NATURAL ALTERNATIVES INTERNATIONAL INC
Form 10-Q
November 13, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT

pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008

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.)**
1185 Linda Vista Drive	
San Marcos, California 92078	**(760) 744-7340**
(Address of principal executive offices)	**(Registrant s telephone number)**

Indicate by check mark whether Natural Alternatives International, Inc. (NAI) (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that NAI was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ No

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

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

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

As of November 13, 2008, 7,060,940 shares of NAI s common stock were outstanding, net of 180,941 treasury shares.

TABLE OF CONTENTS

Table of Contents

SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

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

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

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

development of new products, brands and marketing strategies;

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

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

inventories and the adequacy and intended use of our facilities;

current or future customer orders;

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

management s goals and plans for future operations;

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

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

personnel;

- the outcome of regulatory, tax and litigation matters;
- sources and availability of raw materials;
- operations outside the United States;
- the adequacy of reserves and allowances;
- overall industry and market performance;
- competition;
- current and future economic and political conditions;
- the impact of accounting pronouncements; and
- other assumptions described in this report underlying or relating to any forward-looking statements.

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

Table of Contents

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

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NATURAL ALTERNATIVES INTERNATIONAL, INC.

Condensed Consolidated Balance Sheets

(Amounts in thousands, except share and per share data)

	September 30, 2008 (Unaudited)	June 30, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 3,066	$ 3,518
Certificate of deposit	699	
Accounts receivable - less allowance for doubtful accounts of $17 at September 30, 2008 and June 30, 2008	3,881	6,401
Inventories, net	15,842	14,135
Deferred income taxes	746	746
Income tax receivable	2,189	1,354
Prepaids and other current assets	1,195	1,223
Current assets of discontinued operations	2,908	6,379
Total current assets	30,526	33,756
Property and equipment, net	13,566	12,823
Deferred income taxes	271	271
Other noncurrent assets, net	160	160
Total assets	$ 44,523	$ 47,010
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 6,348	$ 7,245
Accrued liabilities	1,092	1,048
Accrued compensation and employee benefits	1,581	1,332
Income taxes payable	356	409
Line of credit	595	
Current portion of long-term debt	2,363	2,730
Current liabilities of discontinued operations	2,121	2,882
Total current liabilities	14,456	15,646
Deferred rent	1,139	1,164
Long-term pension liability	211	198
Total liabilities	15,806	17,008
Commitments and contingencies		
Stockholders equity:		
Preferred stock; $0.01 par value; 500,000 shares authorized; none issued or Outstanding		

Common stock; $0.01 par value; 20,000,000 shares authorized; issued and outstanding 7,222,604 at September 30, 2008 and 7,210,937 at June 30, 2008		71	71
Additional paid-in capital		18,597	18,485
Accumulated other comprehensive loss		(261)	(261)
Retained earnings		11,409	12,806
Treasury stock, at cost, 180,941 shares at September 30, 2008 and June 30, 2008		(1,099)	(1,099)
Total stockholders equity		28,717	30,002
Total liabilities and stockholders equity	$	44,523	$ 47,010

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NATURAL ALTERNATIVES INTERNATIONAL, INC.

Condensed Consolidated Statements of Operations and Comprehensive (Loss) Income

(Amounts in thousands, except share and per share data)

(Unaudited)

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007
Net sales	$ 19,526	$ 22,885
Cost of goods sold	17,126	18,945
Gross profit	2,400	3,940
Selling, general & administrative expenses	2,618	2,892
Operating (loss) income from continuing operations	(218)	1,048
Other income (expense):		
Interest income	5	2
Interest expense	(43)	(143)
Foreign exchange (loss) gain	(299)	102
Other, net	24	28
	(313)	(11)
(Loss) income from continuing operations before income taxes	(531)	1,037
(Benefit) provision for income taxes	(182)	286
(Loss) income from continuing operations	(349)	751
Loss from discontinued operations, net of tax	(1,048)	(328)
Net (loss) income	$ (1,397)	$ 423
Unrealized gain resulting from change in fair value of derivative instruments, net of tax		7
Comprehensive (loss) income	$ (1,397)	$ 430
Net (loss) income per common share:		
Basic:		
Continuing operations	$ (0.05)	$ 0.11
Discontinued operations	(0.15)	(0.05)
Net (loss) income	$ (0.20)	$ 0.06
Diluted:		
Continuing operations	$ (0.05)	$ 0.11
Discontinued operations	(0.15)	(0.05)
Net (loss) income	$ (0.20)	$ 0.06
Weighted average common shares outstanding:		

Basic	7,033,213	6,914,114
Diluted	7,033,213	7,021,691

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NATURAL ALTERNATIVES INTERNATIONAL, INC.

