TAGLICH BROTHERS
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 14, 2006

LWAY $9.88 – (NasdaqGM)

	FY (12/04)A	FY (12/05)A	*FY (12/06) E*	*FY (12/07) E*
Revenue (in millions)	$16.32	$20.13	***$27.80***	***$35.00***
Earnings per share (diluted)*	$0.12	$0.15	***$0.18***	***$0.24***

52-Week range*	$10.85 – $5.06	Fiscal year ends:	December
Shares outstanding a/o 09/30/06*	16.86 million	Revenue/shares (TTM) *	$1.49
Approximate float*	4.37 million	Price/Sales (TTM) *	6.58X
Market Capitalization	$167 million	Price/Sales (2007)E*	4.80X
Tangible Book value/shr	$1.37	Price/Earnings (TTM) *	58.1X
Price/Book*	7.21X	Price/Earnings (2007)E*	41.2X

* 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 maintaining our Neutral rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY). During the third quarter, the Company acquired Helios Nutrition Ltd. We believe it is prudent to step back and see how Management is able to integrate and leverage the assets of Helios during the final quarter of 2006.

In early August 2006, Lifeway acquired Helios Nutrition Ltd for $8.0 million ($2.526 million in cash, a $4.200 million note to be paid off in sixteen equal installments, and $1.300 million of LWAY's treasury shares). Helios generated revenues of $4.505 million in 2005 and for the first nine months of 2006 generated revenues of $3.499 million.

Lifeway Foods reported third quarter 2006 revenue of $7.457 million, which was an increase of 25.5% versus $5.195 million in the same period last year. Top line results included two months of sales from Helio that amounted to $0.898 million. Net income was $0.740 million or $0.04 per share versus $0.559 million or $0.03 per share in the third quarter of 2005.

Based on results for the first nine months of 2006 and two month impact from Helios, we are increasing our 2006 revenue estimate for 2006 to $27.802 million from our prior estimate of $27.570 million. Given our revenue estimate and cost structure assumptions, we are tweaking our 2006 forecast for net income to $3.115 million or $0.18 per share from $3.109 million or $0.18 per share.

Based on trend analysis of LWAY's base business and the historic number of Helios (8-K/A filing on October 19, 2006), we are lowering our 2007 revenue forecast to $35.000 million (prior forecast was $37.845 million). Our revised net income forecast is $4.150 million or $0.24 per share versus our prior net income of $4.645 million or $0.27 per share.

**** Please view our disclaimer located on page 12.***

405 Lexington Avenue, 51st Floor, New York, N.Y. 10174
(800) 383-8464 • Fax (631) 757-1333
www.taglichbrothers.com

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.

In early August 2006, Lifeway Foods acquired Helios Nutrition Limited (including Pride Main Street Dairy, LLC), its top competitor in the Kefir market. According to SEC filings, 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 third 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, LLC., pursuant to which LWAY purchased all of the issued and outstanding stock of Helios from the stockholders for a combination of an aggregate amount of $1.300 million in LWAY's common stock (approximately 202,650 shares), $2.526 million in cash, and a $4.200 million promissory note (to be paid in sixteen equal installments over the next sixteen quarters) 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 October 19, 2006, 8-K/A filing, Helios generated revenues of $4.505 million in 2005 and for the first six months of 2006 generated revenues of approximately $2.601 million. During the two months of operation under LWAY's management, Helios generated total revenue of $0.898 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.

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.

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 October 24, 2006, the Company announced that four flavors of Lowfat Kefir will be distributed to both Ralph's Grocery stores and ACME Grocery beginning during the last week of October 2006. Ralph's operates 280 stores in Southern California and is owned by Kroger (NYSE: KR). ACME Grocery operates approximately 130 stores in the Philadelphia and Tri-state area and is owned by Albertsons**.** LWAY expects both chains to stock its ProBugs™ children's line of organic Kefir in no-spill pouch.

On October 11, 2006, Lifeway Foods announced it was selected as Dairy Foods magazine's new products Company of the year. According to Donna Berry, Product Development Editor for Dairy Foods Magazine, Lifeway Foods is all about innovation. Dairy Foods magazine is the leading trade publication for the U.S. dairy industry. Winners are chosen by the magazine's prestigious board of industry representatives, with factors such as innovation in product, package and promotion considered in the selection process.

