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Research Report – Update

Investors should consider this report as only a single factor in making their investment decision.

Lifeway Foods, Inc.

Rating: Speculative Buy

Howard Halpern

December 15, 2009

LWAY $11.85 – (NasdaqGM)

	FY (12/07) A	FY (12/08) A	*FY (12/09) E*	*FY (12/10) E*
Sales (in millions)	$38.7	$44.5	***$58.9***	***$67.1***
Earnings per share (diluted)	$0.19	$0.11	***$0.39***	***$0.44***

52-Week range	$14.94 – $6.07	Fiscal year ends:	December
Shares outstanding a/o 09/30/09	16.8 million	Revenue/shares (TTM)	$3.23
Approximate float	4.9 million	Price/Sales (TTM)	3.7X
Market Capitalization	$199 million	Price/Sales (2010)E	3.0X
Tangible Book value/shr	$0.80	Price/Earnings (TTM)	42.3X
Price/Book	14.8X	Price/Earnings (2010)E	26.9X

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 or www.lifeway.net

Key investment considerations:

We are maintaining our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY), but reducing our 12-month price target to $15.30 per share from $16.15. Our price target is based on our sales per share estimate for 2010 and historic price-to-sales analysis.

On November 16, 2009, LWAY reported 3Q09 revenue of $15.4 million, up 37.3% from $11.2 million in the same period last year. Fresh Made (acquired February 2009) contributed $2.2 million to revenue. Net income was $1.4 million or $0.08 per diluted share versus net income of $0.9 million or $0.05 per diluted share.

We project 2009 sales of $58.9 million (prior was $58.5 million) and net income of $6.5 million or $0.39 per share (prior was $7.0 million or $0.41 per share). We revised our 2009 sales projection as 3Q09 results beat our forecast by $0.4 million. Approximately $8.3 million of sales from the acquisition of Fresh Made are included in full year results. Net income has also been revised lower as 3Q09 results were shy of our forecast by $0.01 per share and our projection of gross margin compression to 40.2% from our prior forecast of 40.7%. A sequential increase in milk prices is likely to compress gross margin.

For 2010, we project sales growth of 13.8% to $67.1 million (prior was $66.6 million) and net income to reach $7.5 million or $0.44 per diluted share (prior was $8.0 million or $0.48 per diluted share). Year-over-year growth should be supported sales of LWAY's flagship Kefir product and ProBugs™ Organic Kefir, for kids, and expansion into the Northeastern and Western parts of the US. We project gross margin compression to 38.6% vs. 40.2% forecast for 2009, as the future market forecasts a year-over-year rise in milk prices.

Subsequent to 3Q09, LWAY reported that it paid down an additional $1.5 million in debt used to finance the Fresh Made acquisition. As of November 16, 2009 acquisition debt repayment totaled over $4 million.

**** Please view our disclaimer located on page 13.***

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Recommendation

We are maintaining our Speculative Buy rating on shares of Lifeway Foods, Inc. (NasdaqGM: LWAY) and reducing our 12-month price target to $15.30 per share from $16.15. We believe that investors are likely to accord this stock a lower valuation as commodity prices (i.e., milk costs) increase during 2010. Accordingly, we have increased our discount factor to 20% from 15%.

We are valuing the company's shares using a historical approach the takes into consideration stock price fluctuations over the past five-years. Our valuation model (discounted by 20% to account for microcap risk and company specific risks) applies the 5 year average historic price-to-sales multiple for the company's stock to our sales per share estimate for 2010 of $3.98 per share. According to MSN Money, the five year average price-to-sales multiple for LWAY is 4.8X.

On January 15, 2009, Lifeway Foods again extended 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 seventh extension of the stockholders', standstill, and non-compete agreements, which will now expire on December 31, 2009. As of December 31, 2008, Danone owned approximately 20.7% of LWAY's common shares. If Danone sold its stake in Lifeway Foods, it would most likely have a negative effect of the company's stock price.

The Company

Lifeway Foods, Inc. (NasdaqGM: LWAY) manufactures a cultured dairy beverage called Kefir and also develops Kefir related products at its three-manufacturing/production facilities in Illinois (2) and Minnesota (1). Its Kefir-based product portfolio is distributed in Illinois 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 and Tri State Metropolitan area. Lifeway's products are also distributed to stores throughout the US.

In addition, the company distributes its products throughout the US and to some parts of Canada (Ontario and Quebec). Management believes that the use of verbal agreements arrangements provides the necessary latitude to expand into new markets and establish new relationships on an ongoing basis. The developments in the table are ones we consider building blocks that should support future growth.

2006	Acquired Helios Nutrition Limited (including Pride Main Street Dairy)
	Introduced ProBugs™ product line for kids. It is packaged in a patented no spill spout pouches designed as cartoon bug characters
	Develop La Fruta, a yogurt like drink formulated to accommodate the Hispanic market
2008	Launched Starfruit™ Kefir boutique in Chicago. Starfruit offers several flavors of frozen Kefir (over 20 toppings), customized Kefir parfaits, and smoothie-style Kefir drinks
2009	Acquired in February, Philadelphia based Fresh Made, Inc., which was the nations second largest Kefir manufacturer. Approximately $8.1 million was paid in cash at closing, a note for approximately $2.7 due February 2011 was issued, and 128,948 share of common stock was issued, as well as the purchase of 1.1355 acres of land for $2 million. In 2008, Fresh Made generated sales of approximatley $10 million

<u>*Kefir*</u>

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 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 due to the fermentation process which produces a less sour taste. Less sugar is required so it 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, 2009, versus the same period last year:

- Sales increased to $15.4 million versus $11.2 million. Our estimate was $15.0 million. The 37.5% sales increase was due to the Fresh Made acquisition (added $2.2 million) and organic growth of 17.8% or $2 million from increased brand awareness.
- Gross margin increased to 40.5% versus 31.5%. We estimated 40.6%. The expansion was due to year-over-year decreases in lower milk prices, transportation costs, and petroleum-based production supplies.
- Operating expenses increased to $3.0 million versus $2.1 million. The increase was due primarily to non-cash amortization costs related to the acquisition of Fresh Made.
- EBITDA improved to $3.7 million versus $1.7 million.
- Net income was $1.42 million or $0.08 per share versus net income of $0.9 million or $0.05 per share. Our estimate was $1.6 million or $0.09 per share. The company's provision for income taxes was $1.6 million, or a 54% tax rate compared with a provision for income taxes of $0.3 million or a 24% tax rate in 3Q08. The increase was due to an under estimate of income tax liability in 3Q08, which resulted in an increased adjustment to the provision for income taxes during 3Q09.

Nine-month revenue increased by nearly 29% to $43.6 million (from $33.9 million) driven by the acquisition of Fresh Made (which contributed $5.7 million) and the increased acceptance of Lifeway's flagship product, Kefir and Probugs Organic Kefir for kids. Sales for its historic brands (excluding Fresh Made) grew by 9% on a year-over-year basis.

	9 Mos. 2008	9 Mos. 2009	% Δ
Sales	$ 33,886	$ 43,649	28.8%
Cost of goods sold	22,985	25,729	11.9%
Gross Profit	10,900	17,920	64.4%
Total Operating Expenses	6,520	8,983	37.8%
EBITDA	5,202	10,418	100.3%
Operating Income	4,380	8,938	104.1%
Total Other Income (Expense)	(346)	(463)	
Pre-Tax Income	4,034	8,474	100.3%
Income Tax Expense (Benefit)	1,379	3,024	119.4%
Tax Rate	*34.18%*	*35.69%*	
Net Income	$ 2,655	$ 5,450	105.3%
EPS -- Fully Diluted	$ 0.16	$ 0.32	104.8%
Avg Shares Out-Fully Diluted	16,770	16,812	
Margins			
Gross Margins	32.2%	41.1%	
Operating Margin	12.9%	20.5%	
Pre-Tax Margins	11.9%	19.4%	
Selling expense	9.4%	9.0%	
General and Administrative expense	9.9%	11.6%	

Gross margin for the nine-month period ending September 30, 2009, improved by approximately 900 basis points due to:

- Lower cost of conventional milk, the company's largest raw material;
- Reduced transportation costs; and
- Lower petroleum-based production supplies.

Operating expenses increased versus the first nine months of 2008 by approximately $2.5 million, due to legal and professional fees related to the February 2009 acquisition of Fresh Made, and an increase in amortization expense (a non-cash item) of approximately $0.3 million (or an 112% increase) related to the Fresh Made acquisition. Many of the acquisition-related professional fees are non-recurring expenses. For the first nine months of 2009, the operating expense margin increased to 20.5% versus 19.2%. The year-over-year percentage increase was primarily attributable to the non-recurring expenses related to the acquisition of Fresh Made.

Total other expense for the first nine months of 2009 was $463,000 compared to $346,000. The increase was attributable to higher interest expense related to the Fresh Made acquisition, lower interest income, and a larger loss on sale of marketable securities. Interest expense during the period was $364,000 versus $227,000, while interest income was $145,000 versus $261,000, and loss on sale of marketable securities was $274,000 versus $468,000.

Finances

At September 30, 2009, cash and marketable securities, long-term debt, and stockholders' equity stood at approximately $5.7 million, $7.4 million, and $32.0 million, respectively, compared to $5.5 million, $3.1 million, and $26.3 million, respectively at December 31, 2008. The company debt to equity ratio of 0.43% versus 2.23% for the industry means the LWAY is significantly less leveraged than other dairy product companies.

For the first nine months of 2009, LWAY's working capital needs increased by nearly $2.0 million (which was no change between 2Q09 and 3Q09), due to the Fresh Made acquisition, which resulted in the integration of customer accounts (causing changes in accounts receivables, inventories, and prepaid expenses).

Cash throw-off and cash from operations for the first nine months of 2009 totaled $7.4 million and $5.5 million, respectively, compared to $3.8 million and $3.6 million, respectively. The year-over-year changes allowed the company to increase cash by $0.5 million and pay down over $3.0 million of debt incurred from the Fresh Made acquisition. Subsequent to the end of the quarter the company announced it repaid an additional $1.5 million of debt related to Fresh Made.

Debt

Debt totals $13.6 million, of which $6.2 million is short-term. Total debt consisted of a note payable to Private Bank ($7.3 million, matures February 2014), a line of credit with Private Bank ($2.4 million, matures February 2010), a line of credit with Morgan Stanley ($1.9 million and does not have a maturity date), and subordinated notes payable to Ilya Mandel and Michael Edelson ($2.4 million, matures February 2011).

Marketable Securities

The company's portfolio of marketable securities (at fair value as of September 30, 2009) consisted of:

- 23.3% fixed income type securities (government agency obligations and bonds - corporate/municipal); and

- 76.7% in equities, mutual funds, preferred securities, and limited partnerships.

At September 30, 2009, the company had total unrealized losses of $1.5 million. Also, proceeds from the sale of marketable securities were approximately $5.3 million and $4.7 million, respectively, for the corresponding nine-month periods of 2009 and 2008, respectively.

Based on our estimates LWAY should be able to fund its sales growth from cash on hand and internally generated funds (see first nine month 2009 results and our projections section). Management is not aware of any circumstances or trends other than the February 6, 2009 acquisition of Fresh Made, Inc., which would negatively affect liquidity in 2009 or 2010. Management continues to explore additional acquisition opportunities in order to increase sales, leverage the company's distribution system, and expand its geographic reach across the US.