Condensed Consolidated Statements Of Cash Flows

(Dollars in thousands)

(Unaudited)

	Three Months Ended September 30, 2008	2007
Cash flows from operating activities		
(Loss) income before discontinued operations	$ (349)	$ 751
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	789	754
Non-cash compensation	69	95
Tax benefit from exercise of stock options	(17)	(64)
Deferred income taxes		226
Pension expense, net of contributions	13	12
Loss on disposal of assets	8	
Changes in operating assets and liabilities:		
Accounts receivable	2,521	(1,530)
Inventories, net	(1,707)	235
Other assets	27	(129)
Accounts payable and accrued liabilities	(878)	(883)
Income taxes payable	(871)	600
Accrued compensation and employee benefits	249	(163)
Net cash used by operating activities from continuing operations	(146)	(96)
Net cash provided by operating activities from discontinued operations	(494)	124
Net cash (used in) provided by operating activities	(640)	28
Cash flows from investing activities		
Capital expenditures	(1,540)	(325)
Purchase of certificate of deposit	(699)	
Net cash used by investing activities from continuing operations	(2,239)	(325)
Net cash provided by (used in) investing activities from discontinued operations, including proceeds from the sale of As We Change	2,155	(1)
Net cash used by investing activities	(84)	(326)
Cash flows from financing activities		
Net borrowings on line of credit	595	41
Payments on long-term debt	(366)	(441)
Tax benefit from exercise of stock options	17	64
Repurchase of common stock		(724)
Proceeds from issuance of common stock	26	328
Net cash provided by (used in) financing activities	272	(732)
Net decrease in cash and cash equivalents	(452)	(1,030)

Cash and cash equivalents at beginning of period	3,518	4,095
Cash and cash equivalents at end of period	$ 3,066	$ 3,065
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$ 49	$ 133
Taxes	$ 60	$

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

A. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and applicable rules and regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In management s opinion, all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows have been included and are of a normal, recurring nature. The results of operations for the three months ended September 30, 2008 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

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

Net (Loss) Income per Common Share

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

	Three Months Ended September 30,	
	2008	**2007**
Numerator		
Net (loss) income	$ (1,397)	$ 423
Denominator		
Basic weighted average common shares outstanding	7,033	6,914
Dilutive effect of stock options		108
Diluted weighted average common shares outstanding	7,033	7,022
Basic net (loss) income per common share	$ (0.20)	$ 0.06
Diluted net (loss) income per common share	$ (0.20)	$ 0.06

Shares related to stock options totalling 679,500 for the three months ended September 30, 2008, and 527,000 for the three months ended September 30, 2007, were excluded from the calculation of diluted net income per common share, as the effect of their inclusion would have been anti-dilutive.

Stock-Based Compensation

We have an equity incentive plan under which we have granted nonqualified and incentive stock options to employees, non-employee directors and consultants. We also have an employee stock purchase plan. Effective July 1, 2005, we adopted the fair value recognition provisions of

SFAS No. 123R, *Share Based Payment* (SFAS 123R), using the modified-prospective-transition method. Under that transition method, compensation cost is recognized (a) for all stock-based awards granted before, but not yet vested as of, July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, *Accounting for Stock Based Compensation*, and (b) for all stock-based awards granted after July 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Results for periods before implementation of SFAS 123R have not been restated.

We estimated the fair value of the stock option awards at the date of grant and employee stock purchase plan shares at the beginning of the offering period using the Black-Scholes option valuation model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Option valuation models require the input of highly subjective assumptions. Black-Scholes uses assumptions related to volatility, the risk-free interest rate, the dividend yield (which is assumed to be zero, as we have not paid any cash dividends) and employee exercise behavior. Expected volatilities used in the model are based mainly on the historical volatility of our stock price. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect in the period of grant. The expected life of stock option grants is derived from historical experience. Our operating income was reduced by stock based compensation expense of approximately $69,000 for the three months ended September 30, 2008, and $95,000 for the three months ended September 30, 2007.

Income Taxes

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

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

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

Adoption of New Accounting Standards

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

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

B. Discontinued Operations

On August 4, 2008, RHL sold certain assets related to its catalog and internet business conducted under the name As We Change® to Miles Kimball Company for a cash purchase price of $2,000,000. The purchase price was subject to certain post-closing adjustments based on a final accounting of the value of the assets sold to and the liabilities assumed by the buyer at the closing. As a result of the post-closing review, the purchase price was increased by $299,000, resulting in an aggregate purchase price of $2,299,000. We recorded a loss, net of tax, of $148,000 as a result of this sale and we recognized $221,000 in severance and related payroll costs during the three months ended September 30, 2008.

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

As a result of our decision to sell the legacy RHL business, we also initiated an operational consolidation program during the first quarter of fiscal 2009 that transitioned the remaining branded products business operations to our corporate offices. This operational consolidation program was substantially complete as of September 30, 2008 and resulted in a charge to discontinued operations of $630,000 in severance and other business related exit costs.

Table of Contents

The following table presents the activity and the reserve balances related to these restructuring programs for the three months ended September 30, 2008 (dollars in thousands):

	Charges to Expense	Cash Payments	Balance at September 30, 2008
Employee termination costs	$ 720	$ (14)	$ 706
Lease liabilities and related facility closure costs	131		131
Total	$ 851	$ (14)	$ 837
Accrued restructuring charges:			
Current portion continuing operations			$ 451
Discontinued operations			386
Total			$ 837

The following table summarizes the results of the legacy RHL business for the three months ended September 30 (dollars in thousands):

	2008	2007
Net sales	$ 1,374	$ 2,636
Cost of goods sold and operating expenses	1,967	3,014
Restructuring expenses	851	
Loss on the sale of As We Change®	226	
Other (income) expense	(1)	18
Loss before income taxes	(1,669)	(396)
Income tax benefit	(621)	(68)
Loss from discontinued operations	$ (1,048)	$ (328)

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

	September 30, 2008	June 30, 2008
Assets		
Cash	$ 84	$ 575
Accounts receivable, net	296	349
Inventory, net	360	805
Other current assets	13	204
Deferred income tax asset	80	80
Plant and equipment, net		351
Goodwill and intangible assets	2,075	4,015
Total assets	$ 2,908	$ 6,379
Liabilities		
Accounts payable	$	$ 678

