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INTEGRATED BIOPHARMA INC

Form 10-Q

February 14, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2006

OR

Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number 000-28876

INTEGRATED BIOPHARMA, INC.
(Exact name of registrant in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

22-2407475
(I.R.S. Employer
Identification No.)

225 Long Ave., Hillside, New Jersey 07205
(Address of principal executive offices) (Zip Code)

(888) 319-6962
(Registrant's telephone number, including Area Code)

Not Applicable
(Former name, former address and former fiscal year,
if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and 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 No

Indicate by check whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate by check whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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The number of shares outstanding of each of the Registrant's classes of common equity, as of the latest practicable date:

Class	Outstanding at January 30, 2007
Common Stock, \$0.002 par value	13,582,781 Shares

INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES

FORM 10-Q QUARTERLY REPORT For the Quarterly Period Ended December 31, 2006 INDEX

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Disclosure Regarding Forward-Looking Statements

Certain statements in the Quarterly Report on Form 10-Q may constitute "forward-looking" statements as defined in Section 27A of the Securities Act of 1933 (the "Securities Act"), Section 21E of the Securities Act of 1934 (the "Exchange Act"), the Private Securities Litigation Reform Act of 1995 (the "PSLRA") or in releases made by the Securities and Exchange Commission, all as may be amended from time to time. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Integrated BioPharma, Inc. or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Statements that are not historical fact are forward-looking statements. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as the words, "plan", "believe", "expect", "anticipate", "intend", "estimate", "project", "may", "will", "would", "could", "should", "seeks", or "scheduled to", or other similar words, or the negative of these terms or other variations of these terms or comparable language, or by discussion of strategy or intentions. These cautionary statements are being made pursuant to the Securities Act, the Exchange Act and the PSLRA with the intention of obtaining the benefits of the "safe harbor" provisions of such laws. The Company cautions investors that any forward-looking statements made by the Company are not guarantees or indicative of future performance. Important assumptions and other important factors that could cause actual results to differ materially from those forward-looking statements with respect to the Company, include, but are not limited to, the risks and uncertainties affecting its businesses described in Item 1 of the Company's Annual Report filed on Form 10-K for the year ended June 30, 2006 and in registration statements and other securities filings by the Company.

Although the Company believes that its plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, actual results could differ materially from a projection or assumption in any of its forward-looking statements, are subject to change and inherent risks and uncertainties. The forward-looking statements contained in this Quarterly Report on Form 10-Q are made only as of the date hereof and the Company does not have or undertake any obligation to update or revise any forward-looking statements whether as a result of new information, subsequent events or otherwise, unless otherwise required by law.

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ITEM 1. FINANCIAL STATEMENTS

INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	Three months ended December 31,	
	2006	2005
Sales, net	\$ 20,852,080	\$ 12,968,294

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Cost of sales	14,110,416	7,989,170
Gross profit	6,741,664	4,979,124
Selling and administrative expenses	4,722,379	3,613,109
Operating income	2,019,285	1,366,015
Other expense	(165,977)	(37,030)
Income before income taxes	1,853,308	1,328,985
Federal and state income tax	755,410	20,876
Income before minority interest	1,097,898	1,308,109
Minority interest	-	83,916
Net income	1,097,898	1,392,025
Deemed dividend from beneficial conversion feature of Series B Preferred stock dividend	(1,220,546)	(583,000)
Series B Preferred stock dividends	(1,430,106)	(123,507)
Net (loss) income applicable to common shareholders	\$ (1,552,754)	\$ 685,518
Net (loss) income per common share:		
Basic	\$ (0.11)	\$ 0.05
Diluted	\$ (0.11)	\$ 0.05
Weighted average common shares outstanding	13,565,538	12,726,849
Dilutive potential shares:		
Warrants and options	-	1,160,673
Convertible preferred stock	-	-
Weighted average common share outstanding - assuming dilution	13,565,538	13,887,522

See accompanying notes to condensed consolidated financial statements.

INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

Assets

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2006

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Current Assets:	
Cash and cash equivalents	\$ 5,
Restricted cash	2,
Accounts receivable, net	5,
Inventories, net	14,
Deferred income taxes	3,
Other current assets	1,

Total current assets	31,
Property and equipment, net	4,
Goodwill	
Intangible assets, net	3,
Deferred income taxes	1,
Security deposits and other assets	

Total Assets	\$ 41, =====
Liabilities and Stockholders' Equity:	
Current Liabilities:	
Revolving credit facility	\$ 13,
Note payable - bank	
Accounts payable	3,
Accrued expenses and other current liabilities	2,
State income taxes payable	
Loan payable - Trade Investment Services, LLC, related party	

Total Current Liabilities	20,
Commitments and Contingencies	
Series B 7% Redeemable Convertible Preferred Stock, net of beneficial conversion feature, warrants issued and issuance costs, \$0.002 par value; 1,250 shares authorized; 25 shares issued and outstanding at December 31, 2006 and 675 shares issued and outstanding at June 30, 2006; liquidation preference of \$250,000 at December 31, 2006 and \$6,750,000 at June 30, 2006	
Minority Interest	
Stockholders' Equity:	
Common Stock, \$0.002 par value; 25,000,000 shares authorized; 13,587,511 shares issued at December 31, 2006 and 13,200,961 at June 30, 2006; 13,552,611 shares outstanding at December 31, 2006 and 13,166,061 at June 30, 2006	
Additional paid-in-capital	33,
Accumulated deficit	(11,9
Less: Treasury stock, at cost, 34,900 shares	(

Total Stockholders' Equity	21,

Total Liabilities and Stockholders' Equity	\$ 41, =====

See accompanying notes to condensed consolidated financial statements.

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	Common Shares	Stock Par Value	Additional Paid-in- Capital	Accumulated Deficit
	-----	-----	-----	-----
Balance, June 30, 2006	13,200,961	\$26,402	\$30,580,604	\$ (9,872,742)
Exercise of stock options for cash	366,500	733	732,342	-
Restricted stock award	20,050	40	152,585	-
Compensation expense for employee stock options	-	-	148,714	-
Income tax benefit from exercise of stock options	-	-	343,733	-
Dividends paid on Series B preferred stock	-	-	-	(370,904)
Deemed preferred dividends from issuance of warrants	-	-	1,178,298	(1,178,298)
Deemed dividend from beneficial conversion feature of Series B preferred stock	-	-	-	(1,783,046)
Net income	-	-	-	1,265,986
	-----	-----	-----	-----
Balance December 31, 2006 (Unaudited)	13,587,511	\$27,175	\$33,136,276	\$ (11,939,004)
	=====	=====	=====	=====

See accompanying notes to condensed consolidated financial statements.

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INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	----- 2006 -----
Cash flows from operating activities:	
Net income	\$ 1,265,986
Adjustments to reconcile net income to net cash (used in) provided by operating activities:	
Depreciation and amortization	629,000
Deferred income taxes	525,000
Loss on investment in Micro Nutrition, Inc.	171,000
Allowance for inventory	25,000
Allowance for doubtful accounts (recoveries)	(13,300)
Issuance of common stock for consulting services	186,000
Compensation expense for employee stock options	148,000
Minority interest	(37,500)
Changes in assets and liabilities (excludes impact of acquisitions):	
(Increase) decrease in:	
Accounts receivable	634,000
Inventories	(3,307,400)
Prepaid expenses and other current assets	(64,200)
Security deposits and other assets	(41,700)
(Decrease) increase in:	

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Accounts payable	(227,8
Income taxes payable	301,
Accrued expenses and other liabilities	(321,5

Net cash (used in) provided by operating activities	(125,0

Cash flows from investing activities:	
Purchase of property and equipment	(364,0
Purchase of intangible assets	(322,2

Net cash used in investing activities	(686,2

Cash flows from financing activities:	
Proceeds from the exercise of stock options	733,
Repayments of notes payable-bank	(4,497,2
Repayments of notes payable-TIS	(172,2
Proceeds from revolving credit facility	13,500,
Funding of restricted cash under revolving credit facility	(2,000,0
Redemption of Preferred Stock Series B	(6,500,0
Dividends paid	(370,9

Net cash provided by (used in) financing activities	692,

Net (decrease) increase in cash and cash equivalents	(118,6
Cash and cash equivalents at beginning of period	5,746,

Cash and cash equivalents at end of period	\$ 5,628,
	=====
Supplemental disclosures of cash flow information: Cash paid during the periods for:	
Interest	\$ 78,
	=====
Income taxes	\$ 141,
	=====
Supplemental disclosures of Non-cash transactions:	
Deemed dividend from beneficial conversion feature of Series B Preferred stock	\$(1,783,0
	=====
Deemed preferred dividends from issuance of warrants	\$(1,178,2
	=====
Restricted stock awards	\$ 152,
	=====
See accompanying notes to condensed consolidated financial statements.	

INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Principles of Consolidation and Basis of Presentation

The accompanying financial statements for the interim periods are unaudited and include the accounts of the Company and its subsidiaries, all of which are wholly-owned or majority owned with an offset to minority interest. All significant intercompany transactions and balances have been eliminated. The interim financial statements have been prepared in conformity with Rule 10-01 of Regulation S-X of the Securities and Exchange Commission ("SEC") and therefore

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do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. However, all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the periods presented have been included. These financial statements should be read in conjunction with the financial statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2006 ("10-K"), as filed with the SEC. The June 30, 2006 balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The results of operations for the six months ended December 31, 2006 are not necessarily indicative of the results for the full fiscal year ending June 30, 2007 or for any other period.

The Company is engaged primarily in the manufacturing, distributing, marketing and sales of vitamins, nutritional supplements and herbal products; the manufacture and distribution of paclitaxel, which is the primary chemotherapeutic agent in the treatment of breast cancer; and pharmaceutical technical services through its contract research organization, and the biotechnologies business that uses its patented plant-based technology to produce vaccines and therapeutic antibodies. The Company's customers are located primarily throughout the United States.

Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The most significant estimates include:

- o sales returns and allowances;
- o allowance for doubtful accounts;
- o inventory valuation;
- o valuation and recoverability of long-lived and intangible assets and goodwill, including the values assigned to acquired intangible assets;
- o income taxes and valuation allowance on deferred income taxes, and;
- o accruals for, and the probability of, the outcome of current litigation.

On a continual basis, management reviews its estimates utilizing currently available information, changes in facts and circumstances, historical experience and reasonable assumptions. After such reviews, and if deemed appropriate, those estimates are adjusted accordingly. Actual results could differ from those estimates. Nothing has come to our attention which would cause a change in these estimates.

INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Earnings Per Share. In accordance with FASB Statement No. 128, "Earnings Per Share," basic earnings per common share are based on weighted average number of common shares outstanding. Diluted earnings per share amounts are based on the weighted average number of common shares outstanding, plus the incremental

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shares that would have been outstanding upon the assumed exercise of all potentially dilutive stock options, warrants and convertible preferred stock, subject to antidilution limitations.

During the three and six months ended December 31, 2006, options and warrants to purchase 4,398,818 shares of common stock were outstanding but were not included in the computation of diluted earnings per share as they were antidilutive as a result of net losses available to common shareholders during the period. During the three and six months ended December 31, 2005, 4,361,595 options with exercise prices below average market price were included in the computation of diluted earnings per share.

During the three and six months ended December 31, 2006, Convertible Series B Preferred Stock in the amount of 250,000 common share equivalents were not included in the computation of diluted earnings per share as they were antidilutive as a result of net losses available to common shareholders. During the three and six months ended December 31, 2005, 700,000 common share equivalents were not included in the computation of diluted earnings per share as their conversion price was greater than the average market price of the common shares.

During the three and six months ended December 31, 2006 and 2005, options and warrants to purchase 1,493,500 shares of common stock and 2,564,333 shares of common stock, respectively, were outstanding but were not included in the computation of diluted earnings per share because their exercise price was greater than the average market price of the common shares.

Recent Accounting Pronouncements

In July 2006, the FASB issue FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" ("FIN 48"), which clarifies the accounting for uncertainty in income tax positions. FIN 48 requires that we recognize in our financial statements, the impact of a tax position that is more likely than not to be sustained upon examination based on the technical merits of the position. The provisions of FIN 48 will be effective for us as of the beginning of our fiscal year ending June 30, 2008, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are currently evaluating the impact of adopting FIN 48 on our financial statements.

In September 2006, the FASB issue SFAS No. 157, "Fair Value Measurement" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 17, 2007 and interim periods within those fiscal years. We are evaluating the impact of adopting SFAS 157 on our consolidated financial position, results of operations and cash flows.

Note 2. Goodwill and other Intangible Assets

Goodwill and intangibles with indefinite lives are tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The Company performed its annual impairment test during the third quarter of fiscal 2006. As of December 31, 2006 and June 30, 2006, goodwill consisted of \$145,410 from the Aloe Acquisition.

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INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Other definite lived intangibles are amortized on a straight-line basis over periods not exceeding 20 years. The carrying amount of acquired intangible assets as of December 31, 2006 and June 30, 2006 is as follows:

	December 31, 2006			June 30, 2006	
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization
Intellectual property	\$ 2,100,000	\$ 370,414	\$ 1,729,586	\$ 1,850,000	\$ 271,000
Trade names and patents	1,821,381	267,848	1,553,533	1,749,135	216,000
Unpatented technology	547,000	200,000	347,000	547,000	179,000
License agreement	347,000	66,596	280,404	637,467	100,000
Total	\$ 4,815,381	\$ 904,858	\$ 3,910,523	\$ 4,783,602	\$ 766,000

During the three month period ended December 31, 2006, the Company made a payment of \$250,000 under its intellectual property agreement with the Center for Molecular Biotechnology of Fraunhofer USA, Inc. entered into in January 2004, and subsequent amendments thereto. Amortization expense, recorded on other intangible assets for the three and six months ended December 31, 2006 and 2005, was \$93,965 and \$76,136, and \$187,591 and \$148,109, respectively. Amortization expense is recorded on the straight-line method over periods ranging from 10 years to 20 years. During the three months ended December 31, 2006, the Company disposed of license agreements owned by Micro Nutrition, Inc. in the amount of \$239,728 in connection with its disposition of Micro Nutrition, Inc.

The estimated annual amortization expense for intangible assets for the five succeeding fiscal years is as follows:

Year Ending June 30,	Amortization Expense
2007, remaining	\$ 215,200
2008	377,100
2009	377,100
2010	377,100
2011	377,100
Thereafter	2,186,923
Total	\$ 3,910,523

Note 3. Inventories

Inventories are stated at the lower of cost or market using the first-in, first-out method and consist of the following as of December 31, 2006 and June 30, 2006:

December 31, 2006	June 30, 2006
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Raw materials	\$ 7,468,041	\$ 5,484,485
Work-in-process	1,851,305	1,803,532
Finished goods	4,935,939	3,684,826
Total	\$ 14,255,285	\$ 10,972,843

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INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 4. Property and Equipment

Property and equipment consists of the following as of December 31, 2006 and June 30, 2006:

	December 31, 2006	June 30, 2006
Land and building	\$ 1,250,000	\$ 1,250,000
Leasehold improvements	2,176,599	2,157,321
Machinery and equipment	6,816,345	6,544,096
Transportation equipment	67,847	37,714
	10,310,791	9,989,131
Less: Accumulated depreciation and amortization	(6,226,874)	(5,815,774)
Total	\$ 4,083,917	\$ 4,173,357

Note 5. Note and Loan Payable

Note payable is a promissory note provided by Bank of America dated August 6, 2003 in the amount of \$4.5 million with interest at a variable rate based on 1.25% over the current LIBOR rate. The loan was renewed through January 4, 2007 under the existing terms and conditions of the Note. The Note was guaranteed by Mr. Carl DeSantis, a shareholder and director of the Company. As of June 30, 2006 the interest rate was 6.60%. As of December 31, 2006, the note was paid in full.

