NATURAL ALTERNATIVES INTERNATIONAL INC
Form 10-K
September 19, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT

pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

FOR THE FISCAL YEAR ENDED JUNE 30, 2018

000-15701

(Commission file number)

NATURAL ALTERNATIVES INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**84-1007839**
(State of incorporation)	**(IRS Employer Identification No.)**
1535 Faraday Ave	**(760) 744-7700**

Carlsbad, CA 92008
(Address of principal executive offices) (Registrant's telephone number)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
Common Stock, $0.01 par value per share	Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if Natural Alternatives International, Inc. (NAI) is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes No

Indicate by check mark if NAI is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. Yes No

Indicate by check mark whether 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. Yes No

Indicate by check mark whether NAI has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that NAI was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of NAI's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer	Emerging Growth Company
Non-accelerated filer	Smaller reporting company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether NAI is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No

The aggregate market value of NAI's common stock held by non-affiliates of NAI as of the last business day of NAI's most recently completed second fiscal quarter (December 29, 2017) was approximately $55,042,778 (based on the closing sale price of $10.30 reported by Nasdaq on December 29, 2017). For this purpose, the shares subject to an irrevocable proxy in favor of the NAI Board of Directors, and all of the shares held by NAI's officers, and directors, and their affiliates were assumed to be common stock held by affiliates of NAI.

As of September 18, 2018, 7,563,409 shares of NAI's common stock were outstanding, net of 1,098,268 treasury shares.

DOCUMENTS INCORPORATED BY REFERENCE

Part III (Items 10, 11, 12, 13 and 14) of this Form 10-K incorporates by reference portions of NAI's definitive proxy statement for its Annual Meeting of Stockholders to be held December 7, 2018, to be filed on or before October 29, 2018.

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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," "predicts," "forecasts," or "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, and other financial items;
- our ability to maintain or increase our patent and trademark licensing revenues;
- our ability to develop market acceptance for and increase sales of new products, develop relationships with new customers and maintain or improve existing customer relationships;
- future levels of our revenue concentration risk;
- our ability to protect our intellectual property;
- future economic and political conditions, including implementation of new or increased tariffs;
- our ability to improve operation efficiencies, manage costs and business risks and improve or maintain profitability;
- currency exchange rates, their effect on our results of operations, including amounts that may be reclassified as earnings, the availability of foreign exchange facilities, our ability to effectively hedge against foreign exchange risks and the extent to which we may seek to hedge against such risks;

- the outcome of currently pending litigation, regulatory and tax matters, the costs associated with such matters and the effect of such matters on our business and results of operations

- sources and availability of raw materials, including the limited number of suppliers of beta-alanine;

- inventory levels, including the adequacy of raw material and other inventory levels to meet future customer demand

- the future adequacy and intended use of our facilities;

- potential manufacturing and distribution channels, product returns, and potential product recalls;

- future customer orders;

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

- our ability to operate within the standards set by the U.S. Food and Drug Administration's (FDA) Good Manufacturing Practices;

- our ability to successfully expand our operations, including outside the United States (U.S.);

- the adequacy of our financial reserves and allowances;

- the sufficiency of our available cash, cash equivalents, and potential cash flows from operations to fund our working capital needs and capital expenditures through the next 12 months and longer;

- the impact of accounting pronouncements and our adoption of certain accounting guidance; 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 are or 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 I and elsewhere in this report, as well as in other reports and documents we file with the United States Securities and Exchange Commission (SEC).

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PART I

ITEM 1. BUSINESS

General

Our vision is to enrich the world through the best of nutrition.

We are a leading formulator, manufacturer and marketer of nutritional supplements. Our comprehensive strategic partnerships with our customers allow us to offer a wide range of innovative nutritional products and services to our clients including: scientific research, clinical studies, proprietary ingredients, customer-specific nutritional product formulation, product testing and evaluation, marketing management and support, packaging and delivery system design, regulatory review, and international product registration assistance.

As our primary business activity, we provide private-label contract manufacturing services to companies that market and distribute vitamins, minerals, herbal and other nutritional supplements, as well as other health care products, to consumers both within and outside the U.S. We also own a patent estate related to the ingredient known as beta-alanine, which is primarily commercialized through the direct sale of this raw material and supply agreements with third parties for the distribution and use of this raw material under our CarnoSyn® and SR CarnoSyn® trademarks.

History

Originally founded in 1980, Natural Alternatives International, Inc. reorganized as a Delaware corporation in 1989. Our principal executive offices are located at 1535 Faraday Ave, Carlsbad, CA 92008.

In January 1999, we formed Natural Alternatives International Europe S.A. (NAIE) as our wholly-owned subsidiary, based in Manno, Switzerland. In September 1999, NAIE opened its manufacturing facility in Manno, Switzerland, which has grown over the ensuing years and currently possesses manufacturing capability in encapsulation, powders, and tablets, finished goods packaging, quality control, laboratory testing, warehousing, distribution and administration.

Historically, as part of our business strategy, we have sought to commercialize our patent estate through contract manufacturing, royalty and license agreements. From March 2009 through March 31, 2015, we licensed Compound Solutions, Inc. (CSI) to grant a license to CSI to manufacture, offer for sale and/or sell products incorporating, using or made in accordance with our patent rights and grant a similar sub-license to customers of CSI who purchased beta-alanine from CSI under our CarnoSyn® trademark. During the term of this agreement, we received a fee from CSI that varied based on the quantity and source of beta-alanine sold by CSI. We terminated our relationship with CSI effective April 1, 2015 and began directly selling beta-alanine, and licensing our related patent and trademark rights.

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, to NAIE.

Overview of our Facilities and Operations

Our U.S.-based operations are located in Vista and Carlsbad, California and include manufacturing and distribution, sales and marketing, in-house formulation, laboratory, and other research and development services. Our U.S. manufacturing facilities were recertified on November 8, 2016 by the Therapeutic Goods Administration (TGA) of Australia after its audit of our Good Manufacturing Practices (GMP). TGA evaluates new therapeutic products, prepares standards, develops testing methods and conducts testing programs to ensure that products are high in quality, safe and effective. TGA also conducts a range of assessment and monitoring activities including audits of the manufacturing practices of companies who export and sell products to Australia. TGA certification enables us to manufacture products for export into countries that have signed the Pharmaceutical Inspection Convention, which include most European countries as well as several Pacific Rim countries. TGA certifications are generally reviewed every eighteen to thirty six months. During August 2016, TGA completed an inspection of our facility and quality systems for compliance with good manufacturing practices, and a renewed GMP clearance was issued to NAI expiring August 3, 2020.

Our California facilities also have been awarded GMP registration annually since October 2002 by NSF International (NSF) through the NSF Dietary Supplements Certification Program and received “GMP for Sport” NSF Certified registration on February 16, 2009. GMP requirements are regulatory standards and guidelines establishing necessary processes, procedures and documentation for manufacturers in an effort to assure the products produced by that manufacturer have the identity, strength, composition, quality and purity represented. The NSF Certified for Sport program focuses on minimizing the risk that a dietary supplement or sports nutrition product contains banned substances and was developed due to growing demand from athletes and coaches concerned about banned substances in sports supplements. The program focuses primarily on manufacturing and sourcing processes, while embedding preventative measures throughout. NAI’s participation in the program allows us to produce products bearing the NSF Sport logo.

Our U.S. operations have also been certified by Health Canada as compliant with the GMP requirements outlined in Part 3 of the Canadian Natural Health Products Regulations. Health Canada is the department of the Canadian government with responsibility for national public health. Health Canada has initiated work to modernize its regulatory system for food and health products. Health Canada plays an active role in ensuring access to safe and effective drugs and health products while giving high priority to public safety and strives to provide information needed to make healthy choices and informed decisions regarding one’s health. NAI was issued its initial certification in December 2011 and received its most recent renewal in December 2016 which is valid until December 5, 2019. Not only does this approval demonstrate another level of regulatory compliance by NAI, it may also ease the approval process for our customers who import products into Canada.

During March 2015, our Vista California facility became certified as an Organic Processor and Handler by Natural Food Certifiers (NFC). This certification demonstrates this facility meets the USDA National Organic Program standards and allows us to expand our contract manufacturing and packaging services to include Organic labeled products. The certification requires annual renewal and was last renewed in April 2018. We are registered with the State of California, Department of Public Health Food and Drug Branch as an organic processor. Additionally, we are certified by various Rabbinical and Halal authorities to produce Kosher and Halal certified products. These certifications guarantee that the facility, processes, and ingredients of certified products have been reviewed and found to be in compliance with the strict dietary laws of the respective Jewish and Muslim communities

NAIE also operates a manufacturing, warehousing, packaging and distribution facility in Manno, Switzerland. In January 2004, NAIE obtained a pharmaceutical license to process pharmaceuticals for packaging, import, export and sale within Switzerland and other countries from the Swissmedic Authority of Bern, Switzerland. In March 2007, following the expansion of NAIE’s manufacturing facilities to include powder filling capabilities, NAIE obtained an additional pharmaceutical license from the Swissmedic Authority certifying that NAIE’s expanded facilities conform to GMP. In January 2013, following the additional upgrade of NAIE’s manufacturing facilities to include the manufacture of pharmaceuticals, NAIE obtained an additional pharmaceutical approval from the Swissmedic Authority certifying that NAIE’s upgraded facilities conform to GMP. We believe these licenses and NAIE’s manufacturing capabilities help strengthen our relationships with existing customers and improve our ability to develop relationships with new customers. NAIE's last Swissmedic inspection was conducted in February 2018. The renewed certification was issued in April 2018 and is valid until February 2021.

In addition to our operations in the U.S. and Switzerland, we have had a representative in Japan for many years who provides a range of services to our customers currently present in or seeking to expand into the Japanese market and other markets in the Pacific Rim. These services include regulatory and marketing assistance along with guidance and support in adapting products for these markets.

Business Strategy

Our goals are to achieve long-term growth and profitability and to diversify our sales base. To accomplish these goals, we have and intend to continue to seek to do the following:

- leverage 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 in developing relationships with additional quality oriented customers;

- expand the commercialization of our beta-alanine patent estate through raw material sales, introduction of new products, new contract manufacturing opportunities, additional license and sub-license agreements, and protect our proprietary rights;

- provide strategic partnering services to our private-label contract manufacturing customers, as described below under "Products, Principal Markets and Methods of Distribution"; and

- improve operational efficiencies and manage costs and business risks to improve profitability.

Overall, we believe there is an opportunity to enhance consumer confidence in the quality of our customer's nutritional supplements and their adherence to label claims through education provided by direct sales and direct-to-consumer marketing programs. We believe our GMP and TGA certified manufacturing operations, science based product formulations, peer-reviewed clinical studies and regulatory expertise provide us with a sustainable competitive advantage and provide our customers with a high degree of confidence in the products we manufacture.

While today's consumer may have access to a variety of information, we believe many consumers remain uneducated about nutrition and nutritional supplementation, uncertain about the relevance or reliability of the information available to them, or confused about conflicting claims or information. We believe this state of the market creates a significant opportunity for the direct sales marketing channel. The direct sales marketing channel has proved, and we believe will continue to prove, to be a highly effective method for marketing high-quality nutritional supplements as associates or other individuals educate consumers on the benefits of science based nutritional supplements. Our largest customers operate in the direct sales marketing channel. Thus, the majority of our business has relied primarily on the effectiveness of our customers in this marketing channel.

We also believe there is significant opportunity with the commercialization of our patent estate through the introduction of CarnoSyn® and SR CarnoSyn® beta-alanine into additional markets and with the introduction of new beta-alanine product offerings. Currently, a majority of our sales of CarnoSyn® are to companies that operate in the sports nutrition channel and are focused on products containing the instant release form of beta-alanine. We believe there are several other markets and distribution channels that represent growth opportunities for the distribution of CarnoSyn® and SR CarnoSyn® beta-alanine. We believe SR CarnoSyn® is a superior delivery system of CarnoSyn® beta-alanine based on its sustained release profile that allows for increased daily dosing and improved muscle retention of carnosine. We believe SR CarnoSyn® beta-alanine is a vital component in the further commercialization of our patent estate outside of the sports nutrition channel. Our patents related to instant release beta-alanine begin to expire in 2023 while our patents for SR CarnoSyn® extend through 2026.

We believe our comprehensive approach to customer service is unique within our industry. We believe this comprehensive approach, together with our commitment to high quality, product development and manufacturing capabilities, will provide the means to implement our strategies and achieve our goals. There can be no assurance, however, that we will successfully implement any of our business strategies or that we will increase or diversify our sales, successfully commercialize our patent estate, or improve our overall financial results.

Products, Principal Markets and Methods of Distribution

Our primary business activity is to provide 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 U.S. Our private-label contract manufacturing customers include companies that market nutritional supplements through direct sales marketing channels, direct to consumer ecommerce channels and retail stores. We manufacture products in a variety of forms, including capsules, tablets, chewable wafers, and powders to accommodate a variety of our customer’s preferences.

We provide strategic partnering services to our private-label contract manufacturing customers, including the following:

- customized product formulation;
- clinical studies;
- manufacturing;
- marketing support;
- international regulatory and label law compliance;

- international product registration; and

- packaging in multiple formats and labeling design.

We also seek to commercialize our patent and trademarks through direct distribution and sale of CarnoSyn® and SR CarnoSyn®, new contract manufacturing opportunities, and various license and similar arrangements.

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For the last two fiscal years ended June 30, our net sales were derived from the following (in thousands):

	2018		2017	
	$	%	$	%
Private-label Contract Manufacturing	$110,992	84	$95,024	78
Patent and Trademark Licensing	21,445	16	26,922	22
Total Net Sales	$132,437	100	$121,946	100

Research and Development

We are committed to quality research and development. We focus on the development of new science based products and the improvement of existing products. We periodically test and validate our products to help ensure their stability, potency, efficacy and safety. We maintain quality control procedures to verify that our products comply with applicable specifications and standards established by the FDA and other regulatory agencies. We also direct and participate in clinical research studies, often in collaboration with scientists and research institutions, to validate the benefits of a product and provide scientific support for product claims and marketing initiatives. We believe our commitment to research and development, as well as our facilities and strategic alliances with our suppliers and customers, allow us to effectively identify, develop and market high-quality and innovative products.

As part of the services we provide to our private-label contract manufacturing customers, we may perform, but are not required to perform, certain research and development activities related to the development or improvement of their products. While our customers often do not pay directly for this service, the cost of this service is often included as a component of the price we charge to manufacture and deliver their products. Research and development costs, including costs associated with international regulatory compliance services we provide to our customers, are expensed as incurred.

Our research and development expenses for the fiscal year ended June 30, 2018 decreased to $1.5 million, compared to $1.6 million for the fiscal year ended June 30, 2017.

Sources and Availability of Raw Materials

We use raw materials in our operations including powders, excipients, empty capsules, and components for packaging and distributing our finished products. In addition, the commercialization of our beta-alanine patent estate depends on the availability of the raw material beta-alanine. We conduct identity testing for all raw materials we purchase and, on a predetermined testing protocol basis, we evaluate raw materials to ensure their quality, purity and potency before we use them in our products. We typically buy raw materials in bulk from qualified vendors located both within and outside the U.S.

Our contract manufacturing business did not experience any significant shortages or difficulties obtaining adequate supplies of raw materials during fiscal 2018. However, there continues to be significant pricing pressures associated with various vitamins, minerals and herbs in the raw material marketplace including new and potential increased tariffs. Throughout fiscal 2019, we expect upward pricing pressures for raw materials and other costs will continue as a result of limited supplies of various ingredients, the effects of higher labor and transportation costs, and potential tariffs levied on goods we import from overseas, including beta-alanine.

Customers

We have two private-label contract manufacturing customers, each of which individually represent more than 10% of our consolidated net sales. The loss of either of these customers could result in a significant negative impact to our financial position and results of operations. We continue to focus on obtaining new private-label contract manufacturing customers to reduce the risks associated with deriving a significant portion of our sales from a limited number of customers.

Competition

We compete with other manufacturers, distributors and marketers of vitamins, minerals, herbs, and other nutritional supplements both within and outside the U.S. The nutritional supplement industry is highly fragmented and competition for the sale of nutritional supplements comes from many sources. These products are sold primarily through retailers (drug store chains, supermarkets, and mass market discount retailers), health and natural food stores, and direct sales channels (network marketing, online marketing and mail order).

We believe private-label contract manufacturing competition in our industry is based on, among other things, customized services offered, product quality and safety, innovation, price and customer service. We believe we compete favorably with other companies because of our ability to provide comprehensive solutions for customers, our certified manufacturing operations, our commitment to quality and safety, and our research and development activities.

Our future competitive position for private-label contract manufacturing and patent and trademark licensing will likely depend on, but not be limited to, the following:

- the continued acceptance of our products by our customers and consumers;

- our ability to protect our proprietary rights in our patent estate and the continued validity of such patents;
- our ability to successfully expand our product offerings related to our patent and trademark estate;
- our ability to maintain adequate inventory levels to meet our customer's demands;
- our ability to expand;
- our ability to continue to manufacture high quality products at competitive prices;
- our ability to attract and retain qualified personnel;
- the effect of any future governmental regulations on our products and business;
- the results of, and publicity from, product safety and performance studies performed by governments and other research institutions;
- the continued growth of the global nutrition industry; and
- our ability to respond to changes within the industry and consumer demand, financially and otherwise.