Recent Developments

On December 9, 2009, the company announced a new distribution channel with the 7-Eleven convenience store chain. Shipments of six flavors of Lifeway's 8oz Grab n' Go bottles, all three flavors of Probugs™, and three varieties of its Probiotic Kefir Wellness Bars began immediate shipment to approximately 275 stores.

On September 18, 2009, Lifeway announced expanded distribution of two of its Kefir products to all of the Albertsons grocery stores in California and select Albertsons grocery stores in Nevada. The shipments of Low Fat Strawberry and Low Fat Original Kefir in the 32 ounce bottle sizes will be to approximately 280 stores.

In November 2009, the company announced that starting in late December 2009 it will resume shipments to Costco stores in the Midwest.

Market Comment

Lifeway Foods' product portfolio includes cultured dairy products known as Kefir, which includes probiotic functional cultures. There are no publicly traded direct Kefir competitors. We believe Dannon's Activia yogurt is the closest competitive product, which generated sales growth of approximately 38% in 2008. As acceptance of Activia increases, it should assist LWAY's growth through the acceptance by consumers of probiotic dairy products.

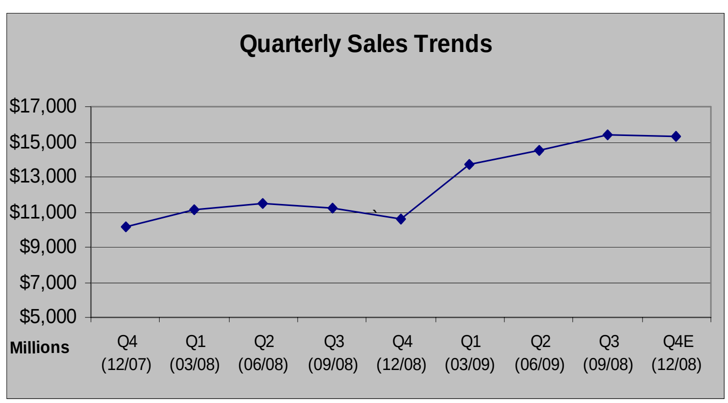
The company's target markets, health conscious consumers and the growing elderly US population, are the driving force behind the functional and probiotic foods segment of the food industry.

We believe that the following factors should benefit the company's product portfolio:

- Functional foods and beverages provide a potential health benefit consumers can see results from. LWAY's beverage offerings target digestive health, and a January 2009 article entitled How Functional Foods can Ride the Recession points out that the digestive health is a growing segment focus for health conscious consumers;
- In the June 2009 issue of Dairy Foods, an article by Susan Zaripheh and Gregory Miller, reported that dairy products may be an ideal vehicle for creating value-added products because it already contains a number of beneficial nutrients and is a good source of nine essential nutrients (calcium, Potassium, Vitamins A & B12, etc.). The article also provided information from The International Food Information Council Foundation survey of consumer attitudes (2008), which indicated that Americans most likely believed that foods and beverages could improve heart health, physical energy, stamina, and digestive health;
- According to Euromonitor International, dairy products are the market leader for probiotic infused value-added offerings, with $182 million in U.S. market sales of probiotic spoonable yogurt between 2001 and 2006. Euromonitor claims that the U.S. Canadian probiotic food market is worth $1.8 billion; and
- The report Dairy Wholesaling in the US, issued in September 2009 by IBIS, stated that domestic demand for dairy products will continue to depend on disposable income growth, population growth, and consumer preferences. The US population is forecast to grow at a marginal rate of 1.0% per annum over the five years to 2014, which will support some volume growth. Real disposable income is forecast to grow at relatively strong rate over the five years to 2014, which will aid purchases of more expensive dairy foods. Aiding Lifeway is the fact that consumers are expected to continue to be strongly concerned about health and nutritional claims and thus, demand functional dairy products such as those with probiotics, increased calcium, and organic varieties.

Outlook

The acquisition of Fresh Made and results for the last three quarters, suggest that the sequential quarterly sales declines of the second half of 2008 have reversed. The graph (to the right) illustrates the sequential decline and also shows the rebound in sales from the first quarter of 2009. However, we expect a seasonal decline in 4Q09 sales.



To provide some perspective on sales gains, LWAY was able to generate on average $1.2 million in revenue on a weekly basis for 3Q09 (including Fresh Made). Excluding Fresh Made, the weekly rate was $1,019,000. Our 3Q09 forecast was a weekly rate (excluding Fresh Made) of approximately $968,000. We project a weekly rate (excluding Fresh Made) of $975,000 for 4Q09.

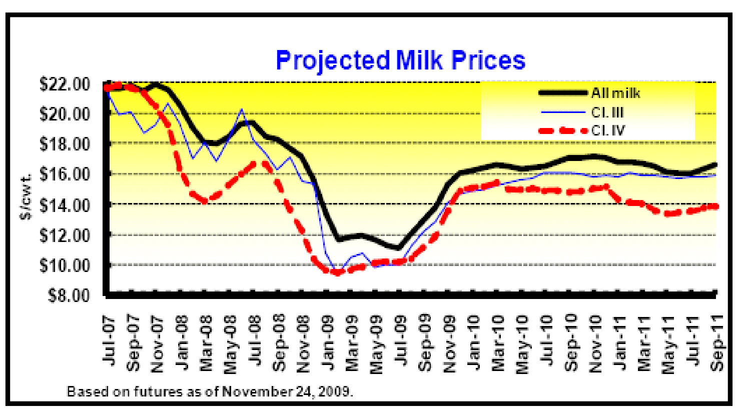
Expectations that weekly sales should grow (including and excluding Fresh Made) should be supported by:

- Increasing product sampling and demonstration activities, use of coupons, and other promotional initiatives that are expected to continue throughout 2009 and into 2010;
- Gaining new distribution outlets at Costco Wholesale, King Soopers, and Shop'n Save. However, Costco tends to rotate products to different divisions throughout the year. The company believes that it can distribute its products in at least two divisions of Costco at any particular time. During December 2009, the company will resume shipments to Costco in the Midwest. By December 11, 2009, its 8oz Grab n' Go bottles, Probugs™, and Wellness Bar products will be in 275 7-Eleven convenience stores in the Chicago area. If successful, the company is prepared to expand the distribution nationwide after 2Q10;
- In September 2009, Lifeway expanded distribution of its two most popular Kefir products to all of the Albertsons grocery stores in California and select Albertsons grocery stores in Nevada (i.e., approximately 280 stores);
- Developing consistent distribution outlets (supermarkets) in the northeast region of the US. In 2Q09, Lifeway commenced shipments of its products direct to ShopRite, a chain of about 200 stores primarily in the northeast. Based on personal observation, it appears that some of Lifeway's products are being sold at Stop & Shop and Wild By Nature locations on Long Island, NY;
- Continuing to expand distribution of it ProBugs offering. ProBugs expansion is occurring in Whole Foods, Jewl-Osco, Publix, and Unfi (an independent national distributor of natural, organic and specialty foods and related products); and
- Obtaining new distribution of its Probiotic Wellness Bars that was launched during 2008. The Wellness Bar has been approved for new distribution at Kroger (certain locations), Jewel-Osco, and Whole Foods. During October 2009, the company started a program to give away one free Kefir Probiotic Wellness Bar to each of the first 5,000 people who registered online at www.Kefir.com. This complimentary offer included free shipping to anywhere in the continental US;
- Expanding distribution of La Fruita. This occurred at the start of 2009 with the distribution to about 150 Supercenter stores in California (i.e., Super A). Additionally, the product was shipped to the 99 Cents Only chain, which operates about 100 stores in the California region.

The February 2009 acquisition of Fresh Made has enhanced 2009 results. This transaction has enhanced Lifeway's purchasing power, increase its ability to target the market category, alleviate some competitive pressures, and provide a platform for sales in the Northeastern US.

<u>Milk Price Perspective and Potential Impact(s)</u>

The November 2009 Dairy Market Report from the National Milk Producers Federation (an organization that provides a forum through which dairy farmers and their cooperatives formulate policy on national issues that affect milk production and marketing) offers the following comments:



Based on futures as of November 24, 2009.

- Dairy prices have been rising for several months, a consequence of the shrinking dairy herd in the US;
- US milk production was down 1.1% in October 2009 from the same period last year;
- By the end of 2009, the US milking herd is expected to be a quarter-million cows smaller than it was July 2008. This is a strong signal for higher dairy prices in early 2010 as evidenced in the chart to the right. If demand were to decrease the expected price rise could be mitigated during the middle of 2010; and

- The chart graphically illustrates projections of prices through September 2011 (Source: November 2009 Dairy Market Report page 4).

The November 2009 Dairy Market Report from the National Milk Producers Federation stated that October 2009 revised all-milk price (defined as the milk-to-feed price ratio) was $12.90, up substantially from July price of $11.30. Also, the futures markets are projecting the all-milk price to average $12.70 in 2009 (three-months ago, the projection was $12.60) and $16.65 in 2010.

Gross margin reported in Q109 and Q209 was approximately 40.2% and 42.5%, respectively. As milk prices rose according to the Dairy Market Report and confirmed by management, gross margin compressed in 3Q09 to 40.5%. Based on the milk price forecast detailed above, gross margin compression should continue into 2010. Overall, on a year-over-year basis (2009 vs. 2008), gross margin will see a substantial improvement since conventional milk prices, on average, were lower then the prices seen last year.

Projections

Operations
For 2009 we project sales of $58.9 million (prior was $58.5 million) and net income of $6.5 million or $0.39 per share (prior was $7.0 million or $0.41 per diluted share). Year-over-year sales growth should approximate 32.5%, which is slightly higher than our prior forecast of 31.5%. The increase in our sales forecast is due to the company exceeding our 3Q09 estimate by $444,000 (The US Bureau of Economic Analysis reported on November 24, 2009 that consumer spending rose 0.2% in October). Economists continue to believe that consumer spending is a key determinant of growth as the economy struggles to emerge from the longest recession since WWII. However, the decrease in our profit forecast is based more on trends that will likely cause 4Q09 gross margin compression (gross margin estimate is 40.2% versus our prior estimate of 40.7%).

For 2010, we project of $67.1 million (prior was $66.6 million), a year-over-year increase of 13.8%. We project net income for 2010 of $7.5 million or $0.44 per share (prior was $8.0 million or $0.48 per share). Our forecast is based on organic growth of the company's flagship Kefir product, its ProBugs™ Organic Kefir for kids, and expansion into the northeast region, the West Coast, and resumption of shipment to Costco in the Mid-west.

Our profit forecast, is based in part on gross margin contraction as milk prices are forecast to increase, especially early in 2010. We project gross margin of 38.6% versus our prior forecast of 40.2%.

Our 2009 and 2010 forecasts are also predicated on the company's:

- Maximizing distribution agreements (both existing and new);
- Expanding the distribution of its Kefir Wellness Snack Bar;
- Completing the consolidation of Fresh Made;
- Keeping interest expense in check. If the company maintains an accelerated debt repayment program (it has already paid down over $4 million during the first eleven months of 2009) we anticipate interest expense for 2009 and 2010 of $0.5 million and $0.5 million, respectively, versus $0.3 million in 2008;

Our forecasts do not include the franchising potential of its Starfruit Café concept, since no definite franchising plan has been announced as of this writing.