Loan payable-Trade Investment Services is a demand loan provided by Trade Investment Services, LLC ("TIS"), a former shareholder of Paxis, dated July 1, 2002 with interest at 9.00%. The Company had accrued and unpaid interest of \$45,661 as of June 30, 2006.

In September 2006, the Company paid off the Note and Loan Payable with proceeds from a \$15.0 million revolving credit facility it secured with a bank. (See Note 6. Revolving Credit Facility.)

Note 6. Revolving Credit Facility and Restricted Cash

On September 1, 2006, the Company entered into a loan agreement with Amalgamated Bank, a financial institution. The loan agreement provides for a one-year secured revolving credit facility of up to \$15.0 million. Concurrently, the Company paid off its \$4.5 million note to the Bank of America, its obligation to Trade Investments Services, LLC and other miscellaneous obligations, including the costs associated with securing the facility with \$5.0 million of borrowings

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under the facility. On October 13, 2006, the Company borrowed an additional \$8.5 million under this facility and as of December 31, 2006 had \$13.5 million outstanding under this facility.

The interest rate under the credit facility is equal to, at the Company's option, either (1), the lender's publicly announced base rate, or (2) 1.5% plus the applicable LIBOR rate. Interest is payable monthly, quarterly or semi-annually, at the Company's election, in arrears not later than the end of each such period. As of December 31, 2006, the weighted average interest rate was 6.90% and the Company had accrued and unpaid interest of approximately \$244,000. The facility also has a commitment fee equal to 0.50% per annum calculated on the unused amount of the facility. As of December 31, 2006, the Company had approximately \$7,600 in accrued and unpaid commitment fees.

The credit facility requires that all principal be repaid in full on the first anniversary of the closing date, which may be extended for up to one year at the lender's option. The facility is secured by a first priority lien on our accounts receivable, equipment, inventory and certain deposit accounts.

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INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The credit facility contains covenants restricting our ability to, among other things: (1) incur or guarantee additional debt; (2) make any investments (other than in the ordinary course of business); (3) engage in any asset sales or dispose of any assets (other than in the ordinary course of business); (4) engage in transactions with affiliates; (5) incur liens; and (6) declare or pay dividends on its common stock. The credit facility also requires us not to exceed a maximum total leverage ratio, to maintain a minimum consolidated earnings before income taxes and depreciation and amortization ("EBITDA"), to maintain a minimum fixed charge coverage ratio and to maintain a minimum deposit balance with the lender (unless certain revenue and EBITDA thresholds are met). On September 1, 2006, the Company deposited \$2.0 million with the lender to satisfy this covenant.

The credit facility also provides for customary events of default, including non-payment defaults and covenant defaults. The Company was in compliance with its loan covenants from inception (September 1, 2006) through December 31, 2006.

Note 7. Significant Risks and Uncertainties

(a) Concentrations of Credit Risk-Cash. The Company maintains balances at several financial institutions. Deposits at each institution are insured by the Federal Deposit Insurance Corporation up to \$100,000. At December 31, 2006, the Company's uninsured cash balances were approximately \$8.2 million.

(b) Concentrations of Credit Risk-Receivables. The Company routinely assesses the financial strength of its customers and, based upon factors surrounding the credit risk of its customers, establishes an allowance for uncollectible accounts and, as a consequence, believes that its accounts receivable credit risk exposure beyond such allowances is limited. The Company does not require collateral in relation to its trade accounts receivable credit risk. The amount of the allowance for uncollectible accounts and other allowances at December 31, 2006 and June 30, 2006 is \$111,651 and \$125,013, respectively.

(c) Major Customers. For the six months ended December 31, 2006, approximately 32% or \$11.0 million, 27% or \$9.0 million and 17% or \$5.8 million of revenues were derived from three customers. For the six months ended December 31, 2005, approximately 37% or \$10.3 million, 27% or \$7.5 million and 26% or \$7.2 million of revenues were derived from three customers. For the three months ended

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December 31, 2006, approximately 36% or \$7.5 million, 27% or \$5.7 million and 17% or \$3.6 million of revenues were derived from three customers. For the three months ended December 31, 2005, approximately 43% or \$5.6 million, 28% or \$3.6 million and 17% or \$2.2 million of revenues were derived from three customers. The loss of any of these customers would have an adverse affect on the Company's operations. Accounts receivable from these three customers comprised approximately 83% of total accounts receivable at December 31, 2006.

(d) Business Risks. The Company insures its business and assets against insurable risks, to the extent that it deems appropriate, based upon an analysis of the relative risks and costs.

The raw materials used by the Company are primarily commodities and agricultural-based products. Raw materials used by the Company in the manufacture of its nutraceutical products are purchased from independent suppliers. Raw materials are available from numerous sources and the Company believes that it will continue to obtain adequate supplies.

Approximately 32% of the Company's employees, located in its New Jersey facility, are covered by a union contract. The contract was renewed in August 2006 and will expire in August 2010.

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INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 8. Commitments and Contingencies

(a) Leases

Related Party Leases- Warehouse and office facilities are leased from Vitamin Realty Associates, L.L.C., a limited liability company, which is 90% owned by the Company's chairman, president and principal stockholder and certain family members and 10% owned by an employee of the Company. The lease provides for minimum annual rental of \$323,559 through May 31, 2015 plus increases in real estate taxes and building operating expenses. On July 1, 2004, the Company leased an additional 24,810 square feet of warehouse space on a month-to-month basis. Rent expense, for the three and six months ended December 31, 2006 and 2005, on these leases were \$170,000 and \$158,000 and \$357,000 and \$321,000, respectively, and is included in both manufacturing and selling and administrative expenses.

Other Lease Commitments- The Company leases manufacturing and office facilities through March 31, 2007. The lease was effective on April 1, 2002 and provided for minimum monthly rental of \$32,500 per month through March 31, 2007 plus increases in real estate taxes and building operating expenses. At its option, the Company has the right to renew the lease for an additional five-year period. On August 27, 2002, the lease was amended reducing the square footage from approximately 32,500 to 22,500 and reducing the monthly rent to \$22,483 per month for the balance of the lease. Rent expense, for the three and six months ended December 31, 2006 and 2005, was \$92,000 and \$98,000 and \$184,000 and \$197,000, respectively and is included in manufacturing expenses. The Company is currently negotiating renewal terms with the landlord of this lease.

The Company leases warehouse and office facilities through March 31, 2007. The lease was effective on March 6, 2004, and provides for a minimum monthly rental of \$9,967. The Company is currently exploring its options regarding this leased facility and expects to lease more space at substantially the same rent per square foot. In September 2006, the Company leased additional warehouse space under a three-year lease commitment with minimum monthly rental payments of \$12,008. The Company leases additional office space on a month-to-month basis;

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minimum monthly rental payments are \$1,126. The lease was effective on October 1, 2005, and provides for a minimum monthly rental of \$1,126. The company leases office space through December 31, 2012, and provides for a minimum monthly rental of \$18,611. The Company leases warehouse equipment for a five (5) year period with an annual rental of \$17,000 and office equipment for a five (5) year period with an annual rental of \$8,400.

The Company leases automobiles under non-cancelable operating lease agreements, which expire through 2009.

The minimum rental commitment for long-term non-cancelable leases is as follows:

Year ending June 30,	Lease Commitments	Related Party Lease Commitments	Total
2007, remaining	\$ 305,700	\$ 161,800	\$ 467,500
2008	398,200	323,600	721,800
2009	380,100	323,600	703,700
2010	236,300	323,600	559,900
2011	205,800	323,600	529,400
Thereafter	292,900	1,267,100	1,560,000
Total	\$ 1,819,000	\$ 2,723,300	\$ 4,542,300

Total rent expense, including real estate taxes and maintenance charges, was approximately \$423,600 and \$448,000 and \$834,600 and \$873,000 for the three and six months ended December 31, 2006 and 2005, respectively.

