

NATURAL ALTERNATIVES INTERNATIONAL INC
Form 10-Q
February 17, 2009
Table of Contents

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, 2008

000-15701

(Commission file number)

NATURAL ALTERNATIVES INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation)

84-1007839
(IRS Employer Identification No.)

1185 Linda Vista Drive

San Marcos, California 92078
(Address of principal executive offices)

(760) 744-7340
(Registrant's telephone number)

Indicate by check mark whether Natural Alternatives International, Inc. (NAI) (1) has 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 NAI was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes No

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

Indicate by check mark whether NAI is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

Yes No

As of February 17, 2009, 7,066,526 shares of NAI's common stock were outstanding, net of 180,941 treasury shares.

Table of Contents

TABLE OF CONTENTS

| | Page |
|--|-------------|
| <u>SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS</u> | 1 |
| PART I <u>FINANCIAL INFORMATION</u> | 2 |
| Item 1. <u>Financial Statements</u> | 2 |
| <u>Condensed Consolidated Balance Sheets</u> | 2 |
| <u>Condensed Consolidated Statements of Operations and Comprehensive (Loss) Income</u> | 3 |
| <u>Condensed Consolidated Statements of Cash Flows</u> | 4 |
| <u>Notes to Condensed Consolidated Financial Statements</u> | 5 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 13 |
| Item 4. <u>Controls and Procedures</u> | 18 |
| PART II <u>OTHER INFORMATION</u> | 19 |
| Item 1. <u>Legal Proceedings</u> | 19 |
| Item 1A. <u>Risk Factors</u> | 19 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 19 |
| Item 3. <u>Defaults Upon Senior Securities</u> | 19 |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u> | 19 |
| Item 5. <u>Other Information</u> | 19 |
| Item 6. <u>Exhibits</u> | 19 |
| <u>SIGNATURES</u> | 24 |

Table of Contents

SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

Certain statements in this report, including information incorporated by reference, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities Exchange Act of 1934, and the Private Securities Litigation Reform Act of 1995. Forward-looking statements reflect current views about future events and financial performance based on certain assumptions. They include opinions, forecasts, intentions, plans, goals, projections, guidance, expectations, beliefs or other statements that are not statements of historical fact. Words such as may, will, should, could, would, expects, plans, believes, anticipates, intends, estimates, ap projects, or the negative or other variation of such words, and similar expressions may identify a statement as a forward-looking statement. Any statements that refer to projections of our future financial performance, our anticipated growth and trends in our business, our goals, strategies, focus and plans, and other characterizations of future events or circumstances, including statements expressing general optimism about future operating results, are forward-looking statements. Forward-looking statements in this report may include statements about:

future financial and operating results, including projections of net sales, revenue, income or loss, net income or loss per share, profit margins, expenditures, liquidity, goodwill valuation and other financial items;

our ability to develop relationships with new customers and maintain or improve existing customer relationships;

development of new products, brands and marketing strategies;

the effect of the discontinuance of Dr. Cherry's television program and our ability to develop a new marketing plan for, and to sustain, our Pathway to Healing® product line;

distribution channels, product sales and performance, and timing of product shipments;

inventories and the adequacy and intended use of our facilities;

current or future customer orders;

the impact on our business and results of operations and variations in quarterly net sales from seasonal and other factors;

management's goals and plans for future operations;

our ability to improve operational efficiencies, manage costs and business risks and improve or maintain profitability;

growth, expansion, diversification, acquisition, divestment and consolidation strategies, the success of such strategies, and the benefits we believe can be derived from such strategies;

personnel;

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

the outcome of regulatory, tax and litigation matters;

sources and availability of raw materials;

operations outside the United States;

the adequacy of reserves and allowances;

overall industry and market performance;

competition;

current and future economic and political conditions;

the impact of accounting pronouncements; and

other assumptions described in this report underlying or relating to any forward-looking statements.

The forward-looking statements in this report speak only as of the date of this report and caution should be taken not to place undue reliance on any such forward-looking statements. Forward-looking statements are subject to certain events, risks, and uncertainties that may be outside of our control. When considering forward-looking statements, you should carefully review the risks, uncertainties and other cautionary statements in this report as they identify certain important factors that could cause actual results to differ materially from those expressed in or implied by the forward-looking statements. These factors include, among others, the risks described under Item 1A of Part II and elsewhere in this report, as well as in other reports and documents we file with the United States Securities and Exchange Commission (SEC).

Unless the context requires otherwise, all references in this report to the Company, NAI, we, our, and us refer to Natural Alternatives International, Inc. and, as applicable, Natural Alternatives International Europe S.A. (NAIE), Real Health Laboratories, Inc. (RHL) and our other wholly owned subsidiaries.

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****NATURAL ALTERNATIVES INTERNATIONAL, INC.****Condensed Consolidated Balance Sheets****(In thousands, except share and per share data)**

| | December 31, 2008 (Unaudited) | June 30, 2008 |
|--|--|--------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 3,337 | \$ 3,518 |
| Certificate of deposit | 699 | |
| Accounts receivable - less allowance for doubtful accounts of \$8 at December 31, 2008 and \$17 at June 30, 2008 | 4,638 | 6,401 |
| Inventories, net | 13,613 | 14,135 |
| Income tax receivable | 1,270 | 1,354 |
| Prepays and other current assets | 974 | 1,223 |
| Current assets of discontinued operations | 3,316 | 6,299 |
| Total current assets | 27,847 | 32,930 |
| Property and equipment, net | 14,039 | 12,823 |
| Other noncurrent assets, net | 159 | 160 |
| Total assets | \$ 42,045 | \$ 45,913 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 5,935 | \$ 7,245 |
| Accrued liabilities | 1,173 | 1,048 |
| Accrued compensation and employee benefits | 1,274 | 1,332 |
| Income taxes payable | 405 | 409 |
| Line of credit | 3,538 | |
| Current portion of long-term debt | 1,994 | 2,730 |
| Current liabilities of discontinued operations | 833 | 1,724 |
| Total current liabilities | 15,152 | 14,488 |
| Deferred income taxes | | 61 |
| Deferred rent | 1,114 | 1,164 |
| Long-term pension liability | 223 | 198 |
| Total liabilities | 16,489 | 15,911 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock; \$0.01 par value; 500,000 shares authorized; none issued or outstanding | 71 | 71 |

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

| | | |
|--|-----------|-----------|
| Common stock; \$0.01 par value; 20,000,000 shares authorized; issued and outstanding 7,247,467 at December 31, 2008 and 7,210,937 at June 30, 2008 | | |
| Additional paid-in capital | 18,741 | 18,485 |
| Accumulated other comprehensive loss | (261) | (261) |
| Retained earnings | 8,104 | 12,806 |
| Treasury stock, at cost, 180,941 shares at December 31, 2008 and June 30, 2008 | (1,099) | (1,099) |
| Total stockholders' equity | 25,556 | 30,002 |
| Total liabilities and stockholders' equity | \$ 42,045 | \$ 45,913 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**NATURAL ALTERNATIVES INTERNATIONAL, INC.****Condensed Consolidated Statements of Operations and Comprehensive (Loss) Income****(In thousands, except share and per share data)****(Unaudited)**

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|------------------------------------|-----------|----------------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net sales | \$ 17,616 | \$ 18,402 | \$ 37,142 | \$ 41,287 |
| Cost of goods sold | 16,844 | 15,226 | 33,970 | 34,171 |
| Gross profit | 772 | 3,176 | 3,172 | 7,116 |
| Selling, general & administrative expenses | 2,838 | 3,075 | 5,456 | 5,967 |
| Operating (loss) income from continuing operations | (2,066) | 101 | (2,284) | 1,149 |
| Other income (expense): | | | | |
| Interest income | | 11 | 5 | 13 |
| Interest expense | (79) | (39) | (122) | (182) |
| Foreign exchange (loss) gain | (45) | 48 | (344) | 150 |
| Other, net | 4 | (28) | 28 | |
| | (120) | (8) | (433) | (19) |
| (Loss) income from continuing operations before income taxes | (2,186) | 93 | (2,717) | 1,130 |
| Provision (benefit) for income taxes | 362 | (49) | 180 | 237 |
| (Loss) income from continuing operations | (2,548) | 142 | (2,897) | 893 |
| Loss from discontinued operations, net of tax | (756) | (322) | (1,804) | (650) |
| Net (loss) income | \$ (3,304) | \$ (180) | \$ (4,701) | \$ 243 |
| Unrealized gain resulting from change in fair value of derivative instruments, net of tax | | 14 | | 22 |
| Comprehensive (loss) income | \$ (3,304) | \$ (166) | \$ (4,701) | \$ 265 |
| Net (loss) income per common share: | | | | |
| Basic: | | | | |
| Continuing operations | \$ (0.36) | \$ 0.02 | \$ (0.41) | \$ 0.13 |
| Discontinued operations | (0.11) | (0.05) | (0.26) | (0.09) |
| Net (loss) income | \$ (0.47) | \$ (0.03) | \$ (0.67) | \$ 0.03 |
| Diluted: | | | | |
| Continuing operations | \$ (0.36) | \$ 0.02 | \$ (0.41) | \$ 0.12 |
| Discontinued operations | (0.11) | (0.05) | (0.26) | (0.09) |
| Net (loss) income | \$ (0.47) | \$ (0.03) | \$ (0.67) | \$ 0.03 |

