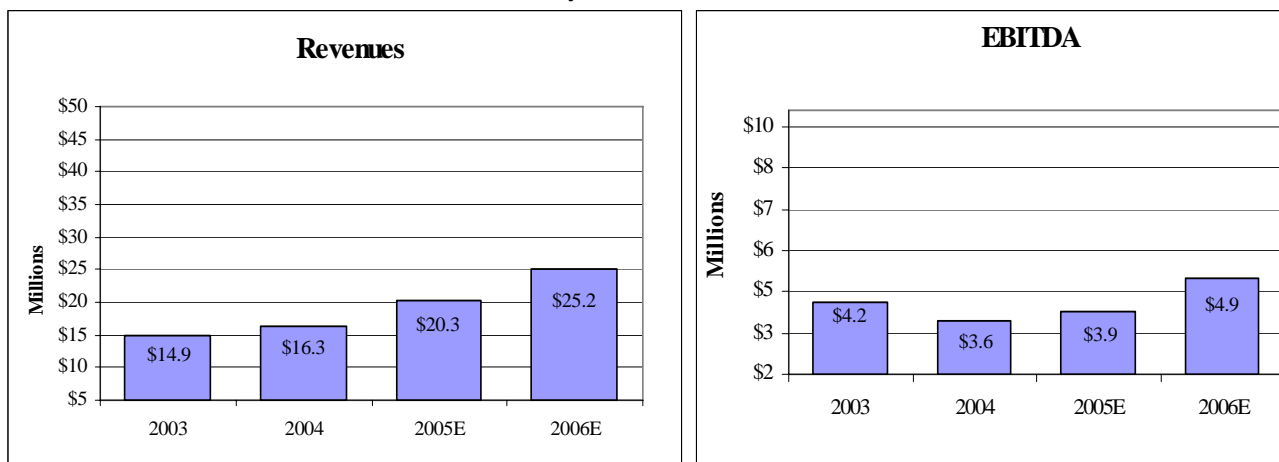
We have adjusted the following from our prior forecast:

- Gross margins to 41.97% from 43.25%; and
- SG&A expenses, as a percentage of revenues, to 26.00% from 25.56%.

Our 2006 forecasts, call for revenue growth of 24.21%, reaching \$25.165 million and net income of \$2.660 million or \$0.32 per diluted share. Our prior forecast called for revenue of \$26.725 million and net income of \$3.215 million or \$0.38 per diluted share.

The chart on top of the next page shows our revenue and EBITDA projections:

Lifeway Foods, Inc.



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

The Company has extended a previously agreed to Stockholders' Agreement with Danone until December 30, 2005. The agreement limits competition between the parties, as well as Groupe Danone not having more than a 20% ownership interest in Lifeway Foods common shares. The ability of Danone to sell, or the prospect of Danone being able to sell competing products could negatively impact future operations.

Legal Issue

On December 4, 2004, a former employee requested a motion for summary judgment on the issue of liability in a lawsuit filed against the Company by a former employee. The motion was granted on February 10, 2005 and on February 18, 2005 the case was referred to a Magistrate Judge for a settlement conference. The cause of action alleges non-payment of overtime wages in violation of federal employment laws, with an estimated amount to be approximately \$90,000 to \$100,000. The suit was filed in the U.S. District Court for the Northern District of Illinois on behalf of all employees who were classified as non-exempt during 2001 through 2003. The Company has accrued a reserve of \$95,000 in anticipation of a settlement.

On April 14, 2003, Vera Smolyansky filed a complaint seeking unspecified damages in the Circuit Court of Cook County, Illinois naming Lifeway as a defendant. The case was dismissed with prejudice on June 30, 2005.

Corporate Governance

Lifeway Foods, Inc.

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

We estimate that the LWAY will return 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.