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INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(b) Intellectual Property Agreement - In connection with the acquisition in January 2004, and subsequent amendments thereto; of intellectual property developed by the Center for Molecular Biotechnology of Fraunhofer USA, Inc., the Company will pay up to a maximum of \$3.2 million for certain technology developed by Fraunhofer USA, Inc. over a five-year period. As of December 31 and June 30, 2006, \$2.1 million and \$1.8 million, respectively have been paid and is being amortized on a straight-line basis over a ten-year period.

(c) Legal Proceedings - NatEx Georgia LLC and Vasili Patarkalishvili v. Robert B. Kay, E. Gerald Kay, Trade Investment Services, LLC, Paxis Pharmaceuticals, Inc., Dean P. Stull and Integrated BioPharma, Inc., pending in the Supreme Court for the State of New York, New York County. Plaintiffs NatEx Georgia LLC and Vasili Patarkalishvili commenced this action on July 19, 2004, alleging claims for breach of contract, fraud and breach of the implied duty of good faith and fair dealing arising out of an alleged failure by Paxis to provide information necessary for NatEx to perform under the parties' agreements by which NatEx had agreed to supply Paclitaxel extract. The complaint seeks damages of more than \$5.0 million. By order dated January 6, 2006, the Court granted in part Defendants' motion to dismiss. The Court dismissed all of the claims against all defendants, except for the breach of contract claim against Paxis. Plaintiffs have filed a notice of appeal of that decision. Certain of the Defendants, including the Company, have filed counter-claims against Plaintiffs for breach of a July 2003 agreement with NatEx and to collect on an \$1.3 million note, though the Company is doubtful of collection on that note. Paxis plans to defend vigorously the remaining claim and prosecute its claims.

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The Pom Wonderful LLC v. Agrolabs, Inc. matter described in our previous public filings has been settled by all parties without material financial impact on our Company. The matter was dismissed by the United States District Court for the Central District of California on January 18, 2007.

Note 9. Related Party Transactions

The Company has a consulting agreement with Eugene Kay, a former employee of the Company and a brother of E. Gerald Kay, the Company's Chairman of the Board. This agreement is on a month-to-month basis for \$1,100 per month. The total consulting expense recorded per this verbal agreement for the three months and six months December 31, 2006 and 2005 was \$3,300 and \$6,600, respectively. The Company has another consulting agreement with EVJ, LLC, a limited liability company controlled by Robert Kay, a director of the Company, the Chairman of its subsidiary, InB: Paxis, and a brother of E. Gerald Kay and Eugene Kay. This agreement was assumed by and became a liability of the Company as a part of the Company's acquisition of Paxis Pharmaceuticals Inc. in fiscal year ended June 30, 2004. The total consulting expense under this agreement was \$30,000 for the three months ended December 31, 2006 and 2005 and \$60,000 and \$70,000 for the six months ended December 31, 2006 and 2005, respectively.

Note 10. Equity Transactions

(a) Stock Option Plan and Warrants - There were no stock options or warrants issued in the periods ended December 31, 2006.

(b) Restricted Stock Award - On August 3, 2006, the Company entered into a separate one-year financial services agreement with a financial advisor whereby it is to issue an initial 12,500 shares of its common stock and will issue additional shares worth \$15,000, on a monthly basis, calculated on the third day of each month by dividing \$15,000 by the prior ten (10) day volume-weighted average closing share price of the common stock of the Company.

As of December 31, 2006, the Company was obligated to issue 20,050 shares of its common stock under this agreement.

The shares of common stock have not been registered under the Securities Act of 1933, as amended (the "Securities Act"), and were issued and sold in reliance upon the exemption from registration contained in Section 4(2) of the Securities Act and Regulation D promulgated thereunder. These shares of common stock may not be offered or sold in the United States in the absence of an effective registration statement or exemption from the registration requirements under the Securities Act.

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INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(c) Series B Redeemable Convertible Preferred Stock - On October 16, 2006, the Company redeemed 650 shares of its Series B Redeemable Convertible Preferred Stock ("Preferred Stock") at a redemption price of \$6.7 million. In addition to the cash consideration, equal to the face amount of the Preferred Stock and the related dividend, the Company also agreed to issue to the holder 100,000 additional Warrants to purchase common stock of the Company at a purchase price of \$12 per share exercisable until October 2011 and agreed to adjust the Warrants issued in 2004 in connection with the initial purchase of the Preferred Stock to conform to the new Warrants. The amended Warrants issued in 2004, along with the additional Warrants issued in October 2006, resulted in additional non-cash dividends on the Preferred Stock of approximately \$1.2 million.

The early redemption of the Preferred Stock extinguished all rights and

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preferences pertinent to the 650 shares of Preferred Stock, including actual dividends, deemed dividends (which are required to be deducted in the calculation of net income attributable to common shareholders and resulted in decreases in net income of approximately \$2.3 million in each of the last two fiscal years), liquidation preferences and the right to convert the Preferred Stock into 650,000 shares of the Company's common stock at \$10 per share. Subsequent to this redemption, only 25 shares of Preferred Stock held by another party remain outstanding.

Note 11. Segment Information

The basis for presenting segment results generally is consistent with overall Company reporting. The Company reports information about its operating segments in accordance with Financial Accounting Standard Board Statement No. 131, "Disclosure About Segments of an Enterprise and Related Information," which establishes standards for reporting information about a company's operating segments.

The Company has divided its operations into three reportable segments as follows: Nutraceuticals, Pharmaceuticals and Biotechnologies. The international sales, concentrated primarily in Mexico and Europe, for the three and six months ended December 31, 2006 and 2005, were \$4.6 million and \$2.2 million and \$8.5 million and \$4.2 million, respectively.

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INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Financial information relating to, the three and six months ended December 31, 2006 and 2005, operations by business segment is as follows:

	For the Three Months Ended December 31,					
	2006					
	Nutra- ceuticals	Pharma- ceuticals	Biotech- nologies	Total	Nutra- ceuticals	Phar ceuti
Sales, net						
U.S. customers	\$14,666,243	\$ 1,336,858	\$ 238,339	\$16,241,440	\$10,151,121	\$ 6
International customers	4,478,775	131,865	-	4,610,640	2,179,809	
Total Sales, net	\$19,145,018	\$ 1,468,723	\$ 238,339	\$20,852,080	\$12,330,930	\$ 6
Segment operating profit (loss)	\$ 3,416,168	\$ (990,722)	\$(406,161)	\$ 2,019,285	\$ 2,530,759	\$ (96
Depreciation	\$ 105,850	\$ 120,606	-	\$ 226,456	\$ 83,226	\$ 1
Capital expenditures	\$ 237,689	\$ 19,278	-	\$ 256,967	\$ 14,475	\$

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For the Six Months Ended
December 31,

	2006					
	Nutra- ceuticals	Pharma- ceuticals	Biotech- nologies	Total	Nutra- ceuticals	Phar- ceuti
Sales, net						
U.S. customers	\$22,421,273	\$ 2,517,144	\$ 354,886	\$25,293,303	\$22,068,971	\$ 1,4
International customers	7,943,218	526,797	-	8,470,015	4,226,531	
Total Sales, net	\$30,364,491	\$ 3,043,941	\$ 354,886	\$33,763,318	\$26,295,502	\$ 1,4
Segment operating profit (loss)	\$ 4,254,925	\$(1,248,466)	\$(619,158)	\$ 2,387,301	\$ 6,073,242	\$(2,43
Depreciation	\$ 200,984	\$ 240,471	\$ -	\$ 441,455	\$ 146,443	\$ 2
Capital expenditures	\$ 321,351	\$ 42,673	\$ -	\$ 364,024	\$ 55,498	\$

As of December 31,

	2006					
	Nutra- ceuticals	Pharma- ceuticals	Biotech- nologies	Total	Nutra- ceuticals	Phar- ceuti
Total Assets	\$32,882,189	\$ 6,852,166	\$2,108,453	\$41,842,808	\$29,911,297	\$ 5,8

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Certain statements set forth under this caption constitute "forward-looking statements." See "Disclosure Regarding Forward-Looking Statements" on page 1 of this report for additional factors relating to such statements. The following discussion should also be read in conjunction with the Condensed Consolidated Financial Statements of the Company and Notes thereto included elsewhere herein and the Company's Annual Report on Form 10-K for the year ended June 30, 2006.