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

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

- Revenue increased to $7.457 million versus $5.195 million;
- Gross margin declined to 38.32% versus 40.84%;
- Operating expenses increased to $1.738 million versus $1.359 million;
- EBITDA increased to $1.285 million versus $0.930 million; and
- Net income was $0.740 million or $0.04 per share versus net income of $0.559 million or $0.03 per share.

The year-over-year revenue increase of 43.5% was attributable to higher sales for the existing Lifeway Foods line, which experienced growth of 26.3% and the two month contribution from Helios Nutrition. The organic growth was primarily attributable to increased awareness of the Company's existing drinkable dairy products (i.e., its flagship Kefir product, Organic Kefir, La Fruta, as well as its new Probugs™ Kefir drink designed specifically for kids). The two month of sales from Helios Nutrition and its subsidiary, Pride of Main Street Dairy was $0.898 million, consisting of $0.764 million from the Helios brand and $0.134 million from its subsidiary Pride of Main Street. No public information for Helios was available for the same period last year.

Gross margin declined by 252 basis points versus the same period last year. The decrease in gross margin was primarily related to the increase in the cost of freight (the Company's second largest cost of goods sold component), which was 85% higher in the current period compared to the same period last year. Management expects to see the cost of freight decrease during the upcoming fourth quarter of 2006.

Operating expenses in the quarter increased by $0.379 million, primarily due to legal and regulatory expenses related to the stock split and Helios acquisition. As a percentage of revenue, operating expenses decreased to 23.31% versus 26.16% in the third quarter of 2005. The decrease was due to higher overall revenues in concert with efforts to improve production automation.

In comparison, Taglich Brothers' estimates called for revenue of $7.200 million and net income of $0.665 million or $0.04 per share.

Balance Sheet as of September 30, 2006

The Company had cash and cash equivalents of $1.242 million and short-term marketable securities of $8.042 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 $13.534 million versus $14.474 million in 2005. The Company's long-term liabilities stood at $6.192 million, which was an increase from $2.903 million at the end of 2005. The changes in cash, working capital, and long-term liabilities resulted from the August 2006 acquisition of Helios Nutrition.

The Company's portfolio mix of marketable securities (at fair value as of September 30, 2006) consisted of:

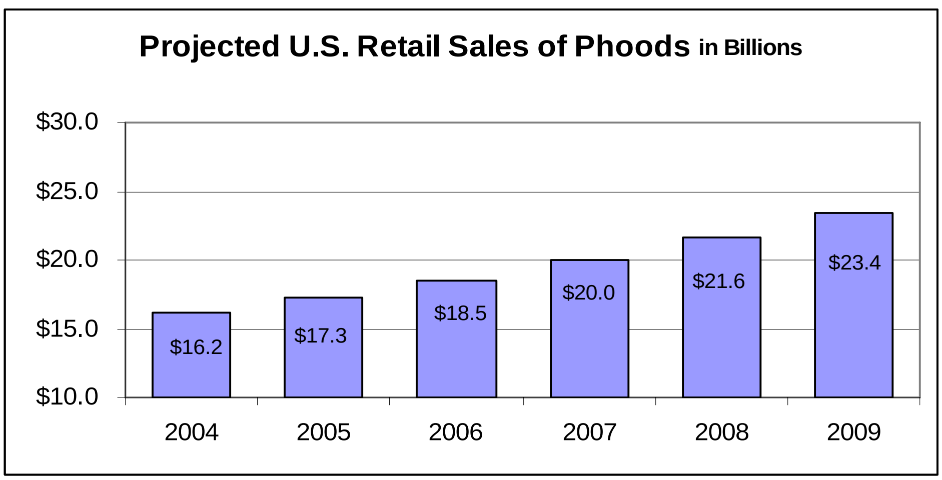
– 32.6% fixed income securities; and

– 67.4% 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 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, The Nutrition Business Journal (NBJ is a research, publishing and consulting company serving the nutrition, natural products and alternative health care industries) estimates that the Functional Food Market was worth $72 billion in 2005. NBJ estimates the global Functional Food Market could reach $500 billion by 2010. However, other leading market research firms (Deloitte and AC Nielsen) estimate that the global market might only reach $167 billion by 2010.