Accrued liabilities	963	1,046
Deferred income tax liability	1,158	1,158
Total liabilities	2,121	2,882
Net assets of discontinued operations	$ 787	$ 3,497

Table of Contents

C. Inventories

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

	September 30, 2008	June 30, 2008
Raw materials	$ 11,730	$ 10,428
Work in progress	3,503	2,517
Finished goods	1,684	1,997
Reserves	(1,075)	(807)
	$ 15,842	$ 14,135

D. Property and Equipment

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

	Depreciable Life In Years	September 30, 2008	June 30, 2008
Land	N/A	$ 393	$ 393
Building and building improvements	7 39	2,727	2,723
Machinery and equipment	3 12	21,307	19,963
Office equipment and furniture	3 5	3,811	3,774
Vehicles	3	204	204
Leasehold improvements	1 15	10,340	10,283
Total property and equipment		38,782	37,340
Less: accumulated depreciation and amortization		(25,216)	(24,517)
Property and equipment, net		$ 13,566	$ 12,823

E. Debt

We have a bank credit facility of $9.9 million, comprised of a $7.5 million working capital line of credit and $2.4 million in outstanding term loans. The working capital line of credit is secured by our accounts receivable and other rights to payment, general intangibles, inventory and equipment, has an interest rate of Prime Rate or LIBOR plus 1.75%, as elected by NAI from time to time, and borrowings are subject to eligibility requirements for current accounts receivable and inventory balances. As of September 30, 2008 the outstanding balances on the term loans consisted of a $300,000, 15 year term loan due June 2011, secured by our San Marcos building, at an interest rate of 8.25%; a $600,000, 10 year term loan with a twenty year amortization, secured by our San Marcos building, at an interest rate of LIBOR plus 2.25%; a $200,000, five year term loan, secured by equipment, at an interest rate of LIBOR plus 2.10%; and a $1.3 million, four year term loan, secured by equipment, at an interest rate of LIBOR plus 2.10%. As of September 30, 2008, we had $595,000 outstanding on the working capital line of credit. Monthly payments on the term loans are approximately $121,000 plus interest.

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

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

November 1, 2007 to November 1, 2008 and the allowable contract term thereunder from November 1, 2008 to November 1, 2009. We are currently in discussions with the lender to extend the availability of our Foreign Exchange Facility.

As of September 30, 2008 and June 30, 2008, we were not in compliance with our quarterly net income financial covenant under our credit facility, which requires quarterly net income after taxes of at least $1.00. We were also not in compliance with our quarterly fixed charge coverage ratio as of September 30, 2008, which requires a quarterly fixed charge coverage ratio of no less than 1.25 to 1.0. Additionally, we were not in compliance with our annual net income financial covenant as of June 30, 2008, which required an annual fiscal year net income of at least $750,000. Our lender agreed to waive its default rights as a result of these covenant violations as of September 30, 2008, for a $25,000 waiver fee, and as of June 30, 2008. We anticipate a net after-tax loss during the second quarter of fiscal 2009 related to an expected increase in operating costs, unfavorable foreign currency fluctuations and additional severance and other exit costs associated with discontinuing our RHL operations. As a result, we do not expect to meet our net after-tax income covenant as of December 31, 2008. If we fail to meet this covenant, we intend to request a waiver from our lender but there is no assurance when or if or on what terms a waiver will be provided. Therefore, in accordance with SFAS No. 78, *Classification of Obligations that are Callable by the Creditor* (SFAS 78), we have reclassified all of our long-term debt to current at September 30, 2008 and June 30, 2008.

On September 22, 2006, NAIE, our wholly owned subsidiary, entered into a credit facility to provide it with a credit line of up to CHF 1,300,000, or approximately $1.2 million, which is the initial maximum aggregate amount that can be outstanding at any one time

Table of Contents

under the credit facility. This maximum amount was reduced by CHF 160,000, or approximately $146,000, as of December 31, 2007 and will be reduced by an additional CHF 160,000 at the end of each succeeding calendar year. On February 19, 2007, NAIE amended its credit facility to provide that the maximum aggregate amount that may be outstanding under the facility cannot be reduced below CHF 500,000, or approximately $456,000. As of September 30, 2008, there was no outstanding balance under the credit facility.

Under its credit facility, NAIE may draw amounts either as current account loan credits to its current or future bank accounts or as fixed loans with a maximum term of 24 months. Current account loans will bear interest at the rate of 5% per annum. Fixed loans will bear interest at a rate determined by the parties based on current market conditions and must be repaid pursuant to a repayment schedule established by the parties at the time of the loan. If a fixed loan is repaid early at NAIE s election or in connection with the termination of the credit facility, NAIE will be charged a pre-payment penalty equal to 0.1% of the principal amount of the fixed loan or CHF 1,000 (approximately $912), whichever is greater. The bank reserves the right to refuse individual requests for an advance under the credit facility, although its exercise of such right will not have the effect of terminating the credit facility as a whole.

The composite interest rate on all of our outstanding debt was 5.75% at September 30, 2008 and 8.25% at September 30, 2007.