The nutritional supplement industry is highly competitive and we expect the level of competition to remain high over the near term. We do not believe it is possible to accurately estimate the total number or size of our competitors. The nutritional supplement industry has undergone consolidation in the recent past and we expect that trend may continue in the near term.

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Government Regulation

Our business is subject to varying degrees of regulation by a number of government authorities in the U.S., including the FDA, the Federal Trade Commission (FTC), the Consumer Product Safety Commission, the U.S. Department of Agriculture, and the Environmental Protection Agency. Various state and local agencies in areas where we operate and in which our products are sold also regulate our business, such as the California Department of Health Services, Food and Drug Branch. The areas of our business these and other authorities regulate include, among others:

- product claims and advertising;
- product labels;
- product ingredients; and
- how we manufacture, package, distribute, import, export, sell and store our products.

The FDA, in particular, regulates the formulation, manufacturing, packaging, storage, labeling, promotion, distribution and sale of vitamins and other nutritional supplements in the U.S., while the FTC regulates marketing and advertising claims. In August 2007, a new rule issued by the FDA went into effect requiring companies that manufacture, package, label, distribute or hold nutritional supplements to meet certain GMP's to ensure such products are of the quality specified and are properly packaged and labeled. We are committed to meeting or exceeding the standards set by the FDA and believe we are currently operating within the FDA mandated GMP.

The FDA also regulates the labeling and marketing of dietary supplements and nutritional products, including the following:

- the identification of dietary supplements or nutritional products and their nutrition and ingredient labeling;
- requirements related to the wording used for claims about nutrients, health claims, and statements of nutritional support;
- labeling requirements for dietary supplements or nutritional products for which "high potency" and "antioxidant" claims are made;

- notification procedures for statements on dietary supplements or nutritional products; and

- premarket notification procedures for new dietary ingredients in nutritional supplements.

The Dietary Supplement Health and Education Act of 1994 (DSHEA) revised the provisions of the Federal Food, Drug and Cosmetic Act concerning the composition and labeling of dietary supplements and defined dietary supplements to include vitamins, minerals, herbs, amino acids and other dietary substances. DSHEA generally provides a regulatory framework to help ensure safe, quality dietary supplements and the dissemination of accurate information about such products. The FDA is generally prohibited from regulating active ingredients in dietary supplements as drugs unless product claims trigger regulatory status, such as claims that a product may heal, mitigate, cure or prevent an illness, disease or malady.

In December 2006, the Dietary Supplement and Nonprescription Drug Consumer Protection Act was passed, which further revised the provisions of the Federal Food, Drug and Cosmetic Act. Under the Act, manufacturers, packers or distributors whose name appears on the product label of a dietary supplement or nonprescription drug are required to include contact information on the product label for consumers to use in reporting adverse events associated with the product’s use and to notify the FDA of any serious adverse event report. Events reported to the FDA are not considered an admission from a company that its product caused or contributed to the reported event. We are committed to meeting or exceeding the requirements of this Act.

We are also subject to a variety of other regulations in the U.S., including those relating to health, safety, bioterrorism, taxes, labor and employment, import and export, the environment and intellectual property. All of these regulations require significant financial and operational resources to ensure compliance, and we cannot assure you we will always be in compliance despite our best efforts to do so.

Our operations outside the U.S. are similarly regulated by various agencies and entities in the countries in which we operate and in which our products are sold. The regulations of these countries may conflict with those in the U.S. and may vary from country to country. The sale of our products in certain European countries is subject to the rules and regulations of the European Union, which may be interpreted differently among the countries within the European Union. In other markets outside the U.S., we may be required to obtain approvals, licenses or certifications from a country’s Ministry of Health or comparable agency before we begin operations or the marketing of products in that country. Approvals or licenses may be conditioned on reformulation of our products for a particular market or may be unavailable for certain products or product ingredients. These regulations may limit our ability to enter certain markets outside the U.S. As with the costs of regulatory compliance in the U.S., foreign regulations require significant financial and operational resources to ensure compliance, and we cannot assure you we will always be in compliance despite our best efforts to do so. Our failure to maintain regulatory compliance within and outside the U.S. could impact our ability to sell our products and thus, adversely impact our financial position and results of operations.

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Intellectual Property

Trademarks. We have developed and use trademarks in our business, particularly relating to corporate, brand and product names. We own 37 trademark registrations; including eight registrations in the U.S. Six of these U.S. registrations are incontestable. Federal registration of a trademark in the United States affords the owner nationwide exclusive trademark rights in the registered mark and the ability to prevent subsequent users from using the same or similar mark. However, to the extent a common law user has developed trademark rights in a mark in connection with similar goods or services in a particular geographic area, the nationwide rights conferred by federal registration can be subject to that user’s prior rights in that geographic area. In addition, rights in a registered mark are dependent upon the continued use of the mark in connection with the goods and/or services set forth in the registration.

We have 27 foreign trademark registrations covering 41 countries including, registrations for CarnoSyn and SR CarnoSyn in Australia, Brazil, Canada, China, Cuba, the European Union Intellectual Property Office, Hong Kong, Israel, Japan, Mexico, New Zealand, Poland, and South Korea. Registrations have also been obtained for CarnoSyn and the SR Carnosyn logo in Switzerland and for CarnoSyn SR in Australia and the European Union. We currently have three U.S. trademark applications pending and three International applications pending. We also claim common law ownership and protection of certain unregistered trademarks and service marks based upon our continued use of the marks under common law. In some countries, such as the United States, common law offers protection of a mark within the particular geographic area in which it is used.

We believe our registered and unregistered trademarks constitute valuable assets, adding to the recognition of our products and services in the marketplace. These and other proprietary rights have been and will continue to be important in enabling us to compete; however, we cannot assure you that our current or future trademark applications will be granted or our current trademarks or registrations will be maintained.

Trade Secrets. We own certain intellectual property, including trade secrets, which we seek to protect, in part, through confidentiality agreements with employees and other parties. We regard our proprietary technology, trade secrets, trademarks and similar intellectual property as critical to our success, and we rely on a combination of trade secrets, contract, patent, copyright and trademark law to establish and protect the rights in our products and technology. The laws of certain foreign countries may not protect our intellectual property rights to the same extent as the laws of the U.S.

Patents and Patent Licenses. We currently own seven U.S. patents and seventeen corresponding patents registered in countries throughout North America, Europe and Asia. We also have pending applications in several countries. All of these patents and patent rights relate to the ingredient known as beta-alanine. Certain of these patents were assigned to NAI and we make certain ongoing royalty payments to the prior owners of the patents. We also license rights to the prior owners for certain uses that are covered by the patents. The royalty payments and license continue until the expiration of the patents. We also sell beta-alanine, and license our patent and trademark rights related to beta-alanine.

These patents begin to expire in 2023.

Beginning in fiscal 2009, the licensing, raw material sales, and revenues we have received associated with the sale and licensing of beta-alanine under the CarnoSyn® and SR CarnoSyn® trade names have grown steadily from $515,000 in fiscal 2009 to $21.4 million in fiscal 2018. During fiscal 2018, our revenues included $127,000 of royalties and $21.3 million related to the direct sale of beta-alanine. We incurred intellectual property litigation and patent compliance expenses of approximately $2.9 million during fiscal 2018 primarily in connection with our efforts to protect our proprietary rights and patent estate. We expect to continue to incur these types of litigation expenses during fiscal 2019.

Employees

As of June 30, 2018, we employed 174 full-time employees in the U.S., three of whom held executive management positions. Of the remaining full-time employees, 36 were employed in research, laboratory and quality control, 12 in sales and marketing, and 123 in manufacturing and administration. From time to time we use temporary personnel to help us meet short-term operating requirements. These positions typically are in manufacturing and manufacturing support. As of June 30, 2018, we had 15 temporary personnel.

As of June 30, 2018, NAIE employed an additional 72 full-time employees and 5 part-time employees. Most of these positions were in the areas of manufacturing and manufacturing support.

Our employees are not represented by a collective bargaining agreement and we have not experienced any work stoppages as a result of labor disputes. We believe our relationship with our employees is good.

Seasonality

In addition to general economic factors, we are impacted by seasonal factors and trends, such as major cultural events and vacation patterns. We manufacture and sell products to customers that operate in many different countries throughout the world and these seasonal factors vary by region. Although we believe the impact of seasonality on our consolidated results of operations is minimal, our quarterly results may vary significantly in the future due to the timing of private-label contract manufacturing and CarnoSyn® and SR CarnoSyn® beta-alanine raw material orders. We can give no assurances that revenue trends will follow our historical patterns. The market price of our common stock may be adversely affected by these seasonal factors.

Financial Information about Our Business Segments and Geographic Areas

Our operations are comprised of two reportable segments:

- Private-label contract manufacturing, in which we primarily provide manufacturing services to companies that market and distribute nutritional supplements and other health care products.
- Royalty, licensing, and raw material sales associated with the sale and license of beta-alanine under our CarnoSyn® and SR CarnoSyn® trademarks.

Our private-label contract manufacturing products are sold both in the U.S. and in markets outside the U.S., including Europe, Australia, Asia and Canada. Our primary markets outside the U.S. are Europe and Asia. Our patent and trademark licensing activities are primarily based in the U.S.

For additional financial information, including financial information about our business segment and geographic areas, please see the consolidated financial statements and accompanying notes to the consolidated financial statements included under Item 8 of this report.

Our activities in markets outside the U.S. are subject to political, economic and other risks in the countries in which our products are sold and in which we operate. For more information about these and other risks, please see Item 1A in this report.

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ITEM 1A. RISK FACTORS

You should carefully review and consider the risks described below, as well as the other information in this report and in other reports and documents we file with the SEC when evaluating our business and future prospects. The risks and uncertainties described below are not the only ones we face. Additional material risks and uncertainties, not presently known to us, or that we currently see as immaterial, may also occur. If any of the following risks or any additional risks and uncertainties actually occur or become material, 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. You should not draw any inference as to the magnitude of any particular risk from its position in the following discussion.

Because we derive a significant portion of our revenues from a limited number of customers, our revenues would be adversely affected by the loss of a major customer or a significant change in their business, personnel or the timing or amount of their orders.

We have in the past and expect to continue to derive a significant portion of our revenues from a relatively limited number of customers. During the fiscal year ended June 30, 2018, sales to our largest customer, The Juice Plus+ Company, were approximately 56% of our consolidated net sales. We also have one other private-label contract manufacturing customer that represented 10% of our consolidated net sales. No other customers represented more than 10% of our consolidated net sales. The loss of one of these customers or other major customers, a significant decline in sales to any one of these customers, a significant change in their business personnel, or in any one of these customer's ability to make payments when due, could materially and adversely affect our financial condition and results of operations. Furthermore, the timing of our customers' orders is impacted by, among other factors, their marketing programs, their customer demand, seasonality, their raw material suppliers we are sometimes required to use, their supply chain management, entry into new markets and their new product introductions, all of which are outside of our control. All of these attributes have had and are expected to have a significant impact on our business.

Our future growth and stability depends, in part, on our ability to diversify our sales. Our efforts to establish new sales from existing customers and new customers could require significant initial investments, which may or may not result in higher sales and improved financial results.

Our business strategy depends in large part on our ability to develop new product sales from current and new customer relationships. These activities often require a significant up-front investment including, among others, customized formulations, regulatory compliance, product registrations, package design, product testing, pilot production runs, and the build-up of initial inventory. We may experience significant delays from the time we increase our operating expenses and make investments in inventory until the time we generate net sales from new products or customers, and it is possible after incurring such expenditures we may not generate material revenue from new products or customers. If we incur significant expenses and investments in inventory that we are not able to recover, and we are not able to compensate for those expenses, our operating results would be adversely affected.

We currently derive significant revenues and income from sales of beta-alanine and licensing our patents. Our ability to maintain or grow our sales of beta-alanine and license revenue from our other patents is contingent on our ability to continue to defend our patents, and commercialize the sale of beta-alanine under our instant release CarnoSyn® patents and trademark and our sustained release Carnosyn® patents and trademark.

We own multiple patents and trademarks related to the use of beta-alanine in food and nutritional supplements. A majority of our revenue and income from this segment is currently derived from activity related to licensing our patents associated with instant release beta-alanine, sold under our trade name CarnoSyn®. Fifteen patents related to CarnoSyn® expired in August 2017 and we have four remaining patents for this version of CarnoSyn®, which begin to expire in August 2023. There is no assurance we will be successful maintaining our historical CarnoSyn® instant release beta-alanine sales levels or growing future sales volumes with our remaining CarnoSyn® instant release patent estate. If we are not successful it could have a material adverse effect on our business, results of operations, and financial condition.

We believe SR CarnoSyn® is a superior delivery system for CarnoSyn® beta-alanine based on its sustained release profile that allows for increased daily dosing and improved muscle retention of carnosine. Our patents related to SR CarnoSyn® extend through 2026 and we believe the introduction of SR CarnoSyn® beta-alanine is an important step in the further commercialization of our patent estate. There can be no assurance that we will be successful in getting the market to transition to this new form of beta-alanine or that we will be successful launching new products utilizing SR CarnoSyn® beta-alanine. If we are not successful in either one of these goals, it could have a material adverse effect on our business, results of operations, and financial condition.

We have incurred, and may continue to incur significant costs defending our intellectual property. We may be unable to protect our intellectual property rights or may inadvertently infringe on the intellectual property rights of others.

We possess and may possess in the future certain proprietary technology, trade secrets, trademarks, trade names, licenses, patents and similar intellectual property. We may continue to incur significant patent and trademark litigation costs associated with creating and defending our intellectual property. During fiscal 2018, we incurred approximately $2.9 million in patent litigation and prosecution expense and may incur significant similar expenses during fiscal 2019. These efforts are described in more detail under Item 3 of this report. There is no assurance we will be able to protect our intellectual property adequately or that our intellectual property rights will be upheld. If pending legal proceedings to invalidate our patent rights are successful, they could have a material adverse impact upon our financial condition and results of operations. Furthermore, the laws of certain foreign countries may not protect our intellectual property rights to the same extent as the laws of the U.S. Additional litigation in the U.S. or abroad may be necessary to enforce our intellectual property rights, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement. Such litigation, even if successful, could result in substantial additional costs and diversion of resources and could have a material adverse effect on our business, results of operations and financial condition. If such infringement claims are asserted against us, we may seek to obtain a license under the third party's intellectual property rights. There can be no assurance such a license would be available on terms acceptable or favorable to us, if at all.

Possible new tariffs on imported goods from China and elsewhere could adversely affect our business operations.

The President of the United States has recently ordered U.S. government agencies to consider new and increased tariffs on a wide range of goods and materials imported from China and other governments, in addition to the tariffs already imposed. These goods may include products and applications, including ingredients we or our customers require for their products. In addition these goods may include beta-alanine. The commercialization of our beta-alanine patent estate depends on the availability of the raw material beta-alanine. In response, China and other governments announced plans to impose tariffs on certain American products if additional U.S. tariffs are imposed. The resulting tariffs could have a significant adverse effect on our customer's businesses, the availability of beta-alanine, and the cost of our products. While it is too early to predict how the additional potential U.S. tariffs will be imposed, or how any tariffs will impact our business, we believe the imposition of additional tariffs by the U.S. or other governments on products or ingredients we use in the products we manufacture could adversely impact our customers as a result of increased product costs, and such tariffs could have an adverse impact on the availability of beta-alanine and the licensing of our patents and trademarks and our distribution of this raw material.

If so, this could adversely impact our ability to license our patents and trademarks, our ability to sell beta-alanine, and our customers' ability to compete in the market place, reducing demand for our products, and products we manufacture for them. Any of these events could have a material adverse effect on our business and results of operations.

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Our operating results will vary. We experienced declines in net sales and incurred losses in past years and there is no guarantee our sales will improve or we will earn a profit in future years. Fluctuations in our operating results may adversely affect the share price of our common stock.

Our net sales increased during fiscal 2018 as compared to fiscal 2017, but there can be no assurance our net sales will continue to improve in the near term, or we will earn a profit in any given year. We have experienced net losses in the past and may incur losses in the future. Our operating results may fluctuate from year to year and/or from quarter to quarter due to various factors including differences related to the timing of revenues and expenses for financial reporting purposes and other factors described in this report. At times, these fluctuations may be significant. We anticipate generating positive net income in fiscal 2019, although there is no assurance we will be able to do so. Fluctuations in our operating results may adversely affect the share price of our common stock.

Our products and manufacturing activities are subject to extensive government regulation, which could limit or prevent the sale of our products in some markets and could increase our costs.