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

Weighted average common shares outstanding:

| | | | | |
|---------|-----------|-----------|-----------|-----------|
| Basic | 7,057,614 | 6,980,195 | 7,045,413 | 6,947,155 |
| Diluted | 7,057,614 | 7,067,113 | 7,045,413 | 7,044,402 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**NATURAL ALTERNATIVES INTERNATIONAL, INC.****Condensed Consolidated Statements of Cash Flows****(In thousands)****(Unaudited)**

| | Six Months Ended December 31, | |
|--|--|-------------|
| | 2008 | 2007 |
| Cash flows from operating activities | | |
| (Loss) income before discontinued operations | \$ (2,897) | \$ 893 |
| Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities: | | |
| Change in allowance for uncollectible accounts receivable | (9) | 1 |
| Depreciation and amortization | 1,547 | 1,497 |
| Non-cash compensation | 181 | 195 |
| Tax benefit from exercise of stock options | (88) | (64) |
| Deferred income taxes | (61) | |
| Pension expense, net of contributions | 25 | 25 |
| Loss on disposal of assets | 8 | 69 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 1,772 | (544) |
| Inventories, net | 522 | 1,093 |
| Other assets | 250 | 37 |
| Accounts payable and accrued liabilities | (1,237) | (612) |
| Income taxes payable | 168 | 62 |
| Accrued compensation and employee benefits | (58) | 64 |
| Net cash provided by operating activities from continuing operations | 123 | 2,716 |
| Net cash (used in) operating activities from discontinued operations | (1,866) | (358) |
| Net cash (used in) provided by operating activities | (1,743) | 2,358 |
| Cash flows from investing activities | | |
| Capital expenditures | (2,771) | (705) |
| Purchase of certificate of deposit | (699) | |
| Net cash used by investing activities from continuing operations | (3,470) | (705) |
| Net cash provided by (used in) investing activities from discontinued operations, including proceeds from the sale of As We Change | 2,155 | (18) |
| Net cash used by investing activities | (1,315) | (723) |
| Cash flows from financing activities | | |
| Net borrowings on line of credit | 3,538 | |
| Payments on long-term debt | (736) | (892) |
| Tax benefit from exercise of stock options | 88 | 64 |
| Repurchase of common stock | | (724) |
| Net activity from issuance of common stock | (13) | 432 |
| Net cash provided by (used in) financing activities | 2,877 | (1,120) |

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

| | | |
|--|----------|----------|
| Net (decrease) increase in cash and cash equivalents | (181) | 515 |
| Cash and cash equivalents at beginning of period | 3,518 | 4,095 |
| Cash and cash equivalents at end of period | \$ 3,337 | \$ 4,610 |
| Supplemental disclosures of cash flow information | | |
| Cash paid during the period for: | | |
| Interest | \$ 140 | \$ 211 |
| Taxes | \$ 60 | \$ 419 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****A. Basis of Presentation and Summary of Significant Accounting Policies****Basis of Presentation**

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and applicable rules and regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In management's opinion, all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows have been included and are of a normal, recurring nature. The results of operations for the three and six months ended December 31, 2008 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

You should read the financial statements and these notes, which are an integral part of the financial statements, together with our audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2008 (2008 Annual Report). The accounting policies used to prepare the financial statements included in this report are the same as those described in the notes to the consolidated financial statements in our 2008 Annual Report unless otherwise noted below.

Reclassification

Certain prior year amounts have been reclassified to conform with the current year's presentation. Such reclassifications had no effect on net (loss) income.

Net (Loss) Income per Common Share

We compute net income per common share in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings Per Share*. This statement requires the presentation of basic income per common share, using the weighted average number of common shares outstanding during the period, and diluted net income per common share, using the additional dilutive effect of all dilutive securities. The dilutive impact of stock options account for the additional weighted average shares of common stock outstanding for our diluted net income per common share computation. We calculated basic and diluted net income per common share as follows (in thousands, except per share data):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|--|--|-------------|--|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Numerator | | | | |
| Net (loss) income | \$ (3,304) | \$ (180) | \$ (4,701) | \$ 243 |
| Denominator | | | | |
| Basic weighted average common shares outstanding | 7,058 | 6,980 | 7,045 | 6,947 |
| Dilutive effect of stock options | | 87 | | 97 |
| Diluted weighted average common shares outstanding | 7,058 | 7,067 | 7,045 | 7,044 |
| Basic net (loss) income per common share | \$ (0.47) | \$ (0.03) | \$ (0.67) | \$ 0.03 |
| Diluted net (loss) income per common share | \$ (0.47) | \$ (0.03) | \$ (0.67) | \$ 0.03 |

Shares related to stock options of 879,492 for the three months ended December 31, 2008, and 973,096 for the six months ended December 31, 2008, were excluded from the calculation of diluted net (loss) income per common share, as the effect of their inclusion would have been anti-dilutive.

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

Shares related to stock options of 577,000 for the three months ended December 31, 2007, and 552,000 for the six months ended December 31, 2007, were excluded from the calculation of diluted net (loss) income per common share, as the effect of their inclusion would have been anti-dilutive.

Stock-Based Compensation

We have an equity incentive plan under which we have granted nonqualified and incentive stock options to employees, non-employee directors and consultants. We also have an employee stock purchase plan. Effective July 1, 2005, we adopted the fair value recognition provisions of SFAS No. 123R, *Share Based Payment* (SFAS 123R), using the modified-prospective-transition method. Under that transition method, compensation cost is recognized (a) for all stock-based awards granted before, but not yet vested as of, July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, *Accounting*

Table of Contents

for *Stock Based Compensation*, and (b) for all stock-based awards granted after July 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Results for periods before implementation of SFAS 123R have not been restated.

We estimated the fair value of the stock option awards at the date of grant and employee stock purchase plan shares at the beginning of the offering period using the Black-Scholes option valuation model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Option valuation models require the input of highly subjective assumptions. Black-Scholes uses assumptions related to volatility, the risk-free interest rate, the dividend yield (which is assumed to be zero, as we have not paid any cash dividends) and employee exercise behavior. Expected volatilities used in the model are based mainly on the historical volatility of our stock price. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect in the period of grant. The expected life of stock option grants is derived from historical experience.

Our net loss for the three months ended December 31, 2008 included stock based compensation expense of approximately \$112,000. Our net loss for the three months ended December 31, 2007 included stock based compensation expense of approximately \$100,000. Our net loss included stock-based compensation expense of approximately \$181,000 for the six months ended December 31, 2008. Our net income was reduced by stock-based compensation expense of approximately \$195,000 for the six months ended December 31, 2007.

Adoption of New Accounting Standards

Effective July 1, 2008, the Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS 157) for its financial assets and liabilities. In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 157-2, *Effective Date of FASB Statement No. 157*, which delayed the effective date of SFAS 157 for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. SFAS 157 establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurement. The adoption of SFAS 157 on July 1, 2008 did not have any effect on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115* (SFAS 159), effective as of the beginning of the first fiscal year that begins after November 15, 2007. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value with changes in fair value recognized in earnings for each reporting period. The adoption of SFAS 159 on July 1, 2008 did not have any effect on the Company's consolidated financial statements as the Company did not elect any eligible items for fair value measurement.

B. Discontinued Operations

On August 4, 2008, RHL sold certain assets related to its catalog and internet business conducted under the name *As We Change*® to Miles Kimball Company for a cash purchase price of \$2,000,000. The purchase price was subject to certain post-closing adjustments based on a final accounting of the value of the assets sold to and the liabilities assumed by the buyer at the closing. As a result of the post-closing review, the purchase price was increased by \$299,000, resulting in an aggregate purchase price of \$2,299,000. We recorded a loss, net of tax, of \$148,000 as a result of this sale and we recognized \$221,000 in severance and related payroll costs during the six months ended December 31, 2008.

We intend to market for sale legacy RHL's remaining business operations during fiscal 2009, with the exception of our *Pathway to Healing*® product line. As the plan to dispose of the legacy RHL business met the criteria of SFAS No. 144, *Accounting for the Disposal of Long-lived Assets* (SFAS 144), the current and prior periods presented in this report have been reclassified to reflect the legacy RHL business as discontinued operations.

As a result of our decision to sell the legacy RHL business, we also initiated an operational consolidation program during the first quarter of fiscal 2009 that transitioned the remaining branded products business operations to our corporate offices. This operational consolidation program was substantially complete as of September 30, 2008 and resulted in a charge to discontinued operations of \$829,000 in severance and other business related exit costs during the six months ended December 31, 2008.