Also, in a July 2006 article, according to Just-Food's (a global business information provider), the U.S. market for functional foods could grow to over $66.0 billion by 2010, based on average annual growth rates estimated in the Allianz Global Risks report 2002, keeping the 2006 market size estimates by the Institute of Food Technologists (an international not-for-profit scientific society for food science and food technology professionals), as the base year (see chart on top of the next page):

Key Functional Food Markets and their size, 2004

Region	Market size in 2004 (US$bn)	Projected market size in 2010 (US$bn)[1]	Estimated average annual growth rate (%)[2]
US	35.8[4]	66	13
Europe	24.6[3]	40	7
Asia	19.3[3]	30	7

Notes:
1. The projected market size details for Asia, Europe and the US have been calculated by using the average annual growth rate estimates as in Allianz's *Global Risks* report (2002)
2. Allianz *Global Risks* report (2002)
3. 2004 figures estimated by *Nutrition Business Journal*
4. 2006 figures estimated by Institute of Food Technologists, Chicago, US

Source: Allianz *Global Risks* report, *Nutrition Business Journal*, Institute of Food Technologists

Source: Just-Food, July 2006 – An overview of the world's largest functional foods companies: Management briefing: Introduction

According to BCC Research (a technical market research firm), the fastest growing segments within the market are soy foods and functional snacks, which are estimated to grow to approximately $7.3 billion and $11.5 billion, respectively, by 2007. Also, by 2007, functional beverages and teas are estimated to grow at an average annual rate of 5.7%.

The two primary drivers for the growth in the Functional Foods Market are: 1) changing trends in consumer diets towards healthier foods; and 2) growing proportion of aging populations.

Outlook/Projections

Management stated in the Company's November 14, 2006 press release, 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. The Company's CEO reiterated that during the third quarter a lot was accomplished including the acquisition of Helios Nutrition and its Probugs™ product being featured on NBC's The Today Show and Fox and Friends during the summer of 2006.

The Company's CFO commented that even though the Company experienced higher costs, given growth in the top line and increased productivity measures, overall operating expenses as a percentage of revenues decreased in the current period compared to the same period last year.

We anticipate that the Company is likely to experience a weekly sales run rate on its core business (excluding the acquisition of Helios) of approximately $0.519 million for the fourth quarter of 2006, which is a sequential increase from a weekly run rate in the first, second, and third quarters of 2006, of $0.462 million, $0.490 million, and $0.501 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. 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.

Additionally, fourth quarter top line results will reflect the acquisition of Helios, which will positively impact the top line during the final three months of 2006. Given publicly available financial information regarding the operations of Helios, we are making the assumption that sequential growth will occur from the $0.898 million for the two month period (August and September 2006). Our forecast includes fourth quarter 2006 (October, November, and December) top line results from Helios in the amount of $1.230 million. The 4.5 month contribution to top line results from Helios in 2006 should total approximately $2.128 million.

Based on results for the first nine months of 2006, comments made in the Company's third quarter 10-Q filing, and the information related to the Helios acquisition, we are tweaking our 2006 revenue estimate to $27.802 million from our prior revenue estimate of $27.570 million. Given our revenue estimate and cost structure assumptions, we are adjusting our 2006 forecast for net income to $3.155 million or $0.18 per share from $3.109 million or $0.18 per diluted share. Our forecast incorporates the following:

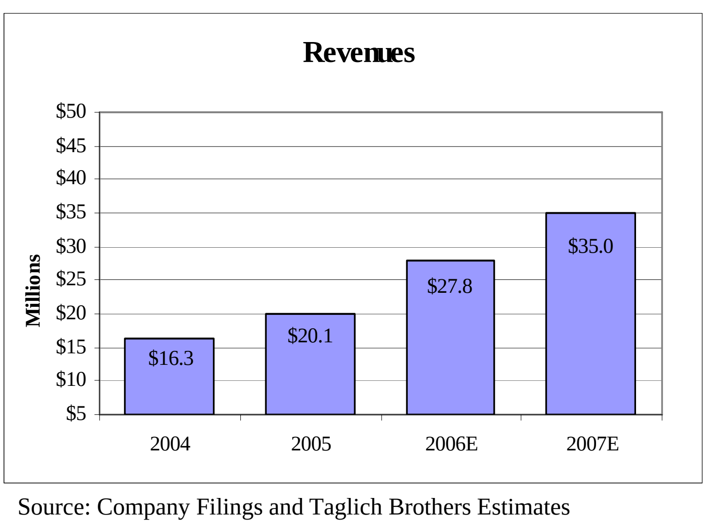
– New distribution agreements with Ralph's Grocery stores in Southern California and ACME Grocery in the Philadelphia and Tri-state area. Shipments of four flavors of Lowfat Kefir and ProBugs™ were scheduled to begin during the last week of October 2006;
– The continued rollout of it ProBugs™ offering;
– Integration of the Helios acquisition;
– Increased interest expense. We anticipate interest expense for 2006 of $0.340 million versus $0.101 million in 2005.
– 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).

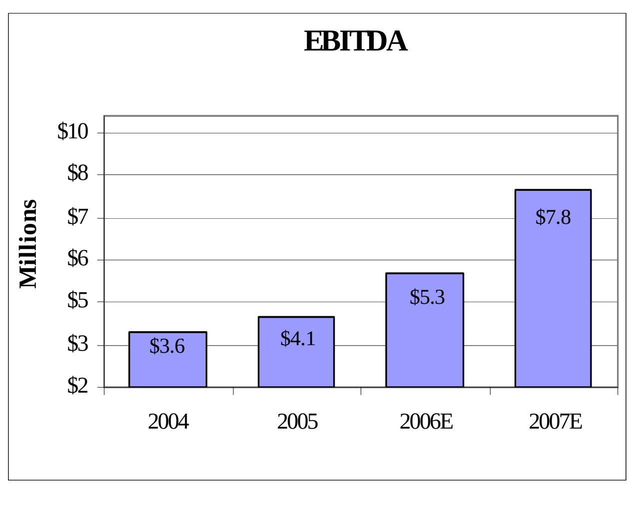
We have adjusted the following from our prior forecast, based on the previously discussed operating trends:

– Gross margins to 41.32% from 42.69%; and
– SG&A expenses, as a percentage of revenues, to 24.41% from 25.78%.

Based on Lifeway's core operations and analysis of the historic financial information of Helios (8-K/A filing on October 19, 2006) we believe year-over-year revenue growth (combined operations in 2007 versus 4.5 months of the combined operations) should reach 25.89%. Therefore, our revised forecast for 2007 calls for revenue of $35.000 million and net income of $4.150 million or $0.24 per share versus our prior revenue forecast of $37.845 million and net income of $4.645 million or $0.27 per share. We anticipate gross margin of 43.21% and SG&A expenses, as a percentage of revenue of 22.87%. Our prior forecast assumed gross margin of 43.59% and SG&A expenses, as a percentage of revenues of 23.91%. In addition, interest expense should approximate $0.550 million versus our prior estimate of $0.300 million

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 July 24, 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 September 30, 2006, the fair value of the Company's marketable securities available for sale was $8.042 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, September, October, and December 2006 meetings 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 eleven months of 2006, average daily volume has declined to 27,141 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.