Federal Reserve

Investors should be aware that if the Federal Reserve continues increasing interest rates (over the last twelve meetings it has increased rates 25 basis points each time), 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

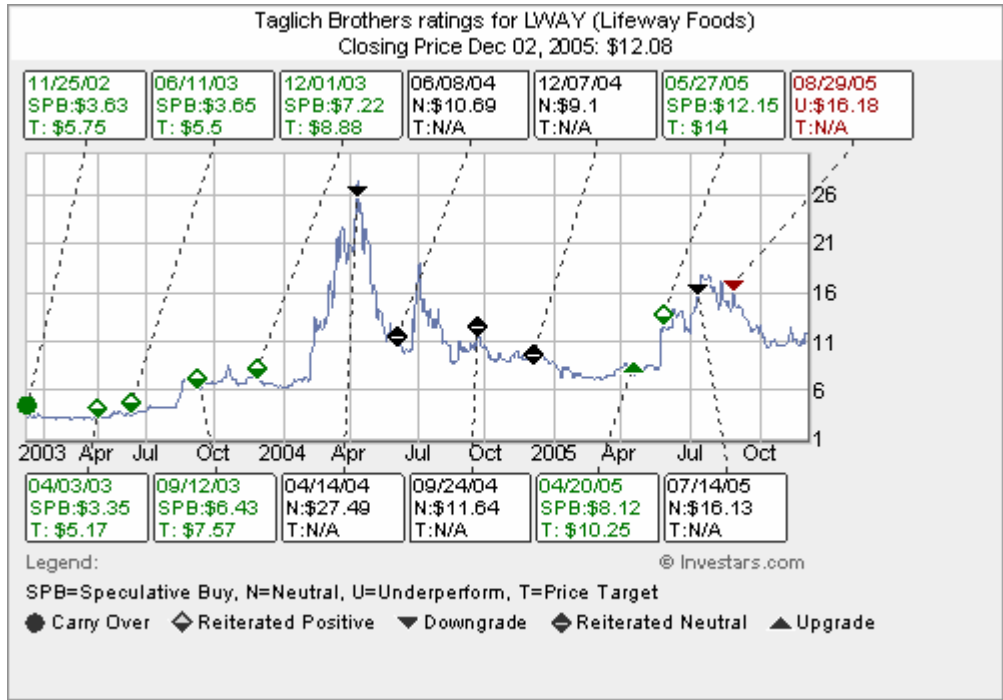
Liquidity has the potential to be a concern. Based on our calculations average daily-volume during 2003 increased to 4,451 shares from 1,943 shares in 2002. During 2004, average volume increased significantly to 154,399 shares traded a day. During the first eleven months of 2005, average volume declined to 44,102 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

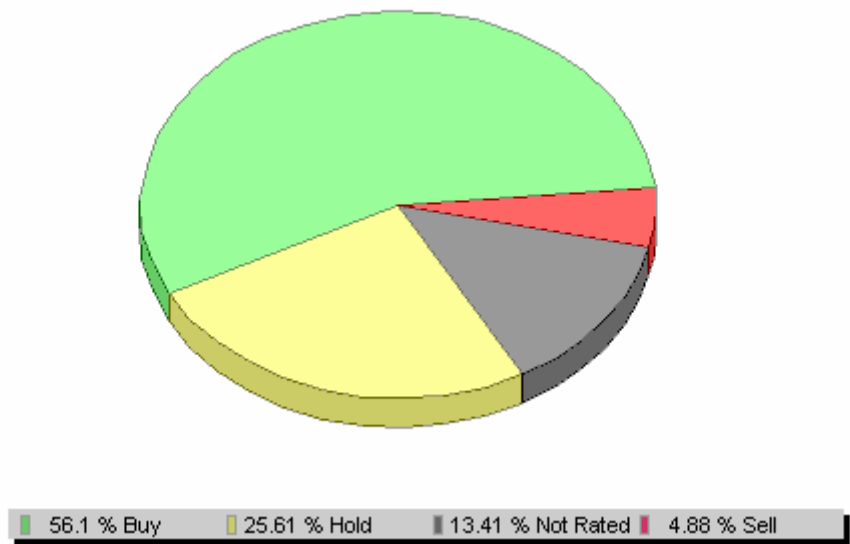
We are maintaining our Underperform rating on Lifeway Foods, Inc. (NasdaqNM: LWAY) since we continue to believe its shares remain fairly valued based on our current revenue, EBITDA, and EPS estimates.