The Company is engaged primarily in the manufacturing, distributing, marketing and sales of vitamins, nutritional supplements and herbal products; the manufacture and distribution of paclitaxel, which is the primary chemotherapeutic agent in the treatment of breast cancer; and pharmaceutical technical services through its contract research organization. The Company's customers are located primarily throughout the United States.

Critical Accounting Policies and Estimates

Estimates. The preparation of financial statements in conformity with generally

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accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The most significant estimates include:

- o sales returns and allowances;
- o allowance for doubtful accounts;
- o inventory valuation;
- o valuation and recoverability of long-lived and intangible assets and goodwill, including the values assigned to acquired intangible assets;
- o income taxes and valuation allowance on deferred income taxes, and;
- o accruals for, and the probability of, the outcome of current litigation.

On a continual basis, management reviews its estimates utilizing currently available information, changes in facts and circumstances, historical experience and reasonable assumptions. After such reviews, and if deemed appropriate, those estimates are adjusted accordingly. Actual results could differ from those estimates. There have been no material changes in the calculation of these estimates since the audited financial statements at June 30, 2006.

Allowances for Doubtful Accounts and Sales Returns

The Company makes judgments as to its ability to collect outstanding receivables and provides allowances for the portion of receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. The Company continuously monitors payments from its customers and maintains allowances for doubtful accounts for estimated losses in the period they become known.

The Company's return policy is to only accept returns for defective products. If defective products are returned, it is the Company's agreement with its customers that the Company cure the defect and reship the product. The policy is that when the product is shipped the Company makes an estimate of any potential returns or allowances.

If the historical data the Company uses to calculate the allowance provided for doubtful accounts does not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and the future results of operations could be materially affected. In recording any additional allowances, a respective charge against income is reflected in the general and administrative expenses, and would reduce the operating results in the period in which the increase is recorded.

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We performed a sensitivity analysis to determine the impact of fluctuations in our estimates for our allowance for doubtful accounts. As of December 31, 2006 the allowance was \$111,651. If this number were in error by plus or minus one percent of the account receivable balance, the impact would be an additional \$52,100 of income or expense.

Inventory Valuation

Inventories are stated at the lower of cost or market ("LCM"), which reflects management's estimates of net realizable value. The inventory amounts are

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composed primarily of inventory items in both the nutraceutical and pharmaceutical segments of business. As a result of our nutraceutical inventory being manufactured primarily on a purchase order basis, the quantity of both raw materials and finished goods inventory provides for minimal risk for potential overstock or obsolescence. Pharmaceutical inventory is valued at market values, which is lower than our cost basis.

Mail order inventory is expiration date sensitive. The Company reviews this inventory and considers sales levels (by SKU), term to expiration date, potential for retesting to extend expiration date and evaluates potential for obsolescence or overstock.

We performed a sensitivity analysis to determine the impact of fluctuations in our estimates for inventory allowances. As of December 31, 2006 the allowance was \$25,000. If this number were in error by plus or minus one percent of the total inventory balance, the impact would be an additional expense of \$142,800.

Long Lived Assets

Purchased intangibles consisting of patents and unpatented technological expertise, intellectual property, license fees and trade names purchased as part of business acquisitions are presented net of related accumulated amortization and are being amortized on a straight-line basis over the remaining useful lives.

The Company records impairment losses on other intangible assets when events and circumstances indicated that such assets might be impaired and the estimated fair value of the asset is less than its recorded amount in accordance with Statement of Financial Accounting Standards ("SFAS") No 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". The Company reviews the value of its long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate. Conditions that would necessitate an impairment assessment include material adverse changes in operations, significant adverse differences in actual results in comparison with initial valuation forecasts prepared at the time of acquisition, a decision to abandon certain acquired products, services, or marketplaces, or other significant adverse changes that would indicate the carrying amount of the recorded asset might not be recoverable.

Goodwill and Other Intangible Assets - The Financial Accounting Standards Board ("FASB") has issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets". SFAS 142 requires that goodwill and intangible assets with indefinite lives no longer be amortized against earnings, but instead tested for impairment at least annually based on a fair-value approach as described in SFAS 142.

Intangible assets with finite lives are amortized over their estimated useful lives. The useful life of an intangible asset is the period over which the asset is expected to contribute directly or indirectly to future cash flows. The carrying value of intangible assets with finite lives is evaluated whenever events or circumstances indicate that the carrying value may not be recoverable. The carrying value is not recoverable when the projected undiscounted future cash flows are less than the carrying value. Tests for impairment or recoverability require significant management judgment, and future events affecting cash flows and market conditions could result in impairment losses.

General - The Company recognizes revenue in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin 104. The Company recognizes product sales revenue when title and risk of loss have transferred to the customer, when estimated provisions for product returns, rebates, chargebacks and other sales allowances are reasonably determinable, and when collectibility

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is reasonably assured. Accruals for these items are presented in the condensed consolidated financial statements as reductions to sales. The Company's net sales represent gross sales invoiced to customers, less certain related charges for discounts, returns, rebates, chargebacks and other allowances. Cost of sales includes the cost of raw materials and all labor and overhead associated with the manufacturing and packaging of the products. Gross margins are affected by, among other things, changes in the relative sales mix among the Company's products, as well as gross margins of acquired entities.

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Operating results in all periods presented reflect the impact of acquisitions. The timing of those acquisitions and the changing mix of businesses as acquired companies are integrated into the Company may affect the comparability of results from one period to another.

Results of Operations

The following table sets forth the income statement data of the Company as a percentage of net sales for the periods indicated:

	For the three months ended December 31,		For t ended
	2006	2005	2006
Sales, net	100.0%	100.0%	100.
Costs and expenses:			
Cost of sales	67.7%	61.6%	67.
Selling and administrative	22.6%	27.9%	25.
	90.3%	89.5%	92.
Income from operations	9.7%	10.5%	7.
Other income (expense):			
Interest expense	(1.0%)	(0.5%)	(0.9)
Other income	0.1%	0.2%	0.
Interest and investment income	0.1%	0.0%	0.
	(0.8%)	(0.3%)	(0.6)
Income before income taxes	8.9%	10.2%	6.
Federal and state income taxes	3.6%	0.2%	2.
Income before minority interest	5.2%	10.0%	3.
Minority interest	0.0%	0.7%	0.
Net income	5.2%	10.7%	3.
Deemed dividend from beneficial conversion feature of Series B Preferred Stock	(5.9%)	(4.4%)	(5.3)
Series B Preferred Stock dividend	(6.9%)	(1.0%)	(4.6)

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Net (loss) income allocable to common shareholders	(7.5%)	5.3%	(6.1%)
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For the six month period ended December 31, 2006 compared to the six month period ended December 31, 2005

Sales, net. Sales, net, for the six months ended December 31, 2006 and 2005 were \$33.8 million and \$27.8 million, respectively, an increase of \$6.0 million or 21.6%. The increase is comprised of the following:

	Six months ended December 31,		Dollar Incr (Decreases)
	2006	2005	2006 vs 2005
Nutraceutical - US Customers	\$ 22,421,273	\$ 22,068,971	\$ 352,302
Nutraceutical - International Customers	7,943,218	4,226,531	3,716,687
Total Nutraceutical	30,364,491	26,295,502	4,068,989
Pharmaceutical - US Customers	2,517,144	1,423,004	1,094,140
Pharmaceutical - International Customers	526,797	27,924	498,873
Total Pharmaceutical	3,043,941	1,450,928	1,593,013
Biotechnologies	354,886	8,971	345,915
Total	\$ 33,763,318	\$ 27,755,401	\$ 6,007,917

This increase is primarily the result of an increase in our Nutraceutical Segment sales of approximately 15.5% or \$4.1 million. Our international sales increased by \$3.7 million, representing 91.3% of the increased sales in our Nutraceutical Segment, as a result of increased sales to Mexico from our contract manufacturing business. Our sales to US Customers increased in our Nutraceuticals Segment by \$352,000 and is offset, in part, by an increase in our promotional advertising cost of \$1.6 million, from \$2.2 million in the six months ended 2005 to \$3.8 million in the six months ended December 31, 2006, absent this advertising cost, sales to US Customers increased by \$1.9 million or 7.9%.

