NUTRACEA
Form 10-Q
August 14, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)
x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2007

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _ to _

Commission File Number 0-32565

NUTRACEA
(Exact Name of Registrant as Specified in its Charter)

California (State or other jurisdiction of incorporation or organization)	**87-0673375** (I.R.S. Employer Identification No.)
5090 North 40th St., Suite 400 **Phoenix, AZ** (Address of Principal Executive Offices)	**85018** (Zip Code)

Issuer's telephone number, including area code: (602) 522-3000

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Securities Exchange Act of 1934). Large accelerated filer o Accelerated filer o Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule l2b-2 of the Exchange Act). Yes o No x

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 141,345,161 as of August 3, 2007.

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FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact are “forward-looking statements” for purposes of federal and state securities laws, including, but not limited to, any projections of earnings, revenue or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements concerning proposed new services or developments; any statements regarding future economic conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing.

Forward-looking statements may include the words “may,” “could,” “will,” “estimate,” “intend,” “continue,” “believe,” “e “anticipate” or other similar words. The forward-looking statements contained herein reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. Actual results may differ materially from those projected. in such forward-looking statements due to a number of factors, risks and uncertainties, including the factors that may affect future results set forth in this Current Report on Form 10-Q and in our annual Report on Form 10-K for the year ended December 31, 2006. We disclaim any obligation to update any forward looking statements as a result of developments occurring after the date of this quarterly report.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

NUTRACEA AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS

	June 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 51,500,000	$ 14,867,000
Restricted cash	545,000	-
Marketable securities	459,000	368,000
Trade accounts receivable, net of allowance for doubtful accounts of $1,075,000 and $20,000, respectively	8,075,000	7,093,000
Inventories	801,000	796,000
Notes receivable, net of discount, current portion	4,274,000	1,694,000
Deposits and other current assets	1,767,000	1,383,000
Total current assets	67,421,000	26,201,000
Notes receivable, net of current portion	5,216,000	682,000
Property and equipment, net	14,673,000	8,961,000
Investment in joint venture	1,250,000	-
Other intangible assets, net	5,616,000	5,097,000
Goodwill	39,372,000	32,314,000
Other non-current assets	12,000	-
Total assets	$ 133,560,000	$ 73,255,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 4,866,000	$ 2,778,000
Accrual for contribution to related party joint venture	1,500,000	-
Deferred revenue	29,000	103,000
Total current liabilities	6,395,000	2,881,000
Commitments and contingencies		
Convertible, series B preferred stock, no par value, $1,000 stated value, 20,000,000 shares authorized, 0 and 470 shares issued and outstanding	-	439,000
Convertible, series C preferred stock, no par value, $1,000 stated value, 25,000 shares authorized, 2 and 5,468 shares issued and outstanding	2,000	5,051,000
Shareholders' equity:		

Common stock, no par value				
350,000,000 shares authorized,				
140,217,953 and 103,977,715 shares issued and outstanding				
in 2007 and 2006, respectively		174,544,000		114,111,000
Accumulated deficit		(47,550,000)		(49,305,000)
Accumulated other comprehensive income, unrealized gain on				
marketable securities		169,000		78,000
Total shareholders’ equity		127,163,000		64,884,000
Total liabilities and shareholders’ equity	$	133,560,000	$	73,255,000

The accompanying notes are an integral part of these consolidated condensed financial statements.

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NUTRACEA AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006
Revenues:				
Net product sales	$ 9,983,000	$ 7,932,000	$ 7,996,000	$ 4,159,000
Royalty and licensing fees	5,010,000	16,000	5,000,000	7,000
Total revenue	14,993,000	7,948,000	12,996,000	4,166,000
Cost of goods sold	4,976,000	4,433,000	3,863,000	2,333,000
Gross margin	10,017,000	3,515,000	9,133,000	1,833,000
Research and development expenses	291,000	198,000	170,000	94,000
Selling, general and administrative expenses	7,970,000	2,852,000	5,657,000	1,348,000
Professional fees	1,995,000	434,000	1,536,000	101,000
Total operating expenses	10,256,000	3,484,000	7,363,000	1,543,000
Income (loss) from operations	(239,000)	31,000	1,770,000	290,000
Other income (expense)				
Interest income (net)	1,388,000	135,000	876,000	109,000
Gain on settlement	1,250,000	-	-	-
Loss on retirement of assets	(309,000)	-	(309,000)	-
Loss on equity investment	(250,000)	-	(250,000)	-
Total income before income tax	1,840,000	166,000-	2,087,000	109,000
Income tax expense	(85,000)	-	(85,000)	-
Net income	$ 1,755,000	$ 166,000	$ 2,002,000	$ 399,000
Basic and diluted earnings per share:				
Basic income per share	$ 0.01	$ 0.00	$ 0.01	$ 0.00
Fully diluted income per share	$ 0.01	$ 0.00	$ 0.01	$ 0.00
Weighted average basic number of shares outstanding	118,952,000	68,808,000	136,257,000	71,792,000
Weighted average diluted number of shares outstanding	148,954,000	119,309,000	167,259,000	123,293,000

The accompanying notes are an integral part of these consolidated condensed financial statements.

NUTRACEA AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006
Net income	$ 1,755,000	$ 166,000	$ 2,002,000	$ 399,000
Other comprehensive income:				
Unrealized gain (loss) on marketable securities	91,000	(13,000)	91,000	(5,000)
Net comprehensive income	$ 1,846,000	$ 153,000	$ 2,093,000	$ 394,000

The accompanying notes are an integral part of these consolidated condensed financial statements.

NUTRACEA AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Cash flow from operating activities:		
Net income	$ 1,755,000	$ 166,000
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	894,000	548,000
Provision for doubtful accounts	1,055,000	
Loss on retirement of assets	309,000	-
Stock-based compensation	1,263,000	540,000
Recognition of deferred income	(73,000)	-
Loss on equity investment	250,000	-
Net changes in operating assets and liabilities (net of effects of of Grainovations, Inc. acquisition and Vital Living, Inc. consolidation):		
Trade accounts receivable	(4,752,000)	(1,811,000)
Inventories	36,000	(258,000)
Deposits and other assets	(380,000)	(14,000)
Accounts payable and accrued liabilities	(726,000)	1,315,000
Net cash (used)/provided by operating activities	(369,000)	486,000
Cash flows from investing activities:		
Proceeds from payments of notes receivable	1,796,000	-
Issuance of notes receivable	(5,029,000)	(800,000)
Investment in Grainovation, Inc.	(2,168,000)	-
Investment in Vital Living, Inc.	(5,144,000)	-
Purchases of property and equipment	(6,026,000)	(1,971,000)
Purchases of other assets	-	(2,415,000)
Purchases of other intangible assets	(109,000)	-
Net cash used in investing activities	(16,680,000)	(5,186,000)
Cash flows from financing activities:		
Proceeds from private placement financing, net of expenses	46,805,000	15,972,000
Proceeds from exercise of common stock options	6,877,000	-
Payment on long-term debt	-	(4,000)
Net cash provided by financing activities	53,682,000	15,968,000
Net increase in cash	36,633,000	11,268,000
Cash, beginning of period	14,867,000	3,491,000
Cash, end of period	$ 51,500,000	$ 14,759,000
Supplemental disclosures:		
Cash paid for interest	$ -	$ -
Cash paid for income taxes	$ 85,000	$ 6,000

Non-cash disclosures of investing and financing activities:				
Accounts receivable converted to note receivable	$	3,881,000	$	-
Accrual for investment in Grain Enhancements joint venture	$	1,500,000	$	-
Accrual for acquisition of equine feed supplement business	$	-	$	733,000
Conversion of preferred stock to common stock	$	5,488,000	$	2,425,000
Unrealized gain (loss) on marketable securites	$	91,000	$	(5,000)

The accompanying notes are an integral part of these consolidated condensed financial statements.