Back on October 3, 2005, the Company announced it expected to report third quarter 2005 revenue of approximately \$5.195 million. In the press release, LWAY did not provide bottom line expectations for the third quarter of 2005. Revenue for the third quarter was in line with expectations; however, net income fell short of our expectations by \$0.106 million. Based on third quarter results and cost pressures, we reduced our EPS estimates by \$0.03 and \$0.06 per diluted share to \$0.27 and \$0.32 per diluted share in 2005 and 2006, respectively, from our prior expectations of \$0.30 and \$0.38 per diluted share.

In addition, the Company and Danone have a Stockholders' Agreement that runs until December 30, 2005. At that time, investors should be cognizant that the term of the current non-competition covenant between Lifeway and Danone expires.



Taglich Brothers Current Ratings Distribution



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. 2002 Year End	Dec. 2003 Year End	Dec. 2004 Year End	Mar. 2005 1st Qtr End	Jun. 2005 2nd Qtr End	Sept. 2005 3rd Qtr End
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 2,732	\$ 4,598	\$ 5,773	\$ 5,434	\$ 2,024	\$ 4,192
Marketable securities	4,172	6,303	6,742	6,895	6,302	7,581
Accounts receivable, net	1,435	1,800	2,024	2,523	2,557	2,638
Other receivables	60	166	72	106	107	109
Inventories	721	812	906	996	1,106	1,301
Prepaid income taxes	-	306	259	103	173	58
Prepaid expenses and other assets	1	1	7	-	102	82
Deferred income taxes	692	27	-	90	55	47
Total current assets	<u>9,813</u>	<u>14,012</u>	<u>15,783</u>	<u>16,147</u>	<u>12,427</u>	<u>16,007</u>
Property, plant and equipment, net	4,472	3,733	3,420	3,432	7,757	7,755
Total assets	<u>\$ 14,285</u>	<u>\$ 17,745</u>	<u>\$ 19,688</u>	<u>\$ 20,048</u>	<u>\$ 20,636</u>	<u>\$ 24,205</u>
LIABILITIES AND STOCKHOLDERS' EQUITY						
Current liabilities:						
Current maturities of notes payable	31	28	9	9	13	535
Accounts payable	639	795	642	789	659	649
Accrued expenses	184	184	196	125	427	454
Taxes payable	398	-	36	-	-	-
Total current liabilities	<u>1,252</u>	<u>1,007</u>	<u>882</u>	<u>923</u>	<u>1,099</u>	<u>1,638</u>
Long-term liabilities	500	473	464	461	454	2,920
Deferred income taxes	453	472	424	406	381	362
Stockholders' equity:						
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509	6,509	6,509	6,509
Paid-in capital	-	-	64	72	75	83
Stock subscription receivable	(15)	(15)	-	-	-	-
Retained earnings	7,600	9,822	11,874	12,600	13,157	13,716
Accumulated other comprehensive income, net of tax	(1,335)	156	119	(53)	5	12
Treasury stock, at cost	(680)	(680)	(649)	(871)	(1,044)	(1,034)
Total stockholders' equity	<u>12,080</u>	<u>15,793</u>	<u>17,918</u>	<u>18,258</u>	<u>18,702</u>	<u>19,285</u>
Total liabilities and stockholders' equity	<u>\$ 14,285</u>	<u>\$ 17,745</u>	<u>\$ 19,688</u>	<u>\$ 20,048</u>	<u>\$ 20,636</u>	<u>\$ 24,205</u>
SHARES OUT	8,437	8,437	8,420	8,412	8,392	8,394