Table of Contents

The following table presents the activity and the reserve balances related to these restructuring programs for the six months ended December 31, 2008 (in thousands):

| | Balance at June 30, 2008 | Charges to Expense | Cash Payments | Balance at December 31, 2008 |
|--|-----------------------------|-----------------------|------------------|---------------------------------|
| Employee termination costs | \$ | \$ 919 | \$ (673) | \$ 246 |
| Lease liabilities and related facility closure costs | | 131 | (36) | 95 |
| Total | \$ | \$ 1,050 | \$ (709) | \$ 341 |

Accrued restructuring charges:

| | |
|---------------------------------------|---------------|
| Current portion continuing operations | \$ 12 |
| Discontinued operations | 329 |
| Total | \$ 341 |

The following table summarizes the results of the legacy RHL business, classified as discontinued operations, for the periods ended December 31 (in thousands):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|--|------------------------------------|----------|----------------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net sales | \$ 800 | \$ 2,009 | \$ 2,174 | \$ 4,645 |
| Cost of goods sold and operating expense | 724 | 2,382 | 2,691 | 5,396 |
| Restructuring expenses | 199 | | 1,050 | |
| Loss on the sale of As We Change® | | | 226 | |
| Other expense | 12 | 19 | 11 | 37 |
| Loss before income taxes | (135) | (392) | (1,804) | (788) |
| Income tax provision (benefit) | 621 | (70) | | (138) |
| Loss from discontinued operations | \$ (756) | \$ (322) | \$ (1,804) | \$ (650) |

Assets and liabilities of the legacy RHL business included in the Condensed Consolidated Balance Sheets are summarized as follows (in thousands):

| | December 31, 2008 | June 30, 2008 |
|--------------------------------|----------------------|------------------|
| Assets | | |
| Cash | \$ 357 | \$ 575 |
| Accounts receivable, net | 551 | 349 |
| Inventory, net | 324 | 805 |
| Other current assets | 38 | 204 |
| Plant and equipment, net | | 351 |
| Goodwill and intangible assets | 2,046 | 4,015 |
| Total assets | \$ 3,316 | \$ 6,299 |
| Liabilities | | |

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

| | | |
|---------------------------------------|----------|----------|
| Accounts payable | \$ | \$ 678 |
| Accrued liabilities | 833 | 1,046 |
| Total liabilities | 833 | 1,724 |
| Net assets of discontinued operations | \$ 2,483 | \$ 4,575 |

C. Inventories

Inventories, net consisted of the following (in thousands):

| | December 31, 2008 | June 30, 2008 |
|------------------|----------------------|------------------|
| Raw materials | \$ 10,072 | \$ 10,428 |
| Work in progress | 2,410 | 2,517 |
| Finished goods | 2,213 | 1,997 |
| Reserves | (1,082) | (807) |
| | \$ 13,613 | \$ 14,135 |

Table of Contents**D. Property and Equipment**

Property and equipment consisted of the following (dollars in thousands):

| | Depreciable Life In Years | December 31, 2008 | June 30, 2008 |
|---|------------------------------|----------------------|------------------|
| Land | N/A | \$ 393 | \$ 393 |
| Building and building improvements | 7 39 | 2,727 | 2,723 |
| Machinery and equipment | 3 12 | 22,483 | 19,963 |
| Office equipment and furniture | 3 5 | 3,825 | 3,774 |
| Vehicles | 3 | 204 | 204 |
| Leasehold improvements | 1 15 | 10,382 | 10,283 |
| Total property and equipment | | 40,014 | 37,340 |
| Less: accumulated depreciation and amortization | | (25,975) | (24,517) |
| Property and equipment, net | | \$ 14,039 | \$ 12,823 |

E. Debt

We have a bank credit facility of \$9.5 million, comprised of a \$7.5 million working capital line of credit and \$2.0 million in outstanding term loans. The working capital line of credit is secured by our accounts receivable and other rights to payment, general intangibles, inventory and equipment, has a fluctuating or fixed interest rate as elected by NAI from time to time and described in more detail below, and borrowings are subject to eligibility requirements for current accounts receivable and inventory balances. The working capital line of credit has no pre-determined minimum monthly payments and matures on November 1, 2010. As of December 31, 2008 the outstanding balances on the term loans consisted of a \$280,000, 15 year term loan due June 2011, secured by our San Marcos building, at an interest rate of 8.25%; a \$540,000, 10 year term loan due May 2014 with a twenty year amortization, secured by our San Marcos building, at an interest rate of LIBOR plus 2.25%; a \$140,000, five year term loan due May 2009, secured by equipment, at an interest rate of LIBOR plus 2.10%; and a \$1.0 million, four year term loan due December 2009, secured by equipment, at an interest rate of LIBOR plus 2.10%. Monthly payments on the term loans are approximately \$124,000 plus interest. As of December 31, 2008, we had \$3.5 million outstanding on the working capital line of credit.

On January 24, 2007, we amended our credit facility to extend the maturity date for the working capital line of credit from November 1, 2007 to November 1, 2008, and maintain the ratio of total liabilities/tangible net worth covenant at 1.25/1.0 for the remainder of the term of the credit facility.

On December 18, 2007, we further amended our credit facility to (i) extend the maturity date for the working capital line of credit from November 1, 2008 to November 1, 2009; (ii) reduce the maximum principal amount available under the working capital line of credit from \$12.0 million to \$7.5 million; (iii) reduce the maximum borrowings against inventory from \$6.0 million to \$3.75 million, provided any such borrowings do not at any time exceed eligible accounts receivable; and (iv) extend the availability of the Foreign Exchange Facility from November 1, 2007 to November 1, 2008 and the allowable contract term thereunder from November 1, 2008 to November 1, 2009. Our lender agreed to extend the availability of the Foreign Exchange Facility from November 1, 2008 to November 1, 2010 effective as of November 1, 2008.

On December 29, 2008, we again amended our credit facility to (i) extend the maturity date for the working capital line of credit from November 1, 2009 to November 1, 2010; (ii) modify the interest rate payable on the line of credit from a rate equal to the Prime Rate or LIBOR plus 1.75%, as elected by NAI from time to time, to a rate equal to either a fluctuating rate per annum equal to 2.75% to 3.75% above the Daily One Month LIBOR Rate in effect from time to time or a fixed rate per annum equal to 2.50% to 3.50% above LIBOR, as elected by NAI from time to time, in each case with the percentage above the applicable LIBOR determined based on NAI's fixed charge coverage ratio; (iii) modify the fiscal year end net income requirement for fiscal 2009 from net income after taxes of not less than \$750,000 to a net loss not to exceed \$2,500,000; (iv) modify the fixed charge coverage ratio for the quarter ending March 31, 2009 from not less than 1.25 to 1.0 to not less than 0.50 to 1.0; and (v) eliminate the fixed charge coverage ratio and net income requirements that would have applied to the second quarter of fiscal 2009. In consideration of such amendments, NAI paid a \$25,000 amendment fee to the lender.

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

Based on the impact of our deferred tax asset valuation (as described under Note J below) and our cumulative losses from operations over the previous four fiscal quarters, we do not expect to meet our fixed charge coverage ratio covenant as of March 31, 2009. If we fail to meet this covenant, we intend to request a waiver from our lender but there is no assurance when or if or on what terms a waiver will be provided. Therefore, in accordance with SFAS No. 78, *Classification of Obligations that are Callable by the Creditor* (SFAS 78), we have reclassified all of our long-term debt to current debt at December 31, 2008 and June 30, 2008.

Table of Contents

On September 22, 2006, NAIE, our wholly owned subsidiary, entered into a credit facility to provide it with a credit line of up to CHF 1,300,000, or approximately \$1.2 million, which is the initial maximum aggregate amount that can be outstanding at any one time under the credit facility. This maximum amount was reduced by CHF 160,000, or approximately \$152,000, as of December 31, 2007 and will be reduced by an additional CHF 160,000 at the end of each succeeding calendar year. On February 19, 2007, NAIE amended its credit facility to provide that the maximum aggregate amount that may be outstanding under the facility cannot be reduced below CHF 500,000, or approximately \$474,000. As of December 31, 2008, there was no outstanding balance under the credit facility.

Under its credit facility, NAIE may draw amounts either as current account loan credits to its current or future bank accounts or as fixed loans with a maximum term of 24 months. Current account loans will bear interest at the rate of 5% per annum. Fixed loans will bear interest at a rate determined by the parties based on current market conditions and must be repaid pursuant to a repayment schedule established by the parties at the time of the loan. If a fixed loan is repaid early at NAIE's election or in connection with the termination of the credit facility, NAIE will be charged a pre-payment penalty equal to 0.1% of the principal amount of the fixed loan or CHF 1,000 (approximately \$947), whichever is greater. The bank reserves the right to refuse individual requests for an advance under the credit facility, although its exercise of such right will not have the effect of terminating the credit facility as a whole.

The composite interest rate on all of our outstanding debt was 6.70% at December 31, 2008 and 8.23% at December 31, 2007.