F. Defined Benefit Pension Plan

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

The components included in the net periodic benefit for the periods ended September 30 were as follows (dollars in thousands):

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007
Interest cost	$ 20	$ 21
Expected return on plan assets	(7)	(27)
Net periodic benefit	$ (13)	$ (6)

G. Economic Dependency

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

	Three Months Ended September 30, 2008		2007	
	Net Sales by Customer	% of Total Net Sales	Net Sales by Customer	% of Total Net Sales
Customer 1	$ 5,401	28%	$ 9,175	40%
Customer 2	9,872	50	8,732	38
Customer 3	(a)	(a)	2,747	12
	$ 15,273	78%	$ 20,654	90%

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

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

	Three Months Ended September 30, 2008		**2007**	
	Raw Material Purchases by Supplier	**% of Total Raw Material Purchases**	**Raw Material Purchases by Supplier**	**% of Total Raw Material Purchases**
Supplier 1	$ 1,768	17%	$ 3,319	26%
Supplier 2	1,079	10	2,122	16
	$ 2,847	27%	$ 5,441	42%

10

Table of Contents

H. Segment Information

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

During the fourth quarter of fiscal 2008 we undertook a careful review of our branded products portfolio and operations. As a result of this review we decided to narrow our branded products focus and portfolio, which we expect to significantly improve our overall profitability and allow us to better pursue our growth strategies. As a result, before the end of fiscal 2008, we developed and approved a plan to sell the legacy RHL business.

On August 4, 2008, RHL sold certain assets related to its catalog and internet business conducted under the name As We Change® to Miles Kimball Company for a cash purchase price of $2,000,000. The purchase price was subject to certain post-closing adjustments based on a final accounting of the value of the assets sold to and the liabilities assumed by the buyer at the closing. As a result of the post-closing review, the purchase price was increased by $299,000, resulting in an aggregate purchase price of $2,299,000. We recorded a loss, net of tax, of $148,000 as a result of this sale and we recognized $221,000 in severance and related payroll costs during the three months ended September 30, 2008.

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

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

Our operating results by business segment were as follows (dollars in thousands):

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007
Net Sales		
Private label contract manufacturing	$ 18,742	$ 21,819
Branded products	784	1,066
	$ 19,526	$ 22,885

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007
Income from Continuing Operations		
Private label contract manufacturing	$ 1,468	$ 2,719
Branded products	50	145
Income from operations of reportable segments	1,518	2,864
Corporate expenses not allocated to segments	(1,736)	(1,816)

	$ (218)	$ 1,048

	September 30, 2008	June 30, 2008
Total Assets		
Private label contract manufacturing	$ 41,538	$ 40,569
Branded products	77	62
	$ 41,615	$ 40,631

Table of Contents

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

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

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007
United States	$ 13,193	$ 16,606
Markets outside the United States	6,333	6,279
Total net sales	$ 19,526	$ 22,885

Products manufactured by NAIE accounted for 55% of net sales in markets outside the United States for the three months ended September 30, 2008, and 38% for the three months ended September 30, 2007. No products manufactured by NAIE were sold in the United States during the three months ended September 30, 2008 and 2007.

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

	Long-Lived Assets		Total Assets		Capital Expenditures Three Months Ended	
	September 30, 2008	June 30, 2008	September 30, 2008	June 30, 2008	September 30, 2008	September 30, 2007
United States	$ 12,218	$ 11,473	$ 34,354	$ 33,196	$ 1,439	$ 297
Europe	1,779	1,781	7,261	7,435	101	28
	$ 13,997	$ 13,254	$ 41,615	$ 40,631	$ 1,540	$ 325

I. Contingencies

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

As of November 13, 2008, neither NAI nor its subsidiaries were a party to any material pending legal proceeding nor was any of their property the subject of any material pending legal proceeding.

Table of Contents

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

The following discussion and analysis is intended to help you understand our financial condition and results of operations for the three months ended September 30, 2008. You should read the following discussion and analysis together with our unaudited condensed consolidated financial statements and the notes to the condensed consolidated financial statements included under Item 1 in this report, as well as the risk factors and other information included in our 2008 Annual Report and other reports and documents we file with the SEC. Our future financial condition and results of operations will vary from our historical financial condition and results of operations described below based on a variety of factors.

Executive Overview

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

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

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

During the fourth quarter of fiscal 2008, in an effort to enhance stockholder value, improve working capital and enable us to focus on our core contract manufacturing business, we elected to narrow our branded products focus and developed a plan to sell the legacy RHL business. On August 4, 2008, RHL sold certain assets related to its catalog and internet business conducted under the name As We Change® to Miles Kimball Company for a cash purchase price of $2,000,000. The purchase price was subject to certain post-closing adjustments based on a final accounting of the value of the assets sold to and the liabilities assumed by the buyer at the closing. As a result of the post-closing review, the purchase price was increased by $299,000, resulting in an aggregate purchase price of $2,299,000. We recorded a loss, net of tax, of $148,000 as a result of this sale and recognized $221,000 in severance and related payroll costs during the three months ended September 30, 2008. We intend to market for sale legacy RHL s remaining business operations during fiscal 2009, with the exception of our Pathway to Healing® product line. The financial information presented in this report has been reclassified to reflect the legacy RHL business as discontinued operations.

As a result of our decision to sell the legacy RHL business, we also initiated an operational consolidation program during the first quarter of fiscal 2009 that transitioned the remaining branded products business operations to our corporate offices. This operational consolidation program was substantially complete as of September 30, 2008 and resulted in a charge to discontinued operations of $630,000 in severance and other business related exit costs.

During the first quarter of fiscal 2009, our net sales from continuing operations were 14.7% lower than in the first quarter of fiscal 2008. Private label contract manufacturing sales declined 14.1% due to lower volumes of existing products in existing markets sold to one of our largest customers along with the impact of unfavorable foreign currency fluctuations . This decline was partially offset by an increase in sales to one of our other largest customers and sales to new customers. Net sales from our branded products declined 26.5% in the first quarter of fiscal 2009 as compared to the first quarter of fiscal 2008 due to the continued softening of our Pathway to Healing® product line.

