NATURAL ALTERNATIVES INTERNATIONAL INC
Form 10-Q
May 13, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT

pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2008

000-15701

(Commission file number)

NATURAL ALTERNATIVES INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**84-1007839**
(State of incorporation)	**(IRS Employer Identification No.)**
1185 Linda Vista Drive	
San Marcos, California 92078	**(760) 744-7340**
(Address of principal executive offices)	**(Registrant s telephone number)**

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

Indicate by check mark whether NAI is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

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

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

As of May 13, 2008, 7,023,435 shares of NAI s common stock were outstanding, net of 180,941 treasury shares.

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SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

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

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

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

development of new products, brands and marketing strategies;

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

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

our ability to expand the customer base of the As We Change® catalog and achieve higher sales, profitability and cash flows as a result;

inventories and the adequacy and intended use of our facilities;

current or future customer orders;

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

management s goals and plans for future operations;

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

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

personnel;

the outcome of regulatory, tax and litigation matters;

sources and availability of raw materials;

operations outside the United States;

the adequacy of reserves and allowances;

overall industry and market performance;

competition;

current and future economic and political conditions;

the impact of accounting pronouncements; and

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

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

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

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NATURAL ALTERNATIVES INTERNATIONAL, INC.

Condensed Consolidated Balance Sheets

(In thousands, except share and per share data)

	March 31, 2008 (Unaudited)	June 30, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 3,804	$ 4,876
Accounts receivable - less allowance for doubtful accounts of $20 at March 31, 2008 and June 30, 2007	4,773	5,264
Inventories, net	17,792	14,099
Deferred income taxes	1,441	1,441
Other current assets	3,103	2,204
Total current assets	30,913	27,884
Property and equipment, net	13,872	15,059
Goodwill and purchased intangibles, net	4,078	4,268
Other noncurrent assets, net	169	169
Total assets	$ 49,032	$ 47,380
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 9,104	$ 6,330
Accrued liabilities	2,391	1,840
Accrued compensation and employee benefits	1,289	1,403
Line of credit		
Income taxes payable		270
Current portion of long-term debt	1,541	1,825
Total current liabilities	14,325	11,668
Long-term debt, less current portion	1,656	2,756
Deferred income taxes	1,620	1,620
Deferred rent	1,190	1,238
Long-term pension liability	113	76
Total liabilities	18,904	17,358
Commitments and contingencies		
Stockholders equity:		
Preferred stock; $0.01 par value; 500,000 shares authorized; none issued or outstanding		
Common stock; $0.01 par value; 20,000,000 shares authorized; issued and outstanding 7,204,376 at March 31, 2008 and 7,001,230 at June 30, 2007	71	69

Additional paid-in capital		18,335		17,335
Accumulated other comprehensive loss		(153)		(184)
Retained earnings		12,974		13,177
Treasury stock, at cost, 180,941 shares at March 31, 2008 and 70,000 at June 30, 2007		(1,099)		(375)
Total stockholders equity		30,128		30,022
Total liabilities and stockholders equity	$	49,032	$	47,380

See accompanying notes to condensed consolidated financial statements.

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NATURAL ALTERNATIVES INTERNATIONAL, INC.

Condensed Consolidated Statements of Operations and Comprehensive (Loss) Income

(In thousands, except share and per share data)

(Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Net sales	$ 21,929	$ 23,791	$ 67,858	$ 73,001
Cost of goods sold	17,856	18,394	54,239	56,387
Gross profit	4,073	5,397	13,619	16,614
Selling, general & administrative expenses	5,019	4,801	14,168	14,221
(Loss) income from operations	(946)	596	(549)	2,393
Other income (expense):				
Interest income	5	3	18	8
Interest expense	(68)	(137)	(281)	(534)
Foreign exchange gain	155	7	305	63
Other, net	61	10	56	(3)
	153	(117)	98	(466)
(Loss) income before income taxes	(793)	479	(451)	1,927
(Benefit) provision for income taxes	(347)	110	(248)	617
Net (loss) income	$ (446)	$ 369	$ (203)	$ 1,310
Unrealized gain resulting from change in fair value of derivative instruments, net of tax	9	34	31	48
Comprehensive (loss) income	$ (437)	$ 403	$ (172)	$ 1,358
Net (loss) income per common share:				
Basic	$ (0.06)	$ 0.05	$ (0.03)	$ 0.19
Diluted	$ (0.06)	$ 0.05	$ (0.03)	$ 0.18
Weighted average common shares outstanding:				
Basic	7,013,664	6,885,489	6,969,324	6,815,323
Diluted	7,013,664	7,202,454	6,969,324	7,193,626

See accompanying notes to condensed consolidated financial statements.