The manufacturing, packaging, labeling, advertising, promotion, distribution, and sale of our products are subject to regulation by numerous national and local governmental agencies in the U.S. and in other countries. For example, we are required to comply with certain GMP and incur costs associated with the audit and certification of our facilities. Failure to comply with governmental regulations may result in, among other things, injunctions, product withdrawals, recalls, product seizures, fines, and criminal prosecutions. Any action of this type by a governmental agency could materially adversely affect our ability to successfully market our products and services. In addition, if such governmental agency has reason to believe the law is being violated (for example, if it believes we do not possess adequate substantiation for product claims), it can initiate an enforcement action. Governmental agency enforcement could result in orders requiring, among other things, limits on advertising, consumer redress, divestiture of assets, rescission of contracts, and such other relief as may be deemed necessary. Violation of these orders could result in substantial financial or other penalties. Any action by a governmental agency could materially adversely affect our ability and our customers' ability to successfully market and continue selling the products involved.

Before commencing operations of marketing our products in markets outside the U.S., we may be required to obtain approvals, licenses, or certifications from a country's ministry of health or comparable agency. Approvals or licensing may be conditioned on reformulation of products or even may be unavailable with respect to certain products or product ingredients. We must also comply with product labeling and packaging regulations that vary from country to country. Furthermore, the regulations of these countries may conflict with those in the U.S. and with each other. The sale of our products in certain European countries is subject to the rules and regulations of the European Union, which may be interpreted differently among the countries within the European Union. The cost of complying with these various and potentially conflicting regulations can be substantial and could adversely affect our results of operations.

We cannot predict the nature of any future laws, regulations, interpretations, or applications, nor can we determine what effect additional governmental regulations, when and if adopted, would have on our business. They could include requirements for the reformulation of certain products to meet new standards, the recall or discontinuance of certain products, additional compliance costs or record keeping requirements, expanded or different labeling, and additional scientific substantiation. Any or all of these requirements could have a material adverse effect on our operations.

A significant or prolonged economic downturn, could have, and at certain times in the past has had, a material adverse effect on our results of operations.

Our results of operations are affected by the level of business activity of our customers and licensees, which in turn is affected by the level of consumer demand for their products. A significant or prolonged economic downturn may adversely affect the disposable income of many consumers and may lower demand for the products we produce for our private-label contract manufacturing customers and products sold or manufactured by others using our licensed patent rights. Any decline in economic conditions in the U.S. and the various foreign markets in which our customers operate could negatively impact our customers' businesses and our operations. A significant enough decline in consumer demand and the level of business activity of our customers due even if only due in part to general economic conditions could have a material adverse effect on our revenues and profit margins.

The failure of our suppliers to supply quality materials in sufficient quantities, at a favorable price, and in a timely fashion could adversely affect the results of our operations.

We buy our raw materials from a limited number of suppliers. During fiscal 2018, two of our suppliers, Van Drunen Farms and Capsugel, each represented more than 10% of our total raw material purchases. During fiscal 2017, one of our suppliers, Scientific Living, represented more than 10% of our raw material purchases. The loss of any of our major suppliers or of any supplier who provides us hard to obtain materials could adversely affect our business operations. Although we believe we could establish alternate sources for most of our raw materials, any delay in locating and establishing relationships with other sources could result in shortages of products we manufacture from such raw materials, with a resulting loss of sales and customers. In certain situations we may be required to alter our products or with our customer's consent to substitute different materials from alternative sources.

A shortage of raw materials or an unexpected interruption of supply thereof could also result in higher prices for those materials. We have experienced increases in various raw material costs, transportation costs and the cost of petroleum-based raw materials and packaging supplies used in our business. Increasing raw material and product cost pricing pressures have continued throughout fiscal 2018 as a result of limited supplies of various ingredients and the effects of higher labor and transportation costs. We expect these upward pressures to continue through fiscal 2019. Although we may be able to raise our prices in response to significant increases in the cost of raw materials, we may not be able to raise prices sufficiently or quickly enough to offset the negative effects such cost increases could have on our results of operations or financial condition.

There can be no assurance suppliers will provide the quality raw materials needed by us in the quantities requested or at a price we are willing to pay. Because we do not control the actual production of these raw materials, we are also subject to delays caused by interruption in production of materials including those resulting from conditions outside of our control, such as weather, transportation interruptions, strikes, terrorism, natural disasters, and other catastrophic events.

In addition, our efforts to commercialize our patent estate and the revenues we receive from related supply agreements are substantially dependent on the availability of the raw material beta-alanine and sales of beta-alanine or products incorporating beta-alanine. The availability of beta-alanine, and thus sales of such raw material and products using such material, could be negatively impacted by any shortages, interruptions and similar events described above, which could in turn adversely affect the amount of revenue and product margin we earn from the sale of beta-alanine. Additional tariffs imposed by any government on beta-alanine could have an adverse impact on the price we have to pay for beta-alanine and the availability of beta-alanine.

Our industry is highly competitive and we may be unable to compete effectively. Increased competition could adversely affect our financial condition.

The market for our products, and those of our customers, is highly competitive. Some of our competitors are larger than we are and have greater financial resources and broader name recognition than we do. Our competitors may be able to devote greater resources to research and development, marketing and other activities that could provide them with a competitive advantage. Our market has relatively low entry barriers and is highly sensitive to the introduction of new products that may rapidly capture significant market share. Our competitors may not stress the level of quality we provide and could manufacture at lower costs. Our competitors are largely private and not subject to the same disclosure requirements as a publicly traded company. Increased competition could result in price reductions, reduced profit margins or loss of market share, any of which could have a material adverse effect on our financial condition and results of operations. There can be no assurance that we will be able to compete effectively in this intensely competitive environment.

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We could be exposed to product liability claims or other litigation, which may be costly and could materially adversely affect our operations.

We could face financial liability due to product liability claims if the use of our products results in significant loss or injury. Additionally, the manufacture and sale of our products involves the risk of injury to consumers from tampering by unauthorized third parties or product contamination. We could be exposed to future product liability claims that, among others: our products contain contaminants; we provide consumers with inadequate instructions about product use; or we provide inadequate warning about side effects or interactions of our products with other substances. Even if we were to prevail in any such claims, the cost of litigation and settlement could be significant.

We maintain product liability insurance coverage, including primary product liability and excess liability coverage. The cost of this coverage has increased dramatically in recent years, while the availability of adequate insurance coverage has decreased. While we expect to be able to continue our product liability insurance, there can be no assurance we will in fact be able to continue such insurance coverage, or that our insurance will be adequate to cover any liability we may incur, or our insurance will continue to be available at an economically reasonable cost.

Additionally, it is possible one or more of our insurers could exclude from our coverage certain ingredients used in our products. In such event, we may have to stop using those ingredients or rely on indemnification or similar arrangements with our customers who wish to continue to include those ingredients in their products. A substantial increase in our product liability risk or the loss of customers or product lines, or the failure of a customer to honor indemnification agreements could have a material adverse effect on our results of operations and financial condition.

If we or our private-label contract manufacturing customers expand into additional markets outside the U.S. or our or their sales in markets outside the U.S. increase, our business could become increasingly subject to political, economic, regulatory and other risks in those markets, which could adversely affect our business.

Our future growth may depend, in part, on our ability and the ability of our private-label contract manufacturing customers to expand into additional markets outside the U.S. or to improve sales in markets outside the U.S. There can be no assurance we or our customers will be able to expand in existing markets outside the U.S. or enter new markets on a timely basis, or that new markets outside the U.S. will be profitable. There are significant regulatory and legal barriers in markets outside the U.S. that must be overcome to operate in such markets. We will be subject to the burden of complying with a wide variety of national and local laws, including multiple and possibly overlapping and conflicting laws. We also may experience difficulties adapting to new cultures, business customs and legal systems. Our sales and operations outside the U.S. are subject to political, economic and social uncertainties including, among others:

- changes and limits in import and export controls;
- increases in custom duties and tariffs;
- changes in government regulations and laws;
- coordination of geographically separated locations;
- absence in some jurisdictions of effective laws to protect our intellectual property rights;
- changes in currency exchange rates;
- economic and political instability; and
- currency transfer and other restrictions and regulations that may limit our ability to sell certain products or repatriate profits to the U.S.

Any changes related to these and other factors could adversely affect our business, profitability and growth prospects. If we or our customers expand into additional markets outside the U.S. or improve sales in markets outside the U.S., these and other risks associated with operations outside the U.S. may increase.

Our business is subject to the effects of adverse publicity, which could negatively affect our sales and revenues.

Our business can be affected by adverse publicity or negative public perception about our competitors, our customers, our products, or our industry generally. Adverse publicity may include publicity about the nutritional supplements industry generally, the efficacy, safety and quality of nutritional supplements and other health care products or ingredients in general or our products or ingredients specifically, and regulatory investigations, regardless of whether these investigations involve us or the business practices or products of our competitors, or our customers. Any adverse publicity or negative public perception could have a material adverse effect on our business, financial condition and results of operations. Our business, financial condition and results of operations could be adversely affected if any of our products or any similar products distributed by other companies are alleged to be or are proved to be harmful to consumers or to have unanticipated and unwanted health consequences.

If we are unable to attract and retain qualified management personnel, our business may suffer.

Our executive officers and other management personnel are primarily responsible for our day-to-day operations. We believe our success depends largely on our ability to attract, maintain and motivate highly qualified management personnel. Competition for qualified individuals can be intense and has been increasing in recent years, and we may not be able to hire additional qualified personnel in a timely manner or on terms that would not substantially increase our costs. Any inability to retain a skilled professional management team could adversely affect our ability to successfully execute our business strategies and achieve our goals.

Our manufacturing and third party fulfillment activities are subject to certain risks.

We manufacture the majority of our products at our manufacturing facilities in California and Switzerland. As a result, we are dependent on the uninterrupted and efficient operation of these facilities. Our manufacturing operations, including those of our suppliers, are subject to power failures, blackouts, telecommunications failures, computer viruses, human error, breakdown, failure or substandard performance of our facilities, our equipment, the improper installation or operation of equipment, terrorism, natural or other disasters, intentional acts of violence, and the need to comply with the requirements or directives of governmental agencies, including the FDA. In addition, we may in the future determine to expand or relocate our facilities, which may result in slowdowns or delays in our operations. While we have implemented and regularly evaluate various emergency, contingency and disaster recovery plans and we maintain business interruption insurance, there can be no assurance the occurrence of these or any other operational problems at our facilities in California or Switzerland would not have a material adverse effect on our business, financial condition and results of operations. Furthermore, there can be no assurance our contingency plans will prove to be adequate or successful if needed or our insurance will continue to be available at a reasonable cost or, if available, will be adequate to cover any losses that we may incur from an interruption in our manufacturing and distribution operations.

We outsource our beta-alanine fulfillment and distribution activities and certain contract manufacturing activities. The operation of the third party service provider’s facilities is subject to the interruption and similar risks described above for our facilities and there can be no assurance these interruptions or any other operational problem at such third party’s facilities would not have a material adverse effect on our business, financial condition and results of operations.

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We may pursue acquisitions of other companies that, if not successful, could adversely affect our business, financial condition and results of operations.

We may pursue acquisitions of companies we believe could complement or expand our business, augment our market coverage, provide us with important relationships or otherwise offer us growth opportunities. Acquisitions involve numerous risks, including the following:

- potential difficulties related to integrating the products, personnel and operations of the acquired company;
- failure to operate efficiently as a combined organization utilizing common information and communication systems, operating procedures, financial controls and human resources practices;
- diverting management's attention from the other daily operations of the business;
- entering markets in which we have no or limited prior direct experience and where competitors in such markets have more experience and stronger market positions;
- potential loss of key employees of the acquired company;
- potential inability to achieve cost savings and other potential benefits expected from the acquisition;
- an uncertain sales and earnings stream from the acquired company; and
- potential impairment charges, which may be significant, against goodwill and purchased intangible assets acquired in the acquisition due to changes in conditions and circumstances that occur after the acquisition, many of which may be outside of our control.

There can be no assurance that acquisitions we may pursue will be successful. If we pursue an acquisition but are not successful in completing it, or if we complete an acquisition but are not successful in integrating the acquired company's employees, products or operations successfully, our business, financial position or results of operations could be adversely affected.

Collectively, our officers and directors own a significant amount of our common stock, giving them influence over corporate transactions and other matters and potentially limiting the influence of other stockholders on important policy and management issues.

Our officers and directors, together with their families and affiliates, beneficially owned approximately 28% of our outstanding shares of common stock as of June 30, 2018. Approximately 15% of the outstanding shares of common stock are beneficially owned by Mark LeDoux, and his family and affiliates. Mr. LeDoux is our Chief Executive Officer and Chairman of the Board. As a result, our officers and directors, and in particular Mr. LeDoux, could influence such business matters as the election of directors and approval of significant corporate transactions.

Various transactions could be delayed, deferred, or prevented without the approval of stockholders, including the following:

- transactions resulting in a change in control;
- mergers and acquisitions;
- tender offers;
- election of directors; and
- proxy contests.

There can be no assurance that conflicts of interest will not arise with respect to the officers and directors who own shares of our common stock or that conflicts will be resolved in a manner favorable to us or our other stockholders.

We may not be able to raise additional capital or obtain additional financing if needed.

It is possible our cash from operations could become insufficient to meet our working capital needs and/or to implement our business strategies. In such an event, there can be no assurance our existing line of credit would be sufficient to meet our working capital needs. Furthermore, if we fail to maintain certain loan covenants, we may no longer have access to our credit line. Under the terms of our credit facility, there are limits on our ability to create, incur or assume additional indebtedness without the approval of our lender. Our credit line terminates in February 2021 and there is no guarantee we will be able to extend or renew this credit line on favorable terms or at all.

We may consider issuing additional debt or equity securities in the future to fund potential acquisitions or investments, to refinance existing debt, or for general corporate purposes. If we issue equity or convertible debt securities to raise additional funds, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences and privileges senior to those of our existing stockholders. If we incur additional debt, it may increase our leverage relative to our earnings or to our equity capitalization, requiring us to pay additional interest expenses and potentially lower our credit ratings. At any given time, it could be difficult for us to raise capital due to a variety of factors, some of which may be outside of our control, including a tightening of credit markets, overall poor performance of stock markets, and/or an economic slowdown in the U.S. or other countries, or in the businesses of our customers. There is no assurance we would be able to market such security issuances on favorable terms, or at all, in which case, if we did not have any alternate funds we might not be able to develop or enhance our products, execute our business plan, take advantage of future opportunities, respond to competitive pressures or meet unanticipated customer requirements.

Our inability to raise additional capital or to obtain additional financing if needed could negatively affect our ability to implement our business strategies and meet our goals. This, in turn, could adversely affect our financial condition and results of operations.

If certain provisions of our Certificate of Incorporation, Bylaws and Delaware law are triggered, the market for our shares may decrease.

Certain provisions in our Certificate of Incorporation, Bylaws and Delaware corporate law may discourage unsolicited proposals to acquire our business, even if such proposals would benefit our stockholders. Those provisions include one that authorizes our Board of Directors, without stockholder approval, to issue up to 500,000 shares of preferred stock having such rights, preferences, and privileges, including voting rights, as the Board of Directors designates. The rights of our common stockholders will be subject to, and may be adversely affected by, the rights of holders of any preferred stock that may be issued in the future. Any or all of these provisions could delay, deter or prevent a takeover of our company and could lower the price investors are willing to pay for our common stock and the number of investors willing to own our common stock.

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Our stock price could fluctuate significantly.

Stock prices in general can be volatile and ours is no different. The trading price of our stock may fluctuate in response to the following, as well as other, factors:

- broad market fluctuations and general economic and/or political conditions;
- fluctuations in our financial results;
- relatively low trading volumes;
- future offerings of our common stock or other securities;
- the general condition of the nutritional supplement industry;
- increased competition;
- regulatory action;
- adverse publicity;
- manipulative or illegal trading practices by third parties; and
- our and our customer's and supplier's product and other public announcements.

The stock market has historically experienced significant price and volume fluctuations. There can be no assurance that an active market in our stock will continue to exist or that the price of our common stock will not decline. Our future operating results may be below the expectations of securities analysts and investors. If this were to occur, the price of our common stock could decline, perhaps substantially.

From time to time our shares may be listed for trading on one or more foreign exchanges, with or without our prior knowledge or consent. Certain foreign exchanges may have less stringent listing requirements, rules and enforcement procedures than the Nasdaq Global Market or other markets in the U.S., which may increase the potential for manipulative trading practices to occur on such foreign exchanges. These practices, or the perception by investors that such practices could occur, may increase the volatility of our stock price or result in a decline in our stock price, which in some cases could be significant.

ITEM 2. PROPERTIES

This table summarizes our facilities as of June 30, 2018. We believe our facilities are adequate to meet our operating requirements for the foreseeable future.

Location	Nature of Use	Square Feet	How Held	Lease Expiration Date
Vista, CA USA[(1),(2)]	Manufacturing, warehousing, packaging and distribution	162,000	Leased	March 2024
Manno, Switzerland[(3)]	Manufacturing, warehousing, packaging and distribution	94,217	Leased	June 2024
Carlsbad, CA USA[(4)]	NAI corporate headquarters	20,981	Owned	N/A

(1) This facility is used by NAI for its private-label contract manufacturing segment.