NUTRACEA AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED CONEDNSED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying un-audited interim consolidated condensed financial statements of NutraCea have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission ("SEC"), and should be read in conjunction with the audited consolidated financial statements and notes thereto contained in NutraCea's Annual Report filed with the SEC on Form 10-K. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Notes to the consolidated financial statements that would substantially duplicate the disclosures contained in the audited financial statements for 2006 as reported in the 10-K have been omitted.

The unaudited condensed consolidated financial statements include the accounts of NutraCea and our wholly-owned subsidiaries as well as a variable interest entity, Vital Living, Inc., for which we are the primary beneficiary as defined by Financial Accounting Standards Board, or FASB, Interpretation No. 46 (revised 2003), "Consolidation of Variable Interest Entities," or FIN 46R. All inter-company accounts and transactions have been eliminated. We operate in one business segment, which is the manufacturing and distribution nutritional supplements.

2. STOCK-BASED COMPENSATION

On January 1, 2006, NutraCea adopted SFAS No. 123(R), "Share-Based Payment" ("SFAS 123(R)"). SFAS 123(R) replaced SFAS No. 123 and supersedes APB Opinion No. 25. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The pro forma disclosures previously permitted under SFAS 123 are no longer an alternative to financial statement recognition. NutraCea adopted SFAS 123(R) using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. The consolidated financial statements as of and for the six and three months ended June 30, 2007 and 2006 reflect the impact of adopting SFAS 123(R).

Stock-based compensation expenses totaled $1,263,000 and $825,000 for the six and three months ended June 30, 2007, and $540,000 and $151,000 for the six and three months ended June 30, 2006.

For all agreements where stock is awarded as partial or full consideration, the expense is valued at the fair value of the stock. Expenses for stock options and warrants issued to consultants and employees are calculated based upon fair value using the Black-Scholes valuation method.

Stock-based compensation expenses consisted of the following at:

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006
Consulting fees	$ 281,000	$ 190,000	$ 266,000	$ 25,000
Directors fees	87,000	53,000	50,000	53,000
Employees	840,000	197,000	509,000	73,000
	55,000	100,000	-	-

To directors and former director for services								
Total stock-based compensation expense	$	1,263,000	$	540,000	$	825,000	$	151,000

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The weighted average grant date fair value of the stock options granted during the six months ended June 30, 2007 and 2006 was $2.78 and $1.31 per share, respectively. Assumptions used in the Black-Scholes option-pricing model include (1) risk-free discount rates from 4.51% to 4.84%, (2) expected option life is calculated using the short-cut method allowed by Staff Accounting Bulletin 107, (3) expected volatility ranges from 67.% to 324 % and (4) zero expected dividends. For expected volatility, share-based expenses are calculated beginning in fiscal year 2007 using a share history from the October 5, 2005 date of the NutraCea/RiceX merger which results in a volatility rate of about 67%. In prior periods the fair value was determined using average share prices from inception of the Company to the end of the respective reporting period which yielded volatility rates up to 324%.

3. MARKETABLE SECURITIES

On September 8, 2004, NutraCea purchased 1,272,026 shares of Langley Park Investment Trust, PLC ("Langley"), a United Kingdom closed-end mutual fund that is actively traded on a London exchange. Per the Stock Purchase Agreement, NutraCea paid with 7,000,000 shares of its own common stock.

Per the agreement with Langley, NutraCea may sell 636,013 shares of Langley at any time, and the remaining 636,013 shares of Langley and the 7,000,000 shares of NutraCea are escrowed together for a 2-year period ended October 7, 2006. At the end of the period, Langley's NutraCea shares are measured for any loss in market value and if so, NutraCea must give up that pro-rata portion of its Langley shares up to the escrowed 636,013 shares.

As of June 30, 2007, the NutraCea shares have not lost any value. The Langley shares are recorded at their fair market value of $368,000 at December 31, 2006 and $459,000 at June 30, 2007, with the entire amount shown as a current asset because the escrow period has passed and we may now sell all 1,272,026 shares at any time. We have recorded an unrealized gain of $91,000 in the six months ended June 30, 2007.

Any unrealized holding gains and losses on the marketable securities are excluded from operating results and are recognized as other comprehensive income. The fair value of the securities is determined based on prevailing market prices.

On September 8, 2006, NutraCea commenced a lawsuit against Langley in the United States District Court for the Eastern District of California, Sacramento Division regarding this transaction. The matter was settled on March 27, 2007. Pursuant to the settlement, NutraCea received $1,250,000 from Langley in March 2007 and NutraCea retained all of the Langley shares. The $1,250,000 settlement is included in the income statement as other income.

4. INVENTORY

Inventories are composed of the following;

	June 30, 2007	December 31, 2006
Finished goods	$ 382,000	$ 533,000
Work in process	99,000	-
Raw materials	122,000	168,000
Packaging supplies	198,000	95,000
	$ 801,000	$ 796,000

5. NOTES RECEIVABLE

At June 30, 2007, we held twelve (12) secured promissory notes payable to the Company with aggregate outstanding amounts under these notes of $9,491,000 (net of note discount of $1,000); $4,274,000 is reported as current and $5,216,000 as long-term. These secured promissory notes bear interest at annual rates ranging from 5% to 10% with the principal and all accrued interest due and payable to us at dates ranging from July 2007 to October 2012.

During the six months ended June 30, 2007 we loaned a total of $5,029,000, (net of conversion of 3,881,000 of accounts receivables to short-term note receivable), to certain strategic customers, which loans were evidenced by promissory notes, and received payments totaling $1,176,000 on existing promissory notes. We also accrued interest income of $127,000 and received cash payments of $72,000 for accrued interest during the second quarter.

In February 2007, we converted $3,516,000 of one customers' accounts receivable to a note receivable included in the above total, bearing interest at 7% and due in December 2007. In April 2007 we converted $365,000 of another customers' accounts receivable to a note receivable included in the above total, bearing interest at 10% and due in October 2007.

During the second quarter of 2007 we granted to Pacific Holdings Advisors Limited ("PAHL") an exclusive, perpetual, royalty-free right and license to use and distribute Stabilized Rice Bran ("SRB") and SRB derivative products in certain Southeast Asian countries. PAHL paid a one-time fee of $5,000,000 for these rights. PAHL paid the license fee by issuing to NutraCea an adjustable rate promissory note initially bearing interest at the rate of 4.52% that is guaranteed by the parent of PAHL. The principal and accrued interest under this promissory note is due on five year payment terms.