Our revenue concentration risk for our two largest customers remained constant at 78% as a percentage of our total sales from continuing operations for the first quarter of fiscal 2009 and the comparable prior year period. We expect our contract manufacturing revenue concentration percentage for our two largest customers to remain consistent for the remainder of fiscal 2009.

During fiscal 2008 and continuing through the first quarter of fiscal 2009, we invested substantial time and incurred substantial costs associated with hiring and training new quality assurance and other manufacturing support personnel, increased testing activity, and documentation and validation processes related to our Good Manufacturing Practices (GMPs) compliance programs. These additional expenses negatively impacted our operating income from continuing operations during these periods and we expect this trend to contuinue until we increase the volume of our private label business sufficiently to offset our higher fixed overhead structure. Although the cost of GMP compliance is significant, we believe our commitment to quality and our steadfast support of the FDA mandated GMPs makes us well positioned to operate within the higher standards of the Food and Drug Administration s GMPs and differentiates us from our competitors.

Table of Contents

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

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

- Leveraging our state of the art, certified facilities to increase the value of the goods and services we provide to our highly valued private label contract manufacturing customers, and assist us in developing relationships with additional quality oriented customers;
- Implementing focused initiatives to grow our Pathway to Healing® product line;
- Improving operational efficiencies and managing costs and business risks to improve profitability; and
- Identifying and evaluating additional acquisition opportunities that could increase product lines, expand distribution channels, enhance manufacturing capabilities or reduce risk associated with a variety of factors.

Looking forward, as a result of the uncertain near-term economic conditions including unfavorable currency markets, we expect reduced net sales from our branded products business and higher operating costs related to our GMPs compliance programs in the second quarter of fiscal 2009, as compared to the second quarter in fiscal 2008. The anticipated increased operating expenses, unfavorable foreign currency fluctuations, and additional severance and other exit costs associated with discontinuing our RHL operations are expected to result in a net operating loss from continuing operations during the second quarter of fiscal 2009.

Critical Accounting Policies and Estimates

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

Our critical accounting policies are discussed under Item 7 of our 2008 Annual Report. There have been no significant changes to these policies during the three months ended September 30, 2008.

Table of Contents

Results of Operations

The results of our operations for the three months ended September 30 were as follows (dollars in thousands):

	Three Months Ended September 30, 2008		September 30, 2007		Increase (Decrease)	
Private label contract manufacturing	$ 18,742	96%	$ 21,819	95%	$ (3,077)	(14)%
Branded products	784	4%	1,066	5%	(282)	(26)%
Total net sales	19,526	100%	22,885	100%	(3,359)	(15)%
Cost of goods sold	17,126	88%	18,945	83%	(1,819)	(10)%
Gross profit	2,400	12%	3,940	17%	(1,540)	(39)%
Selling, general & administrative expenses	2,618	13%	2,892	13%	(274)	(9)%
Operating (loss) income from continuing operations	(218)	(1)%	1,048	4%	(1,266)	(121)%
Other expenses, net	313	2%	11	0%	302	2,745%
(Loss) income from continuing operations before income taxes	(531)	(3)%	1,037	4%	(1,568)	(151)%
Income tax (benefit) expense	(182)	(1)%	286	1%	(468)	(164)%
(Loss) income from continuing operations	(349)	(2)%	751	3%	(1,100)	(146)%
Loss from discontinued operations, net of tax	(1,048)	(5)%	(328)	(1)%	(720)	(220)%
Net loss	$ (1,397)	(7)%	$ 423	2%	$ (1,820)	(430)%

The percentage decrease in private label contract manufacturing net sales was attributed to the following:

Mannatech, Incorporated (1)	(18)%
NSA International, Inc. (2)	5
Other customers (3)	(1)
Total	(14)%

1 Net sales to Mannatech, Incorporated decreased primarily as a result of lower volumes of established products in existing markets along with a shift in sales mix to lower priced products.
2 The increase in net sales to NSA International, Inc. included an increase in international sales of 51.9% partially offset by a decline in domestic sales of 1.2%.
3 The decrease in net sales to other customers was primarily related to the timing of shipments during the first quarter of fiscal 2009 as compared to the prior year.

Net sales from our branded products segment decreased 26% during the the first quarter of fiscal 2009 due primarily to the continuing impact of the cessation of the Dr. Cherry weekly television program in April 2007, which had served as the primary acquisition vehicle in marketing the Pathway to Healing® product line.

Gross profit margin decreased 5.0 percentage points primarily due to the following:

Contract manufacturing:	
Shift in sales mix	0.9%
Incremental overhead expenses	(2.2)
Incremental direct and indirect labor	(4.0)
Branded products operations	0.3
Total	(5.0)%

Private label contract manufacturing gross profit margin declined 4.9 percentage points to 10.4% in the first quarter of fiscal 2009 compared to 15.3% in the first quarter of fiscal 2008. The decrease in gross profit as a percentage of sales was primarily due to higher per unit private label manufacturing costs associated with lower production levels, increased manufacturing labor and overhead expenses related to implementing newly required GMPs, increased product testing costs associated with new product offerings and the impact of unfavorable foreign currency exchange rates associated with our international sales. These decreases were partially offset by a favorable sales mix shift to higher margin product sales.

