

NATURAL ALTERNATIVES INTERNATIONAL INC  
Form 10-Q  
May 13, 2014  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-Q

QUARTERLY REPORT

pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

FOR THE QUARTERLY PERIOD ENDED March 31, 2014

000-15701

(Commission file number)

NATURAL ALTERNATIVES INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State of incorporation)

84-1007839  
(IRS  
Employer

Identification  
No.)

**1185 Linda Vista Drive**

**San Marcos, California 92078**

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

(Address of principal executive offices)

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.

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

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

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

Yes  No

As of May 13, 2014, 6,997,754 shares of NAI's common stock were outstanding, net of 515,923 treasury shares.



**TABLE OF CONTENTS**

	<b>Page</b>
<b>SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS</b>	1
<b>PART I FINANCIAL INFORMATION</b>	3
Item 1. Financial Statements	3
Condensed Consolidated Balance Sheets	3
Condensed Consolidated Statements of Income and Comprehensive Income	4
Condensed Consolidated Statements of Cash Flows	5
Notes to Condensed Consolidated Financial Statements	6
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	18
Item 4. Controls and Procedures	22
<b>PART II OTHER INFORMATION</b>	23
Item 1. Legal Proceedings	23
Item 1A. Risk Factors	24
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	25
Item 3. Defaults Upon Senior Securities	25
Item 5. Other Information	25
Item 6. Exhibits	26
<b>SIGNATURES</b>	29

## **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 royalty and licensing revenues;

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

- our ability to protect our intellectual property;

- 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;

- the costs associated with defending and resolving potential new claims, even if such claims are without merit;

- 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;

- future levels of our revenue concentration risk;

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

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inventories, including the adequacy of inventory levels to meet future customer demand and the adequacy and intended use of our facilities;

• development of new products and marketing strategies;

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

• current or future customer orders, product returns, and potential product recalls;

• 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, and consolidation strategies, the success of such strategies, and the benefits we believe can be derived from such strategies;

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

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

• our ability to increase our marketing and advertising efforts for our Pathway to Healing® product line, the timing of such efforts and their effect on future sales;

• the adequacy of our reserves and allowances;

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

• overall industry and market performance;

• competition and competitive advantages;

• current and future economic and political conditions;

• 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.

1

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

Unless the context requires otherwise, all references in this report to the “Company,” “NAI,” “we,” “our,” and “us” refer to Natural Alternatives International, Inc. and, as applicable, Natural Alternatives International Europe S.A. (NAIE).



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

	<b>March 31,</b>	<b>June</b>
	<b>2014</b>	<b>30,</b>
	<b>(Unaudited)</b>	<b>2013</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 15,217	\$16,697
Accounts receivable - less allowance for doubtful accounts of \$140 at March 31, 2014 and \$144 at June 30, 2013	6,843	6,605
Inventories, net	14,367	10,035
Deferred income taxes	567	609
Income tax receivable	389	160
Prepaid expenses and other current assets	1,253	1,217
Total current assets	38,636	35,323
Property and equipment, net	8,875	9,205
Deferred income taxes	1,116	1,527
Other noncurrent assets, net	902	585
Total assets	\$ 49,529	\$46,640
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 4,658	\$3,539
Accrued liabilities	2,102	1,130
Accrued compensation and employee benefits	961	807
Income taxes payable	462	466
Total current liabilities	8,183	5,942
Other noncurrent liabilities, net	171	134
Deferred rent	—	225
Total liabilities	8,354	6,301
Commitments and contingencies		
Stockholders' equity:		
Preferred stock; \$.01 par value; 500,000 shares authorized; none issued or outstanding	—	—
Common stock; \$.01 par value; 20,000,000 shares authorized; issued and outstanding (net of treasury shares) 6,997,754 at March 31, 2014 and 6,914,555 at June 30, 2013	74	73
Additional paid-in capital	19,809	19,662

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Accumulated other comprehensive loss	(586	)	(430	)
Retained earnings	24,571		23,667	
Treasury stock, at cost, 515,923 shares at March 31, 2014 and 494,122 at June 30, 2013	(2,693	)	(2,633	)
Total stockholders' equity	41,175		40,339	
Total liabilities and stockholders' equity	\$ 49,529		\$ 46,640	

*See accompanying notes to condensed consolidated financial statements.*

## NATURAL ALTERNATIVES INTERNATIONAL, INC.

## Condensed Consolidated Statements of Income and Comprehensive Income

(In thousands, except share and per share data)

(Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Net sales	\$19,127	\$15,835	\$52,757	\$45,981
Cost of goods sold	15,685	12,972	44,056	37,357
Gross profit	3,442	2,863	8,701	8,624
Selling, general & administrative expenses	2,274	2,294	7,179	7,299
Income from operations	1,168	569	1,522	1,325
Other (expense) income:				
Interest income	7	14	28	35
Interest expense	(3)	(5)	(8)	(16)
Foreign exchange loss	(25)	(57)	(15)	(72)
Other, net	(94)	—	(87)	—
	(115)	(48)	(82)	(53)
Income before income taxes	1,053	521	1,440	1,272
Provision for income taxes	431	343	536	295
Net income	\$622	\$178	\$904	\$977
Unrealized gain (loss) resulting from change in fair value of derivative instruments, net of tax	83	124	(120)	(412)
Change in minimum pension liability, net of tax	(36)	—	(36)	—
Comprehensive income	\$669	\$302	\$748	\$565
Net income per common share:				
Basic	\$0.09	\$0.03	\$0.13	\$0.14
Diluted	\$0.09	\$0.03	\$0.13	\$0.14
Weighted average common shares outstanding:				
Basic	6,819,071	6,841,163	6,817,643	6,883,304
Diluted	6,842,951	6,843,897	6,845,765	6,891,023

See accompanying notes to condensed consolidated financial statements.



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

	<b>Nine Months Ended</b>	
	<b>March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Cash flows from operating activities</b>		
Net income	\$904	\$977
Adjustments to reconcile net income to net cash provided by operating activities:		
Decrease of uncollectible accounts receivable	(15 )	(101 )
Depreciation and amortization	2,325	2,275
Deferred income taxes	453	—
Non-cash compensation	148	135
Pension expense	37	7
Gain on disposal of assets	(27 )	(22 )
Changes in operating assets and liabilities:		
Accounts receivable	(223 )	2,737
Inventories, net	(4,332 )	(1,725 )
Other assets	(401 )	110
Accounts payable and accrued liabilities	1,748	(1,934 )
Income taxes	(200 )	59
Accrued compensation and employee benefits	154	(451 )
Net cash provided by operating activities	571	2,067
<b>Cash flows from investing activities</b>		
Capital expenditures	(2,198 )	(1,379 )
Proceeds from the sale of property & equipment	207	31
Net cash used by investing activities	(1,991 )	(1,348 )
<b>Cash flows from financing activities</b>		
Issuance of common stock	—	37
Repurchase of common stock	(60 )	(596 )
Net cash used by financing activities	(60 )	(559 )
Net (decrease) increase in cash and cash equivalents	(1,480 )	160
Cash and cash equivalents at beginning of period	16,697	14,478
Cash and cash equivalents at end of period	\$15,217	\$14,638
<b>Supplemental disclosures of cash flow information</b>		
Cash paid during the period for:		
Interest	\$13	\$13

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Taxes	\$ 305	\$ 255
Disclosure of non-cash activities:		
Change in unrealized loss resulting from change in fair value of derivative instruments, net of tax	\$ 120	\$ 412
Fixed assets in accounts payable	\$ 5	\$ —

*See accompanying notes to condensed consolidated financial statements.*

## **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 (U.S. GAAP) have been condensed or omitted pursuant to such rules and regulations. In management's opinion, all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows have been included and are of a normal, recurring nature. The results of operations for the three and nine months ended March 31, 2014 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, 2013 ("2013 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 2013 Annual Report unless otherwise noted below.

#### **Reclassifications**

Certain items previously reported in our prior years' condensed consolidated financial statements have been reclassified to conform with current year presentation. The reclassification relates to the classification of certain operating expenses from our NAIE operations previously classified as cost of goods sold, which are now being classified as part of selling, general & administrative expenses. This reclassification was made to reflect the change in operational activity of NAIE, which has historically been primarily a manufacturing specific operation but is now transitioning to perform additional selling and administrative functions. The reclassified amount relating to the three months ended March 31, 2013 totaled \$85,000. The reclassified amount relating to the nine months ended March 31, 2013 totaled \$343,000. This reclassification had no effect on previously reported total assets, stockholders' equity, or net income.

## **Recent Accounting Pronouncements**

In July 2013, the Financial Accounting Standards Board (the "FASB") issued guidance on the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This amendment to previous income tax guidance clarifies that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax benefit is disallowed. In situations where a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be netted with the deferred tax asset. These amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. We adopted Accounting Standard Update 2013-11 during our third quarter of fiscal 2014 and there was not significant impact to our consolidated financial statements as a result of our adoption of this amendment.

## **Net Income per Common Share**

We compute net income per common share using the weighted average number of common shares outstanding during the period, and diluted net income per common share using the additional dilutive effect of all dilutive securities. The dilutive impact of stock options account for the additional weighted average shares of common stock outstanding for our diluted net income per common share computation. We calculated basic and diluted net income per common share as follows (in thousands, except share and per share data):



	<b>Three Months Ended March 31, 2014</b>		<b>Nine Months Ended March 31, 2013</b>	
<b>Numerator</b>				
Net income	\$622	\$178	\$904	\$977
<b>Denominator</b>				
Basic weighted average common shares outstanding	6,819	6,841	6,818	6,883
Dilutive effect of stock options	24	3	28	8
Diluted weighted average common shares outstanding	6,843	6,844	6,846	6,891
Basic net income per common share	\$0.09	\$0.03	\$0.13	\$0.14
Diluted net income per common share	\$0.09	\$0.03	\$0.13	\$0.14

Shares related to stock options representing the right to acquire 280,019 shares of common stock for the three months ended March 31, 2014, and 303,929 shares for the nine months ended March 31, 2014, were excluded from the calculation of diluted net income per common share, as the effect of their inclusion would have been anti-dilutive.

Shares related to stock options representing the right to acquire 390,000 shares of common stock for the three months ended March 31, 2013, and 457,800 shares for the nine months ended March 31, 2013, were excluded from the calculation of diluted net income per common share, as the effect of their inclusion would have been anti-dilutive.