Pharmaceuticals sales for the six months ended December 31, 2006 were \$3.0 million compared to \$1.5 million for the comparable period. This increase is primarily due to increased sales of approximately \$290,000 of our API in the six months ended December 31, 2006 compared to the six months ended December 31, 2005. Additionally, our CRO business had increased sales of approximately \$1.3 million in the six months ended December 31, 2006 compared to the six months ended December 31, 2005. These increased sales are a result of the Segment implementing its sales and marketing strategy in the fiscal year ended June 30, 2006.

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Our Biotechnologies Segment did not significantly contribute to our net sales and gross profits in the six month periods ended December 31, 2006 and 2005.

For the six months ended December 31, 2006, approximately 76% of revenues were derived from three customers as compared 90% of revenues for the six months ended December 31, 2005. The loss of any of these customers would have an adverse affect on our operations. We continue to expand our customer base by expanding from selling its propriety branded nutraceutical products primarily to "club" stores to the retail sales segment and expanding its sales in the international market.

Cost of sales. Cost of sales increased to \$22.6 million for the six months ended December 31, 2006 as compared to \$17.4 million for the six months ended December 31, 2005. Cost of sales increased as a percentage of sales to 67% for the six months ended December 31, 2006 as compared to 63% for the six months ended December 31, 2005. The increase of approximately four percent (4.0%) in our cost of sales is primarily a result of our increased promotional advertising costs of \$1.6 million in the six months ended December 31, 2006 to \$3.8 million from \$2.2 million in the six months ended December 31, 2005, which are netted against sales. If these advertising costs were not netted in sales, our costs of sales as a percentage of sales, as adjusted, would have been 60.3% for the six months ended December 31, 2006 compared to 58.0% for the six months ended December 31, 2005.

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Selling and Administrative Expenses. Selling and administrative expenses were \$8.7 million for the six months ended December 31, 2006, an increase of \$1.7 million or 24.3% as compared with \$7.0 million for the six months ended December 31, 2005. As a percentage of sales, net, selling and administrative expenses were 25.9% for the six months ended December 31, 2006 and 25.3% for the prior comparable period. A tabular presentation of the changes in selling and administrative expenses is as follows:

	Six months ended December 31,		Dollar Increase (Decrease)
	2006	2005	2006 vs 2005
Salaries	\$ 1,706,329	\$ 1,381,806	\$ 324,523
Advertising	1,471,605	1,042,553	429,052
Consulting and other professional fees	774,161	824,083	(49,922)
Indirect expenses	662,638	516,616	146,022
Commissions	563,854	514,980	48,874
Insurance	374,112	324,777	49,335
Depreciation & Amortization	358,103	296,383	61,720
Auto, Travel & Entertainment	356,815	342,520	14,295
Employee Benefits	344,298	282,714	61,584
Office Rent	276,050	332,131	(56,081)
Marketing	263,407	51,914	211,493
Research & Development	223,923	14,508	209,415
Office	219,146	140,980	78,166
Loss on investment in Micro Nutrition, Inc.	171,529	-	171,529
Compensation expense for employee stock options	148,714	221,614	(72,900)
Other	819,330	736,175	83,155
Total	\$ 8,734,014	\$ 7,023,754	\$ 1,710,260

Salaries increased approximately \$324,500 in the six months ended December 31, 2006 or 23.5% as a result of hiring an investor relations officer at the end of our fiscal year ended June 30, 2006. In addition to his base salary, in the six months ended December 31, 2006, this employee earned a performance bonus based on a transaction which occurred in the six months ended December 31, 2006, his combined compensation was approximately \$262,500 with no comparable expense in the six months ended December 31, 2005. The balance of the increase or \$62,000 represents a 4.5% increase over salaries in the six months ended December 31, 2005 as a result of net new employees and general salary increases. A decrease in consulting and other professional fees of \$49,900 offset the increase in salaries, in part.

Advertising expense increased approximately \$429,000 or 41.2% in the six months ended December 31, 2006 as part of our marketing plan to increase advertising to support our proprietary branded nutraceutical products. We spent \$795,000 in media advertisements such as radio, in store commercials, magazines and newspaper ads in the six months ended December 31, 2006 compared to \$459,000 in the comparable prior period, an increase of \$336,000, and increased other trade advertising expenses by \$93,000.

We also incurred additional marketing expenses of \$211,000 in the six months ended December 31, 2006 on the design and printing of new marketing materials used in the general marketing of our products as compared to the six months ended December 31, 2005.

Indirect expenses increased by approximately \$146,000 in the six months ended December 31, 2006 to \$662,600 from \$516,600 in the comparable 2005 period as a result of increased sales in our Hauser subsidiary increasing its billable hours to clients. Indirect expenses include costs that are not billable to clients, including non-billable time, laboratory expenses and other related costs.

Commissions increased approximately \$48,900 or 9.5%. Commissions as a percentage of sales that commissions are owed was 3.3% of such sales in the six months ended December 31, 2006 compared to 2.9% of such sales in the six months ended December 31, 2005. Our commission payout rates range from three to five percent of qualifying sales. The increase in the payout rate from the six months ended December 31, 2005 to the six months ended December 31, 2006 is a result of an increase in sales qualifying for a five percent commission payment.

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Research and Development costs increased approximately \$210,000 in the six months ended December 31, 2006 to \$224,000 from \$15,000 in the comparable 2005 period as a result of reaching milestones established in our research agreement with Fraunhofer, which triggered payments of \$200,000.

Other expense, net. Other expense, net was \$193,300 for the six months ended December 31, 2006 as compared to \$96,600 for the comparable period a year ago. The increase of \$96,700 was primarily attributable to an increase in interest expense of \$162,000 due to the increase in the amount of the debt outstanding, offset in part, by an increase in interest and other income of approximately \$65,100.

Federal and state income tax, net. Federal and state income tax increased from \$65,600 in the six months ended December 31, 2005 to \$965,600 in the six months ended December 31, 2006. Our effective tax rate increased from 2.0% to 44.0%. The dollar amount increase and the increase in our effective tax rates are primarily a result of increased state taxes of approximately \$380,000 owed in

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certain states where our subsidiaries file separate tax returns and do not have operating losses from our other subsidiaries to offset their taxable income in such states. Additionally, in the six months ended December 31, 2006, we had a deferred and current federal tax expense of approximately \$585,000 with no federal tax expense in the six months ended December 31, 2005 as a result of offsetting valuation allowances recorded in such period.

Net income. The Company's net income for the six months ended December 31, 2006 was \$1.3 million as compared to net income of \$3.3 million for the six months ended December 31, 2005. This decrease in net income of approximately \$2.0 million is primarily the result of an increase in selling and administrative expenses of \$1.7 million, an increase in other expense of approximately \$96,600, and an increase in federal and state income taxes of approximately \$900,000, offset by an increase in gross profit of approximately \$748,000.

For the three month period ended December 31, 2006 compared to the three month period ended December 31, 2005

Sales, net. Sales, net, for the quarter ended December 31, 2006 and 2005 were \$20.8 million and \$13.0 million, respectively, an increase of \$7.9 million or 60.8%. The increase is comprised of the following:

	Three months ended December 31,		Dollar Increa (Decrease)
	2006	2005	2006 vs 2005
Nutraceutical - US Customers	\$ 14,666,243	\$ 10,151,121	\$ 4,515,122
Nutraceutical - International Customers	4,478,775	2,179,809	2,298,966
Total Nutraceutical	19,145,018	12,330,930	6,814,088
Pharmaceutical - US Customers	1,336,858	628,229	708,629
Pharmaceutical - International Customers	131,865	5,739	126,126
Total Pharmaceutical	1,468,723	633,968	834,755
Biotechnologies	238,339	3,396	234,943
Total	\$ 20,852,080	\$ 12,968,294	\$ 7,883,786

This increase is primarily the result of an increase in our Nutraceutical Segment sales of approximately \$6.8 million or 55.3%. Our sales to US Customers increased in our Nutraceutical Segment by \$4.5 million and is offset, in part, by an increase in our promotional advertising expenses of \$1.9 million, from \$1.5 million in the three months ended December 31, 2005 to \$3.4 million in the three months ended December 31, 2006, absent this advertising cost, sales to US Customers increased by \$6.4 million or 55.1%. Our international sales increased by \$2.3 million, representing 33.7% of the increased sales in our Nutraceutical Segment, resulting from increased sales to Mexico from our contract manufacturing business.