Finances
For 2009, we project cash throw-off of $8.9 million (versus $4.4 million in 2008) and cash from operations of $6.4 million (versus $4.7 million) which should allow the company to continue paying down the debt incurred to finance the Fresh Made acquisition. During the first eleven months of 2009, LWAY paid down in excess of $4.0 million of debt. We project an increase in 2009 working capital of $2.4 million due to the integration of Fresh

Made's receivables and needed inventory build to support increased sales volume. Cash at the end of 2009 should increase to nearly $352,000 from $277,248 at December 31, 2008.

For 2010, we project cash throw-off growing to $9.2 million and cash from operations of $9.0 million, applied to an increase of approximately $0.3 million in working capital and repayment of approximately $8.0 million of debt obligations. Our year-end cash forecast for 2010 is approximately $0.7 million, up approximately $300,000 from our 2009 forecast.

Risks

In our view, these are the principal risks underlying the stock:

Commodities
The company's products use conventional and organic raw materials, such as milk, sugar, and fruit from unaffiliated suppliers. Lifeway is not limited or contractually bound to any supplier. If the price of those commodity products were to unexpectedly rise and remain at high levels, it would negatively impact margins.

Regulation
Lifeway is subject to regulation by federal, state and local governmental authorities regarding the distribution and sale of food products. The company believes it is in compliance with all material government permits, licenses, qualifications, and approvals for its operations, as well as 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. .

Groupe Danone SA Relationship
According to the company's 2008 10-K filing, the company entered into a seventh extension of the stockholders' agreement with Danone Foods, Inc. on January 15, 2009 (the terms of the non-compete period and standstill period of the stockholders' agreement expire on December 31, 2009). As of December 31, 2008, Danone owned approximately 20.7% of LWAY's common shares. If Danone were to sell its stake in Lifeway Foods stock price could be adversely affected.

Competition
Lifeway faces a small amount of direct competition in the United States and Canadian markets for its Kefir products; however, they do compete to some degree with other yogurt and dairy products.

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, entry into markets where the company has limited or no direct experience, and the potential loss of key employees of the acquired company.

Growth Management
Revenue growth slowed during 2008. As growth momentum is regained, management will need to meet the challenges associated with managing growth and controlling costs in order to grow EBITDA and bottom line results and pay down the debt incurred to acquire Fresh Made.

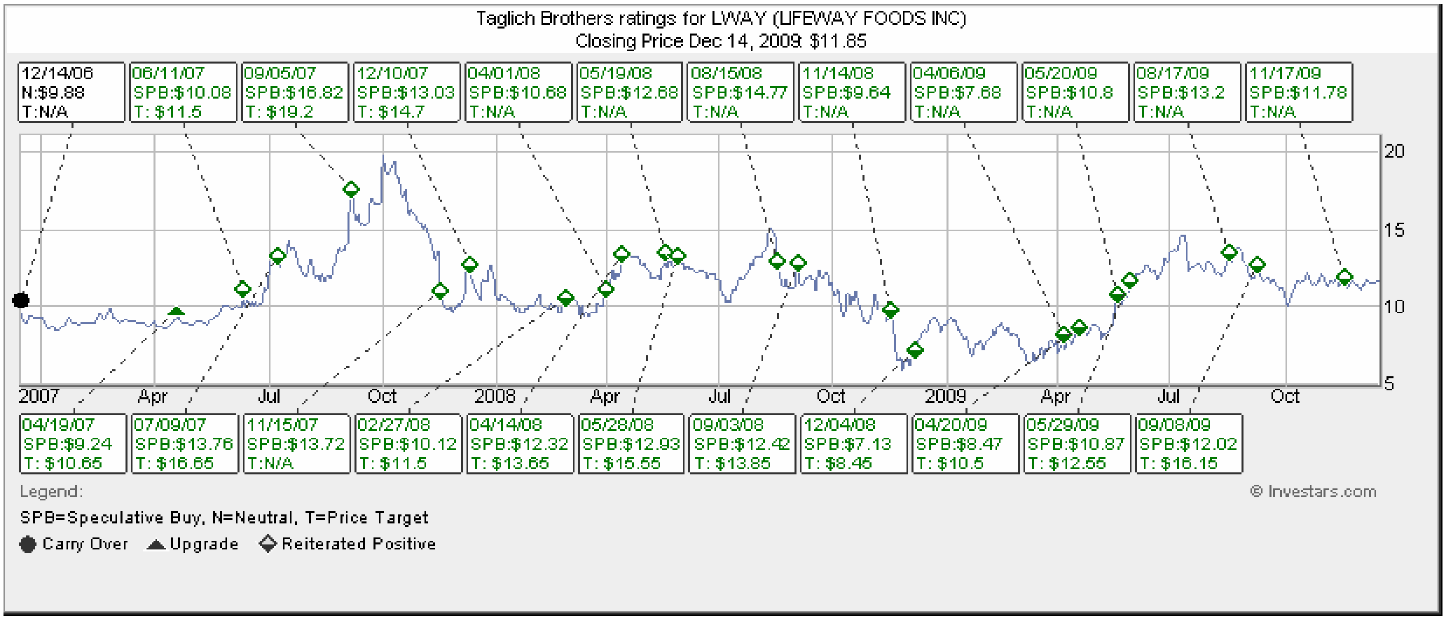
Internal Controls
The company had identified and disclosed a continued material weaknesses in internal control for financial reporting of incomplete and undocumented financial reporting processes, no documented accounting procedures manual available for employee use, and no documented accounting procedures in valuing of marketable securities temporary impairment. The company has implemented use of a software program called Microsoft Business Solutions-Navision as of June 1, 2009 to increase financial reporting capability, to implement additional controls and strengthen the existing controls over the financial reporting process, and to allow for additional documentation of the financial reporting process. The company engaged a firm to assist with development of an

accounting manual, which should be completed this year. The company has undertaken more frequent and vigorous discussions with its accountants and engaged a firm to assist with documenting such procedures.