## Revenue Recognition

To recognize revenue, four basic criteria must 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 (1) the seller's price to the buyer is substantially fixed or determinable at the date of sale; (2) the buyer has paid the seller, or the buyer is obligated to pay the seller and the obligation is not contingent on resale of the product; (3) the buyer's obligation to the seller would not be changed in the event of theft or physical destruction or damage of the product; (4) the buyer acquiring the product for resale has economic substance apart from that provided by the seller; (5) the seller does not have significant obligations for future performance to directly bring about resale of the product by the buyer; and (6) 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 and branded products. The estimated returns are based on the trailing six months of private label contract manufacturing gross sales and our historical experience for both private label contract manufacturing and branded product returns.

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 followed the provisions of ASU No. 2009-13 for all multiple element agreements. Under this guidance, the delivered item(s) has value to the customer on a standalone basis and, if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in our control.

A delivered item is considered a separate unit of accounting when the delivered item has value to the partner on a standalone basis based on the consideration of the relevant facts and circumstances for each arrangement. Arrangement consideration is allocated at the inception of the agreement to all identified units of accounting based on their relative selling price. The relative selling price for each deliverable is determined using vendor specific objective evidence, or VSOE, of selling price or third-party evidence of selling price if VSOE does not exist. If neither VSOE nor third-party evidence of selling price exists, we use our best estimate of the selling price for the deliverable. The amount of allocable arrangement consideration is limited to amounts that are fixed or determinable. The consideration received is allocated among the separate units of accounting, and the applicable revenue recognition criteria are applied to each of the separate units. Changes in the allocation of the sales price between delivered and undelivered elements can impact revenue recognition but do not change the total revenue recognized under any agreement. If facts and circumstances dictate that a deliverable has standalone value from the undelivered items, the deliverable is identified as a separate unit of accounting and the amounts allocated to the deliverable are recognized upon the delivery of the deliverable, assuming the other revenue recognition criteria have been met. However, if the amounts allocated to the deliverable through the relative selling price allocation exceed the upfront fee, the amount recognized upon the delivery of the deliverable is limited to the upfront fee received. If facts and circumstances dictate that the deliverable does not have standalone value, the transaction price, including any upfront fee payments received, are allocated to the identified separate units of accounting and recognized as those items are delivered and accepted.

In addition, we enter into arrangements that provide for milestone payments upon contractually stated events. Under the Milestone Method, we recognize consideration that is contingent upon the achievement of a milestone in its entirety as revenue in the period in which the milestone is achieved only if the milestone is substantive in its entirety. A milestone is considered substantive when it meets all of the following three criteria: 1) The consideration is commensurate with either the entity's performance to achieve the milestone or the enhancement of the value of the delivered item(s) as a result of a specific outcome resulting from the entity's performance to achieve the milestone, 2) The consideration relates solely to past performance, and 3) The consideration is reasonable relative to all of the deliverables and payment terms within the arrangement. A milestone is defined as an event (i) that can only be achieved based in whole or in part on either the entity's performance or on the occurrence of a specific outcome resulting from the entity's performance, (ii) for which there is substantive uncertainty at the date the arrangement is entered into that the event will be achieved and (iii) that would result in additional payments being due to us.

We currently own certain U.S. patents, and each patent's corresponding foreign patent applications. All of these patents and patent rights relate to the ingredient known as beta-alanine marketed and sold under the CarnoSyn® trade name. We have sold this ingredient to a customer and, since March 2009, we have had an agreement with Compound Solutions, Inc. (CSI) under which we have agreed to grant a license of certain of our patent rights to customers of CSI who purchase beta-alanine from CSI. Before October 1, 2011, we received a fee from CSI that varied based on the amount of net sales of beta-alanine sold by CSI less CSI's costs and other agreed upon expenses. As of October 1, 2011, we receive a fee from CSI that varies based on the quantity of beta-alanine sold by CSI and the source of such beta-alanine.

In June 2011, we entered into a license and supply agreement (Agreement) with Abbott Laboratories (Abbott) under which we agreed to grant an exclusive license to Abbott for the use of beta-alanine in certain medical foods and medical nutritionals. Under the terms of the agreement, Abbott paid an initial license fee of \$300,000, an additional fee of \$300,000 in January 2012, and upon achievement of certain milestones, an additional license fee of \$150,000 was paid on October 3, 2012. The license and supply agreement provided Abbott with the right to terminate the agreement at any time up to March 31, 2012, at which time, if not terminated, Abbott was required to pay \$4.3 million payable over six annual payments with the initial installment payment of \$708,334 due March 31, 2012. We have determined that each of the milestone payments meets the definition of a milestone in accordance with the milestone method of revenue recognition.

In February 2012 and June 2012, we amended the Agreement and extended Abbott's termination rights initially through July 31, 2012 and then further through October 31, 2012 in exchange for two payments of \$354,167 each by Abbott to NAI. Abbott made the first payment on March 13, 2012 and the second payment on July 12, 2012. In October 2012, the Agreement was amended for a third time. Unless earlier terminated by Abbott, the amendment requires Abbott to pay to NAI (i) upon earlier of achievement of certain milestones or December 1, 2012, additional license fees of \$204,167; (ii) upon earlier of achievement of certain milestones or June 1, 2013, additional license fees of \$204,167; (iii) upon earlier of achievement of certain milestones or July 1, 2013, additional license fees of \$150,000; (iv) upon earlier of achievement of certain milestones or December 1, 2013, additional license fees of \$150,000; and (v) approximately \$2.8 million payable over four annual payments beginning on March 31, 2014. The payment noted in (i) was collected in December 2012, the payment noted in (ii) was collected in May 2013, the payment noted in (iii) was collected in July 2013 and the payment noted in (iv) was collected in January 2014.

Effective November 27, 2013, citing further time and cost required to bring its anticipated product to market, Abbott exercised its right to terminate the Agreement.

We recorded royalty and licensing income as a component of revenue in the amount of \$1.1 million during the three months ended March 31, 2014 and \$3.8 million during the nine months ended March 31, 2014. We recorded royalty and licensing income as a component of revenue in the amount of \$1.0 million during the three months ended March 31, 2013 and \$3.2 million during the nine months ended March 31, 2013. These royalty and licensing income 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 \$143,000 during the three months ended March 31, 2014 and \$523,000 during the nine months ended March 31, 2014. We recognized royalty expense as a component of cost of goods sold in the amount of \$133,000 during the three months ended March 31, 2013 and \$426,000 during the nine months ended March 31, 2013.

### **Stock-Based Compensation**

We have an omnibus incentive plan that was approved by our Board of Directors effective as of October 15, 2009 and approved by our stockholders at the Annual Meeting of Stockholders held on November 30, 2009. Under the plan, we may grant nonqualified and incentive stock options and other stock-based awards to employees, non-employee directors and consultants. Our prior equity incentive plan was terminated effective as of November 30, 2009.

We estimate the fair value of stock option awards at the date of grant 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 we assume 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.

During fiscal 2013 we granted a total of 98,000 restricted stock shares to the members of our Board of Directors and certain key members of our management team pursuant to our 2009 Omnibus Incentive plan. Each restricted share will vest over three years and these shares cannot be sold or otherwise transferred and the rights to receive dividends, if declared by our Board of Directors, are forfeitable until the shares become vested. During the three months ended September 30, 2013, 10,000 of these shares were forfeited due to the termination of employment of one of the grantees. On March 7, 2014 we granted 105,000 restricted stock shares to the members of our Board of Directors and certain key members of our management team pursuant to our 2009 Omnibus Incentive plan. These restricted stock grants will vest over three years and cannot be sold or otherwise transferred and the rights to receive dividends, if declared by our Board of Directors, are forfeitable until the shares become vested.

Our net income included stock based compensation expense of approximately \$46,000 for the three months ended March 31, 2014 and approximately \$148,000 for the nine months ended March 31, 2014. Our net income included stock based compensation expense of approximately \$52,000 for the three months ended March 31, 2013 and approximately \$135,000 for the nine months ended March 31, 2013.

### **Fair Value of Financial Instruments**

Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. We use a three-level hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs are inputs that reflect our assumptions about the inputs that market participants would use in pricing the asset or liability and are developed based on the best information available under the circumstances.

The fair value hierarchy is broken down into three levels based on the source of inputs. In general, fair values determined by Level 1 inputs use quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. We classify cash, cash equivalents, and marketable securities balances as Level 1

assets. Fair values determined by Level 2 inputs are based on quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active and models for which all significant inputs are observable or can be corroborated, either directly or indirectly by observable market data. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. These include certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

As of March 31, 2014 and June 30, 2013, we did not have any financial assets or liabilities classified as Level 1. We classify derivative forward exchange contracts as Level 2 assets. The fair value of our forward exchange contracts as of March 31, 2014 was a net liability of \$204,000. The fair value of our forward exchange contracts as of June 30, 2013 was an asset of \$95,000. As of March 31, 2014 and June 30, 2013, we did not have any financial assets or liabilities classified as Level 3. We did not transfer any assets between Levels 1, 2 and 3 during fiscal 2013 or the nine month period ended March 31, 2014.

## B. Inventories

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

	<b>March 31, 2014</b>	<b>June 30, 2013</b>
Raw materials	\$10,214	\$6,516
Work in progress	3,376	1,576
Finished goods	1,582	2,358
Reserves	(805 )	(415 )
	<b>\$14,367</b>	<b>\$10,035</b>

**C. Property and Equipment**

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

	<b>Depreciable Life In Years</b>	<b>March 31, 2014</b>	<b>June 30, 2013</b>
Land	N/A	\$393	\$393
Building and building improvements	7 – 39	2,793	2,793
Machinery and equipment	3 – 12	26,523	26,141
Office equipment and furniture	3 – 5	3,206	3,030
Vehicles	3	209	136
Leasehold improvements	1 – 15	10,921	10,771
Total property and equipment		44,045	43,264
Less: accumulated depreciation and amortization		(35,170)	(34,059)
Property and equipment, net		\$8,875	\$9,205

**D. Other comprehensive (loss) income**

	<b>Three Months Ended March 31, 2014</b>		
	<b>Unrealized</b>		
	<b>Defined</b>		
	<b>Benefit Losses on</b>		
	<b>Cash</b>	<b>Total</b>	
	<b>Pension</b>		
	<b>Plan</b>	<b>Flow</b>	
	<b>Hedges</b>		
Balance as of December 31, 2013	\$ (482)	\$ (151)	) \$ (633)
Other comprehensive loss before reclassifications	—	35	35
Amounts reclassified from OCI	—	112	112
Tax effect of OCI activity	(36 )	(64 )	(100)
Other comprehensive loss	(36 )	83	47
Balance as of March 31, 2014	\$ (518)	\$ (68 )	) \$ (586)

**Nine Months Ended  
March 31, 2014**

	<b>Unrealized</b>		
	<b>Defined</b>		
	<b>Benefit Losses on</b>		
	<b>Cash</b>	<b>Total</b>	
	<b>Pension</b>		
	<b>Plan</b>	<b>Flow</b>	
	<b>Hedges</b>		
Balance as of June 30, 2013	\$(482)	\$ 52	\$(430)
Other comprehensive loss before reclassifications	—	(533)	(533)
Amounts reclassified from OCI	—	343	343
Tax effect of OCI activity	(36 )	70	34
Other comprehensive loss	(36 )	(120)	(156)
Balance as of March 31, 2014	\$(518)	\$ (68)	\$(586)

During the three months ended March 31, 2014, the amounts reclassified from OCI were comprised of \$116,000 of losses reclassified to net revenues and \$4,000 related to the amortization of forward points reclassified to other income. During the nine months ended March 31, 2014, the amounts reclassified from OCI were comprised of \$361,000 of losses reclassified to net revenues and \$18,000 related to the amortization of forward points reclassified to other income.