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

	<u>FY2002</u>	<u>FY2003</u>	<u>FY2004</u>	<u>FY2005E</u>	<u>FY2006E</u>
Revenue	\$ 12,212	\$ 14,878	\$ 16,319	\$ 20,260	\$ 25,165
Cost of goods sold	<u>6,744</u>	<u>7,841</u>	<u>9,035</u>	<u>11,758</u>	<u>14,510</u>
Gross Profit	5,468	7,037	7,284	8,502	10,655
<i>Gross Margins</i>	44.78%	47.30%	44.64%	41.97%	42.34%
Sales, general and administrative	<u>2,891</u>	<u>3,558</u>	<u>4,334</u>	<u>5,268</u>	<u>6,400</u>
<i>EBITDA</i>	3,385	4,167	3,620	3,885	4,935
Operating Income	2,578	3,479	2,950	3,234	4,255
<i>Operating Margin</i>	21.11%	23.38%	18.08%	15.96%	16.91%
Other Income (Expense)					
Interest income	187	97	186	288	340
Interest expense	(75)	(41)	(31)	(91)	(160)
Gain on sale of marketable securities	18	(1,294)	354	336	-
Other than temporary reduction of marketable securities	(236)	89	(16)	3	-
Gain on sale of assets	<u>-</u>	<u>1,246</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Other Income (Expense)	<u>(105)</u>	<u>98</u>	<u>492</u>	<u>536</u>	<u>180</u>
Pre-Tax Income	2,472	3,576	3,442	3,769	4,435
<i>Pre-Tax Margins</i>	20.24%	24.04%	21.09%	18.60%	17.62%
Income Tax Expense (Benefit)	<u>943</u>	<u>1,355</u>	<u>1,390</u>	<u>1,507</u>	<u>1,775</u>
<i>Tax Rate</i>	38.16%	37.89%	40.39%	40.00%	40.02%
Net Income	<u>\$ 1,529</u>	<u>\$ 2,221</u>	<u>\$ 2,052</u>	<u>\$ 2,262</u>	<u>\$ 2,660</u>
EPS -- Fully Diluted	<u>\$ 0.18</u>	<u>\$ 0.26</u>	<u>\$ 0.24</u>	<u>\$ 0.27</u>	<u>\$ 0.32</u>
Avg Shares Out-Fully Diluted *	<u>8,531</u>	<u>8,437</u>	<u>8,439</u>	<u>8,410</u>	<u>8,425</u>
Percent of Revenue					
Cost of Revenues	55.22%	52.70%	55.36%	58.03%	57.66%
Sales, General and Administrative expenses	23.67%	23.92%	26.56%	26.00%	25.43%
YEAR / YEAR GROWTH					
Total Revenues	14.30%	21.83%	9.69%	24.15%	24.21%
Operating Income	79.34%	34.96%	-15.18%	9.60%	31.59%
Pre-Tax Income	36.47%	44.67%	-3.75%	9.50%	17.67%
Net Income	25.21%	45.31%	-7.62%	10.21%	17.61%

* Adjusted for the 2-1 stock split effective March 9, 2004

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	<u>2,099</u>	<u>2,266</u>	<u>2,240</u>	<u>2,430</u>	<u>9,035</u>
Gross Profit	1,836	1,736	1,899	1,813	7,284
<i>Gross Margins</i>	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	<u>882</u>	<u>1,049</u>	<u>1,158</u>	<u>1,244</u>	<u>4,334</u>
<i>EBITDA</i>	1,110	846	901	764	3,620
Operating Income	954	687	741	569	2,950
<i>Operating Margin</i>	24.24%	17.16%	17.91%	13.40%	18.08%
Other Income (Expense)					
Interest income	41	34	50	61	186
Interest expense	<u>(8)</u>	<u>(8)</u>	<u>(8)</u>	<u>(8)</u>	<u>(31)</u>
Total Other Income (Expense)	<u>302</u>	<u>39</u>	<u>70</u>	<u>80</u>	<u>492</u>
Pre-Tax Income	1,256	726	811	649	3,442
<i>Pre-Tax Margins</i>	31.91%	18.15%	19.60%	15.29%	21.09%
Income Tax Expense (Benefit)	<u>491</u>	<u>294</u>	<u>296</u>	<u>309</u>	<u>1,390</u>
<i>Tax Rate</i>	39.06%	40.50%	36.51%	47.66%	40.39%
Net Income	<u>\$ 765</u>	<u>\$ 432</u>	<u>\$ 515</u>	<u>\$ 340</u>	<u>\$ 2,052</u>
EPS -- Fully Diluted	<u>\$ 0.09</u>	<u>\$ 0.05</u>	<u>\$ 0.06</u>	<u>\$ 0.04</u>	<u>\$ 0.24</u>
Avg Shares Out-Fully Diluted	<u>8,437</u>	<u>8,438</u>	<u>8,440</u>	<u>8,440</u>	<u>8,439</u>
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%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2005
(in thousands)