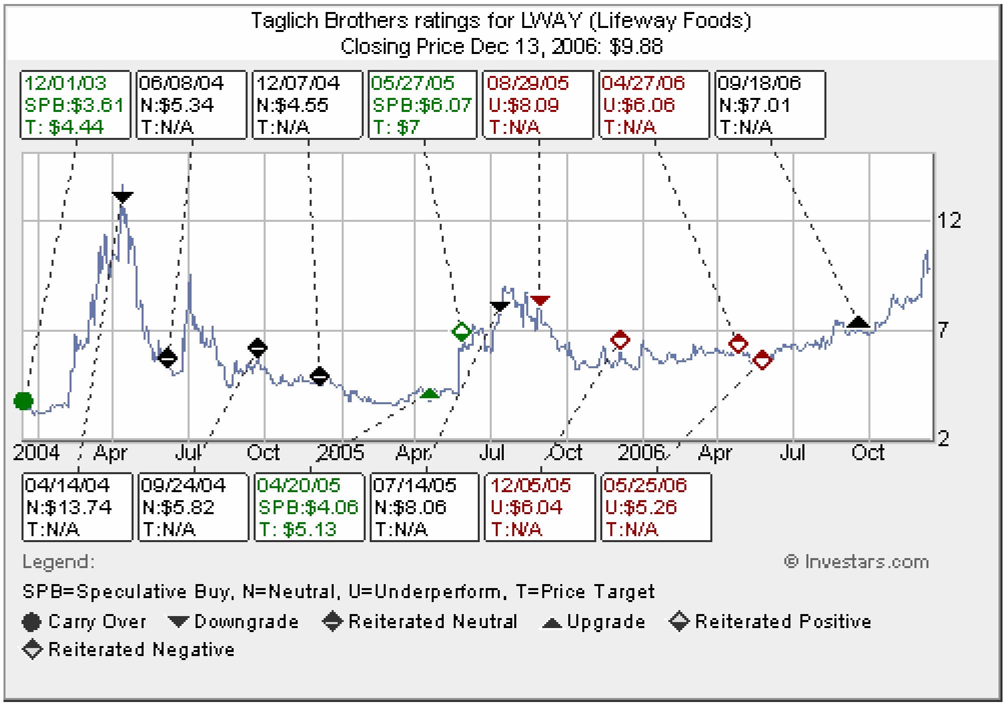
Conclusion

We are maintaining our Neutral rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY). During the third quarter, the Company acquired Helios Nutrition Ltd., the second largest producer of Kefir behind LWAY.

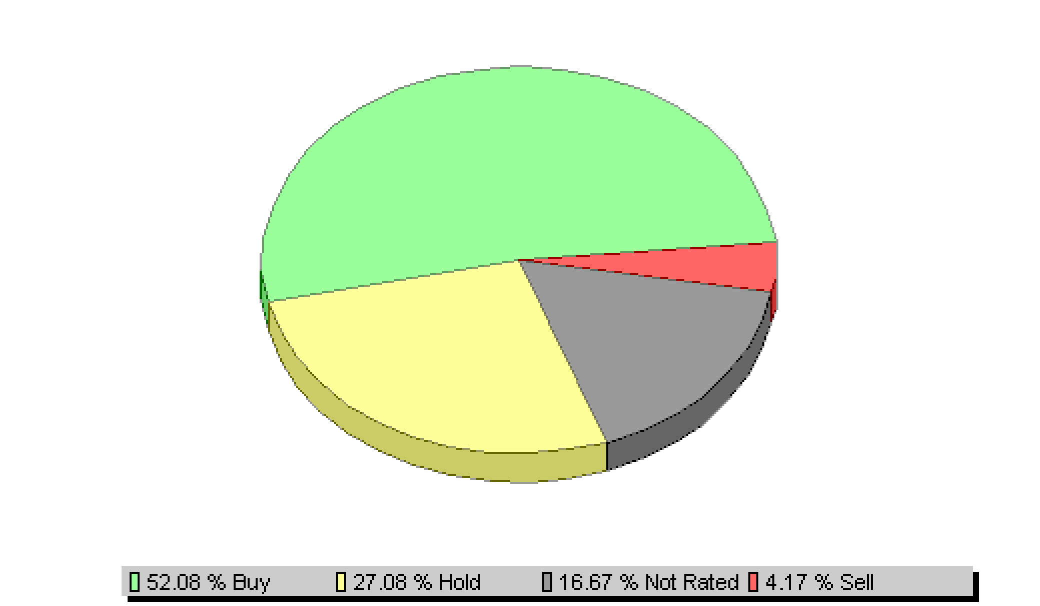
We believe it is prudent to step back and see how Management is able to integrate and leverage the assets of Helios over the final quarter of 2006. In early August 2006, Lifeway acquired Helios Nutrition Ltd for

$8.0 million ($2.526 million in cash, a $4.200 million note to be paid off in sixteen equal installments, and $1.300 million of LWAY's treasury shares. Helios generated revenues of $4.505 million in 2005 and for the first nine months of 2006 generated revenues of $3.499 million.