#### **E. Debt**

On December 16, 2010, we executed a Credit Agreement (“Credit Agreement”) with Wells Fargo Bank, National Association. This Credit Agreement replaced our previous credit facility and provides us with a line of credit of up to \$5.0 million. The line of credit may be used to finance working capital requirements. In consideration for granting the line of credit and each subsequent extension amendment, we pay an annual commitment fee of \$12,500. 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) net income after taxes of not less than \$750,000 on a trailing four quarter basis as of the end of each calendar quarter beginning with the four quarter period ended December 31, 2010; and (ii) a ratio of total liabilities to tangible net worth of not greater than 1.25 to 1.0 at any time. 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 2.75% above the daily one month LIBOR rate as in effect from time to time. If a fixed rate is elected, it would equal a per annum rate of 2.50% above the LIBOR rate in effect on the first day of the applicable fixed rate term. Any amounts outstanding under the line of credit must be paid in full on or before November 1, 2015; provided, however, that we must maintain a zero balance on advances under the line of credit for a period of at least 30 consecutive days during each fiscal year. Amounts outstanding that are subject to a fluctuating interest rate may be prepaid at any time without penalty. Amounts outstanding that are subject to a fixed interest rate may be prepaid at any time in minimum amounts of \$100,000, subject to a prepayment fee equal to the sum of the discounted monthly differences for each month from the month of prepayment through the month in which the then applicable fixed rate term matures.

Our obligations under the Credit Agreement are secured by our accounts receivable and other rights to payment, general intangibles, inventory, equipment and fixtures. We also have a foreign exchange facility with Wells Fargo in effect until November 1, 2014, and with Bank of America, N.A. in effect until August 15, 2015.

On March 31, 2014, we were in compliance with all of the financial and other covenants required under the Credit Agreement.

On September 22, 2006, NAIE, our wholly owned subsidiary, entered into a credit facility with Credit Suisse to provide NAIE with a credit line of up to CHF 1.3 million, or approximately \$1.5 million, which was the initial maximum aggregate amount that could be outstanding at any one time under the credit facility. This maximum amount is reduced annually by CHF 160,000, or approximately \$180,000. 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 \$564,000. As of March 31, 2014, there was no outstanding balance under this 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 \$1,127), 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.

We did not use our working capital line of credit nor did we have any long-term debt outstanding during the nine months ended March 31, 2014. As of March 31, 2014, we had \$5.6 million available under our credit facilities.

#### 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, we adopted an amendment to freeze benefit accruals to the participants. We contribute an amount not less than the minimum funding requirements of the Employee Retirement Income Security Act of 1974 nor more than the maximum tax-deductible amount.

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

	<b>Three Months Ended March 31,</b>		<b>Nine Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Interest cost	\$22	\$22	\$66	\$66
Expected return on plan assets	(9)	(3)	(28)	(8)
Net periodic expense	\$13	\$19	\$38	\$58

**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 sales, or the growth rate of sales to these customers, or in their ability to make payments when due, 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 private label contract manufacturing net sales were as follows (dollars in thousands):

	Three Months Ended March 31,				Nine Months Ended March 31,			
	2014		2013		2014		2013	
	Net Sales by Customer	% of Total Net Sales	Net Sales by Customer	% of Total Net Sales	Net Sales by Customer	% of Total Net Sales	Net Sales by Customer	% of Total Net Sales
Customer 1	\$6,321	36 %	\$7,304	50 %	\$16,849	35 %	\$22,172	53 %
Customer 2	2,823	16	2,455	17	8,484	18	7,072	17
Customer 3	2,921	17	1,483	10	7,960	17	(a)	(a)
	\$12,065	69 %	\$11,242	77 %	\$33,293	70 %	\$29,244	70 %

(a) Sales were less than 10% of the respective period's total private label contract manufacturing net sales.

We buy certain products, including beta-alanine, 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 March 31,				Nine Months Ended March 31,			
	2014		2013		2014		2013	
	Raw Material Purchases by Supplier	% of Total Raw Material Purchases	Raw Material Purchases by Supplier	% of Total Raw Material Purchases	Raw Material Purchases by Supplier	% of Total Raw Material Purchases	Raw Material Purchases by Supplier	% of Total Raw Material Purchases
Supplier 1	(a)	(a)	\$829,000	14 %	(a)	(a)	(a)	(a)
	(a)	(a)	\$829,000	14 %	(a)	(a)	(a)	(a)

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

**H. Segment Information**

Our business consists of three segments for financial reporting purposes. The three segments are identified as (i) private label contract manufacturing, which primarily relates to the provision of private label contract manufacturing services to companies that market and distribute nutritional supplements and other health care products, (ii) patent and trademark licensing, which primarily includes royalty income from our license and supply agreements associated with the sale and use of beta-alanine under our CarnosSyn® trade name and the sale of beta-alanine raw material, and (iii) branded products, which relates to the marketing and distribution of our branded nutritional supplements and consists primarily of the products sold under our Pathway to Healing® product line.

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 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, corporate legal, finance, information technology, and other corporate level related expenses, which are not allocated to any 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 2013 Annual Report.

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

	<b>Three Months Ended March 31, 2014</b>		<b>Nine Months Ended March 31, 2014</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Net Sales</b>				
Private label contract manufacturing	\$17,692	\$14,505	\$48,056	\$41,773
Patent and trademark licensing	1,141	1,009	3,812	3,207
Branded products	294	321	889	1,001
	\$19,127	\$15,835	\$52,757	\$45,981

	<b>Three Months Ended March 31,</b>		<b>Nine Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Income from Operations</b>				
Private label contract manufacturing	\$1,717	\$1,353	\$3,434	\$3,924
Patent and trademark licensing	570	337	1,500	654
Branded products	46	11	61	85
Income from operations of reportable segments	2,333	1,701	4,995	4,663
Corporate expenses not allocated to segments	(1,165)	(1,132)	(3,473)	(3,338)
	\$1,168	\$569	\$1,522	\$1,325

	<b>March 31, 2014</b>	<b>June 30, 2013</b>
<b>Total Assets</b>		
Private label contract manufacturing	\$48,180	\$45,032
Patent and trademark licensing	1,141	1,388
Branded products	208	220
	\$49,529	\$46,640

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

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

	<b>Three Months Ended March 31,</b>		<b>Nine Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
United States	\$8,992	\$9,485	\$26,695	\$27,288
Markets outside the United States	10,135	6,350	26,062	18,693
Total net sales	\$19,127	\$15,835	\$52,757	\$45,981

Products manufactured by NAIE accounted for approximately 61% of net sales in markets outside the U.S. for the three months ended March 31, 2014, and 73% for the three months ended March 31, 2013. NAIE accounted for 55% of net sales in markets outside the U.S. for the nine months ended March 31, 2014, and 72% for the nine months ended March 31, 2013. No products manufactured by NAIE were sold in the U.S. during the nine months ended

March 31, 2014 and 2013.

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

	<b>Long-Lived Assets</b>		<b>Total Assets</b>		<b>Capital Expenditures Nine Months Ended</b>	
	<b>March 31, 2014</b>	<b>June 30, 2013</b>	<b>March 31, 2014</b>	<b>June 30, 2013</b>	<b>March 31, 2014</b>	<b>March 31, 2013</b>
United States	\$6,588	\$6,728	\$34,376	\$32,450	\$1869	\$635
Europe	2,287	2,477	15,153	14,190	329	719
	\$8,875	\$9,205	\$49,529	\$46,640	\$2,198	\$1,354

## I. Income Taxes

The effective tax rate for the three months ended March 31, 2014 was an expense of 40.9% and the effective tax rate for the nine months ended March 31, 2014 was an expense of 37.2%. The rate differs from the U.S. federal statutory rate of 34% primarily due to the recognition of state income taxes partially offset by the favorable impact of foreign earnings taxed at less than the U.S. statutory rate and adjustments for discrete items that occurred during the three months ended March 31, 2014, as discussed below. The estimated state tax rate included in the effective tax rate has been adjusted for changes in the estimated California apportionment factor and estimates of income taxes in other states resulting from a state nexus study which was completed during the quarter.

To determine our quarterly provision for income taxes, we used an estimated annual effective tax rate, which is based on expected annual income, statutory tax rates and tax planning opportunities available in the various jurisdictions to which the Company is subject. Certain significant or unusual items are separately recognized in the quarter in which they occur and can be a source of variability in the effective tax rate from quarter to quarter. For the three months ended March 31, 2014 these discrete items included (1) an expense to adjust the state deferred tax assets as a result of a change in the estimated state tax rate, (2) an expense to establish a valuation allowance on a portion of the deferred tax asset for the California net operating loss, (3) a net benefit of state taxes as a result of adjusting California apportionment and filing in other states for prior years, and (4) a true-up of the R&D credit claimed on the federal income tax return filed in the current quarter. We recognize interest and penalties related to uncertain tax positions, if any, as an income tax expense.

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 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 three months ended March 31, 2014, as a result of changes in California apportionment rules and the state nexus study which was completed during the quarter, the Company determined that \$193,000 of the deferred tax asset for California net operating losses was not more likely than not to be realized. As a result, we have established a valuation allowance on our net deferred tax assets for this amount.