(2) At this facility we use approximately 93,000 square feet for production, 60,000 square feet for warehousing and 9,000 square feet for administrative functions.

(3) This facility is used by NAIE in connection with our private-label contract manufacturing segment. We exercised the option to renew the lease of this facility until June 2024 and are presently negotiating revised terms.

(4) We purchased the Carlsbad facility in March 2016.

ITEM 3. 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 intellectual property, product liability, employment, 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, even if unfavorable, 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 we do not expect.

As of September 18, 2018, neither NAI nor its subsidiary were a party to any material pending legal proceeding nor was any of our property the subject of any material pending legal proceeding. We are currently involved in several matters in the ordinary course of our business, each of which is related to enforcing our intellectual property rights.

There is no assurance NAI will prevail in these litigation matters or in similar proceedings it may initiate or that litigation expenses will not be greater than anticipated.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR OUR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock trades on the Nasdaq Global Market under the symbol "NAII." Below are the high and low sales prices of our common stock as reported on the Nasdaq Global Market for each quarter of the fiscal years ended June 30, 2018 and 2017:

	Fiscal 2018		**Fiscal 2017**	
	High	**Low**	**High**	**Low**
First Quarter	$11.25	$9.15	$13.62	$9.63
Second Quarter	$10.95	$9.65	$14.40	$11.00
Third Quarter	$12.15	$10.15	$12.40	$8.25
Fourth Quarter	$11.25	$9.20	$11.00	$8.80

Holders

As of September 18, 2018, there were approximately 210 stockholders of record of our common stock. On that same date, the last sales price of our common stock as reported on NASDAQ was $9.60 per share.

Dividends

We have never paid a dividend on our common stock and we do not intend to pay a dividend in the foreseeable future. Our current policy is to retain all earnings to provide funds for operations and future growth. Additionally, under the terms of our credit facility, we are precluded from paying a dividend while such facility is in place.

Recent Sales of Unregistered Securities

During the fiscal year ended June 30, 2018, we issued 500,000 restricted shares of NAI common stock to Juice Plus+. These shares were not registered with the SEC or any state in conformance with applicable exemptions from those requirements. The 500,000 shares issued to Juice Plus+ were restricted and subject to a risk of forfeiture in the event Juice Plus+ did not maintain certain contractual commitments to NAI. These restrictions lapse as to 100,000 of the 500,000 shares on each anniversary of the date of issuance provided Juice Plus+ is in compliance with the applicable contractual commitments at that time. 400,000 of the 500,000 shares presently remain restricted and subject to a risk of forfeiture until at least August 2019.

Repurchases

During the year ended June 30, 2018, we did not repurchase any shares of our common stock under our treasury stock repurchase plan.

Equity Compensation Plan Information

The following table sets forth information regarding outstanding options and shares reserved for future issuance under our existing equity compensation plans as of June 30, 2018:

Plan Category	**Number of Shares to be Issued Upon Exercise of Outstanding Options, Warrants, and Rights**	**Weighted-Average Exercise Price of Outstanding Options, Warrants, and Rights**	**Number of Shares of Outstanding Restricted Stock**	**Weighted-Average Exercise Price of Outstanding Restricted Stock**	**Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Shares Reflected in Column (a) and (c))**

	(a)	**(b)**	**(c)**	**(d)**	**(e)**
Equity compensation plans approved by stockholders	135,000	$ 6.32	856,989	N/A	319,000
Equity compensation plans not approved by stockholders	N/A	N/A	N/A	N/A	N/A
Total	135,000	$ 6.32	856,989	N/A	319,000

ITEM 6. SELECTED FINANCIAL DATA

As a smaller reporting company, we are not required to provide Item 6 disclosure in this Annual Report.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion and analysis is intended to help you understand our financial condition and results of operations as of June 30, 2018 and 2017 and for each of the last two fiscal years then ended. You should read the following discussion and analysis together with our audited consolidated financial statements and the notes to the consolidated financial statements included under Item 8 in this report. 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. You should carefully review the risks described under Item 1A and elsewhere in this report, which identify certain important factors that could cause our future financial condition and results of operations to vary.

Executive Overview

The following overview does not address all of the matters covered in the other sections of this Item 7 or other items in this report or contain all of the information that may be important to our stockholders or the investing public. You should read this overview in conjunction with the other sections of this Item 7, the financial statements and accompanying notes, 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 U.S. Historically, our revenue has been largely dependent on sales to two or three 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, the demand for such customers' products, and general industry and economic conditions. Our revenue also includes raw material sales, royalty and licensing revenue generated from our patent estate pursuant to license and supply agreements with third parties for the distribution and use of the ingredient known as beta-alanine sold under our CarnoSyn® and SR Carnosyn® trademarks.

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 by developing relationships with additional, quality-oriented, private-label contract manufacturing customers, and commercializing our patent estate through sales of beta-alanine under our Carnosyn® and SR Carnosyn® trade names, royalties from license agreements, and potentially additional contract manufacturing opportunities with these licensees.

During fiscal 2018, our net sales were 9% higher than in fiscal 2017. Private-label contract manufacturing sales increased 17% due primarily to the sale of new products to existing customers and higher volumes of current products to existing customers located primarily in U.S., Asian, and European markets. These increases were partially offset by discontinued U.S. customer relationships. The increase in sales included shipment of new products and increased sales of existing products to our largest customer under our previously announced expanded relationship. Revenue concentration from our largest private-label contract manufacturing customer as a percentage of our total net sales increased to 56% in fiscal 2018 from 50% for fiscal 2017. We expect this percentage to be the same in fiscal 2019 as it was in fiscal 2018.

During fiscal 2018, CarnoSyn® beta-alanine revenue decreased 20% to $21.4 million as compared to $26.9 million for fiscal 2017. The decrease in CarnoSyn® revenue was primarily due to decreased beta-alanine shipments as a result of market and seasonal factors and lower average beta-alanine sales prices. During the quarter ended December 31, 2017, the sports nutrition retail market conditions declined most notably in the older “brick and mortar” sales channels as products transitioned to higher levels of internet based sales. This transition resulted in excess inventory in certain channels and delayed the re-order rates for many of our customer brands. Additionally, while we still have active patents covering instant release CarnoSyn® beta-alanine, we experienced increased competition from companies selling generic beta-alanine beginning in the second quarter of fiscal 2018 resulting in certain customers discontinuing the use of our CarnoSyn® beta-alanine. To offset this decline, and in addition to legal actions we have prosecuted and others we may institute, we have increased our sales and marketing activities to consumers, customers, potential customers, and brand owners on multiple platforms to promote and reinforce the features and benefits of utilizing CarnoSyn® beta-alanine. During the second half of fiscal 2018, our re-order rates improved and reached near historical levels suggesting to us both improved sports nutrition retail market conditions and potentially a positive impact from our marketing activities. Additionally, our SR CarnoSyn® product and raw material sales continued to rise as more brands adopted product offerings of this sustained release delivery system. There can be no assurance our sales and marketing efforts or the recent apparent improvement in retail market conditions will continue.

To protect our CarnoSyn® business and its underlying patent estate, we incurred litigation and patent compliance expenses of approximately $2.9 million during fiscal 2018 and $4.2 million during fiscal 2017. The decrease in these legal expenses on a year over year basis was primarily due to the settlement of most of the existing cases. We describe our efforts to protect our patent estate in more detail under Item 1 of Part II of this report. Our ability to maintain or further increase our beta-alanine royalty and licensing revenue will depend in large part on our ability to develop a market for our sustained release form of beta-alanine marketed under our SR Carnosyn® tradename, maintenance of our patent rights, the availability and the cost of the raw material beta-alanine when and in the amounts needed, the ability to expand distribution of beta-alanine to new and existing customers, and continued compliance by third parties with our license agreements and patent and trademark rights.

During fiscal 2019, we plan to continue our 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;

- Expanding the commercialization of our beta-alanine patent estate through raw material sales, developing a market for our sustained release form of beta-alanine marketed under our SR Carnosyn® trademark, new contract manufacturing opportunities, license agreements and protecting our proprietary rights; and

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

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Critical Accounting Policies and Estimates

Our consolidated financial statements included under Item 8 in this report have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). Our significant accounting policies are described in the notes to our consolidated financial statements. The preparation of financial statements in accordance with GAAP 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. 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. Some of our critical accounting policies include those listed below.

Revenue Recognition

To recognize revenue we require four basic criteria to be met: 1) there is evidence that an arrangement exists; 2) delivery has occurred; 3) the fee is fixed or determinable; and 4) collectability is reasonably assured. Revenue from sales transactions where the buyer has the right to return the product is recognized at the time of sale only if (a) our price to the buyer is substantially fixed or determinable at the date of sale; (b) the buyer has paid us, or the buyer is obligated to pay us and the obligation is not contingent on resale of the product; (c) the buyer’s obligation to us would not be changed in the event of theft or physical destruction or damage of the product; (d) the buyer acquiring the product for resale has economic substance apart from that provided by us; (e) we do not have significant obligations for future performance to directly bring about resale of the product by the buyer; and (f) the amount of future returns can be reasonably estimated. We recognize revenue upon determination that all criteria for revenue recognition have been met. The criteria are usually met at the time title passes to the customer, which usually occurs upon shipment. Revenue from shipments where title passes upon delivery is deferred until the shipment has been delivered.

We record reductions to gross revenue for estimated returns of private-label contract manufacturing products. The estimated returns are based on the trailing six months of private-label contract manufacturing gross sales and our historical experience. However, the estimate for product returns does not reflect the impact of a potential large product recall resulting from product nonconformance or other factors as such events are not predictable nor is the related economic impact estimable.

We currently own certain U.S. patents, and in some cases those patents’ corresponding foreign patent applications. All of these patents and patent rights relate to the ingredient known as beta-alanine marketed and sold by us under our CarnoSyn® and SR Carnosyn® trademarks, combined with a license to our patent estate. We recorded beta-alanine raw material sales and royalty and licensing income as a component of revenue in the amount of $21.4 million during fiscal 2018 and $26.9 million during fiscal 2017. These royalty income and raw material sale amounts resulted in royalty expense paid to the original patent holders from whom NAI acquired its patents and patent rights. We recognized royalty expense as a component of cost of goods sold in the amount of $854,000 during fiscal 2018 and $1.0 million during fiscal 2017.

Inventory Reserve

We operate primarily as a private-label contract manufacturer and build products based upon anticipated demand or following receipt of customer specific purchase orders. From time to time, we build inventory for private-label contract manufacturing customers under a specific purchase order with delivery dates that may subsequently be rescheduled or canceled at the customer's request. We value inventory at the lower of cost or market on an item-by-item basis and establish reserves equal to all or a portion of the related inventory to reflect situations in which the cost of the inventory is not expected to be recovered. This valuation method requires us to make estimates regarding the market value of our inventory, including an assessment for excess and obsolete inventory. Once we establish an inventory reserve amount in a fiscal period, the reduced inventory value is maintained until the inventory is sold or otherwise disposed. In evaluating whether inventory is stated at the lower of cost or market, management considers such factors as the amount of inventory on hand, the estimated time required to sell such inventory, the remaining shelf life and efficacy, the foreseeable demand within a specified time horizon and current and expected market conditions. Based on this evaluation, we record adjustments to cost of goods sold to adjust inventory to its net realizable value. These adjustments are estimates, which could vary significantly, either favorably or unfavorably, from actual realization of inventory value if future economic conditions, customer demand or other factors differ from expectations.

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Accounting for Income Taxes

We account for uncertain tax positions using the more-likely-than-not recognition threshold. Our practice is to recognize interest and/or penalties related to income tax matters in income tax expense. As of June 30, 2018 and June 30, 2017, we had not recorded any tax liabilities for uncertain tax positions.

We estimate income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure, together with assessing temporary differences resulting from differing treatment of items, such as property and equipment depreciation, for tax and financial reporting purposes. Actual income taxes could vary from these estimates due to future changes in income tax law or results from final tax examination reviews.

The Tax Cuts and Jobs Act (the “Act”) was enacted on December 22, 2017. Among other things, the Act reduces the U.S. federal corporate tax rate to 21% and requires companies to pay a one-time deemed repatriation transition tax on earnings of U.S.-owned foreign subsidiaries that were previously tax deferred. We recognized a discrete expense as a component of our provision for income taxes due to the one-time transition tax, as well as effect of the Act on our existing deferred tax balances. The impact of the Tax Legislation may differ from these estimates, possibly materially, during the one-year measurement period ending December 22, 2018 due to, among other things, further refinement of our calculations, changes in interpretations and assumptions we made, guidance that may be issued and actions we may take as a result of the Act.

As part of the Act, we are required to recognize a one-time deemed repatriation transition tax based on our total post-1986 earnings and profits (E&P) from our Swiss subsidiary, NAIE. This accumulated E&P amount has historically been considered permanently reinvested thereby allowing us to defer recognizing any U.S. income tax on the amount. As a result of the Act we recorded a provisional amount for our one-time transition tax liability resulting in an increase in U.S. income tax expense during the year ended June 30, 2018 of $1.7 million, which was treated as a discrete expense. In accordance with the provisions of the Act, we will elect to pay this tax over an eight-year period. Further, the transition tax is based in part on the amount of those earnings held in cash and other specified assets. We no longer consider undistributed foreign earnings from NAIE earned prior to December 31, 2017 as indefinitely reinvested. We do consider undistributed foreign earnings from NAIE earned after December 31, 2017 to be indefinitely reinvested. As a result, we have recorded $1.1 million in estimated foreign (i.e., non U.S.) withholding taxes on the amounts deemed repatriated under the Act, which was also treated as a discrete expense during the period.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are measured using enacted tax rates for each of the jurisdictions in which we operate, and the tax rates 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 income in the period that includes the enactment date. As of June 30, 2018, we remeasured certain deferred tax assets and liabilities based on the tax rates expected to apply in the future. We remeasured deferred tax asset and liability balances based on the newly enacted 21% tax rate. This resulted in us using a blended 28.06% rate for balances expected to reverse in 2018 and the 21% rate for balances expected to reverse thereafter. The amount we recorded from remeasuring our deferred tax balance was $212,000 and was treated as a discrete expense for the year ended June 30, 2018.

We record valuation allowances to reduce our deferred tax assets to an amount that we believe is more likely than not to be realized. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will ultimately be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. During the year ended June 30, 2018, there was no change to our valuation allowance.

We are subject to taxation in the U.S., Switzerland and various U.S. state jurisdictions. Our tax returns for the fiscal years ended June 30, 2015 and forward are subject to examination by U.S. tax authorities and for fiscal years ended June 30, 2007 and forward are subject to examination by state tax authorities. Our tax filings for the fiscal year ended June 30, 2015 and forward are subject to examination by Swiss tax authorities.

It is our policy to establish reserves based on management’s assessment of exposure for certain positions taken in previously filed tax returns that may become payable upon audit by tax authorities. Our tax reserves are analyzed quarterly and adjustments are made as events occur that we believe warrant adjustments to the reserves. There were no adjustments to these reserves during the year ended June 30, 2018.

On an interim basis, we estimate what our effective tax rate will be for the full fiscal year and record a quarterly income tax provision in accordance with the anticipated annual rate. As the fiscal year progresses, we refine our estimate based upon actual events and earnings by jurisdiction during the year. This continual estimation process periodically results in a change to our expected effective tax rate for the fiscal year. When this occurs, we adjust the income tax provision during the quarter in which the change in estimate occurs so that the year-to-date provision equals the expected annual rate.

Derivative Financial Instruments

We typically have used derivative financial instruments in the management of the foreign currency exchange risk inherent in our forecasted transactions denominated in Euros. We may continue to hedge our foreign currency exposures by entering into offsetting forward exchange contracts and currency options. To the extent we use derivative financial instruments, we account for them using the deferral method, when such instruments are intended to hedge identifiable, firm foreign currency commitments or anticipated transactions and are designated as, and effective as, hedges. Foreign exchange exposures arising from certain transactions that do not meet the criteria for the deferral method are marked-to-market.

We recognize any unrealized gains and losses associated with derivative instruments in income in the period in which the underlying hedged transaction is realized. In the event the derivative instrument is deemed ineffective we would recognize the resulting gain or loss in income at that time. As of June 30, 2018, we held derivative contracts designated as cash flow hedges primarily to protect against the foreign exchange risks inherent in our forecasted sales of products at prices denominated in currencies other than the U.S. dollar. As of June 30, 2018, the notional amounts of our foreign exchange contracts were $34.4 million (€ 29.0 million). These contracts will mature over the next 14 months.

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Results of Operations

The following table sets forth selected consolidated operating results for each of the last two fiscal years, presented as a percentage of net sales (dollars in thousands).