F. Defined Benefit Pension Plan

We sponsor a defined benefit pension plan that provides retirement benefits to employees based generally on years of service and compensation during the last five years before retirement. Effective June 20, 1999, our Board of Directors amended the plan to freeze the accrued benefit of each plan member at its then current amount and to no longer allow inactive plan members or other employees to become active members of the plan. We contribute an amount not less than the minimum funding requirements of the Employee Retirement Income Security Act of 1974 nor more than the maximum tax-deductible amount.

The components included in the net periodic expense for the periods ended December 31 were as follows (in thousands):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|--------------------------------|------------------------------------|-------|----------------------------------|-------|
| | 2008 | 2007 | 2008 | 2007 |
| Interest cost | \$ 20 | \$ 21 | \$ 40 | \$ 42 |
| Expected return on plan assets | (7) | (9) | (14) | (17) |
| Net periodic expense | \$ 13 | \$ 12 | \$ 26 | \$ 25 |

G. Economic Dependency

We had substantial net sales to certain customers during the periods shown in the following table. The loss of any of these customers, or a significant decline in net sales or the growth rate of sales to these customers could have a material adverse impact on our net sales and net income. Net sales to any one customer representing 10% or more of the respective period's total net sales were as follows (dollars in thousands):

| | Three Months Ended December 31, | | | | Six Months Ended December 31, | | | |
|------------|---------------------------------|-------------------------|--------------------------|-------------------------|-------------------------------|-------------------------|--------------------------|-------------------------|
| | 2008 | | 2007 | | 2008 | | 2007 | |
| | Net Sales by Customer | % of Total Net Sales | Net Sales by Customer | % of Total Net Sales | Net Sales by Customer | % of Total Net Sales | Net Sales by Customer | % of Total Net Sales |
| Customer 1 | \$ 9,034 | 51% | \$ 10,730 | 58% | \$ 18,907 | 51% | \$ 19,462 | 47% |
| Customer 2 | 4,132 | 23 | 4,640 | 25 | 9,533 | 26 | 13,814 | 34 |
| Customer 3 | 1,959 | 11 | (a) | (a) | (a) | (a) | (a) | (a) |
| | \$ 15,125 | 85% | \$ 15,370 | 83% | \$ 28,440 | 77% | \$ 33,276 | 81% |

(a) Net sales were less than 10% of the period's total net sales.

Table of Contents

We buy certain products from a limited number of raw material suppliers. The loss of any of these suppliers could have a material adverse impact on our net sales and net income. Raw material purchases from any one supplier representing 10% or more of the respective period's total raw material purchases were as follows (dollars in thousands):

| | Three Months Ended December 31, | | | | Six Months Ended December 31, | | | |
|------------|------------------------------------|-----------------------------------|------------------------------------|-----------------------------------|------------------------------------|-----------------------------------|------------------------------------|-----------------------------------|
| | 2008 | | 2007 | | 2008 | | 2007 | |
| | Raw Material Purchases by Supplier | % of Total Raw Material Purchases | Raw Material Purchases by Supplier | % of Total Raw Material Purchases | Raw Material Purchases by Supplier | % of Total Raw Material Purchases | Raw Material Purchases by Supplier | % of Total Raw Material Purchases |
| Supplier 1 | \$ 1,233 | 14% | \$ (a) | (a) | \$ 2,048 | 11% | \$ 3,730 | 20% |
| Supplier 2 | \$ 1,222 | 14% | 586 | 11% | 2,301 | 13 | 2,708 | 15 |
| | \$ 2,455 | 28% | \$ 586 | 11% | \$ 4,349 | 24% | \$ 6,438 | 35% |

(a) Purchases were less than 10% of the respective period's total raw material purchases.

H. Segment Information

Our business consists of two segments, as defined by SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, identified as private label contract manufacturing, which primarily provides private label contract manufacturing services to companies that market and distribute nutritional supplements and other health care products, and branded products, which markets and distributes branded nutritional supplements.

During the fourth quarter of fiscal 2008 we undertook a careful review of our branded products portfolio and operations. As a result of this review we decided to narrow our branded products focus and portfolio, which we expect to significantly improve our overall profitability and allow us to better pursue our growth strategies. As a result, before the end of fiscal 2008, we developed and approved a plan to sell the legacy RHL business. On August 4, 2008, RHL sold certain assets related to its catalog and internet business conducted under the name As We Change® to Miles Kimball Company for a cash purchase price of \$2,299,000.

We intend to market for sale legacy RHL's remaining business operations during fiscal 2009, with the exception of our Pathway to Healing® product line. As the plan to dispose of the legacy RHL business met the criteria of SFAS 144, the current and prior periods presented in this report have been reclassified to reflect the legacy RHL business as discontinued operations.

We evaluate performance based on a number of factors. The primary performance measures for each segment are net sales and income or loss from operations before corporate allocations. Operating income or loss for each segment does not include corporate general and administrative expenses, interest expense and other miscellaneous income and expense items. Corporate general and administrative expenses include, but are not limited to: human resources, legal, finance, information technology, and other corporate level related expenses, which are not allocated to either segment. The accounting policies of our segments are the same as those described in Note A above and in the consolidated financial statements included in our 2008 Annual Report.

Our operating results from continuing operations by business segment were as follows (in thousands):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|--------------------------------------|---------------------------------|-----------|-------------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net Sales | | | | |
| Private label contract manufacturing | \$ 16,978 | \$ 17,387 | \$ 35,720 | \$ 39,205 |
| Branded products | 638 | 1,015 | 1,422 | 2,082 |

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

\$ 17,616 \$ 18,402 \$ 37,142 \$ 41,287

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|------------------------------------|----------|----------------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| (Loss) Income from Operations | | | | |
| Private label contract manufacturing | \$ (70) | \$ 1,944 | \$ 1,399 | \$ 4,663 |
| Branded products | 70 | 130 | 118 | 276 |
| Income from operations of reportable segments | | 2,074 | 1,517 | 4,939 |
| Corporate expenses not allocated to segments | (2,066) | (1,973) | (3,801) | (3,790) |
| | \$ (2,066) | \$ 101 | \$ (2,284) | \$ 1,149 |

Table of Contents

| | December 31, 2008 | June 30, 2008 |
|--------------------------------------|----------------------|------------------|
| Total Assets | | |
| Private label contract manufacturing | \$ 38,407 | \$ 39,479 |
| Branded products | 322 | 135 |
| | \$ 38,729 | \$ 39,614 |

Our private label contract manufacturing products are sold both in the United States and in markets outside the United States, including Europe, Australia and Japan. Our primary market outside the United States is Europe. Our branded products are sold only in the United States.

Net sales by geographic region, based on the customers' location, were as follows (in thousands):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|-----------------------------------|---------------------------------------|------------------|----------------------------------|------------------|
| | 2008 | 2007 | 2008 | 2007 |
| United States | \$ 11,669 | \$ 13,294 | \$ 24,863 | \$ 29,899 |
| Markets outside the United States | 5,947 | 5,108 | 12,279 | 11,388 |
| Total net sales | \$ 17,616 | \$ 18,402 | \$ 37,142 | \$ 41,287 |

Products manufactured by NAIE accounted for approximately 52% of net sales in markets outside the United States for the three months ended December 31, 2008, and 62% for the three months ended December 31, 2007. NAIE accounted for 54% of net sales in markets outside the United States for the six months ended December 31, 2008, and 49% for the six months ended December 31, 2007. No products manufactured by NAIE were sold in the United States during the six months ended December 31, 2008 and 2007.

Assets and capital expenditures by geographic region, based on the location of the company or subsidiary at which they were located or made, were as follows (in thousands):

| | Long-Lived Assets | | Total Assets | | Capital Expenditures Six Months Ended | |
|---------------|----------------------|------------------|----------------------|------------------|--|----------------------|
| | December 31, 2008 | June 30, 2008 | December 31, 2008 | June 30, 2008 | December 31, 2008 | December 31, 2007 |
| United States | \$ 12,215 | \$ 11,202 | \$ 31,268 | \$ 32,179 | \$ 2,364 | \$ 595 |
| Europe | 1,983 | 1,781 | 7,461 | 7,435 | 407 | 110 |
| | \$ 14,198 | \$ 12,983 | \$ 38,729 | \$ 39,614 | \$ 2,771 | \$ 705 |

I. Restructuring Costs

During the first six months of fiscal 2009, the continued decline in economic conditions in the United States and the various foreign markets we service negatively impacted our customers' businesses and our operations. As a result, during the second quarter of fiscal 2009 we implemented a cost reduction program that resulted in the elimination of certain personnel and business activities. The cost reduction program is expected to reduce the financial impact of the anticipated reduction in future sales. This program resulted in a charge to our operations of \$558,000 in severance from a reduction in force during the second quarter of fiscal 2009. All payments related to this cost reduction program are expected to be completed within the next twelve months.

The following table presents the activity and the reserve balance related to this restructuring program for the six months ended December 31, 2008 (in thousands):

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

| | Balance at June 30, 2008 | Charges to Expense | Cash Payments | Balance at December 31, 2008 |
|---|---|-------------------------------|--------------------------|---|
| Employee termination costs recorded to cost of goods sold | \$ | \$ 187 | \$ (65) | \$ 121 |
| Employee termination costs recorded to selling, general and administrative expenses | | 371 | (3) | 368 |
| Total | \$ | \$ 558 | \$ (68) | \$ 489 |

Table of Contents

J. Income Taxes

We account for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates, for each of the jurisdictions in which we operate, expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date.