The total amount of unrecognized tax benefits was approximately \$88,000 as of March 31, 2014. The accrual for the unrecognized tax benefit relates to a tax liability for prior years and the current year in states where the Company has not previously filed offset by net benefit that will be received from filing amended returns in California. The Company is in the process of filing prior year and current year tax returns in these states under each state's voluntary disclosure amnesty programs. The gross liability for income taxes related to unrecognized tax benefits is included in other current liabilities in the Company's balance sheet. There are no penalties or interest related to uncertain tax positions accrued as of March 31, 2014.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences of temporary differences between the financial reporting basis and tax basis of our assets and liabilities. Deferred tax assets and liabilities are measured using enacted 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.

We are subject to taxation in the U.S., Switzerland, and various state jurisdictions. Our tax years for the fiscal year ended June 30, 2005 and forward are subject to examination by U.S. 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.

We do not record U.S. income tax expense for NAIE's retained earnings that are declared as indefinitely reinvested offshore, thus reducing our overall income tax expense. The amount of earnings designated as indefinitely reinvested in NAIE is based on the actual deployment of such earnings in NAIE's assets and our expectations of the future cash needs of our U.S. and foreign entities. Income tax laws are also a factor in determining the amount of foreign earnings to be indefinitely reinvested offshore.

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. The tax reserves are analyzed quarterly and adjustments are made as events occur that we believe warrant adjustments to the reserves.

## **J. Treasury Stock**

On June 2, 2011, the Board of Directors authorized the repurchase of up to \$2.0 million of our common stock. Under the repurchase plan, we may, from time to time, purchase shares of our common stock, depending upon market conditions, in open market or privately negotiated transactions. For the year ended June 30, 2013, we purchased 132,132 shares at a weighted average cost of \$5.32 per share and a total cost of \$703,000, including commissions and fees. During the three months ended March 31, 2014, we did not purchase any common stock as part of the repurchase plan. During the nine months ended March 31, 2014, we purchased 5,100 shares at a weighted average cost of \$4.55 per share and a total cost of \$23,000 including commissions and fees.

During the quarter ended March 31, 2014 we acquired 6,701 shares from employees in connection with restricted stock shares that vested during the quarter. These shares were returned to the Company by the related employees and in return the Company paid each employee's required tax withholding. The valuation of the shares acquired and thereby the amount of shares returned to the Company was calculated based on the closing share price on the date the shares vested.



## K. Derivatives and Hedging

We are exposed to gains and losses resulting from fluctuations in foreign currency exchange rates relating to forecasted product sales denominated in foreign currencies and transactions of NAIE, our foreign subsidiary. As part of our overall strategy to manage the level of exposure to the risk of fluctuations in foreign currency exchange rates, we may use foreign exchange contracts in the form of forward contracts. There can be no guarantee any such contracts, to the extent we enter into such contracts, will be effective hedges against our foreign currency exchange risk.

During the three and nine months ended March 31, 2014, we had forward 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. These contracts are expected to be settled through August 2015. For derivative instruments that are designated and qualify as cash flow hedges, we record the effective portion of the gain or loss on the derivative in accumulated other comprehensive income (“OCI”) as a separate component of stockholders’ equity and subsequently reclassify these amounts into earnings in the period during which the hedged transaction is recognized in earnings.

For foreign currency contracts designated as cash flow hedges, hedge effectiveness is measured using the spot rate. Changes in the spot-forward differential are excluded from the test of hedge effectiveness and are recorded currently in earnings as interest expense. We measure effectiveness by comparing the cumulative change in the hedge contract with the cumulative change in the hedged item. During the three and nine months ended March 31, 2014, we did not have any losses or gains related to the ineffective portion of our hedging instruments. No hedging relationships were terminated as a result of ineffective hedging or forecasted transactions no longer probable of occurring for foreign currency forward contracts. We monitor the probability of forecasted transactions as part of the hedge effectiveness testing on a quarterly basis.

As of March 31, 2014, the notional amounts of our foreign exchange contracts designated as cash flow hedges were approximately \$14.2 million (EUR 10.4 million). As of March 31, 2014, a net loss of approximately \$127,000 related to derivative instruments designated as cash flow hedges was recorded in OCI. We expect approximately \$129,000 will be reclassified into earnings in the next 12 months along with the earnings effects of the related forecasted transactions.

As of March 31, 2014, the fair value of our cash flow hedges was a net liability of \$204,000. Of this amount \$11,000 was classified in prepaids and other current assets, \$217,000 was classified in accrued liabilities, and \$2,000 was classified as other noncurrent assets, net in our Condensed Consolidated Balance Sheets. During the three months ended March 31, 2014 we recognized \$35,000 of gains in OCI and reclassified \$116,000 of losses from OCI to revenue. During the nine months ended March 31, 2014 we recognized \$533,000 of losses in OCI and reclassified \$361,000 of losses from OCI to revenue. During the three months ended March 31, 2013 we recognized \$217,000 of

gains in OCI and reclassified 11,000 of gains from OCI to revenue. During the nine months ended March 31, 201 we recognized \$167,000 of gains in OCI and reclassified \$518,000 of gains from OCI to revenue.

## **L. 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 operation. However, a settlement payment or unfavorable outcome could adversely impact our results of operation. 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.

On September 8, 2011, NAI and CSI filed a complaint in the U.S. District Court for the District of Delaware against DNP International Co., Inc. (DNP) alleging claims of unfair competition, violation of the Delaware Deceptive Trade Practices Act and interference with business relations. On December 22, 2011, DNP filed a complaint in the U.S. District Court for the District of Delaware against NAI and CSI for declaratory judgment of non-infringement and invalidity of three of NAI's patents. On January 27, 2012, DNP amended its complaint to add declaratory judgment claims against a fourth NAI patent ("381 patent). On February 6, 2012, the Company and CSI moved to dismiss the cases related to the three previously asserted patents for lack of subject matter jurisdiction. On the same day, the Company filed its answer and counterclaims for infringement by DNP of the "381 patent. DNP subsequently agreed to voluntarily dismiss CSI from the lawsuit. On March 2, 2012, the Court ordered the dismissal of CSI. On April 15, 2013, the Court consolidated the two lawsuits referenced above for purposes of pretrial matters. The Court also entered a Scheduling Order setting a trial date in April 2015.

On December 21, 2011, NAI filed a lawsuit in the U.S. District Court for the Southern District of Texas, Houston Division, alleging infringement by Woodbolt Distribution, LLC, also known as Cellucor (Woodbolt), Vitaquest International, Inc., d/b/a Garden State Nutritionals (Garden State) and F.H.G. Corporation, d/b/a Integrity Nutraceuticals (Integrity), of NAI's '381 patent. The complaint alleges that Woodbolt sells nutritional supplements, including supplements containing beta-alanine such as C4 Extreme™, M5 Extreme™, and N-Zero Extreme™, that infringe the '381 patent. Woodbolt, in turn, filed a complaint seeking a declaratory judgment of non-infringement and invalidity of the '381 patent in the U.S. District Court for the District of Delaware. On February 17, 2012, Woodbolt filed a First Amended Complaint, realleging its original claims against the Company and asserting new claims of violation of the Sherman Antitrust Act (15 U.S.C. § 2) and Unfair Competition. The Company reasserted the arguments in its prior motion to dismiss and moved to dismiss the new claims asserted by Woodbolt. On January 23, 2013, the Delaware Court granted the Company's motion to dismiss Woodbolt's case. On June 5, 2012, the Court in the above-referenced Texas case consolidated the pending suit with a second patent infringement case filed against Woodbolt by the Company on May 3, 2012, asserting infringement its '422 patent. On November 9, 2012, NAI filed a supplemental complaint adding allegations of infringement of Woodbolt's Cellucor Cor –Performance β-BCAA™ and Cellucor Cor –Performance™ Creatine products. On June 14, 2013, NAI filed a third patent infringement lawsuit in the U.S. District Court for the Southern District of Texas, Houston Division, against Woodbolt, BodyBuilding.com and GNC Corporation alleging infringement of the '381 and '422 patents by Woodbolt's Neon Sport Volt™ product. Woodbolt asserted the same defenses and counterclaims as set forth in the earlier lawsuits. On June 24, 2013, the Court consolidated the case with the earlier-filed lawsuits identified above. On June 25, 2013, Woodbolt filed a lawsuit in the U.S. District Court for the Southern District of Texas, Houston Division, against a newly-issued NAI U.S. patent no. 8,470,865, asserting declaratory judgment claims of non-infringement, invalidity and unenforceability. On July 1, 2013, Woodbolt's lawsuit was consolidated with the three pending lawsuits filed by NAI. On July 24, 2013, NAI filed its Answer and Amended Counterclaims against Woodbolt alleging infringement of the '865 patent by the products accused in the pending cases previously filed by NAI. On August 14, 2013, Woodbolt filed a counterclaim to NAI's counterclaim asserting violation of the Sherman Antitrust Act (15 U.S.C. § 2) and Unfair Competition. On September 4, 2013, NAI moved to have Woodbolt's counterclaims dismissed from the case. All of the consolidated cases remain pending. Woodbolt has also requested inter partes re-examination of the '381 and '422 patents by the USPTO. On July 26, 2012, the USPTO accepted the request to re-examine the '381 patent. On December 6, 2013, the USPTO rejected the claims of the '381 patent and issued a right of appeal notice. On January 6, 2014, the Company filed its notice of appeal. On August 17, 2012, the USPTO accepted the request to re-exam the '422 patent.

A declaration of non-infringement, invalidity or unenforceability of certain of our patents could have a material adverse impact upon our business results, operations, and financial condition.

On February 13, 2013, several entities, including the Company, were sued for various causes of action pertaining to product liability in Superior Court for the State of California (County of San Diego) captioned *Sparling v. USPLabs, LLC, et al.* Case No. 37-2013-00034663-CU-PL-CTL. On March 21, 2013, co-defendant USP Labs LLC filed a Notice of Removal to the U.S. District Court for the Southern District of California, Civil Action No. 3:13-cv-00667-JLS-DHB. Specific allegations against the Company are for negligence, strict products liability, breach of express and implied warranties and wrongful death. The Company has been provided with defense counsel by CSI's insurance company. Additionally, the Company has sought indemnification from co-defendant USPLabs, LLC. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. On April 19, 2013, the Company filed a motion to dismiss the allegations against it. On October 11, 2013, the Court granted a motion by co-defendant, USPLabs', to transfer the case to the U.S. District Court for the Western District of

Texas. The Court has set a trial date for March 26, 2015. The Company's motion to dismiss is still pending.

