Taglich Brothers, Inc.
The Standard of Excellence in the Microcap Market

Member: NASD, SIPC

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
December 7, 2004

LWAY $9.10 - (NasdaqNM)

	FYE (12/01)	FYE (12/02)	FYE (12/03)	***FYE (12/04) E***	***FYE (12/05) E***
Revenue (in millions)	$10.7	$12.2	$14.9	***$16.28***	***$18.55***
Earnings per share (diluted)*	$0.14	$0.18	$0.26	***$0.25***	***$0.29***

52week range*	$28.24 – $6.375	Fiscal year ends:	December
Shares outstanding*	8.44 million	Revenue/shares (TTM)*	$1.90
Trading float	2.36 million	Price/Sales (TTM)*	4.79X
Insider and institutional ownership	72.0%	Price/Sales (2005)*	4.17X
Tangible Book value/shr* a/o 09-30-04	$2.05	Price/Earnings (TTM)*	50.6X
Price/Book*	4.44X	Price/Earnings (2005)*	31.4X

* 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 Neutral rating on shares of Lifeway Foods. It is our view that based on our EBITDA and earnings per share estimates, LWAY's shares are fairly valued.

Lifeway Foods reported third quarter revenue of $4.139 million, which was an increase of 7.87% versus $3.837 million in the third quarter of 2003. Net income was $0.515 million or $0.06 per diluted share versus $0.709 million or $0.08 per diluted share in the third quarter of 2003.

The Company and Danone did not renew an existing Support Agreement that expired on December 31, 2003. It is anticipated that this and other agreements would be discussed and possibly renegotiated pending the expiration of an existing Stockholders' Agreement that was extended until December 31, 2004.

Based on results for the first nine months of the year, we are lowering our revenue estimate for 2004 to $16.3 million from our prior estimate of $16.7 million. We are also adjusting our 2005 revenue estimate to $18.6 million from our prior estimate of $19.0 million.

Given our revenue estimates and statements made by Management in the Company's third quarter 10Q filing, we are forecasting net income for 2004 of $2.122 million or $0.25 per diluted share. Our prior estimate called for net income of $2.412 million or $0.29 per diluted share. Our net income forecast for 2005 is $2.445 million or $0.29 per diluted share versus our prior estimate of $2.770 million or $0.33 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. Distribution of its twelve Kefir based products in Illinois are 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 ten 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.

Danone Foods, Inc., the U.S. subsidiary of Groupe Danone of Paris, France, has a 20% ownership interest in the Company. According to the Company's 8-K filing, on October 29, 2004, Lifeway and Danone Foods, Inc., entered into a second extension of an existing Stockholders' Agreement. The extension expires on December 31, 2004.

Early in 2004, the Company formed Lifeway Foods Canada, as a unit of its subsidiary, LFI Enterprises, Inc., for the purpose of investigating commercial opportunities in Quebec. As of September 30, 2004, the Company has not announced any developments relative to Lifeway Foods Canada.

During the third quarter of 2004, the Company announced the acquisition of Ilya's Farms, Inc., a privately-held Philadelphia based producer of fine gourmet cream cheeses, for $0.576 million in cash. According to Management, this acquisition provides Lifeway with an east coast presence and distribution center, as well as adding to existing product lines. According to the Company, Ilya's Farms generates approximately $0.6 million in annual sales.

On November 15, 2004, The Company's Board of Directors appointed Edward P. Smolyansky to serve as the Company's Treasurer and Chief Financial and Accounting Officer. Mr. Smolyansky has served as the Controller of the Company since June 2002 and also acted as an Executive Assistant since receiving his baccalaureate degree in finance from Loyola University of Chicago.

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, 2004, versus the same period last year:

- Revenue increased to $4.139 million versus $3.837 million;
- Operating expenses increased to $1.158 million versus $0.871 million;
- EBITDA decreased to $0.901 million versus $1.232 million; and
- Net income was $0.515 million or $0.06 per diluted share versus net income of $0.709 million or $0.08 per diluted share.