Pharmaceuticals sales for the three months ended December 31, 2006 were \$1.5 million compared to \$634,000 for the comparable period. This increase is

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primarily due to increased sales of approximately \$820,000 in the quarter ended December 31, 2006 compared to the quarter ended December 31, 2005 in our CRO business. These increased sales are a result of the Segment implementing its sales and marketing strategy in the fiscal year ended June 30, 2006.

Our Biotechnologies Segment did not significantly contribute to our net sales and gross profits in the quarters ended December 31, 2006 and 2005.

For the three months ended December 31, 2006, approximately 80% of revenues were derived from three customers as compared 88% of revenues for the three months ended December 31, 2005. The loss of any of these customers would have an adverse affect on the Company's operations. The Company continues to expand its customer base by expanding from selling its propriety branded nutraceutical products primarily to "club" stores to the retail sales segment and expanding its sales in the international market.

Cost of sales. Cost of sales increased to \$14.1 million for the three months ended December 31, 2006 as compared to \$8.0 million for the three months ended December 31, 2005. Cost of sales increased as a percentage of sales to 68% for the three months ended December 31, 2006 as compared to 62% for the three months ended December 31, 2005. The increase of approximately six percent (6.0%) in cost of sales is primarily a result of our increased promotional advertising costs of \$1.9 million in the three months ended December 31, 2006 to \$3.4 million from \$1.5 million in the three months ended December 31, 2005, which is netted against sales. If these advertising costs were not netted in sales, our costs of sales as a percentage of sales, as adjusted, would have been 58.1% for the three months ended December 31, 2006 compared to 55.1% for the six months ended December 31, 2005.

Selling and Administrative Expenses. Selling and administrative expenses were \$4.7 million for the three months ended December 31, 2006, an increase of \$1.1 million or 30.7% as compared with \$3.6 million for the three months ended December 31, 2005. As a percentage of sales, net, selling and administrative expenses were 22.6% for the three months ended December 31, 2006 and 27.9% for the prior comparable period. A tabular presentation of the changes in selling and administrative expenses is as follows:

	Three months ended December 31,		Dollar Increase (Decrease)
	2006	2005	2006 vs 2005
Advertising	\$ 790,673	\$ 546,306	\$ 244,367
Salaries	777,644	711,515	66,129
Consulting and other professional fees	424,225	376,796	47,429
Commissions	413,573	228,864	184,709
Indirect expenses	327,972	253,953	74,019
Insurance	234,426	287,794	(53,368)
Research & Development	223,225	5,662	217,563
Auto, Travel & Entertainment	205,185	192,805	12,380
Depreciation & Amortization	179,231	148,101	31,130
Loss on investment in Micro Nutrition, Inc.	171,529	-	171,529
Employee Benefits	143,323	128,825	14,498
Compensation expense for employee stock options	60,096	70,097	(10,001)
Marketing	56,228	22,457	33,771
Other	715,049	639,934	75,115
Total	\$ 4,722,379	\$ 3,613,109	\$ 1,109,270

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Salaries increased approximately \$66,100 in the three months ended December 31, 2006 or 9.3% as a result of net new employees and general salary increases.

Advertising expense increased approximately \$244,000 or 44.7% in the three months ended December 31, 2006 as part of our marketing plan to increase advertising to support our proprietary branded nutraceutical products. We spent \$660,000 in media advertisements such as radio, in store commercials, magazines and newspaper ads in the three months ended December 31, 2006 compared to \$222,000 in the comparable prior period, an increase of \$438,000, offset by a reduction in other trade advertising of \$193,000.

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We also incurred additional marketing expenses of \$33,800 in the three months ended December 31, 2006 on the design and printing of new marketing materials used in the general marketing of our products as compared to the three months ended December 31, 2005.

Commissions increased approximately \$184,700 or 80.7%. Commissions as a percentage of sales that commissions are owed was 3.4% of such sales in the three months ended December 31, 2006 compared to 2.9% of such sales in the three months ended December 31, 2005. Our commission payout rates range from three to five percent of qualifying sales. The increase in the payout rate from the three months ended December 31, 2005 to the three months ended December 31, 2006 is a result of an increase in sales qualifying for a five percent commission payment.

Research and Development costs increased approximately \$218,000 in the three months ended December 31, 2006 to \$223,000 from \$5,700 in the comparable 2005 period as a result of reaching milestones established in our research agreement with Fraunhofer, which triggered payments of \$200,000.

Other expense, net. Other expense, net was \$166,000 for the three months ended December 31, 2006 as compared to \$37,000 for the comparable period a year ago. The increase of \$129,000 was primarily attributable to an increase in interest expense of \$140,800 due to the increase in the amount of the debt outstanding, offset in part, by an increase in interest and other income of approximately \$12,000.

Federal and state income tax, net. Federal and state income tax increased from \$20,900 in the three months ended December 31, 2005 to \$755,400 in the three months ended December 31, 2006. Our effective tax rate increased from 1.6% to 40.8%. The dollar amount increase and the increase in our effective tax rates are primarily a result of increased state taxes of approximately \$225,000 owed in certain states where our subsidiaries file separate tax returns and do not have operating losses from our other subsidiaries to offset their taxable income in such states. Additionally, in the three months ended December 31, 2006, we had current and deferred federal tax expense of approximately \$509,000 with no federal tax expense in the three months ended December 31, 2005 as a result of offsetting valuation allowances recorded in such period.

Net income. The Company's net income for the three months ended December 31, 2006 was \$1.1 million as compared to net income of \$1.4 million for the three months ended December 31, 2005. This decrease in net income of approximately \$300,000 is primarily the result of an increase in gross profit of approximately \$1.76 million, offset by increases in selling and administrative expenses of \$1.1 million increases in other expense of approximately \$128,900, and an increase in federal and state income taxes of approximately \$734,500.

Seasonality. The Company's results of operations in its Pharmaceuticals and

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Biotechnologies segments are not significantly affected by seasonal factors. The Nutraceutical business segment tends to be seasonal. The Company has found that in its first fiscal quarter ending in September, orders for its branded proprietary nutraceutical products slow (absent the addition of new customers with a significant first time order), as buyers in their markets may have purchased sufficient inventory to carry them through the summer months. Conversely, in the Company's second fiscal quarter, ending in December, orders for its products increase as the demand for the Company's branded nutraceutical products seems to increase in late December to early January as consumers become health conscious as they enter the new year.

The Company believes that there are other non-seasonal factors that also may also influence the variability of quarterly results including, but not limited to, general economic and industry conditions that affect consumer spending, changing consumer demands and current news on nutritional supplements. In addition, our recent growth has caused additional variability in our quarterly results. Accordingly, a comparison of the Company's results of operations from consecutive periods is not necessarily meaningful, and the Company's results of operations for any period are not necessarily indicative of future periods.

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Liquidity and Capital Resources

The Company's primary sources of liquidity and capital resources are cash generated from operations. The Company also has a \$15.0 million revolving line of credit available through September 1, 2007 with a one-year renewal option available at the lender's option. The Company's principal uses of cash have been to finance working capital, acquisitions, capital expenditures and Preferred Series B Stock dividend payments and the redemption of its Preferred Series B Stock. The Company anticipates these uses will continue to be its principal uses of cash in the future, except that subsequent to October 2006, the Company's use for Preferred Series B Stock dividend payments will not be a significant use as it redeemed 650 shares in October 2006 and the cash dividends on the remaining 25 shares will be approximately \$9,700 for the remainder of fiscal 2007 and none thereafter as the shares will be either converted or redeemed by its maturity date of April 20, 2007.