On May 8, 2013, several entities, including the Company, were sued for various causes of action pertaining to product liability in Superior Court for the State of California (County of Los Angeles) captioned *Carolynne v. USPLabs, LLC*, Case No. BC 508212. Specific allegations against the Company are for negligence, strict products liability, breach of express and implied warranties. The Company has been provided with defense counsel by CSI's insurance company. Additionally, the Company has sought indemnification from co-defendant USPLabs. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. On June 28, 2013, the Company filed a demurrer seeking dismissal of the allegations against it. The Company's motion is still pending.

On November 1, 2013, several entities, including the Company, were sued for various causes of action pertaining to product liability in Superior Court for the State of California (County of San Diego) captioned *Reed v. USPLabs, LLC*, Case No. 37-2013-00074052. Specific allegations against the Company are for negligence, strict products liability, and breach of express and implied warranties. The Company has been provided with defense counsel by CSI's insurance company. Additionally, the Company has sought indemnification from co-defendant USPLabs. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. The case has been removed to U.S. District Court for the Southern District of California. On December 27, 2013, the Company filed a motion to dismiss the allegations against it. The Company's motion is still pending.

On November 1, 2013, several entities, including the Company, were sued for various causes of action pertaining to product liability in U.S. District Court for the Western District of Texas captioned *Ogbonna v. USPLabs, LLC*, Case No. 13-cv-340. While the Company is named in the caption, the complaint does not contain any specific allegations against the Company. The Company has been provided with defense counsel by CSI's insurance company. Additionally, the Company has sought indemnification from co-defendant USPLabs. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. The case has been removed to U.S. District Court for the Southern District of California. On January 28, 2014, the Company filed a motion to dismiss the allegations against it. On February 19, 2014, the Company's motion to dismiss was granted by the Court.

On January 24, 2014, several entities, including the Company, were sued for various causes of action pertaining to product liability in Superior Court for the State of California (County of Los Angeles) captioned *Little v. USPLabs, LLC*, Case No. BC534065. Specific allegations against the Company are for negligence, strict products liability, and breach of express and implied warranties. The Company has been provided with defense counsel by CSI's insurance company. Additionally, the Company has sought indemnification from co-defendant USPLabs. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. On February 28, 2014, USPLabs filed a Notice of Removal from the Superior Court for the State of California to the U.S. District Court for the Central District of California. On March 7, 2014, the Company filed a Motion to Dismiss. On March 17, 2014, plaintiffs filed a Motion to Remand the case back to Superior Court. On April 25, 2014, the District Court granted plaintiffs' Motion to Remand based on a lack of subject matter jurisdiction and therefore also denied the Company's Motion to Dismiss as moot. The Company intends to file a Demurrer to dismiss the allegations against it in Superior Court.

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

The following discussion and analysis is intended to help you understand our financial condition and results of operations for the three and nine months ended March 31, 2014. 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 2013 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 U.S. Historically, our revenue has been largely dependent on sales to one or two private label contract manufacturing customers and subject to variations in the timing of such customers' orders, which in turn is impacted by such customers' internal marketing programs, supply chain management, entry into new markets, new product introductions, the demand for such customers' products, and general industry and economic conditions. Our revenue also includes royalty, licensing revenue, and raw material sales 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® trade name.

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, commercializing our patent estate through contract manufacturing, royalty and license agreements, and developing and growing our own line of branded products.

During the first nine months of fiscal 2014, our net sales were 14.7% higher than in the first nine months of fiscal 2013. Private label contract manufacturing sales increased 15.0% due primarily to higher volumes of existing products to existing customers and new product sales to new customers. This increase was partially offset by lower average sales prices for a portion of our higher volume products and lower average EUR exchange rates. Revenue concentration risk for our two largest private label contract manufacturing customers decreased to 53% as a

percentage of our total private label contract manufacturing sales for the first nine months of fiscal 2014 compared to 70% in the first nine months of fiscal 2013. We expect our contract manufacturing revenue concentration percentage for our two largest customers to remain materially consistent during the remainder of fiscal 2014.

During the first nine months of fiscal 2014, CarnoSyn® beta-alanine royalty and licensing revenue increased 18.9% to \$3.8 million as compared to \$3.2 million for the first nine months of fiscal 2013. Included in the royalty and licensing revenue during the first nine months of fiscal 2013 was \$103,000 of raw material sales of beta-alanine as compared to zero raw material sales in the same period in fiscal 2014. We did not have any beta-alanine raw material inventory as of both March 31, 2014 and March 31, 2013. We do not anticipate the direct purchase and sale of material quantities of beta-alanine raw material during the remainder of fiscal 2014.

To protect our CarnoSyn® business and its underlying patent estate, we incurred litigation and patent compliance expenses of approximately \$1.7 million during the first nine months of fiscal 2014 and \$1.8 million during the comparable period in fiscal 2013. We describe our efforts to protect our patent estate in more detail under Item 1 of Part II of our 2013 Annual Report. Our ability to maintain or further increase our beta-alanine royalty and licensing revenue will depend in large part on the availability 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, maintaining our patent rights, and the continued compliance by third parties with our patent and trademark rights.

Net sales from our branded products declined 11.2% in the first nine months of fiscal 2014 as compared to the first nine months of fiscal 2013 due to the continued softening of sales of our Pathway to Healing® product line.

During the remainder of fiscal 2014, 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;

- Expanding the commercialization of our beta-alanine patent estate through contract manufacturing, royalty and license agreements and protecting our proprietary rights;

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

## 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 2013 Annual Report and recent accounting pronouncements are discussed under Item A to our Notes to Condensed Consolidated Financial Statements contained in this Quarterly Report. There have been no significant changes to these policies or pronouncements during the three and nine months ended March 31, 2014 other than as listed under Item A to our Notes to Condensed Consolidated Financial Statement contained in this Quarterly Report.

## Results of Operations

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

	Three Months Ended March 31,			Nine Months Ended March 31,		
	2014	2013	% Change	2014	2013	% Change
Private label contract manufacturing	\$17,692	\$14,505	22	\$48,056	\$41,773	15
Patent and trademark licensing	1,141	1,009	13	3,812	3,207	19
Branded products	294	321	(8 )	889	1,001	(11 )
Total net sales	19,127	15,835	21	52,757	45,981	15
Cost of goods sold	15,685	12,972	21	44,056	37,357	18
Gross profit	3,442	2,863	20	8,701	8,624	1
Gross profit %	18.0 %	18.1 %		16.5 %	18.8 %	
Selling, general & administrative expenses	2,274	2,294	(1 )	7,179	7,299	(2 )
% of net sales	11.9 %	14.5 %		13.6 %	15.9 %	
Income from operations	1,168	569	105	1,522	1,325	15
% of net sales	6.1 %	3.6 %		2.9 %	2.9 %	
Other expense, net	115	48	140	82	53	55



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Income before income taxes	1,053	521	102	1,440	1,272	13
% of net sales	5.5	% 3.3	%	2.7	% 2.8	%
Income tax expense	431	343	26	536	295	82
Net income	\$622	\$178	249	\$904	\$977	(8 )
% of net sales	3.3	% 1.1	%	1.7	% 2.1	%

The percentage increase in contract manufacturing net sales was primarily attributed to the following for the periods ended March 31, 2014:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
Mannatech, Incorporated <sup>(1)</sup>	2.5	%	3.4	%
NSA International, Inc. <sup>(2)</sup>	(6.7	)	(12.8	)
Other customers <sup>(3)</sup>	26.2		24.4	
Total	22.0	%	15.0	%

<sup>1</sup> Net sales to Mannatech, Incorporated increased primarily as a result of higher volumes of established products in existing markets.

The decrease in net sales to NSA International, Inc. (NSA) for the three months ended March 31, 2014 included an increase in international sales of 1.7% and a decrease in domestic sales of 26.2%. The decrease in net sales to NSA for the nine months ended March 31, 2014 included a decrease in international sales of 25.0% and a decline in domestic sales of 23.2%. The decrease in international sales during the first nine months is primarily due to a customer driven inventory reduction program initiated during the first quarter of 2014, decreased demand by NSA's consumers, and lower average EUR exchange rates. NSA's inventory reduction program was substantially completed during our second quarter ended December 31, 2013. The domestic decrease is primarily due to lower average sales prices and lower sales primarily associated with a customer driven packaging reconfiguration that was launched during the first quarter of 2014. This new packaging configuration was completed as of September 30, 2013.

<sup>3</sup> The increase in net sales to other customers was primarily due to sales of new products for new customers and a net increase in sales of existing products for other existing customers.

Net sales from our patent and trademark licensing segment increased 13.1% during the third quarter of fiscal 2014 as compared to the third quarter of fiscal 2013 primarily due to increased market demand for CarnoSyn® beta-alanine. Net sales from our patent and trademark licensing segment increased 18.9% during the nine months ended March 31, 2014 as compared to the comparable nine month period last year primarily due to increased market demand for CarnoSyn® beta-alanine partially offset by a \$408,000 decrease in license fees received from Abbott and a \$103,000 decrease in beta-alanine raw material sales. Effective November 27, 2013 Abbott terminated our beta-alanine license and supply agreement. As a result, no further license fee payments will be paid to us under this agreement.

Net sales from our branded products segment decreased 8.4% during the third quarter of fiscal 2014 as compared to the comparable quarter in fiscal 2013 and 11.2% during the nine months ended March 31, 2014 compared to the comparable nine month period last year due primarily to the continued softening of the Pathway to Healing® product line.

Gross profit margin decreased 0.1 percentage points during the third quarter of fiscal 2014 from the comparable quarter in fiscal 2013 and decreased 2.3 percentage points during the nine months ended March 31, 2014 from the comparable nine month period last year. The change in gross profit margin was primarily due to the following for the periods ended March 31, 2014:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
Contract manufacturing:				
Shift in sales and material mix <sup>(1)</sup>	(0.4	)%	(3.2	)%
Incremental overhead expenses <sup>(1)</sup>	1.8		1.0	
Incremental direct and indirect labor <sup>(1)</sup>	(1.1	)	(0.3	)
Patent and trademark licensing <sup>(2)</sup>	(0.3	)	0.4	
Branded products operations <sup>(3)</sup>	(0.1	)	(0.2	)
Total	(0.1	)%	(2.3	)%

Private label contract manufacturing gross profit margin increased 0.3 percentage points in the third quarter of fiscal 2014 and decreased 2.7 percentage points in the first nine months of fiscal 2014 as compared to the comparable periods in fiscal 2013. The decrease in gross profit as a percentage of sales during the nine month period was primarily due to lower average sales prices for a portion of our higher volume products, an unfavorable shift in sales mix to lower margin products, and lower average EUR exchange rates.