The year-over-year revenue increase of 7.9% was primarily attributable to continued growth in its products to existing customers. However, mitigating sales growth was that Sav-A-Lot, the 13th largest grocery chain in the U.S., ceased all product orders. At this time, it is unknown to Management whether Sav-A-Lot will make any future purchases of Lifeway Foods products.

Gross margins decreased to 45.89% versus 50.28% in the same period last year. The significant reduction in gross margins resulted from high milk prices versus the same period last year. Milk is the Company's largest component of cost of goods sold. Management anticipates the Company's gross margins should improve as the price of milk declines from record high levels during the first nine months of 2004.
Operating expenses, as a percentage of revenue, increased to 27.98% versus 22.70% in the third quarter of 2003. The increase in operating expenses, on a percentage basis, was primarily due to:

- $0.042 million recognized in connection with the vesting in the third quarter of 2004 of 2,000 shares (valued at $20.93 per share at the time of the grant) of a total of 5,100 shares of Company stock granted to Lifeway employees on February 12, 2004;
- Increase in utility expenses and rising insurance and professional fees associated with the Sarbanes-Oxley Act of 2002 and other regulatory compliance requirements; and
- Increased professional expenses in connection with the acquisition of Ilya's Farms, Inc. during the third quarter of 2004.

In comparison, Taglich Brothers' estimates called for revenue of $4.3 million and net income of $0.575 million or $0.07 per diluted share.

Balance Sheet as of September 30, 2004
The Company had cash and cash equivalents of $5.348 million and short-term marketable securities of $6.728 million. This compares to cash and cash equivalents of $4.598 million and short-term marketable securities of $6.303 million as of December 31, 2003. Working capital was $14.283 million versus $13.005 million in 2003. The Company's long-term liabilities stood at $0.469 million.

The Company's portfolio mix of marketable securities (at fair value as of September 30, 2004) consisted of:

- 44.96% fixed income securities; and
- 55.04% in equities and mutual funds.

In 2003 and so far 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. Nutritionbusiness.com projects the U.S. Functional Food Market reaching $23.4 billion in 2004. 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

We believe that annual revenue growth should exceed 10.0%; therefore, revenue should reach $16.3 million in 2004, which is a decrease from our prior forecast of $16.7 million. Our revenue estimate for 2005 is $18.6 million, which is approximately a 14% increase from our 2004 estimate. Our prior estimate called for revenue of $19.0 million. Our revenue forecasts are based on:

- Increased acceptance of the Company's products by consumers;
- 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), in national magazines (i.e., Self, Shape, and Men’s Fitness) and through local radio stations;
    - Product demonstrations in stores throughout the U.S.; and
    - Sponsoring and participating in various local sporting events around the country and exhibiting at trade shows.
- The Company building on its current distribution channel, which includes regional supermarket chains and/or regional super-center type stores;
- Expansion of its La Fruta Product line in the Hispanic community. The U.S. Census Bureau, in a March 18, 2004 report, projected the nation’s Hispanic population will grow from 35.6 million to 102.6 million over the next half century; and
- Contribution from the recently acquired Ilya’s Farms, Inc., for the remainder of 2004 and all of 2005.

Based on results for the first nine months of 2004, we are reducing our 2004 net income forecast to $2.122 million or $0.25 per diluted share from our prior forecast of $2.412 million or $0.29 per diluted share. Our forecast incorporates the following:

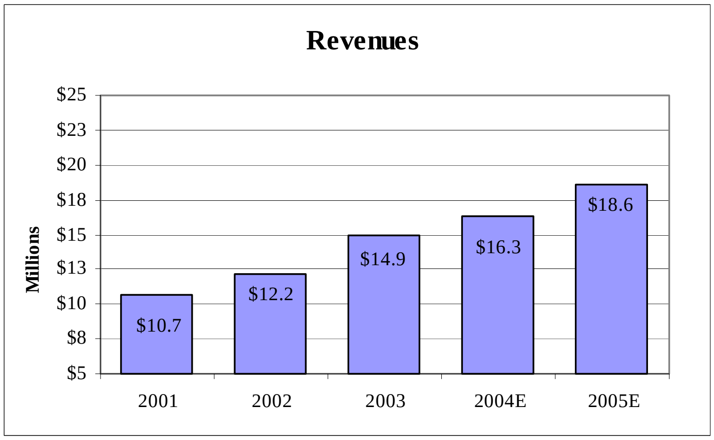
- The average price of milk likely to remain relatively high during the final quarter of 2004 as compared to the same period in 2003. During the first nine months of the year milk prices increased by approximately 70%. The Company raised prices by approximately 20% to help offset the increase in milk prices (this was the Company’s first major increase in nearly three years);
- Expenses associated with the vesting of shares awarded under the Company’s Employee and Consulting Services and Compensation Plan. Expenses will be recognized as the awards vest; and
- Increase costs of being a public company (i.e., insurance, legal, and regulatory compliance).

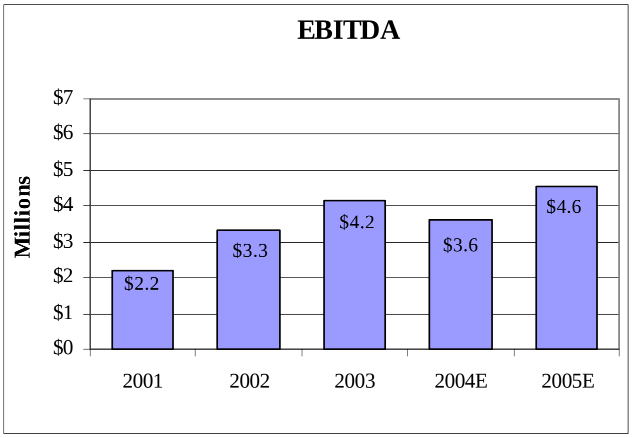
We have adjusted the following from our prior forecast:

- Gross margins to 44.68% from 45.98%; and
- SG&A expenses, as a percentage of revenues, to 26.35% from 24.91%.

For 2005, our net income forecast is $2.445 million or $0.29 per diluted share, based on gross margins of 45.90% and SG&A expenses, as a percentage of revenue, of 24.93%. Our prior forecast called for net income of $2.770 million or $0.33 per diluted share, based on gross margins of 47.25% and SG&A expenses, as a percentage of revenue, of 24.31%.

The following chart 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 in price, 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.

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.

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

We estimate that the LWAY will continue growing revenues in excess of 10% 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.

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

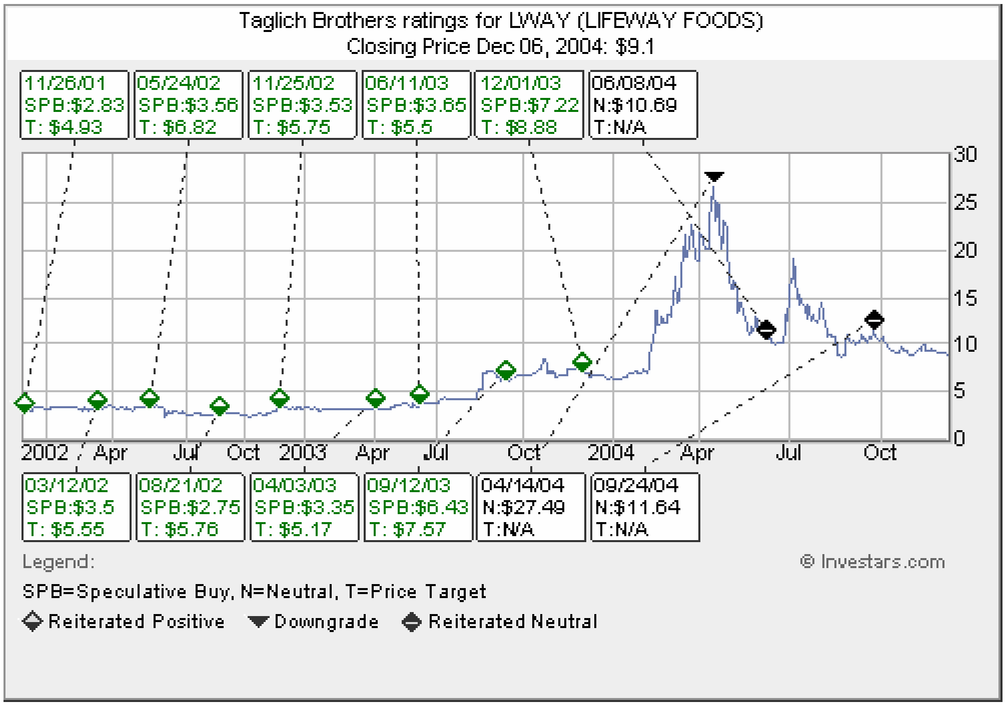
Liquidity has the potential to be a concern. Based on our calculations average daily-volume during 2003 increased to 4,451 shares from 1,943 shares in 2002. During the first ten months of 2004, average volume increased significantly to 175,835 shares traded a day. Even though volume has increased, it is still relatively low; therefore, investors need to be aware that by nature a thinly traded equity can have significant price volatility.