The following table sets forth, for the periods indicated, the Company's net cash flows used in operating, investing and financing activities, its period end cash and cash equivalents and other operating measures:

	For the six months ended December 31,	
	2006	2005
Net cash (used in) provided by operating activities	\$ (125,007)	\$ 1,985,230
Net cash used in investing activities	\$ (686,270)	\$ (337,862)
Net cash provided by (used in) financing activities	\$ 692,621	\$ (175,114)
Cash and cash equivalents at end of period	\$ 5,628,180	\$ 3,899,807
Days sales in inventory	68	69

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Inventory turnover

5.4

5.3

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At December 31, 2006, the Company's working capital was \$11.2 million, a decrease of \$3.9 million over working capital at June 30, 2006 of \$15.1 million. Cash and cash equivalents were \$5.6 million at December 31, 2006, a decrease of \$119,000 from June 30, 2006. The Company used \$125,000 and provided \$2.0 million of net cash from operations for the six months ended December 31, 2006 and 2005, respectively. The primary reason for the increase in cash used in operating activities of \$2.1 million is the increase in cash used in inventories. Our inventory levels increased by \$3.3 million in the six months ended December 31, 2006 based on our increased sales orders for future shipments, including additional raw materials for new products. The Company believes that anticipated sales for next year, current cash balances and its revolving credit facility should meet its cash needs for operations for fiscal 2007.

The Company utilized \$686,300 and \$337,900 of cash in investing activities for the six months ended December 31, 2006 and 2005, respectively. The Company provided for net cash of \$692,600 and utilized \$175,100 of cash from financing activities for the six months ended December 31, 2006 and 2005, respectively. The net cash provided by financing activities of \$692,600 was the result of borrowing \$13.5 million under its revolving credit facility offset, in part by the paydown of notes payable (\$4.7 million), early redemption of 650 shares of our Series B Preferred stock (\$6.5 million) and a required deposit of \$2.0 million, in an interest bearing certificate of deposit, with our lender in connection with our \$15.0 million revolving credit facility.

The Company's total annual commitments at December 31, 2006 for long term non-cancelable leases of approximately \$722,000 consists of obligations under operating leases for facilities and lease agreements for the rental of warehouse equipment, office equipment and automobiles.

The Company believes its sources of cash will be sufficient to fund its operations and meet its cash requirements to satisfy its working capital needs, capital expenditure needs, outstanding commitments, and other liquidity requirements associated with its existing operations over the next twelve months. The Company's ability to fund these requirements will depend on its future operations, performance and cash flow and is subject to prevailing economic conditions and financial, business and other factors, some of which are beyond the Company's control. In addition, as part of the Company's strategy, it may pursue acquisitions and investments that are complementary to its business. Any material future acquisitions or investments will likely require additional capital and therefore, the Company cannot predict or assure that additional funds from existing sources will be sufficient for such future events.

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Capital Expenditures

The Company's capital expenditures for the six months ended December 31, 2006 and 2005 were \$364,00 and \$87,900, respectively. The Company has budgeted approximately \$500,000 for capital expenditures for fiscal 2007. The total amount is expected to be funded from cash provided from its operations.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Recent Accounting Pronouncements - refer to footnote 1 of the condensed consolidated financial statements for the six months ended December 31, 2006

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included in Part I - Item 1.

Impact of Inflation

The Company does not believe that inflation has significantly affected its results of operations.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of business, the Company is party to financial instruments that are subject to market risks arising from changes in interest rates and foreign currency exchange rates, primarily with respect to the Canadian Dollar in its customer receivables. The Company's use of derivative instruments is very limited and it does not enter into derivative instruments for trading purposes. We performed a sensitivity analysis to determine the impact of fluctuations in interest rates relating to our outstanding variable debt. If interest rates varied by plus or minus one percent our income before taxes would be higher or lower in the amount of \$135,000 per annum.

Item 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

As required by Rule 13a-15(b) under the Exchange Act, we carried out an evaluation, under the supervision and with the participation of management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective at the reasonable assurance level to ensure that information required to be disclosed by us in reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. The Company has not completed its Sarbanes Oxley section 404 process, or related assessment in the process of evaluation and testing and is not required to do so until our fiscal year ending June 30, 2008. The Company may identify deficiencies that may require remediation in the process of its evaluation and testing.

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PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

NatEx Georgia LLC and Vasili Patarkalishvili v. Robert B. Kay, E. Gerald Kay, Trade Investment Services, LLC, Paxis Pharmaceuticals, Inc., Dean P. Stull and Integrated BioPharma, Inc., pending in the Supreme Court for the State of New York, New York County. Plaintiffs NatEx Georgia LLC and Vasili Patarkalishvili commenced this action on July 19, 2004, alleging claims for breach of contract, fraud and breach of the implied duty of good faith and fair dealing arising out of an alleged failure by Paxis to provide information necessary for NatEx to perform under the parties' agreements by which NatEx had agreed to supply Paclitaxel extract. The complaint seeks damages of more than \$5.0 million. By order dated January 6, 2006, the Court granted in part Defendants' motion to

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dismiss. The Court dismissed all of the claims against all defendants, except for the breach of contract claim against Paxis. Plaintiffs have filed a notice of appeal of that decision. Certain of the Defendants, including the Company, have filed counter-claims against Plaintiffs for breach of a July 2003 agreement with NatEx and to collect on an \$1.3 million note, though the Company is doubtful of collection on that note. Paxis plans to defend vigorously the remaining claim and prosecute its claims.

The Pom Wonderful LLC v. Agrolabs, Inc. matter described in our previous public filings has been settled by all parties without material financial impact on our Company. The matter was dismissed by the United States District Court for the Central District of California on January 18, 2007.

Item 1A. RISK FACTORS

The risks described in Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended June 30, 2006, could materially and adversely affect our business, financial condition and results of operations. The risk factors discussed in that Form 10-K do not identify all risks that we face because our business operations could also be affected by additional factors that are not presently known to us or that we currently consider to be immaterial to our operations.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Two matters were submitted for a vote at the Company's Annual Meeting of Stockholders held on November 22, 2006 by holders of record of the Company's common stock, par value \$.002 per share at the close of business on October 30, 2006 (the "Record Date"), which was determined to be 13,537,419 shares of common stock. The holders of 10,057,199 shares of common stock, a majority, were present in person or represented by proxy at the meeting. The two matters and the results of the voting at the Annual Meeting are as follows:

1. To elect three Class I directors for a three year term to serve until the 2009 Annual Meeting of Stockholders. The number of votes cast at the meeting for the election of the three (3) directors for a three year term to the 2009 Annual Meeting of Stockholders were as follows:

	For	Withheld
E. Gerald Kay	9,865,907	191,292
Ms. Riva Sheppard	9,866,314	190,885
Mr. Carl DeSantis	9,870,265	186,934

2. To ratify the appointment of Amper Politziner & Mattia, P.C. as the Company's independent auditors. The number of votes cast at the meeting for the proposal to ratify Amper Politziner & Mattia, P.C. as the Company's independent auditors were as follows:

	For	Against	Abstain
	10,052,199	1,700	3,300

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

Exhibit Number	Description
31.1	Certification of pursuant to Section 302 of Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Executive Officer.
31.2	Certification of pursuant to Section 302 of Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Financial Officer.
32.1	Certification of periodic financial report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Chief Executive Officer.
32.2	Certification of periodic financial report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Chief Financial Officer.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INTEGRATED BIOPHARMA, INC. AND SUBSIDIARIES

Date: February 14, 2007

By: /s/ E. Gerald Kay

E. Gerald Kay,
Chief Executive Officer

Date: February 14, 2007

By: /s/ Dina L. Masi

Dina L. Masi,
Senior Vice President & Chief Financial Officer