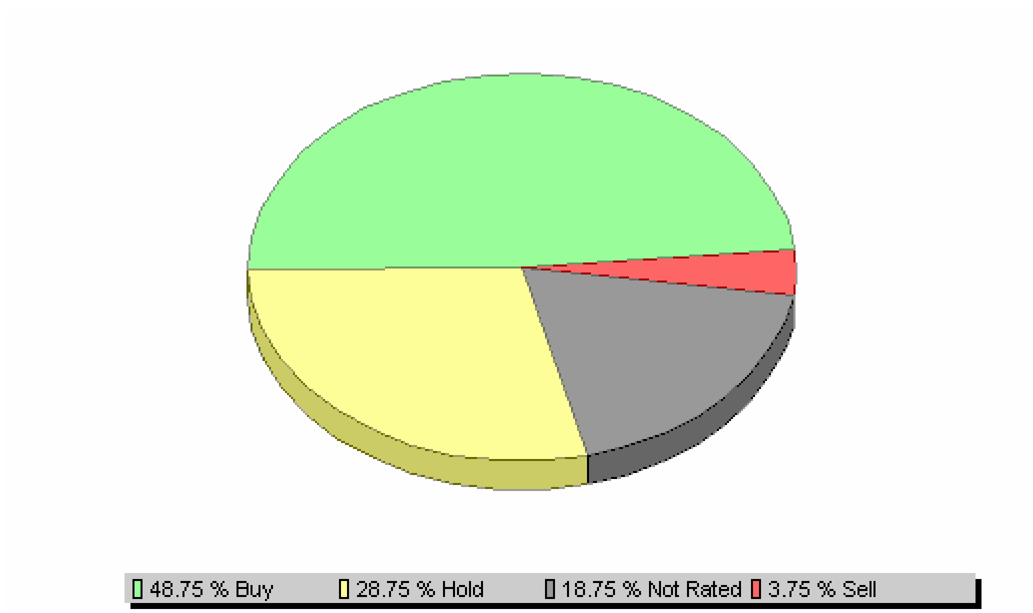
Management Control
Ludmila Smolyansky (mother of the company CEO and CFO), who is chairperson of the board of directors of Lifeway Foods, beneficially owns or controls approximately 44.8% of common shares outstanding, as of June 15, 2009. The Chairperson has the ability to substantially influence matters submitted to stockholders for approval, this could have a negative impact if her interests do not coincide with other shareholders on a particular issue.

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. During 2007, average daily volume was 69,402 shares traded a day. However, during 2008 average daily volume declined to 35,147 shares traded daily. During the first eleven months of 2009, average daily volume was 24,216 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.



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

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

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.

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Public Companies mentioned in this report:

Groupe Danone	(OTC Other: DANYO)
99C Only Stores	(NYSE: NDN)

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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. 2007 A Year End	Dec. 2008 A Year End	March 2009 A 1st Qtr End	June 2009 A 2nd Qtr End	Sept. 2009 A 3rd Qtr End	Dec. 2009 E Year End	Dec. 2010 E Year End
ASSETS							
Current assets:							
Cash and cash equivalents	$ 596	$ 277	$ 607	$ 583	$ 804	$ 352	$ 658
Marketable securities	6,989	5,262	4,286	4,659	4,950	4,800	4,900
Accounts receivable, net	4,210	4,766	6,062	6,065	7,312	6,384	7,079
Other receivables	43	40	27	66	38	70	75
Inventories	3,507	3,098	3,642	3,817	4,107	3,917	4,120
Prepaid income taxes	241	356	73	778	-	775	800
Prepaid expenses and other assets	21	23	23	56	46	29	34
Deferred income taxes	312	920	863	638	364	640	650
Total current assets	**15,919**	**14,742**	**15,584**	**16,662**	**17,621**	**16,967**	**18,315**
Property, plant and equipment, net	9,679	11,063	13,724	13,794	13,812	13,800	13,825
Other assets	500	500	500	500	500	500	500
Intangible assets, net	8,671	8,351	19,019	18,751	18,582	18,700	18,600
Total assets	**$ 34,768**	**$ 34,656**	**$ 48,827**	**$ 49,707**	**$ 50,515**	**$ 49,967**	**$ 51,240**
LIABILITIES AND STOCKHOLDERS' EQUITY							
Current liabilities:							
Current maturities of notes payable	1,136	928	6,982	6,220	6,231	5,800	-
Accounts payable	1,594	2,260	2,369	2,024	2,180	2,644	3,204
Accrued expenses	414	458	487	618	684	546	639
Total current liabilities	**3,144**	**3,647**	**10,260**	**8,862**	**9,095**	**8,991**	**3,843**
Long-term liabilities -- notes payable	4,097	3,108	8,376	7,908	7,401	7,000	6,000
Deferred income taxes	1,713	1,607	1,763	1,942	2,010	2,000	2,100
Stockholders' equity:							
Common stock, no par value; authorized 10,000,000 shares	6,509	6,509	6,509	6,509	6,509	6,509	6,509
Paid-in capital	1,121	1,202	1,886	1,913	1,939	1,913	1,913
Retained earnings	20,471	22,384	23,931	26,463	27,834	28,910	36,399
Accumulated other comprehensive income, net of	(209)	(499)	(843)	(536)	(422)	(2,002)	(2,170)
Treasury stock, at cost	(2,078)	(3,302)	(3,057)	(3,353)	(3,851)	(3,353)	(3,353)
Total stockholders' equity	**25,814**	**26,294**	**28,427**	**30,995**	**32,009**	**31,976**	**39,297**
Total liabilities and stockholders' equity	**$ 34,768**	**$ 34,656**	**$ 48,827**	**$ 49,707**	**$ 50,515**	**$ 49,967**	**$ 51,240**
SHARES OUT	16,828	16,724	16,843	16,813	16,776	16,724	16,724