Branded products gross profit margin increased 1.7 percentage points to 58.6% in the first quarter of fiscal 2009 from 56.9% in the

Table of Contents

first quarter of fiscal 2008 due to a favorable sales mix and lower sales discounts and returns.

Selling, general and administrative expenses from continuing operations decreased $274,000, or 9%, during the first quarter of fiscal 2009 as compared to the same period in the prior fiscal year primarily due to a reduction in research and development costs, business insurance expense and decreased direct-to-consumer operating costs primarily associated with lower marketing and advertising expenses, employee compensation costs and call center and fulfillment expenses.

Other expenses, net increased $302,000 during the first quarter of fiscal 2009 as compared to the same period in the prior fiscal year primarily due to $401,000 in unfavorable foreign currency exchange losses associated with the weakening of the Euro and the related impact on the translation of Euro denominated cash and receivables partially offset by a $100,000 reduction in interest expense associated with lower borrowings and interest rates during the first quarter of fiscal 2009.

Liquidity and Capital Resources

Our primary sources of liquidity and capital resources are cash flows provided by operating activities and the availability of borrowings under our credit facility. Net cash used by operating activities was $640,000 for the three months ended September 30, 2008 compared to net cash provided by operating activities of $28,000 in the comparable quarter last year.

At September 30, 2008, changes in accounts receivable, consisting primarily of amounts due from our private label contract manufacturing customers, provided $2.5 million in cash during the three months ended September 30, 2008 compared to $1.5 million of cash used in the comparable prior year quarter. Cash provided by accounts receivable during the quarter ended September 30, 2008 was the result of lower sales and increased collections of prior period accounts receivable as compared to the comparable prior year quarter. Days sales outstanding was 24 days during the three months ended September 30, 2008 compared to 23 days in the comparable quarter last year.

Approximately $540,000 of our operating cash flow was generated by NAIE in the three months ended September 30, 2008. As of September 30, 2008, NAIE s undistributed retained earnings were considered indefinitely reinvested.

Cash used in investing activities in the three months ended September 30, 2008 was $84,000 compared to $326,000 in the comparable quarter last year. Capital expenditures were $1.5 million during the three months ended September 30, 2008 compared to $325,000 in the comparable quarter last year. Capital expenditures for both years were primarily for manufacturing equipment in our Vista, California and Manno, Switzerland facilities. Additionally, during the three months ended September 30, 2008, we invested $699,000 in a six month certificate of deposit and we received $2.2 million in proceeds related to the sale of our As We Change business.

Our consolidated debt increased to $3.0 at September 30, 2008 from $2.7 million at June 30, 2008 primarily due to borrowings on our working capital line of credit offset by payments on our term loans.

We have a bank credit facility of $9.9 million, comprised of a $7.5 million working capital line of credit and $2.4 million in outstanding term loans. The working capital line of credit is secured by our accounts receivable and other rights to payment, general intangibles, inventory and equipment, has an interest rate of Prime Rate or LIBOR plus 1.75%, as elected by NAI from time to time, and borrowings are subject to eligibility requirements for current accounts receivable and inventory balances. As of September 30, 2008 the outstanding balances on the term loans consisted of a $300,000, 15 year term loan due June 2011, secured by our San Marcos building, at an interest rate of 8.25%; a $600,000, 10 year term loan with a twenty year amortization, secured by our San Marcos building, at an interest rate of LIBOR plus 2.25%; a $200,000, five year term loan, secured by equipment, at an interest rate of LIBOR plus 2.10%; and a $1.3 million, four year term loan, secured by equipment, at an interest rate of LIBOR plus 2.10%. As of September 30, 2008, we had $595,000 outstanding on the working capital line of credit. Monthly payments on the term loans are approximately $121,000 plus interest.

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

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

As of September 30, 2008 and June 30, 2008, we were not in compliance with our quarterly net income financial covenant under our credit facility, which requires quarterly net income after taxes of at least $1.00. We were also not in compliance with our quarterly fixed charge coverage ratio as of September 30, 2008, which requires a quarterly fixed charge coverage ratio of no less than 1.25 to

Table of Contents

1.0. Additionally, we were not in compliance with our annual net income financial covenant as of June 30, 2008, which required an annual fiscal year net income of at least $750,000. Our lender agreed to waive its default rights as a result of these covenant violations as of September 30, 2008, for a $25,000 waiver fee, and as of June 30, 2008. We anticipate a net after-tax loss during the second quarter of fiscal 2009 related to an expected increase in operating costs, unfavorable foreign currency fluctuations and additional severance and other exit costs associated with discontinuing our RHL operations. As a result, we do not expect to meet our net after-tax income covenant as of December 31, 2008. If we fail to meet this covenant, we intend to request a waiver from our lender but there is no assurance when or if or on what terms a waiver will be provided. Therefore, in accordance with SFAS No. 78, *Classification of Obligations that are Callable by the Creditor* (SFAS 78), we have reclassified all of our long-term debt to current at September 30, 2008 and June 30, 2008.

On September 22, 2006, NAIE, our wholly owned subsidiary, entered into a credit facility to provide it with a credit line of up to CHF 1,300,000, or approximately $1.2 million, which is the initial maximum aggregate amount that can be outstanding at any one time under the credit facility. This maximum amount was reduced by CHF 160,000, or approximately $146,000, as of December 31, 2007 and will be reduced by an additional CHF 160,000 at the end of each succeeding calendar year. On February 19, 2007, NAIE amended its credit facility to provide that the maximum aggregate amount that may be outstanding under the facility cannot be reduced below CHF 500,000, or approximately $456,000. As of September 30, 2008, there was no outstanding balance under the credit facility.