	Fiscal Year Ended					
	June 30, 2018		June 30, 2017		Increase (Decrease)	
Private-label contract manufacturing	$110,992	84 %	$95,024	78 %	$15,968	17 %
Patent and trademark licensing	21,445	16 %	26,922	22 %	(5,477)	(20)%
Total net sales	132,437	100%	121,946	100%	10,491	9 %
Cost of goods sold	106,117	80 %	95,742	78 %	10,375	11 %
Gross profit	26,320	20 %	26,204	22 %	116	0 %
Selling, general & administrative expenses	16,787	13 %	16,502	14 %	285	2 %
Income from operations	9,533	7 %	9,702	8 %	(169)	(2)%
Other income, net	1,080	1 %	409	0 %	671	164%
Income before income taxes	10,613	8 %	10,111	8 %	502	5 %
Provision for income taxes	5,562	4 %	2,876	2 %	2,686	93 %
Net income	$5,051	4 %	$7,235	6 %	$(2,184)	(30)%

Private-label contract manufacturing net sales increased 17% due primarily to the sale of new products to existing customers and higher volumes of current products to existing customers located primarily in U.S., Asian, and European markets, which increases were partially offset by discontinued U.S. customer relationships. The increase in sales included shipments of new products and increased sales of existing products to our largest customer under our previously announced expanded relationship.

Net sales from our patent and trademark licensing segment decreased 20% during fiscal 2018. The decrease in beta-alanine raw material sales was primarily due to decreased shipments of beta-alanine as a result of market and seasonal factors and lower average sales prices for the material.

The change in gross profit margin for the year ended June 30, 2018, was as follows:

	Percentage Change
Contract manufacturing[(1)]	0.8

Patent and trademark licensing[2]	(2.4	)
Total change in gross profit margin	(1.6	)

1 Private-label contract manufacturing gross profit margin contribution increased 0.8 percentage points in fiscal 2018 as compared to fiscal 2017. The increase in gross profit as a percentage of sales in fiscal 2018 is primarily due to a favorable shift in product sales mix and a marginal decrease in per unit manufacturing costs.

2 During fiscal 2018, patent and trademark licensing gross profit margin contribution decreased 2.4 percentage points primarily due to decreased raw material sales and decreased royalty income as a percentage of total consolidated net sales which decreases were partially offset by favorable raw material costs.

Selling, general and administrative expenses increased $285,000, or 2%, during fiscal 2018 as compared to fiscal 2017. This increase was primarily due to increased compensation and consulting costs related to our private-label contract manufacturing business and increased marketing, advertising, and research and development costs supporting our CarnoSyn® and SR Carnosyn® brands. Those increases were partially offset by a reduction in patent litigation costs of $1.3 million.

Other income (net) increased $671,000 during fiscal 2018 as compared to fiscal 2017. The increase for fiscal 2018 is due primarily to the favorable interest income associated with the amortization of forward points associated with our foreign exchange hedge contracts.

Our income tax expense increased $2.7 million during fiscal 2018 as compared to fiscal 2017. The increase was primarily due to the discrete income tax expense amounts recorded as a result of the Tax Cuts and Jobs Act enacted on December 22, 2017. Among other things, the Act reduces the U.S. federal corporate tax rate to 21% and requires companies to pay a one-time deemed repatriation transition tax on earnings of U.S.-owned foreign subsidiaries that were previously tax deferred. We have not completed our accounting for all of the tax effects of the Act; however, in certain cases, as described below and in accordance with SAB 118, we have made a reasonable estimate of the effects on our existing deferred tax balances and of the one-time transition tax. In other cases, we have not been able to make a reasonable estimate and continue to account for those items based on our existing accounting under ASC 740, Income Taxes. For the items for which we were able to determine a reasonable estimate, we recognized a provisional amount as a discrete component of our provision for income taxes. The impact of the Act may differ from these estimates, possibly materially, during the one-year measurement period ending December 22, 2018 due to, among other things, further refinement of our calculations, changes in the interpretations and assumptions we made, guidance that may be issued and actions we may take as a result of the Act.

Included in our tax expense for fiscal 2018 is $3.0 million of discrete tax items related to the Act. The discrete tax items include:

$1.7 million associated with a one-time transition tax that is calculated based on our total post-1986 earnings and profits (E&P) from our Swiss subsidiary NAIE. This accumulated E&P amount has historically been considered permanently reinvested outside the U.S. thereby allowing us to defer recognizing any U.S. income taxes on the amount of such E&P. However, under the Act we are required to pay this tax based on a deemed repatriation into the U.S. of such E&P. In accordance with the provisions of the Act, we will elect to pay this tax over an eight-year period.

As of December 31, 2017, we no longer consider undistributed foreign earnings from NAIE earned before December 31, 2017 to be indefinitely reinvested. As a result, we have recorded $1.1 million in estimated foreign withholding taxes on the amounts deemed repatriated under the Act, which was also treated as a discrete expense during the period.

We remeasured certain deferred tax assets and liabilities based on the newly enacted 21% tax rate. The amount recorded from the remeasurement of our deferred tax balance was $212,000.

Our effective tax rate, excluding the impact of the above noted discrete items, for fiscal 2018 was 23.9% as compared to an effective tax rate of 28.4% for fiscal 2017. As a fiscal taxpayer, our U.S. federal statutory rate for fiscal 2018 is 28.06% and is a blended rate of the historic 35% statutory rate and the newly enacted 21% rate. The year over year improvement in our effective tax rate is primarily due to the reduction of the U.S. federal tax rate used in our estimated tax calculation, which reduced to a blended rate of 28.06% as compared to the 34.0% used in the prior year.

We expect our U.S. federal statutory rate to be 21% for fiscal years beginning after June 30, 2018, which should further reduce our effective tax rate on an annualized basis.

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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 facilities. Net cash provided by operating activities was $1.8 million in fiscal 2018 compared to net cash provided by operating activities of $14.1 million in fiscal 2017. Approximately $1.3 million of our operating cash flow was generated by NAIE in fiscal 2018.

Net income decreased by $2.1 million to $5.1 million during fiscal 2018 as compared to net income of $7.2 million in the prior fiscal year primarily due to increased income tax expense as a result of one-time items recorded as a result of the Tax Cut and Jobs Act. At June 30, 2018, changes in accounts receivable, consisting primarily of amounts due from our private-label contract manufacturing customers and our patent and trademark raw material sales activities, used $6.2 million in cash compared to providing $4.8 million in fiscal 2017. The decrease in cash provided by accounts receivable during fiscal 2018 primarily resulted from timing of sales and the related collections. Days sales outstanding was 32 days during fiscal 2018 and fiscal 2017.

Inventory used $9.8 million in cash during fiscal 2018 compared to providing $7.0 million in fiscal 2017. The change in cash activity from inventory during fiscal 2018 was primarily related to increased sales in fiscal 2018 as compared to fiscal 2017 including increased sales and order activity at the end of fiscal 2018 as compared to the end of fiscal 2017. Changes in accounts payable and accrued liabilities provided $4.4 million in cash during fiscal 2018 compared to using $8.0 million during fiscal 2017. The change in cash flow activity related to accounts payable and accrued liabilities is primarily due to the timing of inventory receipts and payments.

Cash used in investing activities in fiscal 2018 was $5.6 million compared to $5.3 million in fiscal 2017. Capital expenditures were $4.1 million during fiscal 2018 compared to $5.4 million in fiscal 2017. Capital expenditures during fiscal 2018 and fiscal 2017 were primarily for manufacturing equipment used in our Vista, California and Manno, Switzerland facilities. Investing activities in fiscal 2018 also included the conversion of $1.5 million of accounts receivable into a note receivable as compared to no such activity in fiscal 2017. At June 30, 2018 and June 30, 2017, on a consolidated basis, we had no outstanding balances due in connection with our loan facility.

On March 20, 2018, we executed an amendment to our credit facility with Wells Fargo Bank, N.A. to extend the maturity date for our working line of credit from February 1, 2020 to February 1, 2021. In addition, the amendment removed any restrictions included in the credit facility on our ability to repurchase our stock. The Credit Agreement provides us with a credit line of up to $10.0 million. The line of credit may be used to finance working capital requirements. There was no commitment fee required as part of this amendment. There are no amounts currently drawn under the line of credit.

Under the terms of the Credit Agreement, borrowings are subject to eligibility requirements including maintaining (i) a ratio of total liabilities to tangible net worth of not greater than 1.25 to 1.0 at any time; and (ii) a ratio of total current assets to total current liabilities of not less than 1.75 to 1.0 at each fiscal quarter end. Any amounts outstanding under the line of credit will bear interest at a fixed or fluctuating interest rate as elected by NAI from time to time; provided, however, that if the outstanding principal amount is less than $100,000 such amount shall bear interest at the then applicable fluctuating rate of interest. If elected, the fluctuating rate per annum would be equal to 1.25% above the daily o style="line-height:120%;text-align:left;text-indent:36px;font-size:10pt;">• Limit or prohibit mining work on protected areas.

Under these laws and regulations, we could be liable for personal injury and clean-up costs and other environmental and property damages, as well as administrative, civil and criminal penalties. We maintain only limited insurance coverage for sudden and accidental environmental damages. Accordingly, we may be subject to liability, or we may be required to cease production from properties in the event of environmental damages. These laws and regulations have been changed frequently in the past. In general, these changes have imposed more stringent requirements that increase operating costs or require capital expenditures in order to remain in compliance. Any such changes could have an adverse effect on our business, financial condition and results of operations.

We are subject to the Federal Mine Safety and Health Act of 1977 and regulations promulgated thereto, which impose stringent health and safety standards on numerous aspects of our operations.

Our exploration and mining work in Alaska is subject to the Federal Mine Safety and Health Act of 1977, which impose stringent health and safety standards on numerous aspects of mineral extraction and processing operations, including the training of personnel, operating procedures, operating equipment and other matters. Our failure to comply with these standards could have a material adverse effect on our business, financial condition or otherwise impose significant restrictions on our ability to conduct mining work.

We may be unable to obtain, maintain or renew permits necessary for the exploration, development or operation of any mining activities, which could have a material adverse effect on our business, financial condition or results of operation.

We must obtain a number of permits that impose strict conditions, requirements and obligations relating to various environmental and health and safety matters in connection with our current and future operations. To obtain certain permits, we may be required to conduct environmental studies, collect and present data to governmental authorities and the general public pertaining to the potential impact of our current and future operations upon the environment and take steps to avoid or mitigate the impact. The permitting rules are complex and have tended to become more stringent over time. Accordingly, permits required for our mining work may not be issued, maintained or renewed in a timely fashion or at all, or may be conditioned upon restrictions which may impede our ability to operate efficiently. The failure to obtain certain permits or the adoption of more stringent permitting requirements could have a material adverse effect on our business, our plans of operation, and properties in that we may not be able to proceed with our exploration, development or mining programs.

Anti-takeover provisions of our certificate of incorporation, bylaws and Delaware law could adversely affect potential acquisition by third parties.

Our certificate of incorporation, bylaws and the Delaware General Corporation Law contain provisions that may discourage unsolicited takeover proposals. These provisions could have the effect of inhibiting fluctuations in the market price of our common stock that could result from actual or rumored takeover attempts, preventing changes in our management or limiting the price that investors may be willing to pay for shares of common stock. Among other things, these provisions:

- Limit the personal liability of directors;
- Limit the persons who may call special meetings of stockholders;
- Prohibit stockholder action by written consent;
- Establish advance notice requirements for nominations for election of the board of directors and for proposing matters to be acted on by stockholders at stockholder meetings;
- Require us to indemnify directors and officers to the fullest extent permitted by applicable law;
- Impose restrictions on business combinations with some interested parties.

Our common stock is thinly traded.

As of September 7, 2012, there are approximately 2.5 million shares of our common stock outstanding, with directors, officers and our technical consultant owning approximately 29% of our common stock. Since our common stock is thinly traded, the purchase or sale of relatively small common stock positions may result in disproportionately large increases or decreases in the price of our common stock.

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We do not intend to pay dividends in the foreseeable future.

For the foreseeable future, we intend to retain any earnings to finance the development of our business, and we do not anticipate paying any cash dividends on our common stock. Any future determination to pay dividends will be at the discretion of our Board of Directors and will be dependent upon then-existing conditions, including our operating results and financial condition, capital requirements, contractual restrictions, business prospects and other factors that our Board of Directors considers relevant. Accordingly, investors must rely on sales of their common stock after any price appreciation, which may never occur, as the only way to realize a return on their investment.

Item 1B. UNRESOLVED STAFF COMMENTS

None

Item 2. PROPERTIES

Our Properties are located in the state of Alaska, and principally consist of mineral leases and unpatented mining claims.

We believe that we hold good title to our Properties in accordance with standards generally accepted in the minerals industry. As is customary in both the gold and rare earths industries, we conduct only a perfunctory title examination at the time we acquire a property. Before we begin any mining activities, however, we will conduct a full title examination and perform curative work on any defects that we deem significant.

Lease with Tetlin Village Council

JEX entered into the Tetlin Lease with the Tetlin Village Council, effective as of July 15, 2008. An undivided 50% leasehold interest was sold to Contango Mining pursuant to the Joint Exploration Agreement dated as of September 29, 2009 in exchange for $1 million and a 1% overriding royalty interest. JEX transferred its remaining 50% leasehold interest to Contango Mining as of September 15, 2010 in exchange for an increased overriding royalty aggregating 3% pursuant to an Amended ORRI Agreement. The Tetlin Lease covers approximately 675,000 acres of land, provides for an initial term of ten (10) years, with an option to renew 50% of the acreage for an additional ten years, or so long as we continue conducting mining operations on the Tetlin Lease. While the Company is required to spend $350,000 per year annually until July 15, 2018 in exploration costs pursuant to the Tetlin Lease, the Company's exploration expenditures on the Tetlin Properties through its 2011 exploration program satisfied this requirement because under the Tetlin Lease, exploration funds spent in any year in excess of $350,000 are credited toward future years' exploration cost requirements.

If the Tetlin Lease is placed into commercial production of precious or non-precious metals, we will be obligated to pay a production royalty to the Native Village of Tetlin, ranging from 2.0% to 5.0%. The Company has purchased 0.75% of this production royalty for $225,000, which reduces the production royalty to a range of 1.25% to 4.25%. On or before July 15, 2020, the Tetlin Village Council has the option to repurchase the 0.75% production royalty for $450,000, or a portion thereof. Until such time as production royalties begin, the Company pays the Tetlin Village Council an advance minimum royalty of $50,000 per year, which is credited toward any production royalty payable to the Tetlin Village Council. On July 15, 2012, the advance minimum royalty increased to $75,000 per year, and subsequent years are escalated by an inflation adjustment.

Gold Mining Claims

A listing of our state of Alaska unpatented mining claims as of September 7, 2012 for gold and associated minerals are listed in Exhibit 99.1.

REE Mining Claims

A listing of our state of Alaska and Federal mining claims as of September 7, 2012 for rare earth elements are listed in Exhibit 99.2.

Location and Access of our Properties

Our Gold Properties are located in the eastern interior region of Alaska. Access to the Tetlin Project claims is available by road and access to public power is available. The Triple Z Project claims are accessible via an ATV trail from the public road. There is no commercial power available.

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Our REE Properties are located throughout the state of Alaska. The Salmon Bay and Stone Rock Bay Project claims are located in the southeastern region of the state. Salmon Bay and Stone Rock are accessible only by aircraft or sea. No commercial sources of power are available. The Alatna, Spooky and Wolf Project claims are located in the interior region and the Swift Project claims are located in western region of Alaska. The Alatna, Spooky, Wolf and Swift claims are accessible by aircraft only and no commercial sources of power are available. We are considering abandoning the Alatna, Spooky, Wolf and Swift claims effective December 1, 2012 to focus our time and resources on the remaining claims.

In general, water rights are acquired on an as-needed basis from the state of Alaska Department of Natural Resources, Division of Mining, Land and Water. Potential water sources include both surface and subsurface waters. Water right applications can be either temporary (seasonal rights) or permanent, such as an operating mine would require. We will obtain water rights as necessary to carry out our exploration programs on our Properties. Such rights normally take approximately one month to acquire via permit.

Prior to JEX's acquisition of the Properties, to the Company's knowledge, the Properties had not been previously explored for minerals.

Fees

The following tables set forth the annual state of Alaska and Federal mining claim rental holding costs for the Company's Alaska projects. Additionally, the state of Alaska claims are subject to annual work commitments. Federal mining claim rents are due and payable in full by August 31 of each year and state of Alaska mining claim rents and work commitments are due and payable by November 30 of each year.

The Company has met the annual work requirements for the Triple Z and TOK/Tetlin claims for the next four years, which is the maximum time frame allowed by Alaska law. The Company's Swift , Wolf and Alatna claims have work commitments totaling $176,800. In lieu of work commitments, the Company can pay $176,800 each year to maintain the claims. The Company's Spooky project is located on state of Alaska lands, but an annual claim rental is not currently required.