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

	FY2007A	FY2008A	**FY2009E**	**FY2010E**
Sales	$ 38,729	$ 44,461	**$ 58,929**	**$ 67,060**
Cost of goods sold	26,310	31,704	**35,254**	**41,200**
Gross Profit	12,420	12,758	**23,675**	**25,860**
Operating Expenses:				
Sales	3,744	4,098	**5,576**	**5,950**
General and administrative	4,238	4,468	**7,007**	**7,450**
Total Operating Expenses	7,982	8,567	**12,583**	**13,400**
EBITDA	5,487	5,284	**13,073**	**14,460**
	1,278	1,492	**6,050**	**7,005**
Operating Income	4,437	4,191	**11,093**	**12,460**
Other Income (Expense)				
Interest income	350	343	**170**	**80**
Interest expense	(410)	(299)	**(489)**	**(500)**
Gain on sale of marketable securities	540	(734)	**(274)**	**-**
Other	(0)	(959)	**(3)**	**-**
Rental income	48	49	**43**	**40**
Total Other Income (Expense)	528	(1,599)	**(553)**	**(380)**
Pre-Tax Income	4,965	2,592	**10,539**	**12,080**
Income Tax Expense (Benefit)	1,813	680	**4,009**	**4,595**
Tax Rate	36.50%	26.23%	**38.04%**	**38.04%**
Net Income	$ 3,153	$ 1,912	**$ 6,530**	**$ 7,485**
EPS -- Fully Diluted*	$ 0.19	$ 0.11	**$ 0.39**	**$ 0.44**
Avg Shares Out-Fully Diluted*	16,856	16,761	**16,810**	**16,829**
Margins				
Gross Margins	32.1%	28.7%	**40.2%**	**38.6%**
Operating Margin	11.5%	9.4%	**18.8%**	**18.6%**
Pre-Tax Margins	12.8%	5.8%	**17.9%**	**18.0%**
Selling expense	9.7%	9.2%	9.5%	8.9%
General and Administrative expense	10.9%	10.1%	11.9%	11.1%
YEAR / YEAR GROWTH				
Total Revenues	39.7%	14.8%	32.5%	13.8%
Net Income	8.8%	(39.3%)	263.9%	15.5%

Lifeway Foods, Inc.
Quarterly Income Statement Model
For the Years Ended December 31, 2008
(in thousands)

	Q1(03/08)A	Q2 (06/08)A	Q3 (09/08)A	Q4 (12/08)A	FY2008A
Sales	$ 11,122	$ 11,523	$ 11,240	$ 10,576	$ 44,461
Cost of goods sold	7,632	7,651	7,703	8,718	31,704
Gross Profit	3,491	3,873	3,537	1,857	12,758
Operating Expenses:					
Sales	1,059	1,154	958	927	4,098
General and administrative	1,065	1,172	1,112	1,119	4,468
Total Operating Expenses	2,124	2,326	2,070	2,046	8,567
EBITDA	1,636	1,821	1,744	82	5,284
Operating Income	1,367	1,546	1,467	(189)	4,191
Other Income (Expense)					
Interest income	103	63	95	82	343
Interest expense	(86)	(69)	(72)	(72)	(299)
Gain on sale of marketable securities	-	(87)	(381)	(265)	(734)
Other	51	-	-	(1,010)	(959)
Rental income	12	12	14	12	49
Total Other Income (Expense)	80	(82)	(344)	(1,253)	(1,599)
Pre-Tax Income	1,447	1,465	1,123	(1,442)	2,592
Income Tax Expense (Benefit)	558	553	268	(699)	680
Tax Rate	38.57%	37.75%	23.86%	48.47%	26.23%
Net Income	$ 889	$ 912	$ 855	$ (743)	$ 1,912
EPS -- Fully Diluted*	$ 0.05	$ 0.05	$ 0.05	$ (0.04)	$ 0.11
Avg Shares Out-Fully Diluted*	16,815	16,765	16,731	16,735	16,761
Margins					
Gross Margins	31.4%	33.6%	31.5%	17.6%	28.7%
Operating Margin	12.3%	13.4%	13.1%	(1.8%)	9.4%
Pre-Tax Margins	13.0%	12.7%	10.0%	(13.6%)	5.8%
Selling expenses	9.5%	10.0%	8.5%	8.8%	9.2%
General and Administrative expenses	9.6%	10.2%	9.9%	10.6%	10.1%
YEAR / YEAR GROWTH					
Total Revenues	23.3%	18.6%	14.5%	3.9%	14.8%
Net Income	(21.7%)	(34.7%)	82.6%	(584.2%)	(39.3%)