Patent and trademark licensing gross profit margin increased 0.7 percentage points to 87.5% in the third quarter of fiscal 2014 from 86.8% in the third quarter of fiscal 2013 primarily due to a slightly lower average royalty expense rate. During the first nine months of fiscal 2014, patent and trademark licensing gross profit margin increased 2.2 percentage points to 86.3% from 84.1% in the first nine months of fiscal 2013 due to a change in the mix of the source of revenue in fiscal 2014 as compared to fiscal 2013 and a lower average royalty expense rate.

Branded products gross profit margin increased 3.4 percentage points to 43.3% in the third quarter of fiscal 2014 from 39.9% in the third quarter of fiscal 2013. During the first nine months of fiscal 2014, gross profit percentage increased 0.8 percentage points to 39.9% from 39.1% during the first nine months of fiscal 2013. The increase in gross profit margin is due primarily to sales mix and lower inventory write-offs.

Selling, general and administrative expenses decreased \$20,000, or 0.9%, during the third quarter of fiscal 2014 as compared to the comparable prior year period. During the first nine months of fiscal 2014, selling, general and administrative expenses decreased \$120,000, or 1.6%, as compared to the comparable prior year period.

Other expense, net increased \$67,000 during the third quarter of fiscal 2014 from the comparable quarter last year primarily due to the recognition of non-income tax expense, which included liabilities related to the current and prior years. This was partially offset by favorable foreign currency translation activity. Other expense, net increased \$29,000 during the nine month period ended March 31, 2014 from the comparable nine month period last year due primarily to the recognition of non-income tax expense, which included liabilities related to the current and prior years. This was partially offset by favorable foreign currency translation activity.

Our income tax expense increased \$88,000 during the third quarter of fiscal 2014 and \$241,000 during the nine months ended March 31, 2014 as compared to the same periods in the prior fiscal year. The increases were attributed to higher pre-tax income as compared to the comparable prior year periods and the recognition of certain discrete tax items, which included (1) an expense to adjust the state deferred tax assets as a result of a change in the estimated state tax rate, (2) an expense to establish a valuation allowance on a portion of the deferred tax asset for the California net operating loss, (3) a net benefit of state taxes as a result of adjusting California apportionment and filing in other states for prior years, and (4) a true-up of the R&D credit claimed on the federal income tax return filed in the current quarter.

### **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 provided by operating activities was \$571,000 for the nine months ended March 31, 2014 compared to \$2.1 million provided by operating activities in the comparable period in the prior year.

At March 31, 2014, changes in accounts receivable, consisting primarily of amounts due from our private label contract manufacturing customers and our patent and trademark licensing activities, used \$223,000 in cash during the nine months ended March 31, 2014 compared to providing \$2.7 million in the comparable period in the prior year. The decrease in cash provided by accounts receivable during the six months ended December 31, 2013 was primarily due to the collection of amounts due from sales of beta-alanine raw materials during the first six months of fiscal 2013 with no such corresponding activity in fiscal 2014 along with timing of sales year over year. Days sales outstanding was 35 days as of March 31, 2014 compared to 44 days as of March 31, 2013.

At March 31, 2014, changes in inventory used \$4.3 million in cash as compared to using \$1.7 million of cash in the comparable prior year period. The increase in cash used by inventory during the nine months ended March 31, 2014 was primarily related to the build-up of inventory due to increased demand and timing of inventory shipments and receipts.

Approximately \$170,000 of our operating cash flow was generated by NAIE in the nine months ended March 31, 2014. As of March 31, 2014, NAIE's undistributed retained earnings were considered indefinitely reinvested.

Capital expenditures were \$2.2 million during the nine months ended March 31, 2014 compared to \$1.4 million in the comparable period in the prior year. Capital expenditures during the nine months ended March 31, 2014 and March 31, 2013 were primarily for manufacturing equipment in our Vista, California and Manno, Switzerland facilities.

We did not have any consolidated debt as of either March 31, 2014 or June 30, 2013.

On December 16, 2010, we executed a Credit Agreement (“Credit Agreement”) with Wells Fargo Bank, National Association. This Credit Agreement replaced our previous credit facility and provides us with a line of credit of up to \$5.0 million. The line of credit may be used to finance working capital requirements. In consideration for granting the line of credit and each subsequent extension amendment, we pay an annual commitment fee of \$12,500. 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) net income after taxes of not less than \$750,000 on a trailing four quarter basis as of the end of each calendar quarter beginning with the four quarter period ended December 31, 2010; and (ii) a ratio of total liabilities to tangible net worth of not greater than 1.25 to 1.0 at any time. 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 2.75% above the daily one month LIBOR rate as in effect from time to time. If a fixed rate is elected, it would equal a per annum rate of 2.50% above the LIBOR rate in effect on the first day of the applicable fixed rate term. Any amounts outstanding under the line of credit must be paid in full on or before November 1, 2015; provided, however, that we must maintain a zero balance on advances under the line of credit for a period of at least 30 consecutive days during each fiscal year. Amounts outstanding that are subject to a fluctuating interest rate may be prepaid at any time without penalty. Amounts outstanding that are subject to a fixed interest rate may be prepaid at any time in minimum amounts of \$100,000, subject to a prepayment fee equal to the sum of the discounted monthly differences for each month from the month of prepayment through the month in which the then applicable fixed rate term matures.

Our obligations under the Credit Agreement are secured by our accounts receivable and other rights to payment, general intangibles, inventory, equipment and fixtures. We also have a foreign exchange facility with Wells Fargo in effect until November 1, 2014, and with Bank of America, N.A. in effect until August 15, 2015.

On March 31, 2014, we were in compliance with all of the financial and other covenants required under the Credit Agreement.

On September 22, 2006, NAIE, our wholly owned subsidiary, entered into a credit facility with Credit Suisse to provide NAIE with a credit line of up to CHF 1.3 million, or approximately \$1.5 million, which was the initial maximum aggregate amount that could be outstanding at any one time under the credit facility. This maximum amount is reduced annually by CHF 160,000, or approximately \$180,000. 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 \$564,000. As of March 31, 2014, there was no outstanding balance under this 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 \$1,127), 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 March 31, 2014, we had \$15.2 million in cash and cash equivalents and \$5.6 million available under our credit facilities. Of these amounts, \$6.2 million of cash and cash equivalents and \$564,000 of the amount available under our credit facilities were held by NAIE. Our intent is to permanently reinvest all of our earnings from foreign operations, and we do not currently anticipate that we will need funds generated from foreign operations to fund our domestic operations. In the event funds from foreign operations are needed to fund our U.S. operations, we may be required to accrue and pay additional U.S. taxes to repatriate any such funds. Overall, we believe our available cash, cash equivalents and potential cash flows from operations will be sufficient to fund our current working capital needs and capital expenditures through at least the next 12 months.

### **Off-Balance Sheet Arrangements**

As of March 31, 2014, we did not have any 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 in the notes to our consolidated financial statements included under Item 1 of this report. Other than those pronouncements, we are not aware of any other pronouncements that materially affect our financial position or results of operations.

## **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 (principal executive officer) and Chief Financial Officer (principal financial and accounting officer), evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2014. 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 March 31, 2014.

There were no changes to our internal control over financial reporting during the quarterly period ended March 31, 2014 that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.



## **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 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 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 May 13, 2014, except as described below, neither NAI nor its subsidiary were a party to any material pending legal proceeding nor was any of their property the subject of any material pending legal proceeding.

On September 8, 2011, NAI and CSI filed a complaint in the U.S. District Court for the District of Delaware against DNP International Co., Inc. (DNP) alleging claims of unfair competition, violation of the Delaware Deceptive Trade Practices Act and interference with business relations. On December 22, 2011, DNP filed a complaint in the U.S. District Court for the District of Delaware against NAI and CSI for declaratory judgment of non-infringement and invalidity of three of NAI's patents. On January 27, 2012, DNP amended its complaint to add declaratory judgment claims against a fourth NAI patent ("381 patent). On February 6, 2012, the Company and CSI moved to dismiss the cases related to the three previously asserted patents for lack of subject matter jurisdiction. On the same day, the Company filed its answer and counterclaims for infringement by DNP of the "381 patent. DNP subsequently agreed to voluntarily dismiss CSI from the lawsuit. On March 2, 2012, the Court ordered the dismissal of CSI. On April 15, 2013, the Court consolidated the two lawsuits referenced above for purposes of pretrial matters. The Court also entered a Scheduling Order setting a trial date in April 2015.

On December 21, 2011, NAI filed a lawsuit in the U.S. District Court for the Southern District of Texas, Houston Division, alleging infringement by Woodbolt Distribution, LLC, also known as Cellucor (Woodbolt), Vitaquest International, Inc., d/b/a Garden State Nutritionals (Garden State) and F.H.G. Corporation, d/b/a Integrity Nutraceuticals (Integrity), of NAI's '381 patent. The complaint alleges that Woodbolt sells nutritional supplements, including supplements containing beta-alanine such as C4 Extreme™, M5 Extreme™, and N-Zero Extreme™, that infringe "'381 patent. Woodbolt, in turn, filed a complaint seeking a declaratory judgment of non-infringement and invalidity of the '381 patent in the U.S. District Court for the District of Delaware. On February 17, 2012, Woodbolt filed a First Amended Complaint, realleging its original claims against the Company and asserting new claims of violation of the Sherman Antitrust Act (15 U.S.C. § 2) and Unfair Competition. The Company reasserted the arguments in its prior motion to dismiss and moved to dismiss the new claims asserted by Woodbolt. On January 23, 2013, the Delaware Court granted the Company's motion to dismiss Woodbolt's case. On June 5, 2012, the Court in the above-referenced

Texas case consolidated the pending suit with a second patent infringement case filed against Woodbolt by the Company on May 3, 2012, asserting infringement of its “422 patent. On November 9, 2012, NAI filed a supplemental complaint adding allegations of infringement of Woodbolt’s Cellucor Cor –Performance β-BCAA™ and Cellucor Cor –Performance™ Creatine products. On June 14, 2013, NAI filed a third patent infringement lawsuit in the U.S. District Court for the Southern District of Texas, Houston Division, against Woodbolt, BodyBuilding.com and GNC Corporation alleging infringement of the “381 and “422 patents by Woodbolt’s Neon Sport Volt™ product. Woodbolt asserted the same defenses and counterclaims as set forth in the earlier lawsuits. On June 24, 2013, the Court consolidated the case with the earlier-filed lawsuits identified above. On June 25, 2013, Woodbolt filed a lawsuit in the U.S. District Court for the Southern District of Texas, Houston Division, against a newly-issued NAI U.S. patent no. 8,470,865, asserting declaratory judgment claims of non-infringement, invalidity and unenforceability. On July 1, 2013, Woodbolt’s lawsuit was consolidated with the three pending lawsuits filed by NAI. On July 24, 2013, NAI filed its Answer and Amended Counterclaims against Woodbolt alleging infringement of the “865 patent by the products accused in the pending cases previously filed by NAI. On August 14, 2013, Woodbolt filed a counterclaim to NAI’s counterclaim asserting violation of the Sherman Antitrust Act (15 U.S.C. § 2) and Unfair Competition. On September 4, 2013, NAI moved to have Woodbolt’s counterclaims dismissed from the case. All of the consolidated cases remain pending. Separately, Woodbolt also requested inter partes re-examination of the ’381 and ’422 patents by the USPTO.