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Gold Claims:	Triple Z	Tetlin	Totals
# 160 Acre Claims	45	54	99
# 40 Acre Claims	—	68	68
# 20 Acre Fed claims	—	—	—
Total Acres	7,200	11,360	18,560
State Claim Rents—160-acre	$2,200	$7,560	$9,760
State Claim Rents—40-acre	$—	$2,380	$2,380
Fed Claim Rents—20-acre	$—	$—	$—
Totals	$2,200	$9,940	$12,140

REE Claims:	Stone Rock	Salmon Bay	Spooky (1)		Wolf (1)	Alatna (1)	Swift (1)	Totals
# 160 Acre Claims	—	—	166		202	127	113	608
# 40 Acre Claims	—	—	—		—	—	—	—
# 20 Acre Fed claims	49	123	—		—	—	—	172
Total Acres	980	2,460	26,560		32,320	20,320	18,080	100,720
State Claim Rents—160-acre	$—	$—	$23,240		$28,280	$17,780	$15,820	$85,120
State Claim Rents—40-acre	$—	$—	$—		$—	$—	$—	$—
Fed Claim Rents—20-acre	$6,860	$17,220	$—		$—	$—	$—	$24,080
Totals	$6,860	$17,220	$23,240	(2)	$28,280	$17,780	$15,820	$109,200

(1) We are considering abandoning the Spooky, Wolf, Alatna and Swift claims effective December 1, 2012 to focus our time and resources on the remaining claims.
(2) Rental not due to the state of Alaska until land is patented .

Acquisition of Other Properties

The Company anticipates from time to time acquiring additional properties in Alaska for exploration, subject to the availability of funds. The acquisitions may include leases or similar rights from Alaska Native corporations or may include filing Federal or state of Alaska mining claims by staking claims for exploration and development. Acquiring additional properties will likely result in additional expense to the Company for minimum royalties, minimum rents and annual exploratory work requirements.

Overriding Royalty Interest

Pursuant to the Amended ORRI Agreement dated September 15, 2010, in consideration of JEX's assignment of its 50% interest in the Properties to Contango Mining, the Company conveyed an overriding royalty interest to JEX which provides that JEX will receive a 3% of 8/8ths overriding royalty interest on all minerals mined from the Properties held by the Company as of the date of the Amended ORRI Agreement. Pursuant to an Advisory Agreement dated September 6, 2012 with JEX, the Company agreed to pay JEX a 2% of 8/8ths ORRI on all minerals mined from properties acquired by the Company after July 1, 2012 in the state of Alaska. In addition, we will pay the Tetlin Village Council a production royalty ranging from 2.0% to 5.0% should we deliver to a purchaser on a commercial basis, precious or non-precious metals derived from the Tetlin Lease. The Company has purchased 0.75% of this production royalty for $225,000, which reduces the production royalty to a range of 1.25% to 4.25%. On or before July 15, 2020, the Tetlin Village Council has the option to repurchase the 0.75% production royalty for $450,000, or a portion thereof.

Item 3. LEGAL PROCEEDINGS

As of the date of this Form 10-K, we are not a party to any legal proceedings and we are not aware of any proceeding contemplated against us.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock began trading on the Over-The-Counter Bulleting Board (OTCBB) on December 20, 2010 under the symbol "CTGO". The table below shows the high and low closing prices of our common stock for the periods indicated.

	High	Low
Fiscal Year 2011:		
Quarter ended September 30, 2010	n/a	n/a
Quarter ended December 31, 2010	$12.50	$6.00
Quarter ended March 31, 2011	$19.50	$7.50
Quarter ended June 30, 2011	$18.50	$13.00
Fiscal Year 2012		
Quarter ended September 30, 2011	$16.00	$12.50
Quarter ended December 31, 2011	$17.88	$12.50
Quarter ended March 31, 2012	$14.00	$7.77
Quarter ended June 30, 2012	$12.98	$8.65

On September 7, 2012, the closing price of our common stock on the OTCBB was $9.25 per share, and there were 2,480,269 shares of Contango ORE, Inc. common stock outstanding held by approximately 51 registered shareholders.

The Company does not intend to declare or pay any dividends and currently intends to retain any available funds generated by its operations for the development and growth of its business. It does not currently anticipate paying any cash dividends on its outstanding shares of common stock in the foreseeable future. Any future decision to pay dividends on its common stock will be at the discretion of its Board and will depend on its financial condition, results of operations, capital requirements, and other factors the Board may deem relevant.

The following table sets forth information about our equity compensation plans at September 7, 2012:

Plan Category	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (b))
Equity compensation plans approved by security holders	—	—	756,094
Equity compensation plans not approved by security holders	—	—	—

On September 15, 2010, the Company's Board of Directors (the "Board") adopted the Contango ORE, Inc. Equity Compensation Plan (the "2010 Plan"), which was approved by the Company's shareholders. Under the 2010 Plan, the Board may grant restricted stock and option awards to officers, directors, employees or consultants of the Company. Awards made under the 2010 Plan are subject to such restrictions, terms and conditions, including forfeitures, if any, as may be determined by the Board. As of September 7, 2012, there were 93,906 restricted shares outstanding and 150,000 options outstanding issued under the 2010 Plan.

Item 6. NOT REQUIRED AS A SMALLER REPORTING COMPANY

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the financial statements and the related notes and other information included elsewhere in this report.

Overview

The Company was formed on September 1, 2010 as a Delaware corporation. We are a Houston-based company, whose primary business is to explore in the state of Alaska for (i) gold ore and associated minerals and (ii) rare earth elements. We have leased or have control over approximately 794,280 acres of Alaskan Native, Federal and state of Alaska properties for the exploration of gold and associated minerals and rare earth elements.

Insolvency of Company

It is possible that our 2012 summer field work program will not identify any commercially exploitable minerals. Should this occur, or if we determine that recovery of any minerals may not be economically profitable, we may be required to cease operations, dissolve and wind up the business of the Company.

Results of Operations

The Company is a newly-formed company that has not commenced mining or producing commercially marketable minerals. To date, we have not generated any revenue from mineral sales or operations. We have no recurring source of revenue and our ability to continue as a going concern is dependent on our ability to raise capital to fund our future exploration and working capital requirements. In the future, we may generate revenue from a combination of mineral sales and other payments resulting from any commercially recoverable minerals from the Properties. We do not expect to generate revenue from mineral sales in the foreseeable future. If our Properties fail to contain any proven reserves, our ability to generate future revenue, and our results of operations and financial position, would be materially adversely affected. Other potential sources of cash, or relief of demand for cash, include external debt, the sale of shares of our stock, joint ventures, or alternative methods such as mergers or sale of our assets. No assurances can be given, however, that we will be able to obtain any of these potential sources of cash. We will need to generate significant revenues to achieve profitability and we may never do so.

Claim Rentals and Minimum Royalties. Claim rentals and minimum royalties consist of Federal and state of Alaska rental payments, annual labor payments, and minimum royalty payments payable to the Native Village of Tetlin. We recognized claim rental expenses of $198,797 for the fiscal year ended June 30, 2012, compared to $281,418 for the fiscal year ended June 30, 2011. The lower level of claim rentals and minimum royalties is due to a reduction in minimum labor costs.

For the fiscal year ended June 30, 2011, we recognized claim rental expenses of $281,418, compared to $192,712 for the fiscal year ended June 30, 2010. The higher level of rentals is due to additional lands acquired in fiscal year 2011.

Exploration Expenses. We incurred approximately $3.5 million of exploration expense for the fiscal year ended June 30, 2012, compared to $2.3 million for the fiscal year ended June 30, 2011. This increase is principally attributable to our summer 2011 work program. Components of exploration expense include drilling, permits, field rentals and field supplies as well as staking, mapping, logging, surveying and plotting expenses. The increase is also attributable to stock-based compensation costs recorded under exploration expense related to the issuance of restricted stock in November 2010 and stock options in September 2011 to our technical consultant, pursuant to the Company's 2010 Equity Compensation Plan. Stock-based compensation costs included in exploration expense totaled $58,326 for the fiscal year ended June 30, 2012, as compared to $21,227 for the fiscal year ended June 30, 2011.

For the fiscal year ended June 30, 2011, we incurred approximately $2.3 million of exploration expense, compared to $0.9 million for the fiscal year ended June 30, 2010. This increase is principally attributable to our summer 2010 work program as well as stock-based compensation expense related to issuing restricted stock in November 2010 to our technical consultant.

Other Operating Expenses. Other operating expenses for the fiscal year ended June 30, 2012 were $28,898, compared to $87,167 for the fiscal year ended June 30, 2011. This decrease is mainly attributable to fewer travel expenses and fees.

Other operating expenses for the fiscal year ended June 30, 2011 were $87,167, compared to $30,485 for the fiscal year ended June 30, 2010. This increase is principally attributable to minimal exploration activities during the fiscal year ended June 30, 2010.

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Stock-based Compensation Expenses. We recognized $192,884 of stock-based compensation expense for the fiscal year ended June 30, 2012, related to restricted stock granted to our officers and directors in November 2010, and stock option awards granted to our officers and directors in September 2011. For the fiscal year ended June 30, 2011, we recognized $63,681 of stock-based compensation expense related to restricted stock granted to officers and directors in November 2010. All issuances of restricted stock and stock options were made pursuant to the Company's 2010 Equity Compensation Plan.

General and Administrative Expenses. General and administrative expenses for the fiscal year ended June 30, 2012, 2011 and 2010 were $337,229, $150,810 and $1,677, respectively. The year-over-year increase is attributable to increased legal, accounting and other professional service costs as we implement Sarbanes-Oxley controls and procedures, XBRL reporting requirements, and expand our business and operations.

The Company's directors and officers currently do not receive cash compensation for their work for the Company, nor does the Company reimburse Contango for the shared services of its management officers or shared office space. If the Company continues its business activities, it is possible that we may be required to fund these expenses, which could lead to a significant increase in our general and administrative expenses.

Liquidity and Capital Resources

The Company is in the initial stage of conducting exploration activities on its Properties, and our longer term liquidity will be impaired to the extent our exploration efforts are not successful in generating commercially viable mineral deposits on the Properties.

Liquidity Outlook. Our initial source of funding was the $3.5 million in cash contributed by Contango which has been fully expended. On March 26, 2012, the Company completed the sale of 882,500 shares of Common Stock to accredited investors at a price of $10.00 per share in a private placement for total proceeds of approximately $8.8 million, including 400,000 shares that were purchased by Mr. Peak, the Company's Chairman and Chief Executive Officer. The placement agents used in connection with the transaction received aggregate placement fees and expenses of approximately $0.4 million. After repaying approximately $0.5 million of short-term debt under the Company's Revolving Line of Credit Promissory Note, the Company is using the remaining $7.9 million to fund its 2012 exploration program in Alaska, estimated at $6.75 million, and for general corporate purposes.

Revolving Line of Credit Promissory Note. On November 10, 2011, the Company entered into a $1.0 million Revolving Line of Credit Promissory Note with Contango (the "CORE Note"). The Company and Contango share common executive officers. The CORE Note contains covenants limiting our ability to enter into additional indebtedness and prohibiting liens on any of our assets or properties. Borrowings under the CORE Note bear interest at 10% per annum. Principal and interest are due on December 31, 2012, and may be prepaid at any time with no prepayment penalty.

On March 30, 2012, the Company repaid the $500,000 it had borrowed under the CORE Note, plus accrued interest of $14,917 from the proceeds of the equity offering. As of September 7, 2012, there are no amounts outstanding under the CORE Note. The Company may re-borrow any portion of the $1.0 million through December 31, 2012.

Capital Budget. Our 2012 capital expenditure budget calls for us to invest approximately $6.75 million per the table below. As of August 31, 2012, we had invested approximately $4.3 million of this amount.

Program	Budget
Chief Danny Prospect exploration and drilling	$3,600,000
Copper Hill,Taixsalsa, MM, Chisana, W and Triple Z leads	$2,750,000
Rare earth element exploration and claim rentals	$400,000
	$6,750,000

We currently have two exploration rigs drilling with one rig focused on our Chief Danny prospect (30 – 40 core holes planned), and one rig dedicated to drilling another approximately 16 - 24 core holes to mature four of our six leads to either the prospect stage or condemnation.

Dissolution of the Company. While the Company was successful in selling shares of Common Stock sufficient to fund its 2012 exploration program, after completion of the 2012 exploration program, the Company anticipates requiring additional funding. If the 2012 exploration program is successful, the Company will be required to seek additional debt or equity funding or capital reorganization. If the 2012 exploration program is not successful, or if the Company is unable to obtain additional

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funding, the Company may be required to cease operations, dissolve and wind-up the business of the Company.

Off-Balance Sheet Arrangements

None

Contractual Obligations

The Tetlin Lease provides for an initial term of ten years, with an option to renew 50% of the acreage for an additional ten years, or so long as we continue conducting mining operations on the Tetlin Lease. The Company is required to spend $350,000 per year annually until July 15, 2018 in exploration costs pursuant to the Tetlin Lease. However, exploration expenditures through our 2011 exploration program have satisfied this requirement because exploration funds spent in any year in excess of $350,000 are credited toward future years' exploration cost requirements. The Tetlin Lease also provides that we will pay the Tetlin Village Council a production royalty ranging from 2.0% to 5.0% should we deliver to a purchaser on a commercial basis precious or non-precious metals derived from the properties under the Tetlin Lease. As of June 30, 2012, the Company has paid the Tetlin Village Council $225,000 in exchange for reducing the production royalty payable to it by 0.75%. These payments lowered the production royalty to a range of 1.25% to 4.25%. On or before July 15, 2020, the Tetlin Village Council has the option to increase its production royalty by (i) 0.25% by payment to CORE of $150,000, (ii) 0.50% by payment to CORE of $300,000, or (iii) 0.75% by payment to CORE of $450,000. Until such time as production royalties begin, the Company pays the Tetlin Village Council an advance minimum royalty of approximately $75,000 per year, which amounts are credited toward the payment of any production royalties. Additionally, we will pay JEX an overriding royalty of 3% should we deliver to a purchaser on a commercial basis precious metals, non-precious metals or hydrocarbons derived from the Properties.

Application of Critical Accounting Policies and Management's Estimates

The discussion and analysis of the Company's financial condition and results of operations is based upon the financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. We have identified below the policies that are of particular importance to the portrayal of our financial position and results of operations and which require the application of significant judgment by management. The Company analyzes its estimates, including those related to its mineral reserve estimates, on a periodic basis and bases its estimates on historical experience, independent third party engineers and various other assumptions that management believes to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of the Company's financial statements:

Mineral Property Interests, Exploration and Development Costs: Mineral property interests include interests in the exploration stage mineral properties acquired. The amount capitalized includes costs paid to acquire mineral property interests as well as the costs paid to obtain the lease rights. Exploration costs are expensed as incurred. Development costs are expensed as incurred until the Company obtains proven and probable reserves within its commercially minable properties. Costs of abandoned projects are charged to earnings upon abandonment. Properties determined to be impaired are written-down to the estimated fair value. The Company periodically evaluates whether events or changes in circumstances indicate that the carrying value of mineral property interests and related property, plant and equipment may not be recoverable.

Stock-Based Compensation. The Company applies the fair value based method to account for stock-based compensation. Under this method, we will measure and recognize compensation expense for all stock-based payments at fair value at the date of grant and amortize the amount over the employee's service period. Management is required to make assumptions including stock price volatility and employee turnover that are utilized to measure compensation expense.

Item 7A. NOT REQUIRED AS A SMALLER REPORTING COMPANY

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and supplemental information required to be filed under Item 8 of Form 10-K are presented on pages F-1 through F- 15 of this Form 10-K.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

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Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures
An evaluation was performed under the supervision and with the participation of the Company’s senior management of the effectiveness of the Company’s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”)) as of June 30, 2012, the end of the period covered by this report. Based on that evaluation, the Company’s management, including the Chairman, Acting Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer, concluded that the Company’s disclosure controls and procedures were effective as of such date to ensure that information required to be disclosed in the reports that the Company files under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and (ii) accumulated and communicated to the Company’s management, including the Chairman, Acting Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, as appropriate, to allow timely decisions regarding required disclosure.

There were no changes to the Company’s internal control over financial reporting (as that term is defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act) during the three months ended June 30, 2012 that have materially affected or are reasonably likely to materially affect, the Company’s internal control over financial reporting.
Management’s Report on Internal Control Over Financial Reporting
The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of the Company's management, including the Chairman, Acting Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the Company's evaluation under the framework in Internal Control - Integrated Framework, the Company's management concluded that its internal control over financial reporting was effective as of June 30, 2012.
This Annual Report on Form 10-K does not include an attestation report from UHY LLP, the Company's registered public accounting firm, regarding internal control over financial reporting. Management's report was not subject to attestation by UHY LLP, pursuant to SEC rules that permit the Company to provide only management's report in this Annual Report on Form 10-K.

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PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information regarding directors, executive officers, promoters and control persons required under Item 10 of Form 10-K will be contained in our Definitive Proxy Statement for our 2011 Annual Meeting of Stockholders (the "Proxy Statement") under the headings "Election of Directors", "Executive Compensation", "Section 16(a) Beneficial Ownership Reporting Compliance" and "Corporate Governance" and is incorporated herein by reference. The Proxy Statement will be filed with the SEC pursuant to Regulation 14A of the Exchange Act, not later than 120 days after June 30, 2012.