6. PROPERTY AND EQUIPMENT

Land, property and equipment consists of the following:

	June 30, 2007	December 31, 2006
Land	$ 9,000	$ 9,000
Furniture and fixtures	2,288,000	916,000
Vehicles	73,000	73,000
Software	391,000	389,000
Leasehold improvements	576,000	430,000
Property, plant and equipment	12,072,000	4,197,000
Construction in progress	1,237,000	4,392,000
Total property, plant, and equipment	16,646,000	10,406,000
Less accumulated depreciation	(1,973,000)	(1,445,000)
Total property, plant, and equipment, net	$ 14,673,000	$ 8,961,000

Depreciation expense for the six months ended June 30, 2007 and 2006 was $642,000 and $432,000, respectively.

7. OTHER INTANGIBLE ASSETS

Other intangibles consisted of the following at:

	June 30, 2007	December 31, 2006
Patents	$ 2,656,000	$ 2,540,000
Copyrights and trademarks	2,992,000	2,987,000
Non-compete agreements	650,000	-
Subtotal of other intangible assets	6,298,000	5,527,000
Less accumulated amortization	(682,000)	(430,000)

Total other intangible assets, net	$ 5,616,000	$ 5,097,000

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Amortization expense for the six months ended June, 2007 and 2006 was $252,000 and $116,000, respectively.

8. EARNINGS PER SHARE

Basic earnings per share are computed by dividing net income by the weighted average number of common shares outstanding during all periods presented. Options and warrants are excluded from the basic earnings per share calculation and are considered in calculating the diluted earnings per share.

The dilutive effect of outstanding options, warrants is calculated using the treasury stock method and the dilutive effect of the convertible series B preferred stock, and convertible series C preferred stock is calculated using the as-if converted method.

Components of basic and diluted earnings per share were as follows:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2007	2006	2007	2006
Net income	$ 1,755,000	$ 166,000	$ 2,002,000	$ 399,000
Weighted average outstanding shares of common stock	118,952,000	68,808,000	136,257,000	71,792,000
Convertible preferred stock	2,000	31,501,000	2,000	31,501,000
Stock options and warrants	47,129,000	47,307,000	47,129,000	47,307,000
Common stock and common stock equivalents	30,000	19,000	31,000	20,000
Total diluted shares	148,954,000	119,309,000	167,259,000	123,293,000
Earnings per share:				
Basic	$ 0.01	$ 0.00	$ 0.01	$ 0.00
Diluted	$ 0.01	$ 0.00	$ 0.01	$ 0.00

9. CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject us to significant concentrations of credit risk consist primarily of trade accounts receivable for sales to major customers. We perform credit evaluations on our customers' financial condition and generally do not require collateral on accounts receivable. We maintain an allowance for doubtful accounts on our receivables based upon expected collection of all accounts receivable. Uncollected accounts have not been significant.

For the six months ended June 30, 2007, two customers accounted for a total of 49% of sales, 26% and 23% respectively. No other customer was responsible for more than 5% of total sales. At June 30, 2007, three customers accounted for 82% of total accounts receivable: 33%, 29%, and 20% respectively. No other customer accounted for more than 3% of the total outstanding accounts receivable.

For the six months ended June 30, 2006, four customers accounted for a total of 76% of sales: 64%, 5%, 4%, and 3% respectively. At June 30, 2006, accounts receivable due from these four customers were 78%, 0%, 2%, and 1%, respectively, of the total outstanding accounts receivable.

10. ACQUISITIONS AND JOINT VENTURES

<u>Grainnovation, Inc.</u>

In April 2007, we acquired 100% of the outstanding stock of Grainnovation, Inc. (“GI”) a privately held company that had equipment for pelletizing horse feed for equine customers of strategic value to NutraCea, and certain assets used in GI’s business for a total of $2,150,000, of which $1,605,000 of the purchase price was paid at closing, with the balance (“holdback”) being due in payments of $235,000 and $310,000 in six months and twelve months respectively, subject to reduction in the event of breaches of representations, warranties and covenants contained in the transaction documents. The holdback is held in third-party escrow and is including in our consolidated condensed balance sheet as restricted cash and current liabilities. The investment is recorded in our financial statements included herein at the aggregate purchase price and its results of operations from the date of acquisition are reflected in our statement of operations for the periods ended June 30, 2007.

Under the purchase agreement, NutraCea may cause the former stockholders of GI to repurchase all the outstanding shares of GI if certain post-closing covenants of the Company are not satisfied in the six months following the closing date of the purchase. Under the repurchase provision we believe we could recover our investment; however, as management considers the repurchase of the GI stock by its' former stockholders as an unlikely event we have not included any such contingency in our financial statements.

The following table summarized the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. We incurred $20,000 in legal fees relating to this purchase, which are added to the purchase price and Goodwill. The Company is in the process of obtaining third-party valuations of certain intangible assets; the allocation of the purchase price is subject to refinement:

Cash	$	1,000
Accounts receivable		26,000
Inventory		11,000
Property and equipment		623,000
Covenant not to compete		650,000
Goodwill		917,000
Total Assets		2,228,000
Accrued liabilities		58,000
Total Liabilities		58,000
Net assets acquired	$	2,170,000

Grain Enhancements LLC

In June 2007, we entered into a joint venture with Pacific Advisors Holdings Limited ("PAHL") to form Grain Enhancements LLC, ("Grain Enhancements") a Delaware limited liability company. NutraCea and PAHL each will hold a 47.5% share of Grain Enhancements. The remaining interest is held by Theorem Group LLC ("Theorem") (3.333%) and Ho'okipa Capital Partners, Inc. (1.667%). The purpose of Grain Enhancements is to develop and market SRB and related products in certain Southeast Asian countries. Grain Enhancements will purchase SRB exclusively from NutraCea until its own facilities are in operation and NutraCea will lease to Grain Enhancements at cost the necessary equipment for such facilities. Payments under the equipment lease will be payable in full upon installation of the equipment.

Under the agreement, NutraCea and PAHL will contribute up to $5,000,000 each to Grain Enhancements to fund the operations, of which $1,500,000 each was due on June 30, 2007. We made our initial contribution in July 2007. Additionally, $2,000,000 each is to be contributed no later than October 2007, and the remaining $1,500,000 from each partner is due no later than August 2008. Theorem was paid $750,000 and $500,000 by NutraCea and Grain Enhancements, respectively, for services relating to the formation of the joint venture. Through June 30, 2007, our portion of Grain Enhancements net loss was $250,000.

Our capital contribution of $1,500,000 made in July 2007, is included in our consolidated condensed balance sheet as a related party paybale at June 30, 2007.

Our investment in Grain Enhancements is accounted for under the equity method of accounting. At June 30, 2007 the value of our investment was $1,250,000.

Summary financial information of Grain Enhancements, LLC at June 30, 2007 is:

Assets		
Due from partners	$	3,000,000
Liabilities and Equity		
Due to Theorem	$	500,000
Partners equity		3,000,000
Accumulated deficit		(500,000)
Total liabilities and equity	$	3,000,000

<u>Vital Living, Inc</u>.

In April 2007 we acquired certain securities of Vital Living, Inc., ("VLI") a publicly traded company. VLI distributes nutritional supplements using similar manufacturing and distribution processes. We paid $1,000,000 for 1,000,000 shares of outstanding preferred stock and $4,226,000 for the outstanding Senior Secured Notes ("Notes"). The Notes are convertible to VLI common stock and bear interest at 12% per annum, payable June 15 and December 15 and mature in December 2008. Our intention is not to exercise our option to convert the Notes into shares of VLI common stock, rather, we intend to acquire certain assets of Vital Living. In June 2007 we entered into a non-binding letter of intent with Vital Living to acquire certain assets, however, we have not entered into a definitive agreement to acquire such assets.