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

	Q1(03/09)A	Q2 (06/09)A	Q3 (09/09)A	Q4 (12/09)E	**FY2009E**	Q1(03/10)E	Q2 (06/10)E	Q3 (09/10)E	Q4 (12/10)E	**FY2010E**
Sales	$ 13,736	$ 14,479	$ 15,434	$ 15,280	**$ 58,929**	$ 15,795	$ 16,580	$ 17,400	$ 17,285	**$ 67,060**
Cost of goods sold	8,217	8,332	9,181	9,525	**35,254**	9,850	10,050	10,450	10,850	**41,200**
Gross Profit	5,519	6,148	6,253	5,755	**23,675**	5,945	6,530	6,950	6,435	**25,860**
Operating Expenses:										
Sales	1,308	1,387	1,231	1,650	**5,576**	1,600	1,400	1,465	1,485	**5,950**
General and administrative	1,668	1,606	1,783	1,950	**7,007**	1,750	1,825	1,850	2,025	**7,450**
Total Operating Expenses	2,976	2,993	3,014	3,600	**12,583**	3,350	3,225	3,315	3,510	**13,400**
EBITDA	2,982	3,708	3,728	2,655	**13,073**	3,095	3,805	4,135	3,425	**14,460**
Operating Income	2,544	3,155	3,239	2,155	**11,093**	2,595	3,305	3,635	2,925	**12,460**
Other Income (Expense)										
Interest income	62	49	34	25	**170**	20	20	20	20	**80**
Interest expense	(154)	(110)	(100)	(125)	**(489)**	(125)	(125)	(125)	(125)	**(500)**
Gain on sale of marketable securities	(150)	54	(178)	-	**(274)**	-	-	-	-	**-**
Other	-	(3)	-	-	**(3)**	-	-	-	-	**-**
Rental income	9	12	12	10	**43**	10	10	10	10	**40**
Total Other Income (Expense)	(233)	1	(232)	(90)	**(553)**	(95)	(95)	(95)	(95)	**(380)**
Pre-Tax Income	2,311	3,156	3,008	2,065	**10,539**	2,500	3,210	3,540	2,830	**12,080**
Income Tax Expense (Benefit)	763	624	1,637	985	**4,009**	945	1,100	1,225	1,325	**4,595**
Tax Rate	33.04%	19.77%	54.42%	47.70%	**38.04%**	37.80%	34.27%	34.60%	46.82%	**38.04%**
Net Income	$ 1,547	$ 2,532	$ 1,371	$ 1,080	**$ 6,530**	$ 1,555	$ 2,110	$ 2,315	$ 1,505	**$ 7,485**
EPS -- Fully Diluted*	$ 0.09	$ 0.15	$ 0.08	$ 0.06	**$ 0.39**	$ 0.09	$ 0.13	$ 0.14	$ 0.09	**$ 0.44**
Avg Shares Out-Fully Diluted*	16,847	16,790	16,799	16,805	**16,810**	16,815	16,825	16,835	16,840	**16,829**
Margins										
Gross Margins	40.2%	42.5%	40.5%	37.7%	**40.2%**	37.6%	39.4%	39.9%	37.2%	**38.6%**
Operating Margin	18.5%	21.8%	21.0%	14.1%	**18.8%**	16.4%	19.9%	20.9%	16.9%	**18.6%**
Pre-Tax Margins	16.8%	21.8%	19.5%	13.5%	**17.9%**	16.8%	19.4%	20.3%	16.4%	**18.0%**
Selling expense	9.5%	9.6%	8.0%	10.8%	**9.5%**	10.1%	8.4%	8.4%	8.6%	**8.9%**
General and Administrative expense	12.1%	11.1%	11.5%	12.8%	**11.9%**	11.1%	11.0%	10.6%	11.7%	**11.1%**
YEAR / YEAR GROWTH										
Total Revenues	23.5%	25.7%	37.3%	44.5%	**32.5%**	23.5%	14.5%	12.7%	13.1%	**13.8%**

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

	FY2007A	FY2008A	9 Mos.2009A	FY2009E	FY2010E
Cash Flows from Operating Activities					
Net Income	$ 3,153	$ 1,912	$ 5,450	$ 6,530	$ 7,485
Depreciation and amortization	1,050	1,093	1,367	1,790	1,600
Gain on sale of marketable securities	(540)	734	274	90	-
Other than temporary reductions of marketable securities	-	959	-	-	-
Issuance of common stock in exchange for services rendered	49	97	113	165	160
Decrease in allowance for doubtful accounts	(41)	71	-	-	-
Deferred income taxes	(224)	(509)	236	280	(10)
	3,447	4,356	7,444	8,855	9,235
Changes In:					
Accounts receivable	(226)	(627)	(2,000)	(1,618)	(695)
Other receivables	28	3	3	(30)	(5)
Inventories	(984)	409	(636)	(820)	(203)
Prepaid income taxes	27	(116)	807	(419)	(25)
Prepaid expenses and other assets	(9)	(2)	5	(6)	(4)
Accounts payable	131	666	(285)	384	560
Accrued expenses	(66)	44	167	88	92
Net Changes in Working Capital	(1,100)	378	(1,940)	(2,420)	(279)
Net cash Provided by Operations	2,347	4,734	5,504	6,434	8,956
Cash Flows from Investing Activities					
Purchase of marketable securities	(5,745)	(5,782)	(6,050)	(3,343)	-
Sale of marketable securities	7,168	5,323	6,793	4,200	-
Acquisition of Fresh Made, net of cash acquired	-	-	(3,443)	-	-
Purchase of property, plant and equipment	(1,825)	(2,157)	(1,021)	(714)	(250)
Net cash used in Investing	(901)	(2,616)	(3,721)	143	(250)
Cash Flows from Financing Activities					
Repayment of notes payable	(1,945)	(1,196)	(2,104)	(6,100)	(8,400)
Proceeds from note payable	300	-	1,754	-	-
Purchase of treasury stock	(753)	(1,239)	(906)	(403)	-
Net cash provided by Financing	(2,398)	(2,436)	(1,256)	(6,503)	(8,400)
Net change in Cash	(952)	(319)	527	74	306
Cash Beginning of Period	1,548	596	277	277	352
Cash End of Period	$ 596	$ 277	$ 804	$ 352	$ 658