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	3.33%
Hold	0	0
Sell	0	0
Not Rated	1	7.69%

Meaning of Ratings

Buy

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

Speculative Buy

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

Neutral

We will remain neutral pending certain developments.

Underperform

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

Sell

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

Some notable Risks within the Microcap Market

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

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

Public Companies mentioned in this report:

Kroger	(NYSE: KR)
Groupe Danone	(NYSE: DA)

* The information and statistical data contained herein have been obtained from sources, which we believe to be reliable but in no way are warranted by us as to accuracy or completeness. We do not undertake to advise you as to changes in figures or our views. This is not a solicitation of any order to buy or sell. Taglich Brothers, Inc. is fully disclosed with its clearing firm, Pershing, LLC, is not a market maker and does not sell to or buy from customers on a principal basis. The above statement is the opinion of Taglich Brothers, Inc. and is not a guarantee that the target price for the stock will be met or that predicted business results for the company will occur. There may be instances when fundamental, technical and quantitative opinions contained in this report are not in concert. We, our affiliates, any officer, director or stockholder or any member of their families may from time to time purchase or sell any of the above-mentioned or related securities. Analysts and members of the Research Department are prohibited from buying or selling securities issued by the companies that Taglich Brothers, Inc. has a research relationship with, except if ownership of such securities was prior to the start of such relationship, then an Analyst or member of the Research Department may sell such securities after obtaining expressed written permission from the Director of Research. As of the date of this report, we, our affiliates, any officer, director or stockholder, or any member of their families do not have a position in the stock of the company mentioned in this report. All research issued by Taglich Brothers, Inc. is based on public information. Taglich Brothers, Inc. does not currently have an Investment Banking relationship with the company mentioned in this report and was not a manager or co-manager of any offering for the company with in the last three years. Since December 2000, the company pays a monthly monetary fee of $1,500 (USD) to Taglich Brothers, Inc. for the creation and dissemination of research reports.

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. 2004 Year End	Dec. 2005 Year End	Mar. 2006 1st Qtr End	Jun. 2006 2nd Qtr End	Sept. 2006 3rd Qtr End
ASSETS					
Current assets:					
Cash and cash equivalents	$ 5,773	$ 4,354	$ 3,818	$ 3,622	$ 1,242
Marketable securities	6,742	7,479	8,338	8,582	8,042
Accounts receivable, net	2,024	2,518	3,054	3,561	3,985
Other receivables	72	56	55	67	60
Inventories	906	1,717	2,024	2,321	2,629
Prepaid income taxes	259	12	40	-	68
Prepaid expenses and other assets	7	9	15	52	47
Deferred income taxes	-	143	-	117	108
Total current assets	**15,783**	**16,287**	**17,345**	**18,321**	**16,181**
Property, plant and equipment, net	3,420	7,751	7,775	7,762	8,574
Total assets	**$ 19,688**	**$ 24,465**	**$ 25,529**	**$ 26,476**	**$ 32,377**
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Current maturities of notes payable	9	532	528	542	1,124
Accounts payable	642	426	453	704	1,252
Accrued expenses	196	355	245	383	271
Taxes payable	36	-	4	441	-
Total current liabilities	**882**	**1,314**	**1,231**	**2,070**	**2,647**
Long-term liabilities	464	2,903	2,888	2,850	6,192
Deferred income taxes	424	349	346	344	346
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	1,081
Stock subscription receivable	-	-	-	-	-
Retained earnings	11,874	14,423	15,318	16,068	16,808
Accumulated other comprehansive income, net of tax	119	(100)	154	1	30
Treasury stock, at cost	(649)	(1,025)	(1,015)	(1,468)	(1,236)
Total stockholders' equity	**17,918**	**19,899**	**21,065**	**21,213**	**23,192**
Total liabilities and stockholders' equity	**$ 19,688**	**$ 24,465**	**$ 25,529**	**$ 26,476**	**$ 32,377**
SHARES OUT	8,420	8,396	8,397	16,793	16,856