Item 11. EXECUTIVE COMPENSATION

The information required under Item 11 of Form 10-K will be contained in the Proxy Statement under the heading "Executive Compensation" and is incorporated herein by reference.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required under Item 12 of Form 10-K will be contained in the Proxy Statement under the heading "Security Ownership of Certain Other Beneficial Owners and Management" and is incorporated herein by reference.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required under Item 13 of Form 10-K will be contained in the Proxy Statement under the heading "Certain Relationships and Related Transactions, and Director Independence" and "Executive Compensation" and is incorporated herein by reference.

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required under Item 14 of Form 10-K will be contained in the Proxy Statement under the heading "Principal Accountant Fees and Services" and is incorporated herein by reference.

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PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements and Schedules:
The financial statements are set forth in pages F-1 to F-15 of this Form 10-K. Financial statement schedules have been omitted since they are either not required, not applicable, or the information is otherwise included.

(b) Exhibits:
The following is a list of exhibits filed as part of this Form 10-K. Where so indicated by a footnote, exhibits, which were previously filed, are incorporated herein by reference.

Exhibit Number	Description
3.1	Certificate of Incorporation of Contango ORE, Inc. (1)
3.2	Bylaws of Contango ORE, Inc. (1)
4.1	Form of Certificate of Contango ORE, Inc. Common Stock (1)
10.1	Mineral Lease, effective as of July 15, 2008, between the Native Village of Tetlin and Juneau Exploration Company, d/b/a Juneau Mining Company, as amended by Amendment No. 1 to Mineral Lease, effective as of October 1, 2009. (1)
10.2	Amendment No. 2 to Mineral Lease, effective as of June 1, 2011 (2)
10.3	Amendment No. 3 to Mineral Lease, effective as of July 1, 2011 (2)
10.4	Chairman Agreement dated as of November 1, 2010, between Contango ORE, Inc. and Kenneth R. Peak (1)
10.5	Form of 2010 Equity Compensation Plan (1)
10.6	Contribution Agreement, dated as of November 1, 2010, between Contango Oil & Gas Company and Contango ORE, Inc. (1)
10.7	Amended and Restated Professional Services Agreement, dated as of November 1, 2010, between Avalon Development Corporation and Contango ORE, Inc. (1)
10.8	Consulting Agreement, dated as of October 15, 2010, between Mr. Donald Adams and Contango ORE, Inc. (2)
10.9	Revolving Line of Credit Promissory Note dated as of November 10, 2011, between Contango ORE, Inc. and Contango Oil & Gas Company. (3)
10.10	Securities Purchase Agreement, dated as of March 22, 2012, between Contango ORE, Inc. and the Purchasers named therein. (4)
10.11	Registration Rights Agreement, dated as of March 22, 2012, between Contango ORE, Inc. and the Purchasers named therein. (4)
10.12	Advisory Agreement, dated as of September 6, 2012, between Contango ORE, Inc. and Juneau Exploration L.P. †
14.1	Code of Ethics †
31.1	Section 302 CEO Certification †
31.2	Section 302 CFO Certification †
32.1	Section 906 CEO Certification †
32.2	Section 906 CFO Certification †
99.1	Schedule of Gold Properties (Excluding Tetlin Lease) (2)
99.2	Schedule of REE Properties (2)
99.3	Report of Behre Dolbear & Company (USA) (5)
101	Interactive Data Files †

† Filed herewith

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1	Filed as an exhibit to the Company's report on Amendment No. 2 to Registration Statement on Form 10, as filed with the Securities and Exchange Commission on November 26, 2010.
2	Filed as an exhibit to the Company's annual report on Form 10-K for the fiscal year ended June 30, 2011, as filed with the Securities and Exchange Commission on September 19, 2011.
3	Filed as an exhibit to the Company's report on Form 10-Q for the three months ended September 30, 2011, as filed with the Securities and Exchange Commission on November 14, 2011.
4	Filed as an exhibit to the Company's report on Form 8-K, as filed with the Securities and Exchange Commission on March 27, 2012.
5	Filed as an exhibit to the Company's report on Form 10-Q for the three months ended December 31, 2011, as filed with the Securities and Exchange Commission on February 6, 2012.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CONTANGO ORE, INC.

/s/ BRAD JUNEAU	/s/ SERGIO CASTRO	/s/ YAROSLAVA MAKALSKAYA
Brad Juneau President and Acting Chief Executive Officer (principal executive officer)	Sergio Castro Chief Financial Officer (principal financial officer)	Yaroslava Makalskaya Chief Accounting Officer (principal accounting officer)

Pursuant to the requirements of the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ BRAD JUNEAU BRAD JUNEAU	President, Acting Chief Executive Officer and Director	September 11, 2012
/s/ JOSEPH COMPOFELICE JOSEPH COMPOFELICE	Director	September 11, 2012
/s/ JOSEPH GREENBERG JOSEPH GREENBERG	Director	September 11, 2012

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CONTANGO ORE, INC.
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Contango ORE, Inc.

We have audited the accompanying balance sheets of Contango ORE, Inc. (an exploration stage company) (the "Company") as of June 30, 2012 and 2011, and the related statements of operations, shareholders' equity and cash flows for each of the three years in the period ended June 30, 2012 and from Inception (October 15, 2009) to June 30, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above presents fairly, in all material respects, the financial position of Contango ORE, Inc. as of June 30, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2012 and from Inception (October 15, 2009) to June 30, 2012 in conformity with accounting principles generally accepted in the United States of America.

/s/ UHY LLP
Houston, Texas
September 11, 2012

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CONTANGO ORE, INC.
(An Exploration Stage Company)
BALANCE SHEETS

	June 30, 2012	2011
ASSETS		
CURRENT ASSETS:		
Cash	$7,765,265	$2,395,100
Prepaid expenses	138,029	78,158
Total current assets	7,903,294	2,473,258
PROPERTY AND EQUIPMENT:		
Mineral properties	1,008,886	1,008,886
Accumulated depreciation, depletion and amortization	—	—
Total property and equipment, net	1,008,886	1,008,886
OTHER ASSETS:		
Other	225,000	75,000
TOTAL ASSETS	$9,137,180	$3,557,144
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$1,728,664	$488,356
Accrued liabilities	73,000	156,408
Total current liabilities	1,801,664	644,764
COMMITMENTS AND CONTINGENCIES (NOTE 11)		
SHAREHOLDERS' EQUITY:		
Common Stock, $0.01 par value, 30,000,000 shares authorized; 2,480,269 shares issued and outstanding at June 30, 2012; 1,566,467 shares issued and outstanding at June 30, 2011	24,803	15,665
Additional paid-in capital	15,527,205	6,853,515
Accumulated deficit during exploration stage	(8,216,492)	(3,956,800)
SHAREHOLDERS' EQUITY	7,335,516	2,912,380
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$9,137,180	$3,557,144

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

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CONTANGO ORE, INC.
(An Exploration Stage Company)
STATEMENTS OF OPERATIONS

	Year Ended June 30,			
	2012	2011	2010	Period from Inception (October 15, 2009) to June 30, 2012
EXPENSES:				
Claim rentals and minimum royalties	$198,797	$281,418	$192,712	$672,927
Exploration expenses	3,501,884	2,271,088	877,762	6,650,734
Other operating expenses	28,898	87,167	30,485	146,550
Stock-based compensation expense	192,884	63,681	—	256,565
General and administrative expenses	337,229	150,810	1,677	489,716
Total expenses	4,259,692	2,854,164	1,102,636	8,216,492
NET LOSS	$4,259,692	$2,854,164	$1,102,636	$8,216,492
LOSS PER SHARE				
Basic and diluted	$2.35	$1.82	$0.70	$4.96
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING				
Basic and diluted	1,814,072	1,566,467	1,566,467	1,657,393

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

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CONTANGO ORE, INC.
(An Exploration Stage Company)
STATEMENTS OF CASH FLOWS

	Year Ended June 30, 2012	2011	2010	Period from Inception (October 15, 2009) to June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss	$(4,259,692)	$(2,854,164)	$(1,102,636)	$(8,216,492)
Adjustments to reconcile net loss to net cash used in operating activities:				
Stock-based compensation	251,210	84,908	—	336,118
Changes in operating assets and liabilities:				
Decrease (increase) in prepaid expenses	(59,871)	155,110	(233,268)	(138,029)
Increase in accounts payable and other accrued liabilities	1,156,900	133,608	511,156	1,801,664
Net cash used in operating activities	(2,911,453)	(2,480,538)	(824,748)	(6,216,739)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Acquisition of other assets	(150,000)	(75,000)	—	(225,000)
Acquisition of properties	—	—	(1,008,886)	(1,008,886)
Net cash used in investing activities	(150,000)	(75,000)	(1,008,886)	(1,233,886)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Shareholders' contributions	—	4,950,638	1,833,634	6,784,272
Common stock issuance, net	8,431,618	—	—	8,431,618
Short-term borrowings	500,000	—	—	500,000
Repayment of short-term borrowings	(500,000)	—	—	(500,000)
Net cash provided by financing activities	8,431,618	4,950,638	1,833,634	15,215,890
NET INCREASE IN CASH AND CASH EQUIVALENTS	5,370,165	2,395,100	—	7,765,265
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	2,395,100	—	—	—
CASH AND CASH EQUIVALENTS, END OF PERIOD	$7,765,265	$2,395,100	$—	$7,765,265
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest	$14,917	$—	$—	$14,917

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

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CONTANGO ORE, INC.
(An Exploration Stage Company)
STATEMENT OF SHAREHOLDERS' EQUITY

	Common Stock		Additional paid-in Capital	Accumulated Deficit Exploration Stage	Total Shareholders' Equity
	Shares	Amount			
Balance at Inception (October 15, 2009)	—	$—	$—	$—	$—
Shareholders' contribution	1,566,467	$15,665	$1,817,969	$—	$1,833,634
Net loss for the period	—	$—	$—	$(1,102,636)	$(1,102,636)
Balance at June 30, 2010	1,566,467	$15,665	$1,817,969	$(1,102,636)	$730,998
Shareholders' contribution	—	—	4,950,638	—	4,950,638
Stock-based compensation	—	—	84,908	—	84,908
Net loss for the period	—	—	—	(2,854,164)	(2,854,164)
Balance at June 30, 2011	1,566,467	$15,665	$6,853,515	$(3,956,800)	$2,912,380
Stock-based compensation	—	—	251,210	—	251,210
Shares vested	31,302	313	(313)		—
Issuance of common stock, net	882,500	8,825	8,422,793		8,431,618
Net loss for the period	—	—	—	(4,259,692)	(4,259,692)
Balance at June 30, 2012	2,480,269	$24,803	$15,527,205	$(8,216,492)	$7,335,516

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

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CONTANGO ORE, INC.
(An Exploration Stage Company)
NOTES TO FINANCIAL STATEMENTS
1. Organization and Business
Contango ORE, Inc. (“CORE” or the “Company”) is a Houston-based, exploration stage company. The Company was formed on September 1, 2010 as a Delaware corporation for the purpose of engaging in the exploration for (i) gold and associated minerals and (ii) rare earth elements in the state of Alaska.
On November 29, 2010, Contango Mining Company (“Contango Mining”), a wholly owned subsidiary of Contango Oil & Gas Company (“Contango”), assigned the Properties (defined below) and certain other assets and liabilities to Contango. Contango contributed the Properties and $3.5 million of cash to the Company, in exchange for approximately 1.6 million shares of the Company’s common stock. The above transactions occurred between companies under common control. Contango subsequently distributed the Company’s common stock to Contango’s stockholders. The Company had no operating history prior to the contribution of assets and liabilities by Contango.
The financial statements of the Company include the financial position, results of operations, and cash flows of Contango Mining since Contango Mining’s inception on October 15, 2009 (the “Inception”). The equity structure (i.e. the number and type of equity interests issued), however, was retroactively adjusted to reflect the capital structure of the Company.
The Company is an exploration stage company as defined by Accounting Standards Codification (“ASC”) 915, “Development Stage Entities.” An investment in the Company involves a high degree of risk. The Company’s fiscal year end is June 30.
As of June 30, 2012, the Company held a 100% leasehold interest in 675,000 acres from the Tetlin Village Council, the council formed by the governing body for the Native Village of Tetlin, an Alaska Native Tribe (“Tetlin Lease”). The Tetlin Lease has a ten year term beginning July 2008 with an option to renew 50% of the acreage for an additional ten years, or so long as we continue conducting mining operations on the Tetlin Lease.
Additionally, the Company holds 18,560 acres in unpatented mining claims from the state of Alaska for the exploration of gold and associated minerals (together with the Tetlin Lease, the “Gold Properties”). The Company also holds interests in and to 3,440 acres in unpatented Federal mining claims and 97,280 acres in unpatented mining claims from the state of Alaska for the exploration of rare earth elements (the “REE Properties”, and together with the Gold Properties, the “Properties”). If any of the Properties are placed into commercial production, the Company would be obligated to pay a 3% overriding royalty to Juneau Exploration LLC (“JEX”).
2. Basis of Presentation
The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). In the opinion of management, these financial statements include all adjustments considered necessary for a fair presentation of the financial statements. All such adjustments are of a normal recurring nature.
Financial statements for the periods from October 15, 2009 to November 29, 2010 represent financial statements of Contango Mining. All assets and liabilities contributed to the Company from Contango Mining on November 29, 2010 were recorded at the carryover historical cost basis.
3. Summary of Significant Accounting Policies
The Company’s significant accounting policies are described below.
Management Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
Cash Equivalents. Cash equivalents are considered to be highly liquid securities having an original maturity of 90 days or less at the date of acquisition.

Revenue Recognition. CORE has yet to realize any revenues. Expenses are presented on the accrual basis of accounting.

Capitalized Costs. The amount capitalized includes costs paid to acquire mineral property interests as well as the costs paid for Federal and state of Alaska unpatented mining claims. Exploration costs are expensed as incurred. Development costs are expensed as incurred until the Company obtains proven and probable reserves within its commercially minable properties.

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Costs of abandoned projects are charged to earnings upon abandonment. Properties determined to be impaired are written-down to their estimated fair value. The Company periodically evaluates whether events or changes in circumstances indicate that the carrying value of mineral property interests and any related property, plant and equipment may not be recoverable.

Common Stock. The Company's certificate of incorporation authorizes us to issue up to 30,000,000 shares of common stock, $0.01, par value. As of June 30, 2012, approximately 2.5 million shares of common stock were issued and outstanding, all of which were fully paid and non-assessable. Holders of common stock are entitled to one vote for each share held of record on all matters to be voted on by stockholders and are not entitled to cumulative voting for the election of directors. Upon the liquidation, dissolution or winding up of our business, after payment of all liabilities and payment of preferential amounts to the holders of preferred stock, if any, the shares of common stock are entitled to share equally in our remaining assets. Pursuant to our certificate of incorporation, no stockholder has any preemptive rights to subscribe for our securities. The common stock is not subject to redemption. The Company's equity structure for all periods prior to November 29, 2010 was retroactively adjusted to reflect the equity structure of the Company.

Stock-Based Compensation. The Company applies the fair value based method to account for stock-based compensation. Under this method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the award vesting period. The fair value of each award is estimated as of the date of grant using the Black-Scholes option-pricing model.

Reclassifications. Certain prior period amounts have been reclassified to conform to current year presentation. These reclassifications were not material and had no effect on cash flows or net loss.

Income Taxes. The Company follows the liability method of accounting for income taxes under which deferred tax assets and liabilities are recognized for the future tax consequences of (i) temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements and (ii) operating loss and tax credit carry-forwards for tax purposes. Deferred tax assets are reduced by a valuation allowance when, based upon management's estimates, it is more likely than not that a portion of the deferred tax assets will not be realized in a future period. The Company recognized a full valuation allowance as of June 30, 2012 and 2011 and has not recognized any tax provision or benefit for the applicable period. The Company reviews its tax positions quarterly for tax uncertainties. The Company did not have any uncertain tax positions as of June 30, 2012 or 2011.

The Company files income tax returns in the United States and certain state jurisdictions. The Company's tax returns through fiscal year 2012 remain open for examination by taxing authorities in the respective jurisdictions where those returns are filed.

Recently Issued Accounting Pronouncements

We have reviewed all recently issued, but not yet effective, accounting pronouncements and do not believe that the future adoption of any such pronouncements will cause a material impact on our financial condition or the results of our operations.

4. Costs Incurred

Costs to acquire and explore the Properties were as follows:

	Year Ended June 30,			
	2012	2011	2010	Period from Inception (October 15, 2009 to June 30, 2012
Acquisition of mineral interests	$—	$—	$1,008,886	$1,008,886
Exploration costs and claim rentals	3,700,681	2,552,506	1,070,474	7,323,661
Total costs incurred	$3,700,681	$2,552,506	$2,079,360	$8,332,547

5. Prepaid Expenses

The Company’s prepaid expenses of $138,029 and $78,158 as of June 30, 2012 and 2011, respectively, relate to claim rentals and certain geological consulting services and exploration activities conducted by Avalon.