Our accounting for the purchase of these securities of VLI qualifies as a Variable Interest Entity ("VIE") in accordance with FASB Interpretations No. 46R "Consolidation of Variable Interest Entities." As the primary beneficiary, we have consolidated VLI into the Financial Statements.

The purchase price allocated to the assets and liabilities in April 2007 is as follows:

Assets		
Cash	$	83,000
Accounts receivable		1,141,000
Inventory		30,000
Property and equipment		15,000
Other assets		28,000
Goodwill		6,141,000
Total Assets	$	7,438,000
Liabilities		
Accounts payable	$	737,000
Accrued liabilities		725,000
Notes payable		750,000
Total Liabilities	$	2,212000
Net assets acquired	$	5,226,000

We have included in our balance sheet at June 30, 2007 the financial position of VLI and in our statement of operations for the six months ended June 30, 2007 the operating results of VLI for the period from April 20, 2007 through June 30, 2007, while eliminating inter-company balances. The effect on our consolidated, condensed balance sheet at June 30, 2007 was an increase in total assets of $1,638,000, an increase in total liabilities of $1,890,000 and a decrease in shareholder equity of $253,000. The effect on our consolidated income statement was an increase in revenues of $597,000, an increase in cost of goods sold of $265,000, an increase in operating expenses of $444,000, an increase of other expenses of $141,000 and a decrease in net income of $253,000.

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11. RELATED PARTY TRANSACTIONS

Vital Living, Inc.

In conjunction with our purchase of certain securities of Vital Living, Inc. (Note 10) we consolidated VLI financial results for the period April 20, 2007 to June 30, 2007 into our financial results for the three months ending June 30, 2007. Also during three months ended end June 30, 2007, we entered into a business relationship with a new customer that is also a customer of VLI. A current officer of VTL is also a principal partner with this new customer. During the quarter ended June 30, 2007, we recorded sales of $2,080,000 to this new customer. At June 30, 2007 we had $2,080,000 included in our accounts receivable of $8,075,000.

Grain Enhancements

In June 2007, we entered into a joint venture with Pacific Advisors Holdings Limited ("PAHL") to form Grain Enhancements LLC, ("Grain Enhancements") a Delaware limited liability company (Note 10). Under the agreement, NutraCea and PAHL will contribute up to $5,000,000 each to Grain Enhancements to fund the operations, of which $1,500,000 each was due on June 30, 2007. At quarter ended June 30, 2007, we accrued the payable and made our initial contribution in July 2007. Additionally, $2,000,000 each is to be contributed no later than October 2007, and the remaining $1,500,000 from each partner is due no later than August 2008. Theorem was paid $750,000 and $500,000 by us and Grain Enhancements, respectively, for services relating to the formation of the joint venture. Through June 30, 2007, our portion of Grain Enhancements net loss was $250,000 (Notes 10 and 12)

We believe that the transactions set forth above were made on terms no less favorable to us than could have been obtained from unaffiliated third parties. In addition, we intend that all such transactions be on terms no less favorable to us than could be obtained from unaffiliated third parties.

12. COMMITMENTS AND CONTINGENCIES

Grain Enhancement LLC

In June 2007, we formed a joint venture with Pacific Advisors Holdings Limited (Note 10) which requires us to make capital contributions to the joint venture totaling up to $5,000,000. Our first contribution of $1,500,000 was made in July 2007. An additional $2,000,000 is due no later than October 2007, and the final contribution, if required, of $1,500,000 is due no later than August 2008.

Facility Lease

We lease corporate office space in Phoenix, AZ. Future amounts due under this lease at June 30, 2007 are in the following table:

Fiscal Year 2007	$ 294,000
Fiscal Year 2008	1,074,000
Fiscal Year 2009	1,393,000
Fiscal Year 2010	1,442,000
Fiscal Year 2011	1,490,000
FiscalYear 2012	1,539,000
Thereafter	5,336,000
Total	$ 12,568.000

Total rent expense for the three and six months ended June 30, 2007 was $249,000 and $276,000, respectively.

13. STOCKHOLDERS EQUITY

Common Stock

During the six months ended June 30, 2007:

Four (4) shareholders converted 470 shares of Series B Convertible preferred Stock into 940,000 shares of our common stock. The preferred shares converted at a conversion rate of 2,000 shares of common stock for each preferred share.

Seventeen (17) shareholders converted 5,466 shares of Series C Convertible preferred Stock into 6,430,580 shares of our common stock. The preferred shares converted at a conversion rate of 1,176 shares of common stock for each preferred share.

Twenty-one (21) shareholders exercised options or warrants and received a total of 3,451,959 shares of common stock for an aggregate purchase price of $3,930,000.

We issued 17,500 shares of our common stock valued at $55,000 to a former member of our board of directors as payment for past services on our board of directors.

Thirty (30) shareholders exercised options or warrants and received a total of 5,400,199 shares of common stock for an aggregate purchase price of $2,947,000.

Options and Warrants

During the six months ended June 30, 2007:

We issued to eleven (11) employees options to purchase a total of 635,000 shares of common stock with vesting periods ranging from immediately to three years. The options expire in ten years and have exercise prices per share ranging from $2.45 to $3.39.

We issued to thirteen (13) employees options to purchase a total of 276,000 shares of common stock with vesting periods ranging from zero to three years. The options expire in ten years and have exercise prices per share ranging from $3.03 to $4.04.

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We issued to three (3) consultants three warrants to purchase a total of 290,000 shares of common stock, with vesting periods ranging from 3 months to two years. These warrants expire after three to five years and have exercise prices per share ranging from $2.38 to $3.03.

We issued to six (6) outside directors options to purchase a total of 210,000 shares of common stock that vest evenly over one year. The options expire in ten years and have exercise prices per share ranging from $3.76 to $3.83.

We issued to one (1) consultant a warrant to purchase a total of 25,000 shares of common stock, with a vesting period of fifteen months. This warrant expires after three years and has an exercise price per share of $3.27.

In June 2007 we granted Pacific Advisors Holdings Limited a warrant to purchase 1,500,000 shares of common stock at $5.25 per share. This warrant vests at 375,000 per quarter beginning July 1, 2007 except that such warrant will not be exercisable until such time as Grain Enhancements LLC has met certain conditions mutually agreed upon by the parties (Note 10).

The expense for stock options and warrants issued to consultants and employees are calculated at fair value using the Black-Scholes valuation method.

February 2007 Private Placement

In addition to the foregoing issuances of our securities, in February 2007 we issued common stock and warrants to twenty-three (23) investors in a private placement transaction for aggregate gross proceeds of approximately $46,805,000 after offering expenses. We issued an aggregate of 20,000,000 shares of common stock at a price of $2.50 per share and warrants to purchase an aggregate of 10,000,000 shares of our common stock at an exercise price of $3.25 per shares. The placement agent for the private placement also received a warrant to purchase 1,200,000 shares of common stock at an exercise price per share of $3.25. Each of the warrants issued in the transaction has a term of five years. The fair value of these 11,200,000 warrants using the Black-Scholes method is approximately $29,153,000. If exercised the company would receive $36,400,000.