Conclusion

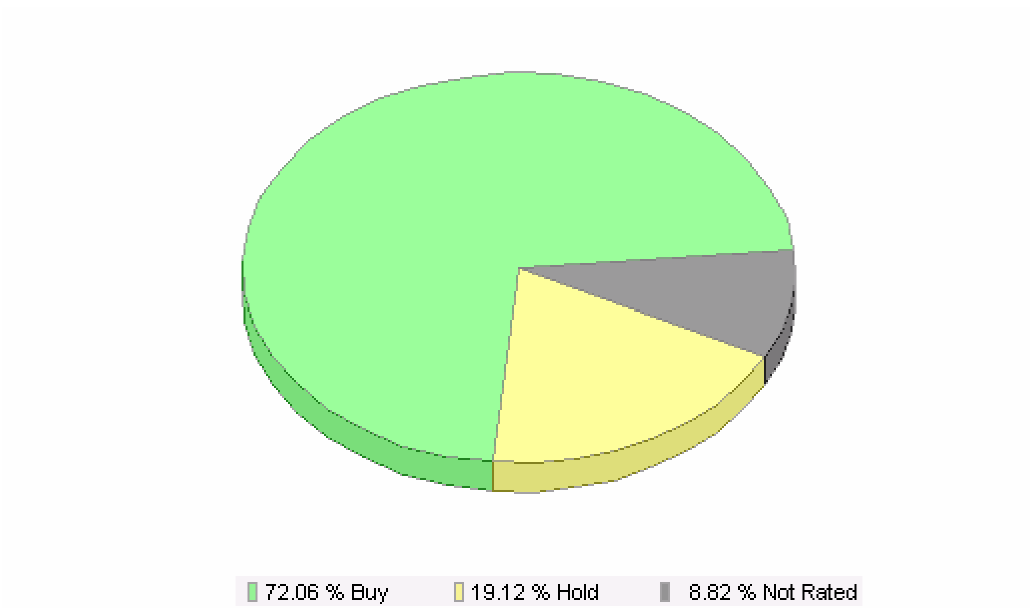
We are maintaining our Neutral rating, pending renewal of a Stockholders’ Agreement with Danone by December 31, 2004.

The Company and Danone did not renew the term of a Support Agreement, which expired on December 31, 2003. It is expected by the parties that this and other agreements would be discussed and possibly renegotiated pending the expiration of an existing Stockholders’ Agreement that was extended until December 31, 2004.

Additionally, we believe that based on our EBITDA and earnings per share estimates for 2004, LWAY’s shares are fairly valued, given its internal growth rates, contraction of industry multiples, and microcap risk. Between 2000 and 2005, the Company’s compounded annual growth rates is expected to be 21.4% and 20.8%, respectively, for net income and EBITDA.