	<u>Q1(03/05)A</u>	<u>Q2 (06/05)A</u>	<u>Q3 (09/05)A</u>	<u>Q4 (12/05)E</u>	<u>FY2005E</u>
Revenue	\$ 4,657	\$ 5,073	\$ 5,195	\$ 5,335	\$ 20,260
Cost of goods sold	<u>2,578</u>	<u>2,956</u>	<u>3,073</u>	<u>3,150</u>	<u>11,758</u>
Gross Profit	2,079	2,116	2,121	2,185	8,502
<i>Gross Margins</i>	44.64%	41.72%	40.84%	40.96%	41.97%
Operating Expenses:					
Sales, general and administrative	1,155	1,279	1,359	1,475	5,268
Total Operating Expenses	<u>1,155</u>	<u>1,279</u>	<u>1,359</u>	<u>1,475</u>	<u>5,268</u>
<i>EBITDA</i>	1,064	1,015	930	875	3,885
Operating Income	924	837	762	710	3,234
<i>Operating Margin</i>	19.84%	16.51%	14.67%	13.32%	15.96%
Other Income (Expense)					
Interest income	65	75	72	75	288
Interest expense	<u>(7)</u>	<u>(7)</u>	<u>(37)</u>	<u>(40)</u>	<u>(91)</u>
Total Other Income (Expense)	<u>259</u>	<u>44</u>	<u>197</u>	<u>35</u>	<u>536</u>
Pre-Tax Income	1,183	881	959	745	3,769
<i>Pre-Tax Margins</i>	25.41%	17.37%	18.47%	13.97%	18.60%
Income Tax Expense (Benefit)	<u>458</u>	<u>324</u>	<u>400</u>	<u>325</u>	<u>1,507</u>
<i>Tax Rate</i>	38.69%	36.80%	41.74%	43.60%	40.00%
Net Income	<u>\$ 725</u>	<u>\$ 557</u>	<u>\$ 559</u>	<u>\$ 420</u>	<u>\$ 2,262</u>
EPS -- Fully Diluted	<u>\$ 0.09</u>	<u>\$ 0.07</u>	<u>\$ 0.07</u>	<u>\$ 0.05</u>	<u>\$ 0.27</u>
Avg Shares Out-Fully Diluted	<u>8,433</u>	<u>8,398</u>	<u>8,401</u>	<u>8,410</u>	<u>8,410</u>
Percent of Revenue					
Cost of Revenues	55.36%	58.28%	59.16%	59.04%	58.03%
Sales, General and Administrative expenses	24.81%	25.21%	26.16%	27.65%	26.00%
YEAR / YEAR GROWTH					
Total Revenues	18.34%	26.75%	25.52%	25.74%	24.15%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2006
(in thousands)

	<u>Q1(03/06)E</u>	<u>Q2 (06/06)E</u>	<u>Q3 (09/06)E</u>	<u>Q4 (12/06)E</u>	<u>FY2006E</u>
Revenue	\$ 5,775	\$ 6,190	\$ 6,515	\$ 6,685	\$ 25,165
Cost of goods sold	<u>3,275</u>	<u>3,585</u>	<u>3,785</u>	<u>3,865</u>	<u>14,510</u>
Gross Profit	2,500	2,605	2,730	2,820	10,655
<i>Gross Margins</i>	43.29%	42.08%	41.90%	42.18%	42.34%
Operating Expenses:					
Sales, general and administrative	1,350	1,575	1,675	1,800	6,400
Total Operating Expenses	<u>1,350</u>	<u>1,575</u>	<u>1,675</u>	<u>1,800</u>	<u>6,400</u>
<i>EBITDA</i>	1,320	1,200	1,225	1,190	4,935
Operating Income	1,150	1,030	1,055	1,020	4,255
<i>Operating Margin</i>	19.91%	16.64%	16.20%	15.26%	16.91%
Other Income (Expense)					
Interest income	85	85	85	85	340
Interest expense	<u>(40)</u>	<u>(40)</u>	<u>(40)</u>	<u>(40)</u>	<u>(160)</u>
Total Other Income (Expense)	<u>45</u>	<u>45</u>	<u>45</u>	<u>45</u>	<u>180</u>
Pre-Tax Income	1,195	1,075	1,100	1,065	4,435
<i>Pre-Tax Margins</i>	20.69%	17.37%	16.89%	15.93%	17.62%
Income Tax Expense (Benefit)	<u>470</u>	<u>425</u>	<u>445</u>	<u>435</u>	<u>1,775</u>
<i>Tax Rate</i>	39.33%	39.54%	40.45%	40.85%	40.02%
Net Income	<u>\$ 725</u>	<u>\$ 650</u>	<u>\$ 655</u>	<u>\$ 630</u>	<u>\$ 2,660</u>
EPS -- Fully Diluted	<u>\$ 0.09</u>	<u>\$ 0.08</u>	<u>\$ 0.08</u>	<u>\$ 0.07</u>	<u>\$ 0.32</u>
Avg Shares Out-Fully Diluted	<u>8,415</u>	<u>8,420</u>	<u>8,430</u>	<u>8,435</u>	<u>8,425</u>
Percent of Revenue					
Cost of Revenues	56.71%	57.92%	58.10%	57.82%	57.66%
Sales, General and Administrative expenses	23.38%	25.44%	25.71%	26.93%	25.43%
YEAR / YEAR GROWTH					
Total Revenues	24.01%	22.03%	25.42%	25.29%	24.21%