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

	FY2004A	FY2005A	**FY2006E**	**FY2007E**
Revenue	$ 16,319	$ 20,132	**$ 27,802**	**$ 35,000**
Cost of goods sold	9,035	11,664	**16,316**	**19,875**
Gross Profit	7,284	8,468	**11,487**	**15,125**
Gross Margins	44.64%	42.06%	**41.32%**	**43.21%**
Sales, general and administrative	4,334	5,066	**6,786**	**8,005**
EBITDA	3,620	4,052	**5,334**	**7,820**
Operating Income	2,950	3,401	**4,701**	**7,120**
Operating Margin	18.08%	16.90%	**16.91%**	**20.34%**
Other Income (Expense)				
Interest income	186	323	**385**	**340**
Interest expense	(31)	(101)	**(340)**	**(550)**
Gain on sale of marketable securities	354	445	**278**	**-**
Other than temporary reduction of marketable securities	(16)	14	**1**	**-**
Total Other Income (Expense)	492	682	**323**	**(210)**
Pre-Tax Income	3,442	4,083	**5,024**	**6,910**
Pre-Tax Margins	21.09%	20.28%	**18.07%**	**19.74%**
Income Tax Expense (Benefit)	1,390	1,535	**1,909**	**2,760**
Tax Rate	40.39%	37.58%	**38.00%**	**39.94%**
Net Income	$ 2,052	$ 2,548	**$ 3,115**	**$ 4,150**
EPS -- Fully Diluted	$ 0.12	$ 0.15	**$ 0.18**	**$ 0.24**
Avg Shares Out-Fully Diluted *	16,877	16,809	**16,844**	**16,954**
Percent of Revenue				
Cost of Revenues	55.36%	57.94%	58.68%	56.79%
Sales, General and Administrative expenses	26.56%	25.17%	24.41%	22.87%
YEAR / YEAR GROWTH				
Total Revenues	9.69%	23.36%	38.10%	25.89%
Operating Income	-15.18%	15.28%	38.22%	51.46%

*** 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)A	Q4 (12/06)E	**FY2006E**
Revenue	$ 6,003	$ 6,367	$ 7,457	$ 7,975	**$ 27,802**
Cost of goods sold	3,213	3,739	4,599	4,765	**16,316**
Gross Profit	2,790	2,629	2,857	3,210	**11,487**
Gross Margins	*46.48%*	*41.29%*	*38.32%*	*40.25%*	**41.32%**
Operating Expenses:					
Sales, general and administrative	1,384	1,699	1,738	1,965	**6,786**
Total Operating Expenses	1,384	1,699	1,738	1,965	**6,786**
EBITDA	1,550	1,078	1,285	1,420	**5,334**
Operating Income	1,406	930	1,119	1,245	**4,701**
Operating Margin	*23.43%*	*14.61%*	*15.01%*	*15.62%*	**16.91%**
Other Income (Expense)					
Interest income	86	122	86	90	**385**
Interest expense	(50)	(63)	(97)	(130)	**(340)**
Total Other Income (Expense)	(0)	287	77	(40)	**323**
Pre-Tax Income	1,406	1,217	1,196	1,205	**5,024**
Pre-Tax Margins	*23.42%*	*19.11%*	*16.04%*	*15.11%*	**18.07%**
Income Tax Expense (Benefit)	511	467	456	475	**1,909**
Tax Rate	*36.37%*	*38.36%*	*38.13%*	*39.41%*	**38.00%**
Net Income	$ 895	$ 750	$ 740	$ 730	**$ 3,115**
EPS -- Fully Diluted	$ 0.05	$ 0.04	$ 0.04	$ 0.04	**$ 0.18**
Avg Shares Out-Fully Diluted	16,792	16,800	16,860	16,925	**16,844**
Percent of Revenue					
Cost of Revenues	53.52%	58.71%	61.68%	59.75%	58.68%
Sales, General and Administrative expenses	23.06%	26.68%	23.31%	24.64%	24.41%
YEAR / YEAR GROWTH					
Total Revenues	28.91%	25.53%	43.54%	53.15%	38.10%

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

Lifeway Foods, Inc.
Quarterly Income Statement Model*
For the Years Ended December 31, 2007
(in thousands)