At December 31, 2008, we recorded a valuation allowance against deferred income tax assets of \$1.9 million, representing the amount of our deferred income tax assets in excess of our deferred income tax liabilities. We recorded the valuation allowance because management was unable to conclude, in light of the cumulative loss we have realized related to our US-based operations for the three year period ended December 31, 2008, that realization of the net deferred income tax asset was more likely than not. The valuation allowance recorded during the quarter ended December 31, 2008 primarily related to the tax benefits of federal net operating loss carryforwards recognized in the first six months of fiscal 2009. As a result of the recognition of this valuation adjustment, we have a \$3.5 million gross deferred tax asset offset by a deferred tax liability of \$1.2 million and a valuation allowance of \$2.3 million resulting in a net deferred tax asset of zero as of December 31, 2008. This valuation allowance did not have any affect on the tax expense and related liability recorded for operating income recognized by our foreign subsidiary during the three and six months ended December 31, 2008.

On July 1, 2007 we adopted the provisions of the FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. Tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. Our practice is to recognize interest and/or penalties related to income tax matters in income tax expense. Upon adoption of FIN 48 on July 1, 2007, we did not record any interest or penalties.

As of December 31, 2008 and June 30 2008, we had unrecognized tax liabilities of \$47,000. The total amount of unrecognized tax liabilities, if recognized, would not materially affect the effective tax rate.

We are subject to taxation in the United States, Switzerland and various state jurisdictions. Our tax years for the fiscal year ended June 30, 2006 and forward are subject to examination by the United States and state tax authorities and our tax years for the fiscal year ended June 30, 2007 and forward are subject to examination by the Switzerland tax authorities.

K. Contingencies

From time to time, we become involved in various investigations, claims and legal proceedings that arise in the ordinary course of our business. These matters may relate to product liability, employment, intellectual property, tax, regulation, contract or other matters. The resolution of these matters as they arise will be subject to various uncertainties and, even if such claims are without merit, could result in the expenditure of significant financial and managerial resources. While unfavorable outcomes are possible, based on available information, we generally do not believe the resolution of these matters will result in a material adverse effect on our business, consolidated financial condition, or results of operations. However, a settlement payment or unfavorable outcome could adversely impact our results of operations. Our evaluation of the likely impact of these actions could change in the future and we could have unfavorable outcomes that we do not expect.

As of February 17, 2009, neither NAI nor its subsidiaries were a party to any material pending legal proceeding nor was any of their property the subject of any material pending legal proceeding.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is intended to help you understand our financial condition and results of operations for the three and six months ended December 31, 2008. You should read the following discussion and analysis together with our unaudited condensed consolidated financial statements and the notes to the condensed consolidated financial statements included under Item 1 in this report, as well as the risk factors and other information included in our 2008 Annual Report and other reports and documents we file with the SEC. Our future financial condition and results of operations will vary from our historical financial condition and results of operations described below based on a variety of factors.

Executive Overview

The following overview does not address all of the matters covered in the other sections of this Item 2 or other items in this report or contain all of the information that may be important to our stockholders or the investing public. This overview should be read in conjunction with the other sections of this Item 2 and this report.

Our primary business activity is providing private label contract manufacturing services to companies that market and distribute vitamins, minerals, herbs and other nutritional supplements, as well as other health care products, to consumers both within and outside the United States. Historically, our revenue has been largely dependent on sales to one or two private label contract manufacturing customers and subject to variations in the timing of such customers' orders, which in turn is impacted by such customers' internal marketing programs, supply chain management, entry into new markets, new product introductions and general industry and economic conditions.

A cornerstone of our business strategy is to achieve long-term growth and profitability and to diversify our sales base. We have sought and expect to continue to seek to diversify our sales both by developing relationships with additional, quality-oriented, private label contract manufacturing customers and developing and growing our own line of branded products. In connection with our efforts to develop and grow our own line of branded products, we have determined to refine the types of products on which we will focus our efforts and in doing so have elected to discontinue certain of our branded products initiatives as described below.

During the fourth quarter of fiscal 2008, in an effort to enhance stockholder value, improve working capital and enable us to focus on our core contract manufacturing business, we elected to narrow our branded products focus and developed a plan to sell the legacy RHL business. On August 4, 2008, RHL sold certain assets related to its catalog and internet business conducted under the name As We Change® to Miles Kimball Company for a cash purchase price of \$2,000,000. The purchase price was subject to certain post-closing adjustments based on a final accounting of the value of the assets sold to and the liabilities assumed by the buyer at the closing. As a result of the post-closing review, the purchase price was increased by \$299,000, resulting in an aggregate purchase price of \$2,299,000. We recorded a loss, net of tax, of \$148,000 as a result of this sale and recognized \$221,000 in severance and related payroll costs during the six months ended December 31, 2008. We intend to market for sale legacy RHL's remaining business operations during fiscal 2009, with the exception of our Pathway to Healing® product line. The financial information presented in this report has been reclassified to reflect the legacy RHL business as discontinued operations.

As a result of our decision to sell the legacy RHL business, we also initiated an operational consolidation program during the first quarter of fiscal 2009 that transitioned the remaining branded products business operations to our corporate offices. This operational consolidation program was substantially complete as of September 30, 2008 and resulted in a charge to discontinued operations of \$829,000 in severance and other business related exit costs during the six months ended December 31, 2008.

During the first six months of fiscal 2009, our net sales from continuing operations were 10.0% lower than in the first six months of fiscal 2008. Private label contract manufacturing sales declined 8.9% primarily due to lower volumes of existing products in existing markets sold to one of our largest customers, unfavorable foreign currency fluctuations, and economic conditions. Net sales from our branded products declined 31.7% in the first six months of fiscal 2009 as compared to the first six months of fiscal 2008 due to the continued softening of our Pathway to Healing® product line.

Our revenue concentration risk for our two largest customers decreased to 77% as a percentage of our total sales from continuing operations for the first six months of fiscal 2009 compared to 81% in the first six months of fiscal 2008. We expect our contract manufacturing revenue concentration percentage for our two largest customers to remain consistent for the remainder of fiscal 2009.

During fiscal 2008, we invested substantial time and incurred substantial costs associated with hiring and training new quality assurance and other manufacturing support personnel, increased testing activity, and documentation and validation processes related to our Good Manufacturing Practices (GMPs) compliance programs and we expect to continue to make investments related to our GMPs through fiscal 2009. These additional expenses negatively impacted our gross margin from continuing operations during fiscal 2008 and the first six months of fiscal 2009 and we expect this trend to continue during fiscal 2009 until we increase the volume of our private label business sufficiently to offset our

higher fixed overhead structure. Although the cost of GMP compliance is

Table of Contents

significant, we believe our commitment to quality and our steadfast support of the FDA mandated GMPs makes us well positioned to operate within the higher standards of the Food and Drug Administration's GMPs and differentiates us from our competitors.

During our first six months of fiscal 2009, the continued decline in economic conditions in the United States and the various foreign markets we service negatively impacted our customers' businesses and our operations. As a result, during the second quarter of fiscal 2009 we implemented a cost reduction program that resulted in the elimination of certain personnel and business activities. The cost reduction program is expected to reduce the financial impact of the anticipated reduction in future sales. This program resulted in a charge to our operations of \$558,000 during the second quarter of fiscal 2009 and is expected to reduce our operating overhead costs by approximately \$3.6 million annually.

Beginning in April 2007, Dr. Cherry ceased airing his weekly television program, which had served as the primary customer acquisition vehicle in marketing the Pathway to Healing® product line. While sales of the product line have been primarily generated by continuity orders from long-standing repeat customers, the loss of the television program has had a negative impact on our ability to acquire new customers. We continue working with Dr. Cherry to evaluate alternative marketing programs and revise marketing plans to support the product line.

During fiscal 2009, we plan to continue to focus on:

Leveraging our state of the art, certified facilities to increase the value of the goods and services we provide to our highly valued private label contract manufacturing customers, and assist us in developing relationships with additional quality oriented customers;

Implementing focused initiatives to grow our Pathway to Healing® product line;

Improving operational efficiencies and managing costs and business risks to improve profitability.

During fiscal 2009, in connection with our efforts to leverage our state of the art facilities, we received recertification of our Swissmedic Authority pharmaceutical license for our Manno, Switzerland manufacturing facility and our Therapeutic Goods Administration (TGA) of Australia certification for our Vista, California manufacturing facilities.

Looking forward, as a result of the uncertain near-term economic conditions including unfavorable currency markets, we expect reduced net sales from both our branded products and contract manufacturing businesses along with higher per unit operating costs related to our reduced manufacturing throughput in the third quarter of fiscal 2009, as compared to the third quarter in fiscal 2008. The negative effect on our operations associated with the anticipated decline in our third quarter sales is expected to be offset by the cost reduction program we implemented during the second quarter of fiscal 2009.