14. SUBSEQUENT EVENTS

In July 2007, six (6) shareholders exercised warrants and received a total of 1,122,856 shares of common stock for an aggregate purchase price of approximately $1,144,000.

15. IMPLEMENTATION OF RECENT ACCOUNTING PRONOUNCEMENTS

During the six months ended June 30, 2007, we implemented the following new critical accounting policies;

In December 2003, the Financial Accounting Standards Board (“FASB”) issued SFAS Interpretation No. 46R, *Consolidation of Variable Interest Entities* (“FIN 46R). Under FIN 46R, if a business enterprise has a controlling financial interest in a variable interest entity, the assets, liabilities, and results of the activities of the variable interest entity should be included in consolidated financial statements with those of the business enterprise. An enterprise that consolidates a variable interest entity is the primary beneficiary of the variable interest entity. FIN 46R became applicable to the Company during the six months ended June 30, 2007. See Note 10 for more information.

In September 2006, the FASB issued SFAS No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 123(R)* (SFAS 158). Under SFAS 158, companies must: a) recognize a net liability or asset to report the funded status of their plans on their statement of financial position, b) measure a plan’s assets and its obligations that determine its funded status as of the end of the employer’s fiscal year, and c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur in comprehensive income. The Company adopted the measurement date provisions of SFAS 158 effective October 1, 2006. The Company will adopt the recognition provisions of SFAS 158 as of the end of fiscal year 2007 as required by SFAS 158.

In June 2006, the FASB issued Interpretation No.48, *Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109*, (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return that results in a tax benefit. Additionally, FIN 48 provides guidance on de-recognition, statement of operations classification of interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 as of January 1, 2007, as required. The adoption of FIN 48 did not have a material impact on the Company’s financial position or results of operations.

In December 2006, the FASB issued FASB Staff Position EITF 00-19-2, *Accounting for Registration Payment Arrangements* (“FSP EITF 00-19-2”), which provides guidance on the accounting for registration payment arrangements. FSP EITF 00-19-2 specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, *Accounting for Contingencies*. A registration payment arrangement is defined in FSP EITF 00-19-2 as an arrangement with both of the following characteristics: (1) the arrangement specifies that the issuer will endeavor (a) to file a registration statement for the resale of specified financial instruments and/or for the resale of equity shares that are issuable upon exercise or conversion of specified financial instruments and for that registration statement to be declared effective by the Securities and Exchange Commission within a specified grace period, and/or (b) to maintain the effectiveness of the registration statement for a specified period of time (or in perpetuity); and (2) the arrangement requires the issuer to transfer consideration to the counterparty if the registration statement for the resale of the financial instrument or instruments subject to the arrangement is not declared effective or if effectiveness of the registration statement is not maintained. FSP EITF 00-19-2 is effective for registration payment arrangements and the financial instruments subject to those arrangements that are entered into or modified subsequent to December 21, 2006. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of FSP EITF 00-19-2, this guidance is effective for financial statements issued for fiscal years beginning after December 15, 2006, and interim periods within those fiscal years. The adoption of FSP EITF 00-19-2 on January 1, 2007 did not have a material impact on the Company’s financial position or results of operations.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for the Company’s year ending September 30, 2009. The Company is currently evaluating the impact of SFAS 159 on the Company’s financial statements.

Item 2. Management's Discussion and Analysis or Plan of Operation

NutraCea is a health-science company focused on the development and distribution of products based upon the use of stabilized rice bran and proprietary rice bran formulations. Rice bran is the outer layer of brown rice which until recently was a wasted by-product of the commercial rice industry. These products include food supplements and medical foods which provide health benefits for humans and animals (known as "nutraceuticals") as well as cosmetics and beauty aids based on stabilized rice bran, rice bran derivatives and the rice bran oils.

The following is a discussion of the consolidated financial condition of our results of operations for the three and six months ended June 30, 2007 and 2006.

THREE MONTHS ENDED JUNE 30, 2007 AND 2006

For the three months ended June 30, 2007, the Company's net income was $2,002,000, or $0.01 per share, compared to $399,000 or $0.00 per share, in the same period of 2006, showing an increase of $1,603,000. The increase for the quarter was primarily due to a $2,307,000 increase in our gross margin on product sales, a $5,000,000 gain on our grant of an exclusive license to Pacific Advisors Holding Limited and an increase of $767,000 in interest income, offset by an increase of $5,820,000 in total operating expenses, and a charge of $309,000 for the loss on abandonment of leasehold improvements at our corporate offices in El Dorado Hills, CA when we moved to Phoenix, AZ.

Our consolidated revenues for the three months ended June 30, 2007 of $12,996,000 increased $8,830,000 from the $4,166,000 consolidated revenues recorded in the same period last year. This increase is composed of the $5,000,000 from the grant of an exclusive license and a $3,837,000, or 92% increase in product sales to $7,996,000 from the $4,159,000 recorded in the three months ended June 30, 2006. This $3,837,000 increase is primarily due to a $2,331,000 increase in sales of our proprietary products, and a $2,080,000 in sales of several new products, offset by a $2,096,000 decrease in infomercial product sales.

Gross margins on product sales in the quarter ended June 30, 2007 were $4,133,000, or 52%, compared to $1,826,000, or 44%, during the same period last year. Gross margins on our various product lines vary widely and the gross margins are impacted from period to period by sales mix and utilization of production capacity.

Research and Development ("R&D") expenses increased from $94,000 for the quarter ended June 30, 2006 to $170,000 for the quarter ended June 30, 2007, or an increase of $76,000. The increase was attributed to higher product development costs and employee related expenses due to increased R&D activities and expanded scientific staff compared to the same period last year. The Company expects to continue research and development expenditures to establish the scientific basis for health claims of existing products and to develop new products and applications.

Sales, General and Administrative expenses were $5,657,000 and $1,348,000 in the quarterly periods ended June 30, 2007 and 2006 respectively, an increase of $4,309,000, or 320%. The increase was composed of a $1,055,000 increase to our provision for doubtful accounts, $788,000 increase in payroll costs due to increased staffing, an increase of $671,000 in advertising costs, a $197,000 increase in travel costs, a $210,000 increase in rent expense, a $112,000 increase in freight costs, $228,000 in expenses associated with relocating our offices to Phoenix, AZ, a $674,000 increase in the amortization of share-based expenses (Note 2), and $574,000 increase in other general administrative expenses.

Professional fees increased $1,435,000 from $101,000 for the quarter ended June 30, 2006 to $1,536,000 for the quarter ended June 30, 2007. The higher professional fees in 2007 primarily relate to consulting fees incurred in connection with marketing and business development activities and a one-time charge of $750,000 for costs associated with developing our joint venture with Grain Enhancements LLC (Note 10). Professional fees include costs related to accounting, legal and consulting services.

SIX MONTHS ENDED JUNE 30, 2007 AND 2006

For the six months ended June 30, 2007, the Company's net income was $1,755,000, or $0.01 per share, compared to net income of $166,000, or $0.00 per share, in the same period of 2006, showing an improvement of $1,589,000. The improvement for the six month period was primarily due to a $1,508,000 increase in our gross margin on product sales, a $5,000,000 gain on our grant of an exclusive license, an increase of $1,253,000 in interest income, and a $1,250,000 gain on the settlement of a lawsuit, offset by an increase of $6,772,000 in total operating expenses, and a charge of $309,000 for the loss on abandonment of leasehold improvements in our corporate offices in El Dorado Hills, CA when we moved from our corporate offices to Phoenix, AZ .