	Q1(03/07)E	Q2 (06/07)E	Q3 (09/07)E	Q4 (12/07)E	**FY2007E**
Revenue	$ 8,300	$ 8,570	$ 8,895	$ 9,235	**$ 35,000**
Cost of goods sold	4,775	4,825	5,025	5,250	**19,875**
Gross Profit	3,525	3,745	3,870	3,985	**15,125**
Gross Margins	*42.47%*	*43.70%*	*43.51%*	*43.15%*	**43.21%**
Operating Expenses:					
Sales, general and administrative	1,865	1,925	1,965	2,250	**8,005**
Total Operating Expenses	1,865	1,925	1,965	2,250	**8,005**
EBITDA	1,835	1,995	2,080	1,910	**7,820**
Operating Income	1,660	1,820	1,905	1,735	**7,120**
Operating Margin	*20.00%*	*21.23%*	*21.42%*	*18.79%*	**20.34%**
Other Income (Expense)					
Interest income	85	85	85	85	**340**
Interest expense	(135)	(135)	(140)	(140)	**(550)**
Total Other Income (Expense)	(50)	(50)	(55)	(55)	**(210)**
Pre-Tax Income	1,610	1,770	1,850	1,680	**6,910**
Pre-Tax Margins	*19.40%*	*20.65%*	*20.80%*	*18.19%*	**19.74%**
Income Tax Expense (Benefit)	615	685	725	735	**2,760**
Tax Rate	*38.19%*	*38.71%*	*39.18%*	*43.75%*	**39.94%**
Net Income	$ 995	$ 1,085	$ 1,125	$ 945	**$ 4,150**
EPS -- Fully Diluted	$ 0.06	$ 0.06	$ 0.07	$ 0.06	**$ 0.24**
Avg Shares Out-Fully Diluted	16,935	16,950	16,960	16,970	**16,954**
Percent of Revenue					
Cost of Revenues	57.53%	56.30%	56.49%	56.85%	56.79%
Sales, General and Administrative expenses	22.47%	22.46%	22.09%	24.36%	22.87%
YEAR / YEAR GROWTH					
Total Revenues	38.27%	34.59%	19.29%	15.79%	25.89%

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

	FY2004A	FY2005A	9 Mos.2006A
Cash Flows from Operating Activities			
Net Income	$ 2,052	$ 2,548	$ 2,385
Depreciation and amortization	670	651	458
Amortization of discounts on securities	-	-	-
Gain on sale of marketable securities	(354)	(445)	(278)
Loss on marketable securities classified as trading	16	(14)	(1)
Gain on sale of assets	-	-	-
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	46	(100)	(59)
	2,525	2,692	2,544
Changes In:			
Accounts receivable	(224)	(494)	(1,198)
Other receivables	94	16	(3)
Inventories	(94)	(811)	(692)
Prepaid income taxes	48	247	(57)
Prepaid expenses and other assets	(6)	(2)	0
Accounts payable	(154)	(215)	428
Accrued expenses	12	159	(84)
Taxes payable	-	-	-
Net Changes in Working Capital	(325)	(1,100)	(1,606)
Net cash Provided by Operations	2,200	1,592	939
Cash Flows from Investing Activities			
Purchase of marketable securities	(6,266)	(6,461)	(5,258)
Sale of marketable securities	6,097	5,810	5,193
Sales of Assets	-	-	-
Change in margin account	-	-	-
Acquisition of Ilya's Farms, Inc., net of assets acquired	(512)	-	-
Acquisition of Helios, net of cash acquired	-	-	(2,515)
Loan acquisition costs	-	-	-
Purchase of property, plant and equipment	(330)	(4,917)	(500)
Net cash used in Investing	(1,011)	(5,567)	(3,080)
Cash Flows from Financing Activities			
Repayment of notes payable	(28)	(37)	(421)
Proceeds from issuance of common stock	15	-	-
Proceeds from note payable	-	3,000	-
Purchase of treasury stock	-	(402)	(550)
Loan costs	-	(7)	-
Net cash provided by Financing	(13)	2,555	(971)
Net change in Cash	1,175	(1,419)	(3,112)
Cash Beginning of Period	4,598	5,773	4,354