Critical Accounting Policies and Estimates

The preparation of our financial statements requires that we make estimates and assumptions that affect the amounts reported in our financial statements and their accompanying notes. We have identified certain policies that we believe are important to the portrayal of our financial condition and results of operations. These policies require the application of significant judgment by our management. We base our estimates on our historical experience, industry standards, and various other assumptions that we believe are reasonable under the circumstances. Actual results could differ from these estimates under different assumptions or conditions. An adverse effect on our financial condition, changes in financial condition, and results of operations could occur if circumstances change that alter the various assumptions or conditions used in such estimates or assumptions.

Our critical accounting policies are discussed under Item 7 of our 2008 Annual Report. There have been no significant changes to these policies during the six months ended December 31, 2008.

Table of Contents**Results of Operations**

The results of our operations for the periods ended December 31 were as follows (in thousands):

| | Three Months Ended December 31, | | | Six Months Ended December 31, | | |
|--|------------------------------------|-----------------|----------------|----------------------------------|---------------|----------------|
| | 2008 | 2007 | % Change | 2008 | 2007 | % Change |
| Private label contract manufacturing | \$ 16,978 | \$ 17,387 | (2) | \$ 35,720 | \$ 39,205 | (9) |
| Branded products | 638 | 1,015 | (37) | 1,422 | 2,082 | (32) |
| Total net sales | 17,616 | 18,402 | (4) | 37,142 | 41,287 | (10) |
| Cost of goods sold | 16,844 | 15,226 | (11) | 33,970 | 34,171 | (1) |
| Gross profit | 772 | 3,176 | (76) | 3,172 | 7,116 | (55) |
| Gross profit % | 4.4% | 17.3% | | 8.5% | 17.2% | |
| Selling, general & administrative expenses | 2,838 | 3,075 | (8) | 5,456 | 5,967 | (9) |
| % of net sales | 16.1% | 16.7% | | 14.7% | 14.5% | |
| Operating (loss) income from continuing operations | (2,066) | 101 | (2,146) | (2,284) | 1,149 | (299) |
| % of net sales | (11.7%) | 0.5% | | (6.1%) | 2.8% | |
| Other expense, net | 120 | 8 | 1,400 | 433 | 19 | 2,179 |
| (Loss) income from continuing operations before income taxes | (2,186) | 93 | (2,451) | (2,717) | 1,130 | (340) |
| % of net sales | (12.4%) | 0.5% | | (7.3%) | 2.7% | |
| Income tax expense (benefit) | 362 | (49) | (839) | 180 | 237 | (24) |
| (Loss) income from continuing operations | (2,548) | 142 | (1,894) | (2,897) | 893 | (424) |
| Loss from discontinued operations, net of tax | (756) | (322) | (135) | (1,804) | (650) | (178) |
| Net (loss) income | \$ (3,304) | \$ (180) | (1,736) | \$ (4,701) | \$ 243 | (2,035) |
| % of net sales | (18.8%) | (1.0%) | | (12.7%) | 0.6% | |

The percentage decrease in contract manufacturing net sales was primarily attributed to the following for the periods ended December 31:

| | Three Months Ended | Six Months Ended |
|--|-----------------------|---------------------|
| Mannatech, Incorporated ⁽¹⁾ | (3) | (11) |
| NSA International, Inc. ⁽¹⁾ | (10) | (2) |
| Other customers ⁽²⁾ | 11 | 4 |
| Total | (2)% | (9)% |

1 A decrease in net sales resulted primarily from the impact of the current economic conditions.

2 An increase in net sales to other customers was primarily due to increased sales from several of our existing customers along with increased sales from a new customer.

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

Net sales from our branded products segment decreased 37% from the comparable quarter in fiscal 2008 and 32% from the comparable six month period last year due primarily to the continuing impact of the cessation of the Dr. Cherry weekly television program in April 2007, which had served as the primary acquisition vehicle in marketing the Pathway to Healing® product line.

Gross profit margin decreased 12.9 percentage points from the comparable quarter in fiscal 2008 and 8.7 percentage points from the comparable six month period last year. The change in gross profit margin was primarily due to the following for the periods ended December 31:

| | Three Months Ended | Six Months Ended |
|---------------------------------------|-------------------------------|-----------------------------|
| Branded products operations | 0.7% | 0.5% |
| Contract manufacturing: | | |
| Shift in sales and material mix | (7.6) | (2.9) |
| Incremental overhead expenses | (4.6) | (3.4) |
| Incremental direct and indirect labor | (0.3) | (2.4) |
| Cost reduction program | (1.1) | (0.5) |
| Total | (12.9)% | (8.7)% |

Table of Contents

Selling, general and administrative expenses decreased \$237,000, or 8%, from the comparable quarter last year and \$511,000, or 9%, from the comparable year to date period last year. The decrease from the comparable quarter was attributed to a reduction in selling, general and administrative expenses primarily from our branded products business totaling \$181,000 associated with our operational consolidation, and a decrease in insurance and investor relations expenses totaling \$105,000. These decreases were partially offset by increased employee severance costs, consulting and professional fees, and other costs totaling \$49,000. The decrease from the comparable year to date period was a combination of a \$232,000 reduction in expenses for our branded products business associated with our operational consolidation, and a decrease in insurance, investor relations and employee compensation expenses totaling \$312,000. These decreases were partially offset by various other expenses totaling \$33,000.

Other expense, net increased \$112,000 from the comparable quarter last year and \$414,000 from the comparable six month period last year due primarily to unfavorable foreign currency exchange losses associated with the weakening of the Euro and the related impact on the translation of Euro denominated cash and receivables.

Our income tax expense of \$362,000 for the quarter ended December 31, 2008 was the result of \$49,000 in taxes from our foreign subsidiary at a statutory tax rate of 20% and \$313,000 in tax expense from our US-based operations related to the establishment of a valuation allowance against our net deferred tax asset. Our income tax expense of \$180,000 for the six months ended December 31, 2008 was the result of \$56,000 in taxes from our foreign subsidiary at a statutory tax rate of 20% and \$124,000 in tax expense from our US-based operations related to the establishment of a valuation allowance against our net deferred tax asset. As a result of our deferred tax asset valuation, we did not record any income tax benefit during the six months ended December 31, 2008 against our year-to-date US-based losses from operations.

Liquidity and Capital Resources

Our primary sources of liquidity and capital resources are cash flows provided by operating activities and the availability of borrowings under our credit facility. Net cash used in operating activities was \$1.7 million for the six months ended December 31, 2008 compared to net cash provided by operating activities of \$2.4 million in the comparable period in the prior year.

At December 31, 2008, changes in accounts receivable, consisting primarily of amounts due from our private label contract manufacturing customers, provided \$1.8 million in cash during the six months ended December 31, 2008 compared to using \$544,000 in the comparable period in the prior year. Cash provided by accounts receivable in the six months ended December 31, 2008 was the result of lower sales and increased collections of prior period accounts receivable as compared to the comparable prior year period. Days sales outstanding was 27 days as of December 31, 2008 compared to 23 days as of December 31, 2007.

Approximately \$1.1 million of our operating cash flow was generated by NAIE in the six months ended December 31, 2008. As of December 31, 2008, NAIE's undistributed retained earnings were considered indefinitely reinvested.

Capital expenditures were \$2.8 million during the six months ended December 31, 2008 compared to \$705,000 in the comparable period in the prior year. Capital expenditures during the six months ended December 31, 2008 and December 31, 2007 were primarily for manufacturing equipment in our Vista, California and Manno, Switzerland facilities. Additionally, during the six months ended December 31, 2008, we invested \$699,000 in a six month certificate of deposit and we received \$2.2 million in proceeds related to the sale of our As We Change business.

Our consolidated debt increased to \$5.5 million at December 31, 2008 from \$2.7 million at June 30, 2008 primarily due to borrowings on our working capital line of credit offset by payments on our term loans.

As of December 31, 2008, we had a bank credit facility of \$9.5 million, comprised of a \$7.5 million working capital line of credit and \$2.0 million in outstanding term loans. The working capital line of credit is secured by our accounts receivable and other rights to payment, general intangibles, inventory and equipment, has a fluctuating or fixed interest rate as elected by NAI from time to time and described in more detail below, and borrowings are subject to eligibility requirements for current accounts receivable and inventory balances. As of December 31, 2008 the outstanding balances on the term loans consisted of a \$280,000, 15 year term loan due June 2011, secured by our San Marcos building, at an interest rate of 8.25%; a \$540,000, 10 year term loan due May 2014 with a twenty year amortization, secured by our San Marcos building, at an interest rate of LIBOR plus 2.25%; a \$140,000, five year term loan due May 2009, secured by equipment, at an interest rate of LIBOR plus 2.10%; and a \$1.0 million, four year term loan due December 2009, secured by equipment, at an interest rate of LIBOR plus 2.10%. Monthly payments on the term loans are approximately \$124,000 plus interest. As of December 31, 2008, we had \$3.5 million outstanding on the working capital line of credit.