Our consolidated revenues through June 30, 2007 of $14,993,000 increased $7,045,000, or 89%, from the same period last year. The revenue increase is attributable to a $2,051,000 increase in product sales and a $5,000,000 fee relating to our grant of an exclusive license. The increase in product sales is made up of a $2,387,000 increase in the sales of proprietary products, $2,080,000 in sales of several new products, an increase of $222,000 of other products, offset by a decrease of $4,689,000 in infomercial sales.

Gross margins on product sales in the six months ended June 30, 2007 were $5,007,000, or 50%, compared to $3,499,000, or 44%, during the same period last year. Gross margins on our various product lines vary widely and the gross margins are impacted from period to period by sales mix and utilization of production capacity.

Research and Development expenses increased from $198,000 for the six months ended June 30, 2006 to $291,000 for the six months ended June 30, 2007, or an increase of $93,000. The increase was attributed to higher product development costs and employee related expenses due to increased R&D activities and expanded scientific staff compared to the same period last year. The Company expects to continue research and development expenditures to establish the scientific basis for health claims of existing products and to develop new products and applications.

Sales, General and Administrative expenses were $7,970,000 and $2,852,000 in the six months ended June 30, 2007 and 2006 respectively, an increase of $5,118,000, or 179%. The increase was composed of a $1,205,000 increase in payroll costs due to increased staffing, a $1,055,000 charge for the increase in allowance for doubtful accounts, an increase of $671,000 in advertising costs, a $314,000 increase in travel costs, a $210,000 increase in rent expense, a $153,000 increase in freight costs, $228,000 in expenses associated with relocating our offices to Phoenix, AZ, a $723,000 increase in the amortization of share-based expenses (Note 2), and a $559,000 increase in other general administrative expenses.

Professional fees increased $1,561,000 from $434,000 for the six months ended June 30, 2006 to $1,995,000 for the six months ended June 30, 2007. The higher professional fees in 2007 primarily relate to consulting fees incurred in connection with marketing and business development activities and a charge of $750,000 for costs associated with developing our joint venture with Grain Enhancements LLC (Note 10). Professional fees include costs related to accounting, legal and consulting services.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2007, our source of liquidity was cash in the amount of $51,500,000. Our cash increased by $36,633,000 in the six months ended June 30, 2007 from our cash position of $14,867,000 at December 31, 2006.

For the first six months of 2007, net cash used by operations was $369,000, compared to net cash provided by operations in the same period of 2006 of $486,000, a decrease of $855,000. This decrease in cash provided by operations resulted primarily from our net income of $1,755,000, plus the non-cash charges against income of $894,000 for depreciation and amortization, $1,055,000 for an increase in the provision for doubtful accounts, a

$309,000 charge for the loss on the retirement of leasehold improvements, a $1,263,000 charge for stock-based compensation, the $250,000 charge for the equity loss on our joint venture, offset by an increase of $4,752,000 in accounts receivable (net of a conversion of a customers' accounts receivable of $3,881,000 to a short-term note receivable (Note 5), a $726,000 decrease in accounts payable and accrued liabilities and a $380,000 increase in deposits and other current assets.

Cash used in investing activities in the first six months of 2007 was $16,680,000, compared to $5,186,000 for the same period of 2006. This increase of $11,494,000 was primarily caused $6,026,000 in expenditures for plant expansions and other fixed assets, a $109,000 for the purchase of intangible assets, $2,168,000 and $5,144,000 for the purchase Grainovation, Inc. and the investment in Vital Living, Inc., respectively, net of cash received in those transactions, and a net outflow of $3,233,000 relating to loans made by us to certain strategic customers, net of $3,881,000 of accounts receivable converted to short-term notes receivable (Note5).

Cash provided by financing activities for the six months ended June 30, 2007, was approximately $53,682,000, which reflects proceeds from our February 2007 private placement financing (see below) and proceeds received upon the exercise of common stock options and warrants. This is an increase of $37,714,000 from the $15,968,000 received from private placement financing in the six months ended June 30, 2006. Our working capital position as of June 30, 2007 was $61,026,000 compared to $23,320,000 as of December 31, 2006.

On February 15, 2007, we sold an aggregate of 20,000,000 shares of our common stock at a price of $2.50 per share in connection with a private placement for aggregate gross proceeds of $50,000,000 (approximately $46,805,000 after offering expenses). Additionally, the investors were issued warrants to purchase an aggregate of 10,000,000 shares of our common stock at an exercise price of $3.25 per share. An advisor for the financing received a customary 6% cash-fee, based on aggregate gross proceeds received from the investors, reasonable expenses and a warrant to purchase 1,200,000 shares of common stock at an exercise price per share of $3.25. The warrants have a term of five years and are exercisable after August 16, 2007.

In April 2007, we acquired shares of convertible preferred stock and secured convertible notes of a Vital Living, Inc. from the holders of those outstanding securities, for an aggregate of $5,226,000. Commencing on October 31, 2007, the notes can be converted into shares of common stock of the customer (Note 10).

On May 1, 2007, we purchased the outstanding stock of Grainnovation, Inc. (“GI”) and certain assets used in the business of GI. The purchase enables us to produce pellets for the equine market. The purchase agreement provides for a cash purchase price of $2,150,000, and allows NutraCea to require the former shareholders of GI to repurchase from NutraCea the stock of GI if certain post-closing covenants are not satisfied by GI in the six month period following the closing of the transaction (Note 10).

In June 2007, we entered into a joint venture Pacific Advisors Holdings Limited to form Grain Enhancement LLC (Note 10). This joint venture required a $1,500,000 capital contribution which was made in July 2007. Additional contributions of $2,000,000 and $1,500,000 are due in October 2007 and October 2008, respectively.

We believe we have sufficient cash reserves to meet all anticipated short-term operating requirements.

OFF BALANCE SHEET ARANGEMENTS

We have not entered into any transactions with unconsolidated entities whereby we have financial guarantees, subordinated retained interests, derivative instruments or other contingent arrangements that expose us to material continuing risk, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing and liquidity support or market risk or credit risk support to the Company.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based upon unaudited consolidated condensed financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses and disclosures on the date of the financial statements. On an on-going basis, our accountants evaluate the estimates, including, but not limited to, those related to revenue recognition. We use authoritative pronouncements, historical experience and other assumptions as the basis for making judgments. Actual results could differ from those estimates.

For further information about other critical accounting policies, see the discussion of critical accounting policies in our 2006 Form 10-K for the fiscal year ended December 31, 2006.

Acquisitions

We account for acquisitions in accordance with Statement of Financial Accounting Standards ("SFAS"), No. 141 "Business Combinations" and accordingly apply the purchase method of accounting for all business combinations initiated after September 30, 2001 and separately identify recognized intangible assets that meet certain criteria, amortizing these assets over their determinable useful lives.

During the six months ended June 30, 2007, we implemented the following new critical accounting policy:

In December 2003, the Financial Accounting Standards Board ("FASB") issued SFAS Interpretation No. 46R, *Consolidation of Variable Interest Entities* ("FIN 46R). Under FIN 46R, if a business enterprise has a controlling financial interest in a variable interest entity, the assets, liabilities, and results of the activities of the variable interest entity should be included in consolidated financial statements with those of the business enterprise. An enterprise that consolidates a variable interest entity is the primary beneficiary of the variable interest entity. FIN 46R became applicable to the Company during the six months ended June 30, 2007. See footnote 10 for more information.