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6. Other Assets

If the Tetlin Lease is placed into commercial production, the Company would be obligated to pay a production royalty to the Native Village of Tetlin, which varies from 2% to 5%, depending on the type of metal produced and the year of production. In June 2011, the Company paid the Tetlin Village Council $75,000 in exchange for reducing the production royalty payable to them by 0.25%. In July 2011, the Company paid the Tetlin Village Council $150,000 in exchange for further reducing the production royalty by 0.50%. These payments lowered the production royalty payable to a range of 1.25% to 4.25%, depending on the type of metal produced and the year of production. On or before July 15, 2020, the Tetlin Village Council has the option to increase its production royalty, if any, by (i) 0.25% by payment to CORE of $150,000, or (ii) 0.50% by payment to CORE of $300,000, or (iii) 0.75% by payment to CORE of $450,000. The Company has classified these payments as "Other Assets" in the financial statements of the Company.

7. Loss Per Share

A reconciliation of the components of basic and diluted net loss per share of common stock is presented in the tables below.

	Year Ended June 30, 2012		
	Loss	Weighted Average Shares	Per Share
Basic Loss per Share:			
Net loss attributable to common stock	$(4,259,692)	1,814,072	$(2.35)
Diluted Loss per Share:			
Net loss attributable to common stock	$(4,259,692)	1,814,072	$(2.35)

	Year Ended June 30, 2011		
	Loss	Weighted Average Shares	Per Share
Basic Loss per Share:			
Net loss attributable to common stock	$(2,854,164)	1,566,467	$(1.82)
Diluted Loss per Share:			
Net loss attributable to common stock	$(2,854,164)	1,566,467	$(1.82)

	Year Ended June 30, 2010		
	Loss	Weighted Average Shares	Per Share
Basic Loss per Share:			
Net loss attributable to common stock	(1,102,636)	1,566,467	(0.70)
Diluted Loss per Share:			
Net loss attributable to common stock	(1,102,636)	1,566,467	(0.70)

	Period from Inception (October 15, 2009) to June 30, 2012		
	Loss	Weighted Average Shares	Per Share
Basic Loss per Share:			
Net loss attributable to common stock	$(8,216,492)	1,657,393	$(4.96)

Diluted Loss per Share:			
Net loss attributable to common stock	$(8,216,492)	1,657,393	$(4.96)

Options to purchase 50,000 shares of common stock were outstanding as of June 30, 2012, but were not included in the computation of diluted earnings per share for the fiscal year ended June 30, 2012, due to being anti-dilutive as a result of the Company's net loss for all periods.

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8. Shareholders' Equity

The Company's authorized capital stock consists of 30,000,000 shares of common stock and 15,000,000 shares of preferred stock. As of June 30, 2012, we had 2,480,269 shares of common stock outstanding and an additional 112,604 shares of restricted stock and stock options outstanding. No shares of preferred stock have been issued.
On November 29, 2010, the Company issued approximately 1.6 million shares of common stock to Contango for distribution to Contango's stockholders of record as of October 15, 2010 on the basis of one share of common stock for each ten (10) shares of Contango's common stock then outstanding in exchange for the assignment by Contango Mining of all of its assets and liabilities, together with $3.5 million in cash to the Company pursuant to the terms of a Contribution Agreement between Contango and the Company (the "Contribution Agreement"). The Company's equity structure for the periods prior to November 29, 2010 was retroactively adjusted to reflect the equity structure of the Company as of November 29, 2010.

On March 26, 2012, the Company completed the sale of 882,500 shares of Common Stock to accredited investors at a price of $10.00 per share in a private placement for total proceeds of approximately $8.8 million, including 400,000 shares that were purchased by Mr. Peak, the Company's Chairman and Chief Executive Officer. The placement agents used in connection with the transaction received aggregate placement fees and expenses of approximately $0.4 million. After repaying approximately $0.5 million of short-term debt under the Company's Revolving Line of Credit Promissory Note with Contango, the Company will use the remaining $7.9 million to fund its 2012 exploration program in Alaska, estimated at $6.75 million, and for general corporate purposes. The shares of Common Stock sold were not registered under the Securities Act of 1933, as amended, but are subject to a Registration Rights Agreement allowing the shares to be registered by the holders at a future date.

9. Line of Credit

On November 10, 2011, the Company entered into a $1.0 million Revolving Line of Credit Promissory Note with Contango (the "CORE Note"). The Company and Contango share common executive officers. The CORE Note contains covenants limiting our ability to enter into additional indebtedness and prohibiting liens on any of our assets or properties. Borrowings under the CORE Note bear interest at 10% per annum. Principal and interest are due on December 31, 2012, and may be prepaid at any time with no prepayment penalty.

On March 30, 2012, the Company repaid the $500,000 it had borrowed under the CORE Note, plus accrued interest of $14,917 from the proceeds of the equity offering. As of June 30, 2012, there were no amounts outstanding under the CORE Note. The Company may re-borrow any portion of the $1.0 million through December 31, 2012.

10. Stock Based Compensation

On September 15, 2010, the Company's Board of Directors (the "Board") adopted the Contango ORE, Inc. Equity Compensation Plan (the "2010 Plan"), which was approved by shareholders on December 8, 2011. Under the 2010 Plan, the Board may issue up to 1,000,000 shares of common stock and options to officers, directors, employees or consultants of the Company. The maximum aggregate number of shares of common stock of the Company with respect to which grants may be made to any individual is 100,000 shares during any calendar year. Awards made under the 2010 Plan are subject to such restrictions, terms and conditions, including forfeitures, if any, as may be determined by the Board. As of June 30, 2012, there were 62,604 restricted shares outstanding and 50,000 options outstanding issued under the 2010 Plan.
Stock-based compensation expense for the periods reflected was as follows:

	Year Ended June 30,		
	2012	2011	2010
Stock-based compensation included in:			
Exploration expenses (1)	$58,326	$21,227	$—

Stock-based compensation expense (2)	192,884	63,681	—
Total stock-based compensation expense	$ 251,210	$ 84,908	$ —

(1) Related to restricted stock and stock option awards to the Company's technical consultant
(2) Related to the restricted stock and stock option awards to the Company's directors and employees.

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Restricted Stock

In November 2010, the Company granted 70,429 restricted shares of common stock to its officers and directors and an additional 23,477 restricted shares to its technical consultant, the owner of Avalon Development Corporation, an Alaska-domiciled domestic corporation (“Avalon”). All shares of restricted stock vest over a three year period, beginning in November 2011, the one-year anniversary of when the restricted stock was issued. Compensation expense related to these shares will be recognized over the vesting period. A summary of the Company’s restricted stock as of June 30, 2012 and the change during the year then ended, is as follows:

	Number of Shares	Weighted Average Fair Value Per Share
Nonvested balance at June 30, 2010	—	$—
Granted	93,906	4.65
Vested	—	—
Forfeited	—	—
Nonvested balance at June 30, 2011	93,906	$4.65
Granted	—	—
Vested	(31,302)	4.65
Forfeited	—	—
Nonvested balance at June 30, 2012	62,604	$4.65

As of June 30, 2012, the total compensation cost related to nonvested awards not yet recognized was $206,202. The remaining costs are expected to be recognized over the next 1.5 years.

Stock Options

In September 2011, the Company granted an aggregate of 50,000 options to its officers, directors and the owner of Avalon at a weighted-average exercise price of $13.13 per share pursuant to the 2010 Plan, to be expensed over the vesting period which is one-third immediately; one-third in September 2012; and one-third in September 2013. The option awards are for services performed during the fiscal year ended June 30, 2011. Under the 2010 Plan, options granted must have an exercise price equal to or greater than the market price of the Company’s common stock on the date of grant. The Company may grant key employees both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and stock options that are not qualified as incentive stock options. Stock option grants to non-employees, such as directors and consultants, may only be stock options that are not qualified as incentive stock options. Options generally expire after five years. As of June 30, 2012, the stock options had a weighted-average remaining life of 4.2 years.

The Company applies the fair value method to account for stock option expense. Under this method, cash flows from the exercise of stock options resulting from tax benefits in excess of recognized cumulative compensation cost (excess tax benefits) are classified as financing cash flows. See Note 3—“Summary of Significant Accounting Policies”. All employee stock option grants are expensed over the stock option’s vesting period based on the fair value at the date the options are granted. The fair value of each option is estimated as of the date of grant using the Black-Scholes options-pricing model.

A summary of the status of stock options granted under the 2010 Plan as of June 30, 2012 and changes during the year then ended, is presented in the table below:

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	For the Year ended June 30, 2012	
	Shares Under Options	Weighted Average Exercise Price
Outstanding, beginning of period	—	$—
Granted	50,000	$13.13
Exercised	—	$—
Forfeited	—	$—
Outstanding, end of period	50,000	$13.13
Aggregate intrinsic value	2,450	
Exercisable, end of the period	16,667	$13.13
Aggregate intrinsic value	817	
Available for grant, end of period	856,094	
Weighted average fair value of options granted during the period (1)	3.38	

(1) The fair value of each option is estimated as of the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants during the year ended June 30, 2012: (i)risk-free rate of 0.42 percent; (ii)expected life of 3 years; (iii) expected volatility of 40 percent; and (iv) expected dividend yield of zero percent.

11. Commitments and Contingencies

Tetlin Lease. Pursuant to the terms of the Tetlin Lease, the Company is required to spend $350,000 per year until July 15, 2018 in exploration costs. However, the Company's exploration expenditures through the 2011 exploration program have satisfied this requirement because exploration funds spent in any year in excess of $350,000 are credited toward future years' exploration cost requirements. Additionally, should we derive revenues from the properties covered under the Tetlin Lease, the Company is required to pay the Tetlin Village Council a production royalty ranging from 2.0% to 5.0%, depending on the type of metal produced and the year of production. As of June 30, 2012, the Company had paid the Tetlin Village Council $225,000 in exchange for reducing the production royalty payable to them by 0.75%. These payments lowered the production royalty to a range of 1.25% to 4.25%. On or before July 15, 2020, the Tetlin Village Council has the option to increase their production royalty by (i) 0.25% by payment to CORE of $150,000, (ii) 0.50% by payment to CORE of $300,000, or (iii) 0.75% by payment to CORE of $450,000. Until such time as production royalties begin, the Company pays the Tetlin Village Council an advance minimum royalty of $50,000 per year. On July 15, 2012, the advance minimum royalty increased to $75,000 per year, and subsequent years are escalated by an inflation adjustment.

Gold Properties. The Company's Triple Z and TOK/Tetlin claims are both located on state of Alaska lands. The annual claim rentals on these two projects total $12,140 per year, and are due and payable in full by November 30 of each year. The Company has met the annual labor requirements for the Triple Z and TOK/Tetlin claims for the next four years.

REE Properties. The Company's Stone Rock and Salmon Bay projects are both located on Federal land. The claim rentals on these two projects total $24,080 per year, and are due and payable in full by August 31 of each year. The Company's Swift , Wolf, and Alatna projects are all located on state of Alaska lands. The claim rentals on these three projects total $61,880 per year, and are due and payable in full by November 30 of each year. Additionally, these three claims also have an annual labor payment totaling $176,800 payable by November 30 of each year, unless the Company meets certain spending requirements for exploration work. The Company's Spooky project is located on state of Alaska lands, but annual claim rental is not currently required. The Company is considering abandoning these state of Alaska claims effective December 1, 2012 to devote more time and resources to our Stone Rock and Salmon Bay projects and our Gold Properties.

We will also pay JEX an overriding royalty of 3% should we derive revenues from any of the existing Properties and an overriding royalty of 2% should we derive revenues from properties acquired after July 1, 2012.

In connection with acquiring all the assets and liabilities of Contango Mining, the Company has assumed any claims, litigation or disputes pending as of the effective date on any matters arising in connection with ownership of the Properties prior to the effective date. The Company is not aware of any legal, environmental or other commitments or contingencies that would have a material effect on the Company’s financial position or results of operations.

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12. Income Taxes

	Year Ended June 30,			
	2012	2011	2010	Period from Inception (October 15, 2009 to June 30, 2012
Provision (benefit) at statutory tax rate	$(1,490,892)	$(998,957)	$(385,923)	$(2,875,772)
Permanent differences	—	48,826	11,296	60,122
Valuation allowance	1,490,892	950,131	374,627	2,815,650
Income tax provision	$—	$—	$—	$—

The benefit for income taxes for the periods indicated below are comprised of the following:

	Year Ended June 30,			
	2012	2011	2010	Period from Inception (October 15, 2009 to June 30, 2012
Current:				
Federal	$—	$—	$—	$—
Deferred:				
Federal	$—	$—	$—	$—

The net deferred tax asset is comprised of the following:

	Year Ended June 30,	
	2012	2011
Deferred tax asset:		
Capitalized exploration expenses	$2,452,896	$1,268,004
Stock Option Expenses	89,798	22,289
Net operating losses	272,956	34,465
Valuation allowance	(2,815,650)	(1,324,758)
Net deferred tax assets	$—	$—

These federal net operating loss carry-forwards will begin expiring in 2031.

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13. Related Party Transactions

In August 2012, Mr. Brad Juneau, the sole manager of the general partner of Juneau Exploration LLC ("JEX"), was elected to the Board of Directors of the Company and elected as President and Acting Chief Executive Officer of the Company following a medical leave of absence of our Chairman, Mr. Peak. JEX is a private company formed primarily for the purpose of generating natural gas and oil prospects. JEX was responsible for securing and negotiating the Tetlin Lease and assisting in obtaining the Properties and initially engaged Avalon to conduct mineral exploration activities on the Tetlin Lease.

Contango Mining Company ("Contango Mining"), the predecessor to the Company, was formed in October 2009 for the purpose of engaging in exploration in the state of Alaska for (i) gold ore and associated minerals and (ii) rare earth elements. Contango Mining initially acquired a 50% interest in the Properties from JEX in exchange for $1 million and a 1% overriding royalty interest ("ORRI") in the Properties under a Joint Exploration Agreement (the “Joint Exploration Agreement”). We estimate that JEX expended approximately $1 million on exploratory activities and related work on the Properties prior to selling the initial 50% interest to Contango Mining. Contango Mining also agreed to reimburse JEX for the next $2 million of exploration costs. During the fiscal year ended June 30, 2011 and 2010, Contango Mining paid JEX approximately $0.9 million and $0.5 million, respectively, for exploration costs incurred by JEX in the state of Alaska.

In September 2010, Contango Mining acquired the remaining 50% interest in the properties by increasing the ORRI granted to JEX to 3% in the Properties. Contango Mining assumed control of the exploration activities and JEX and Contango Mining terminated the Joint Exploration Agreement.

In September 2010, Contango Mining assigned the Properties and certain other assets and liabilities to Contango. On November 29, 2010, Contango contributed the Properties and $3.5 million of cash to the Company, pursuant to the terms of a Contribution Agreement (the “Contribution Agreement”), in exchange for all of the shares of the Company’s common stock in an amount equal to one share of common stock for each ten (10) shares of Contango's common stock then outstanding. Contango distributed all of the Company’s common stock to Contango’s stockholders of record as of October 15, 2010. The transactions above took place between companies under common control. Contango and the Company share the same executive management team.

In September 2012, the Company and JEX entered into an Advisory Agreement in which JEX will continue to provide assistance in acquiring additional properties in Alaska in exchange for an ORRI of 2% of 8/8ths in newly acquired properties.

On March 26, 2012, the Company completed the sale of 882,500 shares of Common Stock to accredited investors at a price of $10.00 per share in a private placement for total proceeds of approximately $8.8 million, including 400,000 shares that were purchased by Mr. Peak, the Company’s Chairman.

The Company currently does not lease office space, but rather uses the corporate offices leased by Contango. Contango’s 60 month lease agreement at 3700 Buffalo Speedway, Ste 960, Houston, TX 77098 expires on December 31, 2015.

14. Subsequent Events

The Company is currently working to acquire additional acreage in the state of Alaska. Accordingly, the Company has paid Chief Danny $15,000 for his assistance in identifying and and helping to acquire such acreage.

In July 2012, the Company granted 75,000 stock options to its directors and officers and an additional 25,000 stock options to its technical consultant. These options vest over 2 years, beginning in July 2012, the date of the grant. The fair value of the options was estimated as of the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: (i) risk-free rate of 0.69 percent; (ii)expected life of 3 years; (iii) expected volatility of 106.5 percent; and (iv) expected dividend yield of zero percent.

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CONTANGO ORE, INC.
QUARTERLY RESULTS OF OPERATIONS (Unaudited)
Quarterly Results of Operations. The following table sets forth the results of operations by quarter for the years ended June 30, 2012, 2011 and 2010:

	Quarter Ended			
	Sept. 30,	Dec. 31,	Mar. 31,	June 30,
Fiscal Year 2012:				
Net loss	1,650,170	492,480	243,079	1,873,963
Basic and diluted loss per share	1.05	0.31	0.15	0.76
Fiscal Year 2011:				
Net loss	$862,128	$296,237	$140,394	$1,555,405
Basic and diluted loss per share	$0.55	$0.19	$0.09	$0.99
Fiscal Year 2010:				
Net loss	n/a	$267,435	$306,134	$529,067
Basic and diluted loss per share	n/a	$0.17	$0.20	$0.34