Table of Contents

On January 24, 2007, we amended our credit facility to extend the maturity date for the working capital line of credit from November 1, 2007 to November 1, 2008, and maintain the ratio of total liabilities/tangible net worth covenant at 1.25/1.0 for the remainder of the term of the credit facility.

On December 18, 2007, we further amended our credit facility to (i) extend the maturity date for the working capital line of credit from November 1, 2008 to November 1, 2009; (ii) reduce the maximum principal amount available under the working capital line of credit from \$12.0 million to \$7.5 million; (iii) reduce the maximum borrowings against inventory from \$6.0 million to \$3.75 million, provided any such borrowings do not at any time exceed eligible accounts receivable; and (iv) extend the availability of the Foreign Exchange Facility from November 1, 2007 to November 1, 2008 and the allowable contract term thereunder from November 1, 2008 to November 1, 2009. Our lender agreed to extend the availability of the Foreign Exchange Facility from November 1, 2008 to November 1, 2010 effective as of November 1, 2008.

On December 29, 2008, we again amended our credit facility to (i) extend the maturity date for the working capital line of credit from November 1, 2009 to November 1, 2010; (ii) modify the interest rate payable on the line of credit from a rate equal to the Prime Rate or LIBOR plus 1.75%, as elected by NAI from time to time, to a rate equal to either a fluctuating rate per annum equal to 2.75% to 3.75% above the Daily One Month LIBOR Rate in effect from time to time or a fixed rate per annum equal to 2.50% to 3.50% above LIBOR, as elected by NAI from time to time, in each case with the percentage above the applicable LIBOR determined based on NAI's fixed charge coverage ratio; (iii) modify the fiscal year end net income requirement for fiscal 2009 from net income after taxes of not less than \$750,000 to a net loss not to exceed \$2,500,000; (iv) modify the fixed charge coverage ratio for the quarter ending March 31, 2009 from not less than 1.25 to 1.0 to not less than 0.50 to 1.0; and (v) eliminate the fixed charge coverage ratio and net income requirements that would have applied to the second quarter of fiscal 2009. In consideration of such amendments, NAI paid a \$25,000 amendment fee to the lender.

Based on the impact of our deferred tax asset valuation (as described in the notes to our unaudited condensed consolidated financial statements included under Item 1 in this report) and our cumulative losses from operations over the previous four fiscal quarters, we do not expect to meet our fixed charge coverage ratio covenant as of March 31, 2009. If we fail to meet this covenant, we intend to request a waiver from our lender but there is no assurance when or if or on what terms a waiver will be provided. Therefore, in accordance with SFAS 78, we have reclassified all of our long-term debt to current debt at December 31, 2008 and June 30, 2008.

On September 22, 2006, NAIE, our wholly owned subsidiary, entered into a credit facility to provide it with a credit line of up to CHF 1,300,000, or approximately \$1.2 million, which is the initial maximum aggregate amount that can be outstanding at any one time under the credit facility. This maximum amount was reduced by CHF 160,000, or approximately \$152,000, as of December 31, 2007 and will be reduced by an additional CHF 160,000 at the end of each succeeding calendar year. On February 19, 2007, NAIE amended its credit facility to provide that the maximum aggregate amount that may be outstanding under the facility cannot be reduced below CHF 500,000, or approximately \$474,000. As of December 31, 2008, there was no outstanding balance under the credit facility.

Under its credit facility, NAIE may draw amounts either as current account loan credits to its current or future bank accounts or as fixed loans with a maximum term of 24 months. Current account loans will bear interest at the rate of 5% per annum. Fixed loans will bear interest at a rate determined by the parties based on current market conditions and must be repaid pursuant to a repayment schedule established by the parties at the time of the loan. If a fixed loan is repaid early at NAIE's election or in connection with the termination of the credit facility, NAIE will be charged a pre-payment penalty equal to 0.1% of the principal amount of the fixed loan or CHF 1,000 (approximately \$947), whichever is greater. The bank reserves the right to refuse individual requests for an advance under the credit facility, although its exercise of such right will not have the effect of terminating the credit facility as a whole.

As of December 31, 2008, we had \$3.3 million in cash and cash equivalents and \$3.4 million available under our line of credit. We believe our available cash, cash equivalents and potential cash flows from operations will be sufficient to fund our current working capital needs, capital expenditures and debt payments through at least the next 12 months.

Off-Balance Sheet Arrangements

As of December 31, 2008, we did not have any significant off-balance sheet debt nor did we have any transactions, arrangements, obligations (including contingent obligations) or other relationships with any unconsolidated entities or other persons that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenue or expenses material to investors.

Recent Accounting Pronouncements

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

Recent accounting pronouncements are discussed under Item 7 of our 2008 Annual Report and in the notes to the condensed consolidated financial statements included under Item 1 in this report. As of December 31, 2008, other than the pronouncements discussed in our 2008 Annual Report and in the notes to the condensed consolidated financial statements included under Item 1 in this report, we are not aware of any other pronouncements that materially affect our financial position or results of operations.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

We maintain certain disclosure controls and procedures as defined under the Securities Exchange Act of 1934. They are designed to help ensure that material information is: (1) gathered and communicated to our management, including our principal executive and financial officers, in a manner that allows for timely decisions regarding required disclosures; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the Securities Exchange Act of 1934 and within the time periods specified by the SEC. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2008. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective for their intended purpose described above as of December 31, 2008.

There were no changes to our internal control over financial reporting during the quarter ended December 31, 2008 that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

From time to time, we become involved in various investigations, claims and legal proceedings that arise in the ordinary course of our business. These matters may relate to product liability, employment, intellectual property, tax, regulation, contract or other matters. The resolution of these matters as they arise will be subject to various uncertainties and, even if such claims are without merit, could result in the expenditure of significant financial and managerial resources. While unfavorable outcomes are possible, based on available information, we generally do not believe the resolution of these matters will result in a material adverse effect on our business, consolidated financial condition, or results of operations. However, a settlement payment or unfavorable outcome could adversely impact our results of operations. Our evaluation of the likely impact of these actions could change in the future and we could have unfavorable outcomes that we do not expect.

As of February 17, 2009, neither NAI nor its subsidiaries were a party to any material pending legal proceeding nor was any of their property the subject of any material pending legal proceeding.

ITEM 1A. RISK FACTORS

You should carefully consider the risks described under Item 1A of our 2008 Annual Report, as well as the other information in our 2008 Annual Report, this report and other reports and documents we file with the SEC, when evaluating our business and future prospects. If any of the identified risks actually occur, our business, financial condition and results of operations could be seriously harmed. In that event, the market price of our common stock could decline and you could lose all or a portion of the value of your investment in our common stock.

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

Our annual meeting of stockholders was held on December 5, 2008. The following table sets forth the matters voted upon at the meeting and the results of the voting on each matter voted upon:

| Matter Voted Upon | Votes For | Withheld | Votes Against | Abstentions | Broker Non-Votes |
|---|-----------|----------|---------------|-------------|------------------|
| Election of one Class III director to serve until the next annual meeting of stockholders held to elect Class III directors and until his successor is elected and qualified: Alan J. Lane | 6,122,859 | 75,078 | | | |

Ratification of the selection of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending June 30, 2009

| | Votes For | Withheld | Votes Against | Abstentions | Broker Non-Votes |
|--|-----------|----------|---------------|-------------|------------------|
| Ratification of the selection of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending June 30, 2009 | 6,188,246 | | 5,147 | 4,544 | |

In accordance with the terms set forth in the proxy statement related to the solicitation of proxies for use at the annual meeting, an abstention from voting was used for the purpose of establishing a quorum, and was considered a vote against a proposal. A broker non-vote was also used for the purpose of establishing a quorum, but was not otherwise counted in the voting process. The named director and the above matter were each approved by the stockholders at the annual meeting.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The following exhibit index shows those exhibits filed with this report and those incorporated by reference:

Table of Contents**EXHIBIT INDEX**

| Exhibit Number | Description | Incorporated By Reference To |
|-----------------------|--|---|
| 3(i) | Amended and Restated Certificate of Incorporation of Natural Alternatives International, Inc. filed with the Delaware Secretary of State on January 14, 2005 | Exhibit 3(i) of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004, filed with the commission on February 14, 2005 |
| 3(ii) | Amended and Restated By-laws of Natural Alternatives International, Inc. dated as of February 9, 2009 | Exhibit 3(ii) of NAI's Current Report on Form 8-K dated February 9, 2009, filed with the commission on February 13, 2009 |
| 4(i) | Form of NAI's Common Stock Certificate | Exhibit 4(i) of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005 |
| 10.1 | 1999 Omnibus Equity Incentive Plan as adopted effective May 10, 1999, amended effective January 30, 2004, and further amended effective December 3, 2004* | Exhibit 10.1 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004, filed with the commission on February 14, 2005 |
| 10.2 | 1999 Employee Stock Purchase Plan as adopted effective October 18, 1999 | Exhibit B of NAI's definitive Proxy Statement filed with the commission on October 21, 1999 |
| 10.3 | Management Incentive Plan* | Exhibit 10.3 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2003, filed with the commission on November 5, 2003 |
| 10.4 | Amended and Restated Employment Agreement dated as of January 30, 2004, by and between NAI and Randell Weaver* | Exhibit 10.5 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on September 14, 2004 |
| 10.5 | Amended and Restated Employment Agreement dated as of January 30, 2004, by and between NAI and Mark A. LeDoux* | Exhibit 10.6 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on September 14, 2004 |
| 10.6 | Amended and Restated Exclusive License Agreement effective as of September 1, 2004 by and among NAI and Dr. Reginald B. Cherry | Exhibit 10.11 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on September 14, 2004 |
| 10.7 | Exclusive License Agreement effective as of September 1, 2004 by and among NAI and Reginald B. Cherry Ministries, Inc. | Exhibit 10.12 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on September 14, 2004 |
| 10.8 | First Amendment to Exclusive License Agreement effective as of December 10, 2004 by and among NAI and Reginald B. Cherry Ministries, Inc. | Exhibit 10.3 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004, filed with the commission on February 14, 2005 |
| 10.9 | Lease of Facilities in Vista, California between NAI and Calwest Industrial Properties, LLC, a California limited liability company (lease reference date June 12, 2003) | Exhibit 10.10 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2003, filed with the commission on November 5, 2003 |
| 10.10 | Credit Agreement dated as of May 1, 2004 by and between NAI and Wells Fargo Bank, National Association | Exhibit 10.11 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2004, filed with the commission on May 17, 2004 |
| 10.11 | First Amendment to Credit Agreement dated as of February 1, 2005 by and between NAI and Wells Fargo Bank, National Association | Exhibit 10.1 of NAI's Current Report on Form 8-K dated February 1, 2005, filed with the commission on February 7, 2005 |
| 10.12 | Form of Indemnification Agreement entered into between NAI and each of its directors | Exhibit 10.15 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on |

Edgar Filing: NATURAL ALTERNATIVES INTERNATIONAL INC - Form 10-Q

September 14, 2004

10.13 Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated May 9, 2005 (English translation)

Exhibit 10.19 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005, filed with the commission on May 13, 2005

20

Table of Contents

| | | |
|-------|---|---|
| 10.14 | Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated July 25, 2003 (English translation) | Exhibit 10.19 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005 |
| 10.15 | Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated June 8, 2004 (English translation) | Exhibit 10.20 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005 |
| 10.16 | Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated February 7, 2005 (English translation) | Exhibit 10.21 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005 |
| 10.17 | License Agreement effective as of April 28, 1997 by and among Roger Harris, Mark Dunnnett and NAI | Exhibit 10.22 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005 |
| 10.18 | Amendment to License Agreement effective as of March 17, 2001 by and among Roger Harris, Mark Dunnnett and NAI | Exhibit 10.23 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005 |
| 10.19 | Amendment effective as of September 15, 2005 to Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated May 9, 2005 (English translation) | Exhibit 10.24 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2005, filed with the commission on November 4, 2005 |
| 10.20 | Lease of RHL Facilities in San Diego, California between RHL and Lessor dated February 5, 2003 | Exhibit 10.4 of NAI's Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005 |
| 10.21 | Promissory Note made by NAI for the benefit of Wells Fargo Equipment Finance, Inc. in the amount of \$3,800,000 | Exhibit 10.5 of NAI's Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005 |
| 10.22 | Patent License Agreement by and between Unither Pharma, Inc. and RHL dated May 1, 2002 | Exhibit 10.6 of NAI's Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005 |
| 10.23 | Second Amendment to Credit Agreement dated as of December 1, 2005 by and between NAI and Wells Fargo Bank, National Association | Exhibit 10.30 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006 |
| 10.24 | Exclusive License Agreement by and between NAI and Richard Linchitz, M.D. effective as of August 23, 2005 | Exhibit 10.32 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006 |
| 10.25 | Letter amendment to Lease of RHL Facilities in San Diego, California between RHL and Lessor dated January 10, 2006 | Exhibit 10.33 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006 |
| 10.26 | First Amendment to Lease of Facilities in Vista, California between NAI and Calwest Industrial Properties, LLC, a California limited liability company, effective December 21, 2004 | Exhibit 10.34 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006 |
| 10.27 | Second Amendment to Lease of Facilities in Vista, California between NAI and Calwest Industrial Properties, LLC, a California limited liability company, effective January 13, 2006 | Exhibit 10.35 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006 |

Table of Contents

| | | |
|-------|--|---|
| 10.28 | Third Amendment to Credit Agreement dated as of March 15, 2006 by and between NAI and Wells Fargo Bank, National Association | Exhibit 10.35 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, filed with the commission on May 9, 2006 |
| 10.29 | Standard Sublease Multi-Tenant by and between J. Gelt Corporation dba Casa Pacifica and RHL (lease reference date March 6, 2006) | Exhibit 10.37 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2006, filed with the commission on September 18, 2006 |
| 10.30 | Loan Agreement between NAIE and Credit Suisse dated as of September 22, 2006, including general conditions (portions of the Loan Agreement have been omitted pursuant to a request for confidential treatment) | Exhibit 10.36 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2006, filed with the commission on November 1, 2006 |
| 10.31 | Employment Agreement effective as of November 20, 2006, by and between NAI and Alvin McCurdy* | Exhibit 10.1 of NAI's Current Report on Form 8-K dated November 20, 2006, filed with the commission on November 21, 2006 |
| 10.32 | Fourth Amendment to Credit Agreement dated as of November 1, 2006, and entered into on January 24, 2007, by and between NAI and Wells Fargo Bank, National Association | Exhibit 10.37 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2006, filed with the commission on January 30, 2007 |
| 10.33 | Sublease Contract for facilities in Manno, Switzerland, between NAIE and Vertime SA effective as of April 1, 2007 (portions of the Sublease Contract have been omitted pursuant to a request for confidential treatment) (English translation) | Exhibit 10.39 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, filed with the commission on May 14, 2007 |
| 10.34 | Second Amendment to License Agreement Amending The First Amendment Dated March 17, 2001 to License Agreement Dated April 28, 1997 by and among Roger Harris, Mark Dunnett and NAI dated as of March 26, 2007 | Exhibit 10.40 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007, filed with the commission on May 14, 2007 |
| 10.35 | First Amendment to Loan Agreement between NAIE and Credit Suisse dated as of February 19, 2007 | Exhibit 10.41 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007, filed with the commission on May 14, 2007 |
| 10.36 | Consulting Agreement effective as of July 1, 2007, by and between Dr. John A. Wise and NAI | Exhibit 10.44 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2007, filed with the commission on October 15, 2007 |
| 10.37 | Fifth Amendment to Credit Agreement dated as of November 1, 2007, and entered into on December 18, 2007, by and between NAI and Wells Fargo Bank, National Association | Exhibit 10.40 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2007, filed with the commission on February 8, 2008 |
| 10.38 | Employment Agreement effective as of February 11, 2008, by and between NAI and Kenneth Wolf* | Exhibit 10.1 of NAI's Current Report on Form 8-K dated February 11, 2008, filed with the commission on February 14, 2008 |
| 10.39 | Asset Purchase Agreement by and between RHL and Miles Kimball Company dated August 4, 2008 | Exhibit 10.1 of NAI's Current Report on Form 8-K dated August 4, 2008, filed with the commission on August 8, 2008 |

Table of Contents

| | | |
|-------|--|--|
| 10.40 | First Amendment to the Amended and Restated Employment Agreement dated January 30, 2004 by and between NAI and Randell Weaver, entered into effective as of June 28, 2008* | Exhibit 10.44 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2008, filed with the commission on September 22, 2008 |
| 10.41 | First Amendment to Employment Agreement dated November 20, 2006 by and between NAI and Alvin McCurdy, entered into effective as of June 28, 2008* | Exhibit 10.45 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2008, filed with the commission on September 22, 2008 |
| 10.42 | Revolving Line of Credit Note made by NAI for the benefit of Wells Fargo Bank, National Association in the amount of \$7,500,000 (with Addendum) | Filed herewith |
| 10.43 | Sixth Amendment to Credit Agreement dated as of November 1, 2008, and entered into on December 29, 2008, by and between NAI and Wells Fargo Bank, National Association | Filed herewith |
| 10.44 | Separation Agreement and General Release of Claims by and between Real Health Laboratories, Inc. and John Dullea effective as of December 26, 2008 | Filed herewith |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer | Filed herewith |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer | Filed herewith |
| 32 | Section 1350 Certification | Filed herewith |

* Indicates management contract or compensatory plan or arrangement.

Table of Contents

Pursuant to the requirements of the Securities Exchange Act of 1934, Natural Alternatives International, Inc., the registrant, has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: February 17, 2009

NATURAL ALTERNATIVES INTERNATIONAL,
INC.

By: /s/ Kenneth E. Wolf
Kenneth E. Wolf, Chief Financial Officer

Mr. Wolf is the principal financial officer of Natural Alternatives International, Inc. and has been duly authorized to sign on its behalf.