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. 2001 Year End	Dec. 2002 Year End	Dec. 2003 Year End	Mar. 2004 1st Qtr End	Jun. 2004 2nd Qtr End	Sept. 2004 3rd Qtr End
ASSETS						
Current assets:						
Cash and cash equivalents	$ 937	$ 2,732	$ 4,598	$ 4,633	$ 5,242	$ 5,348
Marketable securities	5,755	4,172	6,303	6,616	6,549	6,728
Accounts receivable, net	1,317	1,435	1,800	2,007	1,922	1,943
Other receivables	53	60	166	161	64	81
Inventories	801	721	812	795	991	916
Prepaid income taxes	-	-	306	343	377	68
Prepaid expenses and other assets	34	1	1	5	17	8
Deferred income taxes	561	692	27	27	58	91
Total current assets	**9,456**	**9,813**	**14,012**	**14,587**	**15,219**	**15,183**
Property, plant and equipment, net	5,021	4,472	3,733	3,617	3,532	3,483
Total assets	**$ 14,477**	**$ 14,285**	**$ 17,745**	**$ 18,205**	**$ 18,751**	**$ 19,177**
LIABILITIES AND STOCKHOLDERS' EQUITY						
Current liabilities:						
Current maturities of notes payable	90	31	28	24	38	12
Margin account	432	-	-	-	-	-
Accounts payable	543	639	795	739	802	701
Accrued expenses	164	184	184	101	152	187
Taxes payable	145	398	-	-	-	-
Total current liabilities	**1,374**	**1,252**	**1,007**	**864**	**992**	**899**
Long-term liabilities	1,116	500	473	469	447	466
Deferred income taxes	436	453	472	449	435	427
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	-	-	-	-	28	57
Stock subscription receivable	(15)	(15)	(15)	(15)	(5)	(5)
Retained earnings	6,072	7,600	9,822	10,588	11,020	11,535
Accumulated other comprehensive income, net of tax	(729)	(1,335)	156	21	(8)	(58)
Treasury stock, at cost	(287)	(680)	(680)	(680)	(666)	(653)
Total stockholders' equity	**11,550**	**12,080**	**15,793**	**16,423**	**16,878**	**17,385**
Total liabilities and stockholders' equity	**$ 14,477**	**$ 14,285**	**$ 17,745**	**$ 18,205**	**$ 18,751**	**$ 19,177**
SHARES OUT	8,538	8,437	8,437	8,442	8,439	8,441

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

	FY2001	FY2002	FY2003	**FY2004E**	**FY2005E**
Revenue	$ 10,684	$ 12,212	$ 14,878	**$ 16,276**	**$ 18,550**
Cost of goods sold	6,449	6,744	7,841	**9,005**	**10,035**
Gross Profit	4,235	5,468	7,037	**7,271**	**8,515**
Gross Margins	39.64%	44.78%	47.30%	**44.68%**	**45.90%**
Sales, general and administrative	2,785	2,891	3,558	**4,289**	**4,625**
EBITDA	2,216	3,385	4,167	**3,622**	**4,550**
Operating Income	1,450	2,578	3,479	**2,982**	**3,890**
Operating Margin	13.57%	21.11%	23.38%	**18.32%**	**20.97%**
Other Income (Expense)					
Interest income	235	187	97	**175**	**125**
Interest expense	(93)	(75)	(41)	**(33)**	**(35)**
Gain on sale of marketable securities	220	18	(1,294)	**322**	**-**
Other than temporary reduction of marketable securities	-	(236)	89	**(12)**	**-**
Gain on sale of assets	-	-	1,246	**-**	**-**
Total Other Income (Expense)	362	(105)	98	**451**	**90**
Pre-Tax Income	1,812	2,472	3,576	**3,433**	**3,980**
Pre-Tax Margins	16.96%	20.24%	24.04%	**21.09%**	**21.46%**
Income Tax Expense (Benefit)	591	943	1,355	**1,311**	**1,535**
Tax Rate	32.59%	38.16%	37.89%	**38.18%**	**38.56%**
Net Income	$ 1,221	$ 1,529	$ 2,221	**$ 2,122**	**$ 2,445**
EPS -- Fully Diluted	$ 0.28	$ 0.36	$ 0.26	**$ 0.25**	**$ 0.29**
Avg Shares Out-Fully Diluted *	8,636	8,531	8,437	**8,447**	**8,500**
Percent of Revenue					
Cost of Revenues	60.36%	55.22%	52.70%	55.32%	54.10%
Sales, General and Administrative expenses	26.07%	23.67%	23.92%	26.35%	24.93%
YEAR / YEAR GROWTH					
Total Revenues	16.42%	14.30%	21.83%	9.40%	13.98%
Operating Income	24.77%	79.34%	34.96%	1.07%	30.46%
Pre-Tax Income	24.67%	36.47%	44.67%	8.54%	15.93%
Net Income	31.75%	25.21%	45.31%	8.60%	15.21%