On July 26, 2012, the USPTO accepted the request to re-exam the ’381 patent. On December 6, 2013, the USPTO rejected the claims of the “381 patent and issued a right of appeal notice. On January 6, 2014, NAI filed its notice of appeal. On August 17, 2012 the USPTO accepted the request to re-exam the ’422 patent.

A declaration of non-infringement, invalidity or unenforceability of certain of our patents could have a material adverse impact upon our business results, operations, and financial condition.

On February 13, 2013, several entities, including the Company, were sued for various causes of action pertaining to product liability in Superior Court for the State of California (County of San Diego) captioned *Sparling v. USPLabs, LLC, et al.* Case No. 37-2013-00034663-CU-PL-CTL. On March 21, 2013, co-defendant USP Labs LLC filed a Notice of Removal to the U.S. District Court for the Southern District of California, Civil Action No. 3:13-cv-00667-JLS-DHB. Specific allegations against the Company are for negligence, strict products liability, breach of express and implied warranties and wrongful death. The Company has been provided with defense counsel by its insurance company. Additionally, the Company has sought indemnification from co-defendant USPLabs, LLC. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. On April 19, 2013, the Company filed a motion to dismiss the allegations against it. On October 11, 2013, the Court granted co-defendant, USPLabs' motion to transfer the case to the U.S. District Court for the Western District of Texas. The Court has set a trial date for March 26, 2015. The Company's motion to dismiss is still pending.

On May 8, 2013, several entities, including the Company, were sued for various causes of action pertaining to product liability in Superior Court for the State of California (County of Los Angeles) captioned *Carolynne v. USPLabs, LLC*, Case No. BC 508212. Specific allegations against the Company are for negligence, strict products liability and breach of express and implied warranties. The Company has been provided with defense counsel by its insurance company. Additionally, the Company has sought indemnification from co-defendant USP Labs, LLC. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. On June 28, 2013, the Company filed a Demurrer to dismiss the allegations against it. The Company's motion is still pending.

On November 1, 2013, several entities, including the Company, were sued for various causes of action pertaining to product liability in Superior Court for the State of California (County of San Diego) captioned *Reed v. USPLabs, LLC*, Case No. 37-2013-00074052. Specific allegations against the Company are for negligence, strict products liability, and breach of express and implied warranties. The Company has been provided with defense counsel by CSI's insurance company. Additionally, the Company has sought indemnification from co-defendant USPLabs. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. The case has been removed to U.S. District Court for the Southern District of California. On December 27, 2013, the Company filed a motion to dismiss the allegations against it. The Company's motion is still pending.

On November 1, 2013, several entities, including the Company, were sued for various causes of action pertaining to product liability in U.S. District Court for the Western District of Texas captioned *Ogbonna v. USPLabs, LLC*, Case No. 13-cv-340. While the Company is named in the caption, the complaint does not contain any specific allegations against the Company. The Company has been provided with defense counsel by CSI's insurance company. Additionally, the Company has sought indemnification from co-defendant USPLabs. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. The case has been removed to U.S. District Court for the Southern District of California. On January 28, 2014, the Company filed a motion to dismiss the allegations against it. On February 19, 2014, the Company's motion to dismiss was granted by the Court.

On January 24, 2014, several entities, including the Company, were sued for various causes of action pertaining to product liability in Superior Court for the State of California (County of Los Angeles) captioned *Little v. USPLabs*,

*LLC*, Case No. BC534065. Specific allegations against the Company are for negligence, strict products liability, and breach of express and implied warranties. The Company has been provided with defense counsel by CSI's insurance company. Additionally, the Company has sought indemnification from co-defendant USPLabs. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. The Company is not involved in the formulation, manufacture, distribution or sale of the product at issue in the lawsuit. On February 28, 2014, USPLabs filed a Notice of Removal from the Superior Court for the State of California to the U.S. District Court for the Central District of California. On March 7, 2014, the Company filed a Motion to Dismiss. On March 17, 2014, plaintiffs filed a Motion to Remand the case back to Superior Court. On April 25, 2014, the District Court granted plaintiffs' Motion to Remand based on a lack of subject matter jurisdiction and therefore also denied the Company's Motion to Dismiss as moot. The Company intends to file a Demurrer to dismiss the allegations against it in Superior Court.

Although we believe the above litigation matters are supported by valid claims, there is no assurance NAI will prevail in these litigation matters or in similar proceedings it may initiate or that litigation expenses will be as anticipated.

#### **ITEM 1A. RISK FACTORS**

When evaluating our business and future prospects you should carefully consider the risks described under Item 1A of our 2013 Annual Report, as well as the other information in our 2013 Annual Report, this report and other reports and documents we file with the SEC. 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. Additional risks and uncertainties not currently known to us, or that we currently believe to be immaterial, also may materially adversely affect our business, financial condition, or results of operations.

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

**Repurchases**

During the quarter ended March 31, 2014 we acquired 6,701 shares from employees in connection with restricted stock shares that vested during the quarter. These shares were returned to the Company by the related employees and in return the Company paid each employee's required tax withholding. The valuation of the shares acquired and thereby the amount of shares returned to the Company was calculated based on the closing share price on the date the shares vested.

During the quarter ended December 31, 2013, we did not repurchase and shares of our common stock as part of our repurchase plan.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

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:

Exhibit Number	Description	Incorporated By Reference To
3(i)	Amended and Restated Certificate of Incorporation of Natural Alternatives International, Inc. filed with the Delaware Secretary of State on January 14, 2005	Exhibit 3(i) of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004, filed with the commission on February 14, 2005
3(ii)	Amended and Restated By-laws of Natural Alternatives International, Inc. dated as of February 9, 2009	Exhibit 3(ii) of NAI's Current Report on Form 8-K dated February 9, 2009, filed with the commission on February 13, 2009
4(i)	Form of NAI's Common Stock Certificate	Exhibit 4(i) of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.1		

	1999 Omnibus Equity Incentive Plan as adopted effective May 10, 1999, amended effective January 30, 2004, and further amended effective December 3, 2004*	Exhibit 10.1 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004, filed with the commission on February 14, 2005
10.2	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
10.3	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
10.4	First Amendment to Exclusive License Agreement effective as of December 10, 2004 by and among NAI and Reginald B. Cherry Ministries, Inc.	Exhibit 10.13 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
10.5	Lease of Facilities in Vista, California	Exhibit 10.10 of NAI's Quarterly

- between NAI and Calwest Industrial Properties, LLC, a California limited liability company (lease reference date June 12, 2003) Report on Form 10-Q for the quarterly period ended September 30, 2003, filed with the commission on November 5, 2003  
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  
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  
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  
Exhibit 10.20 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2005,
- 10.6 Form of Indemnification Agreement entered into between NAI and each of its directors
- 10.7 Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated May 9, 2005 (English translation)
- 10.8 Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated July 25, 2003 (English translation)
- 10.9 Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated



- |       |   |   |
|-------|---|---|
|       | June 8, 2004<br>(English translation)   | filed with the<br>commission on<br>September 8,<br>2005   |
| 10.10 | Lease of<br>Facilities in<br>Manno,<br>Switzerland<br>between NAIE<br>and Mr. Silvio<br>Tarchini dated<br>February 7,<br>2005 (English<br>translation)  | Exhibit 10.21<br>of NAI's<br>Annual Report<br>on Form 10-K<br>for the fiscal<br>year ended<br>June 30, 2005,<br>filed with the<br>commission on<br>September 8,<br>2005                   |
| 10.11 | Amendment<br>effective as of<br>September 15,<br>2005 to Lease of<br>Facilities in<br>Manno,<br>Switzerland<br>between NAIE<br>and Mr. Silvio<br>Tarchini dated<br>May 9, 2005<br>(English<br>translation)  | Exhibit 10.24<br>of NAI's<br>Quarterly<br>Report on<br>Form 10-Q for<br>the quarterly<br>period ended<br>September 30,<br>2005, filed<br>with the<br>commission on<br>November 4,<br>2005 |
| 10.12 | Loan<br>Agreement<br>between NAIE<br>and Credit<br>Suisse dated as<br>of September<br>22, 2006,<br>including<br>general<br>conditions<br>(portions of the<br>Loan<br>Agreement have<br>been omitted<br>pursuant to a<br>request for<br>confidential<br>treatment) | Exhibit 10.36<br>of NAI's<br>Quarterly<br>Report on<br>Form 10-Q for<br>the quarterly<br>period ended<br>September 30,<br>2006, filed<br>with the<br>commission on<br>November 1,<br>2006 |
| 10.13 | First<br>Amendment to<br>Loan<br>Agreement<br>between NAIE  | Exhibit 10.41<br>of NAI's<br>Quarterly<br>Report on<br>Form 10-Q for  |

and Credit            the quarterly  
Suisse dated as      period ended  
of February 19,      March 31,  
2007                    2007, filed  
                             with the  
                             commission on  
                             May 14, 2007  
                             Exhibit D of  
                             NAI's  
                             definitive  
10.14    2009 Omnibus      Proxy  
            Incentive Plan\*      Statement filed  
                             with the  
                             commission on  
                             October 16,  
                             2009