Under its credit facility, NAIE may draw amounts either as current account loan credits to its current or future bank accounts or as fixed loans with a maximum term of 24 months. Current account loans will bear interest at the rate of 5% per annum. Fixed loans will bear interest at a rate determined by the parties based on current market conditions and must be repaid pursuant to a repayment schedule established by the parties at the time of the loan. If a fixed loan is repaid early at NAIE s election or in connection with the termination of the credit facility, NAIE will be charged a pre-payment penalty equal to 0.1% of the principal amount of the fixed loan or CHF 1,000 (approximately $912), whichever is greater. The bank reserves the right to refuse individual requests for an advance under the credit facility, although its exercise of such right will not have the effect of terminating the credit facility as a whole.

As of September 30, 2008, we had $3.1 million in cash and cash equivalents and $6.6 million available under our working line of credit. We believe our available cash, cash equivalents and potential cash flows from operations will be sufficient to fund our current working capital needs, capital expenditures and debt payments through at least the next 12 months.

Off-Balance Sheet Arrangements

As of September 30, 2008, we did not have any significant off-balance sheet debt nor did we have any transactions, arrangements, obligations (including contingent obligations) or other relationships with any unconsolidated entities or other persons that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenue or expenses material to investors.

Recent Accounting Pronouncements

Recent accounting pronouncements are discussed under Item 7 of our 2008 Annual Report. As of September 30, 2008, other than the pronouncements discussed in our 2008 Annual Report, we are not aware of any other pronouncements that materially affect our financial position or results of operations.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

We maintain certain disclosure controls and procedures as defined under the Securities Exchange Act of 1934. They are designed to help ensure that material information is: (1) gathered and communicated to our management, including our principal executive and financial officers, in a manner that allows for timely decisions regarding required disclosures; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the Securities Exchange Act of 1934 and within the time periods specified by the SEC. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2008. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective for their intended purpose described above as of September 30, 2008.

There were no changes to our internal control over financial reporting during the quarterly period ended September 30, 2008 that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

As of November 13, 2008, neither NAI nor its subsidiaries were a party to any material pending legal proceeding nor was any of their property the subject of any material pending legal proceeding.

ITEM 1A. RISK FACTORS

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

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description	Incorporated By Reference To
3(i)	Amended and Restated Certificate of Incorporation of Natural Alternatives International, Inc. filed with the Delaware Secretary of State on January 14, 2005	Exhibit 3(i) of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004, filed with the commission on February 14, 2005
3(ii)	By-laws of Natural Alternatives International, Inc. dated as of December 21, 1990	NAI s Registration Statement on Form S-1 (File No. 33-44292) filed with the commission on December 21, 1992
3(iii)	Amendment to the By-laws of Natural Alternatives International, Inc. effective as of June 29, 2007	Exhibit 3(ii) of NAI s Current Report on Form 8-K dated June 29, 2007, filed with the commission on July 6, 2007
4(i)	Form of NAI s Common Stock Certificate	Exhibit 4(i) of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.1	1999 Omnibus Equity Incentive Plan as adopted effective May 10, 1999, amended effective January 30, 2004, and further amended effective December 3, 2004*	Exhibit 10.1 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004, filed with the commission on February 14, 2005
10.2	1999 Employee Stock Purchase Plan as adopted effective October 18, 1999	Exhibit B of NAI s definitive Proxy Statement filed with the commission on October 21, 1999
10.3	Management Incentive Plan*	Exhibit 10.3 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2003, filed with the commission on November 5, 2003
10.4	Amended and Restated Employment Agreement dated as of January 30, 2004, by and between NAI and Randell Weaver*	Exhibit 10.5 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on September 14, 2004
10.5	Amended and Restated Employment Agreement dated as of January 30, 2004, by and between NAI and Mark A. LeDoux*	Exhibit 10.6 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on September 14, 2004
10.6	Amended and Restated Exclusive License Agreement effective as of September 1, 2004 by and among NAI and Dr. Reginald B. Cherry	Exhibit 10.11 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on September 14, 2004
10.7	Exclusive License Agreement effective as of September 1, 2004 by and among NAI and Reginald B. Cherry Ministries, Inc.	Exhibit 10.12 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on September 14, 2004
10.8	First Amendment to Exclusive License Agreement effective as of December 10, 2004 by and among NAI and Reginald B. Cherry Ministries, Inc.	Exhibit 10.3 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004, filed with the commission on February 14, 2005
10.9	Lease of Facilities in Vista, California between NAI and Calwest Industrial Properties, LLC, a California limited liability company (lease reference date June 12, 2003)	Exhibit 10.10 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2003, filed with the commission on November 5, 2003
10.10	Credit Agreement dated as of May 1, 2004 by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.11 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2004, filed with the commission on May 17, 2004
10.11	First Amendment to Credit Agreement dated as of February 1, 2005 by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.1 of NAI s Current Report on Form 8-K dated February 1, 2005, filed with the commission on February 7, 2005
10.12	Form of Indemnification Agreement entered into between NAI and each of its directors	Exhibit 10.15 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on September 14, 2004

10.13	Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated May 9, 2005 (English translation)	Exhibit 10.19 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005, filed with the commission on May 13, 2005
10.14	Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated July 25, 2003 (English translation)	Exhibit 10.19 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.15	Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated June 8, 2004 (English translation)	Exhibit 10.20 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.16	Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated February 7, 2005 (English translation)	Exhibit 10.21 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.17	License Agreement effective as of April 28, 1997 by and among Roger Harris, Mark Dunnett and NAI	Exhibit 10.22 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005