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

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

	Q1(03/03)	Q2 (06/03)	Q3 (09/03)	Q4 (12/03)	**FY2003**
Revenue	$ 3,309	$ 3,776	$ 3,837	$ 3,956	**$ 14,878**
Cost of goods sold	1,826	1,734	1,908	2,373	**7,841**
Gross Profit	1,483	2,042	1,929	1,583	**7,037**
Gross Margins	*44.81%*	*54.08%*	*50.28%*	*40.02%*	**47.30%**
Operating Expenses:					
Sales, general and administrative	845	938	871	904	**3,558**
Total Operating Expenses	845	938	871	904	**3,558**
EBITDA	803	1,279	1,232	853	**4,167**
Operating Income	638	1,104	1,058	679	**3,479**
Operating Margin	*19.28%*	*29.23%*	*27.58%*	*17.16%*	**23.38%**
Other Income (Expense)					
Interest income	33	37	25	2	**97**
Interest expense	(8)	(8)	(8)	(18)	**(41)**
Gain (loss) on sale of marketable securities	(347)	16	37	(1,000)	**(1,294)**
Other than temporary reduction of marketable securities	-	-	-	89	**89**
Gain (loss) on sale of assets	1,246	-	-	-	**1,246**
Total Other Income (Expense)	926	45	54	(927)	**98**
Pre-Tax Income	1,564	1,149	1,112	(248)	**3,576**
Pre-Tax Margins	*47.26%*	*30.42%*	*28.99%*	*-6.27%*	**24.04%**
Income Tax Expense (Benefit)	570	457	405	(78)	**1,355**
Tax Rate	*36.47%*	*39.83%*	*36.45%*	*31.46%*	**37.89%**
Net Income	$ 993	$ 691	$ 707	$ (170)	**$ 2,221**
EPS -- Fully Diluted	$ 0.12	$ 0.08	$ 0.08	$ (0.02)	**$ 0.26**
Avg Shares Out-Fully Diluted	8,437	8,437	8,437	8,436	**8,437**
Percent of Revenue					
Cost of Revenues	55.19%	45.92%	49.72%	59.98%	52.70%
Sales, General and Administrative expenses	25.53%	24.85%	22.70%	22.86%	23.92%
YEAR / YEAR GROWTH					
Total Revenues	14.57%	25.75%	24.78%	21.85%	21.83%
Operating Income	-10.90%	117.31%	43.28%	10.36%	34.96%
Pre-Tax Income	103.26%	110.61%	41.98%	-166.27%	44.67%
Net Income	121.93%	96.52%	33.03%	-185.77%	45.31%