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

	<u>FY2002A</u>	<u>FY2003A</u>	<u>FY2004A</u>	<u>9 Mos. 2005A</u>
<i>Cash Flows from Operating Activities</i>				
Net Income	\$ 1,529	\$ 2,222	\$ 2,052	\$ 1,841
Depreciation and amortization	808	688	670	486
Gain on sale of marketable securities	(18)	1,294	(354)	(324)
Loss on marketable securities classified as trading	-	-	16	(14)
Gain on sale of assets	-	(1,246)	-	-
Other than temporary reductions of marketable securities	236	-	-	-
Issuance of common stock in exchange for services rendered	-	-	95	35
Deferred income taxes	(65)	9	46	(69)
	<u>2,490</u>	<u>2,967</u>	<u>2,525</u>	<u>1,954</u>
<i>Changes In:</i>				
Accounts receivable	(119)	(365)	(224)	(613)
Other receivables	(8)	(106)	94	(37)
Inventories	80	(91)	(94)	(395)
Prepaid income taxes	-	(306)	48	201
Prepaid expenses and other assets	32	0	(6)	(75)
Accounts payable	96	156	(154)	7
Accrued expenses	20	0	12	258
Taxes payable	253	(398)	-	-
Net Changes in Working Capital	<u>355</u>	<u>(1,109)</u>	<u>(325)</u>	<u>(655)</u>
Net cash Provided by Operations	<u>2,845</u>	<u>1,857</u>	<u>2,200</u>	<u>1,299</u>
<i>Cash Flows from Investing Activities</i>				
Purchase of marketable securities	(3,316)	(4,284)	(6,266)	(5,149)
Sale of marketable securities	4,025	3,025	6,097	4,466
Sales of Assets	-	1,713	-	-
Change in margin account	(432)	-	-	-
Acquisition of Ilya's Farms, Inc., net of assets acquired	-	-	(512)	-
	-	-	-	(7)
Purchase of property, plant and equipment	<u>(259)</u>	<u>(415)</u>	<u>(330)</u>	<u>(4,772)</u>
Net cash used in Investing	<u>17</u>	<u>39</u>	<u>(1,011)</u>	<u>(5,462)</u>
<i>Cash Flows from Financing Activities</i>				
Repayment of notes payable	(675)	(31)	(28)	(18)
Proceeds from issuance of common stock	-	-	15	-
	-	-	-	3,000
Purchase of treasury stock	(393)	-	-	(402)
Net cash provided by Financing	<u>(1,068)</u>	<u>(31)</u>	<u>(13)</u>	<u>2,581</u>
Net change in Cash	1,795	1,867	1,175	(1,582)
Cash Beginning of Period	<u>936</u>	<u>2,732</u>	<u>4,598</u>	<u>5,773</u>
Cash End of Period	<u>\$ 2,732</u>	<u>\$ 4,598</u>	<u>\$ 5,773</u>	<u>\$ 4,192</u>