Table of Contents

Exhibit Number	Description	Incorporated By Reference To
10.18	Amendment to License Agreement effective as of March 17, 2001 by and among Roger Harris, Mark Dunnett and NAI	Exhibit 10.23 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.19	Amendment effective as of September 15, 2005 to Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated May 9, 2005 (English translation)	Exhibit 10.24 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2005, filed with the commission on November 4, 2005
10.20	Employment Agreement effective as of December 5, 2005, by and between RHL and John F. Dullea*	Exhibit 10.3 of NAI s Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005
10.21	Lease of RHL Facilities in San Diego, California between RHL and Lessor dated February 5, 2003	Exhibit 10.4 of NAI s Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005
10.22	Promissory Note made by NAI for the benefit of Wells Fargo Equipment Finance, Inc. in the amount of $3,800,000	Exhibit 10.5 of NAI s Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005
10.23	Patent License Agreement by and between Unither Pharma, Inc. and RHL dated May 1, 2002	Exhibit 10.6 of NAI s Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005
10.24	Second Amendment to Credit Agreement dated as of December 1, 2005 by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.30 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006
10.25	Exclusive License Agreement by and between NAI and Richard Linchitz, M.D. effective as of August 23, 2005	Exhibit 10.32 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006
10.26	Letter amendment to Lease of RHL Facilities in San Diego, California between RHL and Lessor dated January 10, 2006	Exhibit 10.33 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006
10.27	First Amendment to Lease of Facilities in Vista, California between NAI and Calwest Industrial Properties, LLC, a California limited liability company, effective December 21, 2004	Exhibit 10.34 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006
10.28	Second Amendment to Lease of Facilities in Vista, California between NAI and Calwest Industrial Properties, LLC, a California limited liability company, effective January 13, 2006	Exhibit 10.35 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006
10.29	Third Amendment to Credit Agreement dated as of March 15, 2006 by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.35 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, filed with the commission on May 9, 2006
10.30	Standard Sublease Multi-Tenant by and between J. Gelt Corporation dba Casa Pacifica and RHL (lease reference date March 6, 2006)	Exhibit 10.37 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2006, filed with the commission on September 18, 2006
10.31	Loan Agreement between NAIE and Credit Suisse dated as of September 22, 2006, including general conditions (portions of the Loan Agreement have been omitted pursuant to a request for confidential treatment)	Exhibit 10.36 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2006, filed with the commission on November 1, 2006

Table of Contents

Exhibit Number	Description	Incorporated By Reference To
10.32	Employment Agreement effective as of November 20, 2006, by and between NAI and Alvin McCurdy*	Exhibit 10.1 of NAI s Current Report on Form 8-K dated November 20, 2006, filed with the commission on November 21, 2006
10.33	Fourth Amendment to Credit Agreement dated as of November 1, 2006, and entered into on January 24, 2007, by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.37 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2006, filed with the commission on January 30, 2007
10.34	Sublease Contract for facilities in Manno, Switzerland, between NAIE and Vertime SA effective as of April 1, 2007 (portions of the Sublease Contract have been omitted pursuant to a request for confidential treatment) (English translation)	Exhibit 10.39 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, filed with the commission on May 14, 2007
10.35	Second Amendment to License Agreement Amending The First Amendment Dated March 17, 2001 to License Agreement Dated April 28, 1997 by and among Roger Harris, Mark Dunnett and NAI dated as of March 26, 2007	Exhibit 10.40 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007, filed with the commission on May 14, 2007
10.36	First Amendment to Loan Agreement between NAIE and Credit Suisse dated as of February 19, 2007	Exhibit 10.41 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007, filed with the commission on May 14, 2007
10.37	Consulting Agreement effective as of July 1, 2007, by and between Dr. John A. Wise and NAI	Exhibit 10.44 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2007, filed with the commission on October 15, 2007
10.38	Fifth Amendment to Credit Agreement dated as of November 1, 2007, and entered into on December 18, 2007, by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.40 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2007, filed with the commission on February 8, 2008
10.39	Revolving Line of Credit Note made by NAI for the benefit of Wells Fargo Bank, National Association in the amount of $7,500,000	Exhibit 10.41 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2007, filed with the commission on February 8, 2008
10.40	Employment Agreement effective as of February 11, 2008, by and between NAI and Kenneth Wolf*	Exhibit 10.1 of NAI s Current Report on Form 8-K dated February 11, 2008, filed with the commission on February 14, 2008
10.41	Asset Purchase Agreement by and between RHL and Miles Kimball Company dated August 4, 2008	Exhibit 10.1 of NAI s Current Report on Form 8-K dated August 4, 2008, filed with the commission on August 8, 2008
10.42	First Amendment to the Amended and Restated Employment Agreement dated January 30, 2004 by and between NAI and Randell Weaver, entered into effective as of June 28, 2008*	Exhibit 10.44 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2008, filed with the commission on September 22, 2008
10.43	First Amendment to Employment Agreement dated November 20, 2006 by and between NAI and Alvin McCurdy, entered into effective as of June 28, 2008*	Exhibit 10.45 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2008, filed with the commission on September 22, 2008
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed herewith
32	Section 1350 Certification	Filed herewith

* Indicates management contract or compensatory plan or arrangement.

Table of Contents

SIGNATURES

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

Date: November 13, 2008

NATURAL ALTERNATIVES INTERNATIONAL, INC.

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

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