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)E	**FY2004E**
Revenue	$ 3,935	$ 4,002	$ 4,139	$ 4,200	**$ 16,276**
Cost of goods sold	2,099	2,266	2,240	2,400	**9,005**
Gross Profit	1,836	1,736	1,899	1,800	**7,271**
Gross Margins	*46.65%*	*43.38%*	*45.89%*	*42.86%*	**44.68%**
Operating Expenses:					
Sales, general and administrative	882	1,049	1,158	1,200	**4,289**
Total Operating Expenses	882	1,049	1,158	1,200	**4,289**
EBITDA	1,110	846	901	765	**3,622**
Operating Income	954	687	741	600	**2,982**
Operating Margin	*24.24%*	*17.16%*	*17.91%*	*14.29%*	**18.32%**
Other Income (Expense)					
Interest income	41	34	50	50	**175**
Interest expense	(8)	(8)	(8)	(10)	**(33)**
Total Other Income (Expense)	302	39	70	40	**451**
Pre-Tax Income	1,256	726	811	640	**3,433**
Pre-Tax Margins	*31.91%*	*18.15%*	*19.60%*	*15.24%*	**21.09%**
Income Tax Expense (Benefit)	491	294	296	230	**1,311**
Tax Rate	*39.06%*	*40.50%*	*36.51%*	*35.94%*	**38.18%**
Net Income	$ 765	$ 432	$ 515	$ 410	**$ 2,122**
EPS -- Fully Diluted	$ 0.09	$ 0.05	$ 0.06	$ 0.05	**$ 0.25**
Avg Shares Out-Fully Diluted	8,437	8,438	8,440	8,475	**8,447**
Percent of Revenue					
Cost of Revenues	53.35%	56.62%	54.11%	57.14%	55.32%
Sales, General and Administrative expenses	22.41%	26.22%	27.98%	28.57%	26.35%
YEAR / YEAR GROWTH					
Total Revenues	18.94%	5.99%	7.86%	6.16%	9.40%
Operating Income	49.51%	-37.77%	-29.96%	-11.61%	-14.28%

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

	FY2001A	FY2002A	FY2003A	9 Mos. 2004A
Cash Flows from Operating Activities				
Net Income	$ 1,221	$ 1,529	$ 2,222	$ 1,712
Depreciation and amortization	777	808	688	475
Amortization of discounts on securities	-	-	-	-
Gain on sale of marketable securities	(250)	(18)	1,294	(322)
Loss on marketable securities classified as trading	-	-	-	12
Gain on sale of assets	-	-	(1,246)	-
Other than temporary reductions of marketable securities	-	236	-	-
Issuance of common stock in exchange for services rendered	-	-	-	-
Decrease in allowance for doubtful accounts	-	-	-	-
Provision for doubtful accounts	15	-	-	-
Deferred income taxes	48	(65)	9	46
	1,812	2,490	2,967	1,923
Changes In:				
Accounts receivable	(150)	(119)	(365)	(143)
Other receivables	(53)	(8)	(106)	85
Inventories	119	80	(91)	(104)
Prepaid income taxes	-	-	(306)	238
Prepaid expenses and other assets	(34)	32	0	(8)
Accounts payable	26	96	156	(94)
Accrued expenses	(4)	20	0	3
Taxes payable	80	253	(398)	-
Net Changes in Working Capital	(15)	355	(1,109)	(23)
Net cash Provided by Operations	1,797	2,845	1,857	1,901
Cash Flows from Investing Activities				
Purchase of marketable securities	(9,247)	(3,316)	(4,284)	(5,791)
Sale of marketable securities	7,687	4,025	3,025	5,306
Sales of Assets	-	-	1,713	-
Change in margin account	357	(432)	-	-
Acuisition of Ilya's Farms, Inc., net of assets acquired	-	-	-	(512)
Purchase of property, plant and equipment	(713)	(259)	(415)	(225)
Net cash used in Investing	(1,916)	17	39	(1,221)
Cash Flows from Financing Activities				
Repayment of notes payable	(94)	(675)	(31)	(23)
Proceeds from issuance of common stock	-	-	-	84
Purchase of treasury stock	(287)	(393)	-	-
Payment on stock subscription receivable	-	-	-	10
Stock issuance costs	-	-	-	-
Net cash provided by Financing	(381)	(1,068)	(31)	70
Net change in Cash	(500)	1,795	1,867	750
Cash Beginning of Period	1,437	936	2,732	4,598
Cash End of Period	$ 936	$ 2,732	$ 4,598	$ 5,348