- 10.15 Manufacturing Agreement by and between NSA, Inc. and NAI dated April 1, 2005 Exhibit 10.43 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2009, filed with the commission on February 16, 2010 Exhibit 10.44 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2009, filed with the commission on February 16, 2010
- 10.16 Manufacturing Agreement by and between Mannatech, Inc. and NAI dated April 22, 1998 Exhibit 10.45 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2009, filed with the commission on February 16, 2010
- 10.17 First Amendment to Manufacturing Agreement by and between Mannatech, Incorporated and NAI dated May 23, 2003 Exhibit 10.45 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2009, filed with the

commission  
 on February  
 16, 2010  
 Exhibit  
 10.46 of  
 NAI's  
 Quarterly  
 Second Report on  
 Amendment to Form 10-Q  
 Manufacturing for the  
 Agreement by quarterly  
 10.18 and between period  
 Mannatech, ended  
 Incorporated December  
 and NAI dated 31, 2009,  
 July 1, 2003 filed with  
 the  
 commission  
 on February  
 16, 2010  
 Exhibit  
 10.47 of  
 NAI's  
 Quarterly  
 Third Report on  
 Amendment to Form 10-Q  
 Manufacturing for the  
 Agreement by quarterly  
 10.19 and between period  
 Mannatech, ended  
 Incorporated December  
 and NAI dated 31, 2009,  
 July 1, 2004 filed with  
 the  
 commission  
 on February  
 16, 2010  
 10.20 Fourth Exhibit  
 Amendment to 10.48 of  
 Manufacturing NAI's  
 Agreement by Quarterly  
 and among Report on  
 Mannatech, Form 10-Q  
 Incorporated, for the  
 Mannatech quarterly  
 Swiss period  
 International ended  
 GmbH and December  
 NAI dated 31, 2009,  
 January 1, filed with  
 2008 the

- commission  
on February  
16, 2010  
Exhibit  
10.49 of  
NAI's  
Quarterly  
Manufacturing Report on  
Sales Form 10-Q  
Agreement by for the  
and between quarterly  
10.21 Mannatech, period  
Incorporated ended  
and NAI dated December  
November 19, 31, 2009,  
2004 filed with  
the  
commission  
on February  
16, 2010  
Exhibit  
10.50 of  
NAI's  
Quarterly  
Sales Report on  
Agreement by Form 10-Q  
and among for the  
Mannatech, quarterly  
Incorporated, period  
10.22 Mannatech ended  
Swiss December  
International 31, 2009,  
GmbH and filed with  
NAI dated the  
January 1, commission  
2008 on February  
16, 2010  
10.23 Exclusive Exhibit  
Manufacturing 10.51 of  
Agreement by NAI's  
and between Quarterly  
NSA, Inc., Report on  
NAI and NAIE Form 10-Q  
dated as of for the  
April 1, 2005 quarterly  
period  
ended  
December  
31, 2009,  
filed with  
the

- 10.24 Amended and Restated Employment Agreement dated as of August 31, 2010, by and between NAI and Mark A. LeDoux\* commission on February 16, 2010 Exhibit 10.41 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2010, filed with the commission on September 17, 2010 Exhibit 10.42 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2010, filed with the commission on September 17, 2010
- 10.25 Amended and Restated Employment Agreement dated as of August 31, 2010, by and between NAI and Kenneth E. Wolf commission on September 17, 2010 Exhibit 10.40 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010, filed with the commission on November 12, 2010
- 10.26 License and Fee Agreement effective November 10, 2010 by and among Roger Harris, Mark Dunnett, Kenny Johansson and NAI commission on November 12, 2010

	Exhibit 10.1 of NAI's Current Report on Form 8-K dated December 16, 2010, filed with the commission on December 22, 2010 Exhibit 10.31 of
10.27	Credit Agreement by and between NAI and Wells Fargo Bank, N.A. effective as of December 1, 2010
10.28	ISDA 2002 Master Agreement dated as of March 10, 2011 by and between Bank of America N.A. and NAI (with Schedule dated March 10, 2011)
10.29	Report on Form 10-Q for the quarterly period ended March 31, 2011, filed with the commission on May 16, 2011 Exhibit 10.31 of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2011, filed with the commission on September 22, 2011
10.30	Exhibit 10.1 of NAI's Current Report on Form 8-K dated
	Agreement to License by and between NAI and Compound Solutions, Inc. effective as of July 1, 2011
	First Amendment to Credit Agreement by and between NAI and Wells

- Fargo Bank, December  
 N.A. effective 27, 2011,  
 as of filed with  
 November 28, the  
 2011 commission  
 on  
 December  
 30, 2011  
 Exhibit 10.2  
 of NAI's  
 Revolving Line Current  
 of Credit Note Report on  
 made by NAI Form 8-K  
 for the benefit dated  
 of Wells Fargo December  
 10.31 Bank, N.A. 27, 2011,  
 dated filed with  
 November 28, the  
 2011 in the commission  
 amount of on  
 \$5,000,000 December  
 30, 2011  
 Exhibit  
 10.32 of  
 NAI's  
 Quarterly  
 Lease of Report on  
 Facilities in Form 10-Q  
 Manno, for the  
 Switzerland quarterly  
 10.32 between NAIE period  
 and Mr. Silvio ended  
 Tarchini dated December  
 January 1, 31, 2011,  
 2012 (English filed with  
 translation) the  
 commission  
 on February  
 13, 2012  
 Exhibit  
 10.33 First 10.33 of  
 Amendment to NAI's  
 Agreement to Quarterly  
 License by and Report on  
 between NAI Form 10-Q  
 and Compound for the  
 Solutions, Inc. quarterly  
 effective as of period  
 January 6, ended  
 2012 March 31,  
 2012, filed



10.34 with the  
commission  
on May 14,  
2012  
Exhibit  
10.34 of  
NAI's  
Second Quarterly  
Amendment to Report on  
Agreement to Form 10-Q  
License by and for the  
between NAI quarterly  
and Compound period  
Solutions, Inc. ended  
effective as of March 31,  
March 19, 2012, filed  
2012 with the  
commission  
on May 14,  
2012

- 10.35 First Amendment to Manufacturing Agreement by and between NSA, Inc. and NAI effective as of April 1, 2012
- 10.36 First Exclusive Manufacturing Agreement by and between NSA, Inc., NAI and NAIE effective as of April 1, 2005.
- 10.37 Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated September 3, 2012 (English translation).
- 10.38

Exhibit  
 10.35 of  
 NAI's  
 Quarterly  
 Report on  
 Form 10-Q  
 for the  
 quarterly  
 period  
 ended  
 March 31,  
 2012, filed  
 with the  
 commission  
 on May 14,  
 2012

Exhibit  
 10.36 of  
 NAI's  
 Quarterly  
 Report on  
 Form 10-Q  
 for the  
 quarterly  
 period  
 ended  
 March 31,  
 2012, filed  
 with the  
 commission  
 on May 14,  
 2012

Exhibit  
 10.37 of  
 NAI's  
 Annual  
 Report on  
 Form 10-K  
 for the fiscal  
 year ended  
 June 30,  
 2012, filed  
 with the  
 commission  
 on  
 September  
 21, 2012

	Second	Exhibit
	Amendment to	10.38 of
	Credit	NAI's
	Agreement by	Quarterly
	and between	Report on
	NAI and Wells	Form 10-Q
	Fargo Bank,	for the
	N.A. effective	quarterly
	as of December	period
	7, 2012	ended
		December
		31, 2012,
		filed with
		the
		commission
		on February
		12, 2013
		Exhibit
		10.39 of
		NAI's
	Revolving Line	Quarterly
	of Credit Note	Report on
	made by NAI	Form 10-Q
	for the benefit	for the
	of Wells Fargo	quarterly
10.39	Bank, N.A.	period
	dated	ended
	December 7,	December
	2012 in the	31, 2012,
	amount of	filed with
	\$5,000,000	the
		commission
		on February
		12, 2013
		Exhibit
	Third	10.40 of
	amendment to	NAI's
	the Lease of	Annual
	Facilities in	Report on
	Vista,	Form 10-K
	California	for the fiscal
10.40	between NAI	year ended
	and CWCA	June 30,
	Vista	2013, filed
	Distribution	with the
	77, LLC, a	commission
	Delaware	on
	limited liability	September
	company	19, 2013
10.41	Second	Exhibit
	amendment to	10.41 of

the Amended NAI's  
 and Restated Annual  
 Employment Report on  
 Agreement, by Form 10-K  
 and between for the fiscal  
 NAI and Mark year ended  
 A. LeDoux, June 30,  
 effective July 2013, filed  
 1, 2013\* with the  
 commission  
 on  
 September  
 19, 2013  
 Exhibit  
 10.42 of  
 NAI's  
 Annual  
 Report on  
 Form 10-K  
 for the fiscal  
 year ended  
 June 30,  
 2013, filed  
 with the  
 commission  
 on  
 September  
 19, 2013  
 Exhibit  
 10.43 of  
 NAI's  
 Quarterly  
 Report on  
 Form 10-Q  
 for the  
 quarterly  
 period  
 ended  
 December  
 31, 2013  
 filed with  
 the  
 commission  
 on February  
 12, 2014.

10.42 Second  
 amendment to  
 the Amended  
 and Restated  
 Employment  
 Agreement, by  
 and between  
 and Kenneth E.  
 Wolf, effective  
 July 1, 2013\*

10.43 Third  
 Amendment to  
 Credit  
 Agreement by  
 and between  
 NAI and Wells  
 Fargo Bank,  
 N.A. effective  
 as of  
 November 1,  
 2013

10.44 Revolving Line  
 of Credit Note  
 made by NAI  
 for the benefit  
 of Wells Fargo  
 Bank, N.A.

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dated for the  
 November 1, quarterly  
 2013 in the period  
 amount of ended  
 \$5,000,000 December  
 31, 2013  
 filed with  
 the  
 commission  
 on February  
 12, 2014.

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
101.INS	XBRL Instance Document**	Furnished herewith
101.SCH	XBRL Taxonomy Extension Schema Document**	Furnished herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document**	Furnished herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document**	Furnished herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document**	Furnished herewith

XBRL Taxonomy Extension 101.PRE Presentation Linkbase Document**	Furnished herewith
--	-----------------------

\* Indicates management contract or compensatory plan or arrangement.

\*\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

**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: May 13, 2014

NATURAL ALTERNATIVES  
INTERNATIONAL, INC.

By: /s/ Mark A. LeDoux  
Mark A. LeDoux, Chief Executive Officer  
(principal executive officer)

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.