Recent accounting pronouncements

In February 2007, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for the Company's year ending September 30, 2009. The Company is currently evaluating the impact of SFAS 159 on the Company's financial statements. Put in recent pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 123(R)* (SFAS 158). Under SFAS 158, companies must: a) recognize a net liability or asset to report the funded status of their plans on their statement of financial position, b) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur in comprehensive income. The Company adopted the measurement date provisions of SFAS 158 effective October 1, 2006. The Company will adopt the recognition provisions of SFAS 158 as of the end of fiscal year 2007 as required by SFAS 158.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for the Company's year ending September 30, 2009. The Company is currently evaluating the impact of SFAS 159 on the Company's financial statements.

In June 2006, the FASB issued Interpretation No.48, *Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109*, (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "*Accounting for Income Taxes*". FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of an uncertain tax position taken or expected to be taken in a tax return that results in a tax benefit. Additionally, FIN

48 provides guidance on de-recognition, statement of operations classification of interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 as of January 1, 2007, as required. The adoption of FIN 48 did not have a material impact on the Company’s financial position or results of operations.

In December 2006, the FASB issued FASB Staff Position EITF 00-19-2, *Accounting for Registration Payment Arrangements* ("FSP EITF 00-19-2"), which provides guidance on the accounting for registration payment arrangements. FSP EITF 00-19-2 specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, *Accounting for Contingencies*. A registration payment arrangement is defined in FSP EITF 00-19-2 as an arrangement with both of the following characteristics: (1) the arrangement specifies that the issuer will endeavor (a) to file a registration statement for the resale of specified financial instruments and/or for the resale of equity shares that are issuable upon exercise or conversion of specified financial instruments and for that registration statement to be declared effective by the Securities and Exchange Commission within a specified grace period, and/or (b) to maintain the effectiveness of the registration statement for a specified period of time (or in perpetuity); and (2) the arrangement requires the issuer to transfer consideration to the counterparty if the registration statement for the resale of the financial instrument or instruments subject to the arrangement is not declared effective or if effectiveness of the registration statement is not maintained. FSP EITF 00-19-2 is effective for registration payment arrangements and the financial instruments subject to those arrangements that are entered into or modified subsequent to December 21, 2006. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of FSP EITF 00-19-2, this guidance is effective for financial statements issued for fiscal years beginning after December 15, 2006, and interim periods within those fiscal years. The adoption of FSP EITF 00-19-2 on January 1, 2007 did not have a material impact on the Company's financial position or results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our cash and cash equivalents have been maintained only with maturities of 30 days or less. Our short-term investments have interest reset periods of 30 days or less. These financial instruments may be subject to interest rate risk through lost income should interest rates increase during their limited term to maturity or resetting of interest rates. As of June , 2007, there was no long-term debt outstanding. Future borrowings, if any, would bear interest at negotiated rates and would be subject to interest rate risk. We do not believe that a hypothetical adverse change of 10% in interest rates would have a material effect on our financial position.

Item 4. Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of management, including the Company's principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this quarterly report. Based upon that evaluation, our chief executive officer and our chief financial officer concluded that, as of June 30, 2007, NutraCea's disclosure controls and procedures were adequate to ensure that information required to be disclosed by NutraCea in reports filed or submitted under the Exchange Act were timely recorded, processed and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

During the quarter covered by this report, there was no change in NutraCea's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART 2. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time we are involved in litigation incidental to the conduct of our business. While the outcome of lawsuits and other proceedings against us cannot be predicted with certainty, in the opinion of management, individually or in the aggregate, no such lawsuits are expected to have a material effect on our financial position or results of operations.

Item 1A. Risk Factors

Investors or potential investors in our stock should carefully consider the risks described below. Our stock price will reflect the performance of our business relative to, among other things, our competition, expectations of securities analysts or investors, and general economic market conditions and industry conditions. One should carefully consider the following factors in connection with any investment in our stock. Our business, financial condition and results of operations could be materially adversely affected if any of the following risks occur. Should any or all of the following risks materialize, the trading price of our stock could decline, and investors could lose all or part of their investment.

Risks Related to Our Business

We have a limited operating history and have just generated our first profits since we began operations.

We began operations in February 2000 and incurred losses in each reporting period until 2006. Our prospects for financial success are difficult to forecast because we have a relatively limited operating history. Our prospects for financial success must be considered in light of the risks, expenses and difficulties frequently encountered by companies in new, unproven and rapidly evolving markets. Our business could be subject to any or all of the problems, expenses, delays and risks inherent in the establishment of a new business enterprise, including limited capital resources, possible delays in product development, possible cost overruns due to price and cost increases in raw product and manufacturing processes, uncertain market acceptance, and inability to respond effectively to competitive developments and attract, retain and motivate qualified employees. Therefore, there can be no assurance that our business or products will be successful, that we will be able to achieve or maintain profitable operations or that we will not encounter unforeseen difficulties that may deplete our capital resources more rapidly than anticipated.

There are significant market risks associated with our business.

We have formulated our business plan and strategies based on certain assumptions regarding the size of the rice bran market, our anticipated share of this market and the estimated price and acceptance of our products. These assumptions are based on the best estimates of our management; however there can be no assurance that our assessments regarding market size, potential market share attainable by us, the price at which we will be able to sell our products, market acceptance of our products or a variety of other factors will prove to be correct. Any future success may depend upon factors including changes in the dietary supplement industry, governmental regulation, increased levels of competition, including the entry of additional competitors and increased success by existing competitors, changes in general economic conditions, increases in operating costs including costs of production, supplies, personnel, equipment, and reduced margins caused by competitive pressures.

We depend on limited number of customers.

During 2006, we received approximately 67% of product sales revenue from five customers and approximately 48% of our revenue from one customer. During the six months ended June 30, 2007, we received approximately 49% of our revenue from 2 customers A loss of any of these customers could have a material adverse effect on our revenues and results of operations.

We rely upon a limited number of product offerings.

All of our products are based on stabilized rice bran. Although we will market stabilized rice bran as a dietary supplement, as an active food ingredient for inclusion in our products and in other companies' products, and in other ways, a decline in the market demand for our products, as well as the products of other companies utilizing our products, could have a significant adverse impact on us.

We are dependent upon our marketing efforts.

We are dependent on our ability to market products to animal food producers, food manufacturers, mass merchandise and health food retailers, and to other companies for use in their products. We must increase the level of awareness of dietary supplements in general and our products in particular. We will be required to devote substantial management and financial resources to these marketing and advertising efforts and there can be no assurance that it will be successful.

We rely upon an adequate supply of raw rice bran.

All of our current products depend on our proprietary technology using unstabilized or raw rice bran, which is a by-product from milling paddy rice to white rice. Our ability to manufacture stabilized rice bran raw is currently limited to the production capability of our production equipment at Farmers' Rice Co-operative ("FRC") and our single value-added products plant in Dillon, Montana. Between the Dillon, Montana plant and the facility at FRC, we currently are capable of producing just enough finished products to meet current demand. The existing plants do not allow for dramatic expansion of product demand, therefore domestic production capacity is needed. Anticipating incremental demand for NutraCea Products, we completed the first phase of an expansion of the Dillon, Montana facility in 2006. We have also entered into a new raw rice bran supply agreement with Louisiana Rice Mill ("LRM") in Louisiana. The supply agreement led to the construction of a new stabilization plant in Mermentau which became operational in April 2007. These facilities plus another stabilization and value-added plant scheduled to be operational by the end of 2007 should meet our production needs for 2007, but we do not anticipate that they will meet our longer term supply needs. Therefore, we anticipate building new facilities to meet the forecasted demand for our products and envision we will be able to execute on this initiative. In the event we are unable to create additional production capacity to produce more stabilized rice bran products to fulfill our current and future requirements this could materially and adversely affect our business, results from operations, and financial condition.

We are pursuing other supply sources in the United States and in foreign countries and anticipate being able to secure alternatives and back-up sources of rice bran, although we have not entered into any definitive agreements other than the agreements with Farmers Rice Cooperative and Louisiana Rice Mill. However, there can be no assurance that we will continue to secure adequate sources of raw rice bran to meet our requirements to produce stabilized rice bran products. Since rice bran has a limited shelf life, the supply of rice bran is affected by the amount of rice planted and harvested each year. If economic or weather conditions adversely affect the amount of rice planted or harvested, the cost of rice bran products that we use may increase. We are not generally able to pass cost increases to our customers and any increase in the cost of stabilized rice bran products would have an adverse effect on our results of operations.

We face competition.

Competition in our targeted industries, including nutraceuticals, functional food ingredients, rice bran oils, animal feed supplements and companion pet food ingredients is vigorous, with a large number of businesses engaged in the various industries. Many of our competitors have established reputations for successfully developing and marketing their products, including products that incorporate bran from other cereal grains and other alternative ingredients that are widely recognized as providing similar benefits as rice bran. In addition, many of our competitors have greater financial, managerial, and technical resources than us. If we are not successful in competing in these markets, we may not be able to attain our business objectives.

Our products could fail to meet applicable regulations which could have a material adverse affect on our financial performance.

The dietary supplement and cosmetic industries are subject to considerable government regulation, both as to efficacy as well as labeling and advertising. There is no assurance that all of our products and marketing strategies will satisfy all of the applicable regulations of the Dietary Supplement, Health and Education Act, the Food, Drug and Cosmetic

Act, the U.S. Food and Drug Administration and/or the U.S. Federal Trade Commission. Failure to meet any applicable regulations would require us to limit the production or marketing of any non-compliant products or advertising, which could subject us to financial or other penalties.

Our success depends in part on our ability to obtain patents, licenses and other intellectual property rights for our products and technology.

We have one patent entitled Methods for Treating Joint Inflammation, Pain and Loss of Mobility, which covers both humans and mammals. In addition, our subsidiary RiceX has five United States patents and may decide to file corresponding international applications. RiceX holds patents to the production of Beta Glucan and to a micro nutrient enriched rice bran oil process. RiceX also holds patents to a method to treat high cholesterol, to a method to treat diabetes and to a process for producing Higher Value Fractions from stabilized rice bran. The process of seeking patent protection may be long and expensive, and there can be no assurance that patents will be issued, that we will be able to protect our technology adequately, or that competition will not be able to develop similar technology.

There currently are no claims or lawsuits pending or threatened against us or RiceX regarding possible infringement claims, but there can be no assurance that infringement claims by third parties, or claims for indemnification resulting from infringement claims, will not be asserted in the future or that such assertions, if proven to be accurate, will not have a material adverse affect on our business, financial condition and results of operations. In the future, litigation may be necessary to enforce our patents, to protect our trade secrets or know-how or to defend against claimed infringement of the rights of others and to determine the scope and validity of the proprietary rights of others. Any litigation could result in substantial cost and diversion of our efforts, which could have a material adverse affect on our financial condition and results of operations. Adverse determinations in any litigation could result in the loss of our proprietary rights, subjecting us to significant liabilities to third parties, require us to seek licenses from third parties or prevent us from manufacturing or selling our systems, any of which could have a material adverse affect on our financial condition and results of operations. There can be no assurance that a license under a third party’s intellectual property rights will be available to us on reasonable terms, if at all.

We are dependent on key employees and consultants.

Our success depends upon the efforts of our top management team, including the efforts of Bradley D. Edson, our President and Chief Executive Officer, Todd C. Crow, our Chief Financial Officer, Leo Gingras, our Chief Operating Officer, Margie D. Adelman, our Secretary and Senior Vice President and Kody K. Newland, our Senior Vice President of Sales and Marketing. Although we have written employment agreements with each of the foregoing individuals there is no assurance that such individuals will not die, become disabled, or resign. In addition, our success is dependent upon our ability to attract and retain key management persons for positions relating to the marketing and distribution of our products. There is no assurance that we will be able to recruit and employ such executives at times and on terms acceptable to us.

***We* have not yet achieved positive cash flow**

We have not generated a positive cash flow from operations continuous period to period since commencing operations. We raised in private placements of equity approximately $50,000,000 in February 2007, $17,560,000 in May 2006, and $8,000,000 in October 2005, and paid off all short and long term debt obligations. While we believe that we have adequate cash reserves and working capital to fund current operations, our ability to meet long term business objectives may be dependent upon our ability to raise additional financing through public or private equity financings, establish increasing cash flow from operations, enter into collaborative or other arrangements with corporate sources, or secure other sources of financing to fund long-term operations. There is no assurance that external funds will be available on terms acceptable to us in sufficient amount to finance operations until we do reach sufficient positive cash flow to fund our capital expenditures. In addition, any issuance of securities to obtain such funds would dilute percentage ownership of our shareholders. Such dilution could also have an adverse impact on our earnings per share and reduce the price of our common stock. Incurring additional debt may involve restrictive covenants and increased interest costs and demand on future cash flow. Our inability to obtain sufficient financing may require us to delay, scale back or eliminate some or all of our product development and marketing programs.

Our products may require clinical trials to establish efficacy and safety.

Certain of our products may require clinical trials to establish our benefit claims or their safety and efficacy. Such trials can require a significant amount of resources and there is no assurance that such trials will be favorable to the claims we make for our products, or that the cumulative authority established by such trials will be sufficient to support our claims. Moreover, both the findings and methodology of such trials are subject to challenge by the FDA and scientific bodies. If the findings of our trials are challenged or found to be insufficient to support our claims, additional trials may be required before such products can be marketed.

Risks Related to Our Stock

Our Stock Price is Volatile.

The market price of a share of our common stock has fluctuated significantly in the past and may continue to fluctuate significantly in the future. The high and low sales prices of a share of common stock for the following periods were:

	High	Low
Three months ended June 30, 2007	$ 5.04	$ 2.60
Three months ended March 31, 2007	$ 3.39	$ 2.21
Twelve months ended December 31, 2006	$ 2.74	$ 0.60
Twelve months ended December 31, 2005	$ 1.81	$ 0.30

The market price of a share of our common stock may continue to fluctuate in response to a number of factors, including:

- announcements of new products or product enhancements by us or our competitors;
- fluctuations in our quarterly or annual operating results;
- developments in our relationships with customers and suppliers;
- the loss of services of one or more of our executive officers or other key employees;