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NATURAL ALTERNATIVES INTERNATIONAL, INC.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine Months Ended March 31,	
	2008	**2007**
Cash flows from operating activities		
Net (loss) income	$ (203)	$ 1,310
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Change in allowance for uncollectible accounts receivable		(124)
Depreciation and amortization	2,437	2,517
Amortization of purchased intangibles	190	189
Non-cash equipment impairment charge	69	
Non-cash compensation	319	171
Tax benefit from exercise of stock options	(194)	(442)
Pension expense, net of contributions	37	44
Loss on disposal of assets		5
Changes in operating assets and liabilities:		
Accounts receivable	490	8,983
Inventories, net	(3,692)	(451)
Other assets	(43)	(237)
Accounts payable and accrued liabilities	3,275	2,148
Accrued compensation and employee benefits	(114)	(716)
Income taxes payable	(901)	
Net cash provided by operating activities	1,670	13,397
Cash flows from investing activities		
Capital expenditures	(1,316)	(2,220)
Proceeds from sale of equipment		70
Net cash used in investing activities	(1,316)	(2,150)
Cash flows from financing activities		
Payments on long-term debt	(1,385)	(1,282)
Net payments on line of credit		(9,574)
Tax benefit from exercise of stock options	194	442
Repurchase of common stock	(724)	(82)
Proceeds from issuance of common stock	489	880
Net cash used in financing activities	(1,426)	(9,616)
Net (decrease) increase in cash and cash equivalents	(1,072)	1,631
Cash and cash equivalents at beginning of period	4,876	2,157
Cash and cash equivalents at end of period	$ 3,804	$ 3,788

Supplemental disclosures of cash flow information

Cash paid during the period for:		
Interest	$ 281	$ 516
Taxes	$ 419	$ 671

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

You should read the financial statements and these notes, which are an integral part of the financial statements, together with our audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2007 (2007 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 2007 Annual Report unless otherwise noted below.

Net (Loss) Income per Common Share

We compute net (loss) income per common share in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, Earnings Per Share. This statement requires the presentation of basic net (loss) income per common share, using the weighted average number of common shares outstanding during the period, and diluted net (loss) 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 (loss) income per common share computation. We calculated basic and diluted net (loss) income per common share as follows (amounts in thousands, except per share data):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Numerator				
Net (loss) income	$ (446)	$ 369	$ (203)	$ 1,310
Denominator				
Basic weighted average common shares outstanding	7,014	6,885	6,969	6,815
Dilutive effect of stock options		317		379
Diluted weighted average common shares outstanding	7,014	7,202	6,969	7,194
Basic net (loss) income per common share	$ (0.06)	$ 0.05	$ (0.03)	$ 0.19
Diluted net (loss) income per common share	$ (0.06)	$ 0.05	$ (0.03)	$ 0.18

Shares related to stock options of 1,131,800 for the three months ended March 31, 2008, and 924,567 for the nine months ended March 31, 2008, were excluded from the calculation of diluted net (loss) income per common share, as the effect of their inclusion would have been anti-dilutive.

Shares related to stock options of 219,000 for the three months ended March 31, 2007, and 155,000 for the nine months ended March 31, 2007, were excluded from the calculation of diluted net income per common share, as the effect of their inclusion would have been anti-dilutive.

Stock-Based Compensation

We have an equity incentive plan under which we have granted nonqualified and incentive stock options to employees, non-employee directors and consultants. We also have an employee stock purchase plan. These plans are accounted for under the provisions of SFAS No. 123R, Share Based Payment.

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

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Our net loss included stock based compensation expense of approximately $124,000 for the three months ended March 31, 2008, and $319,000 for the nine months ended March 31, 2008. Our net income was reduced by stock based compensation expense of approximately $75,000 for the three months ended March 31, 2007, and $171,000 for the nine months ended March 31, 2007.

Income Taxes

On July 1, 2007 we adopted the provisions of the Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. Tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods.

As of June 30, 2007 and March 31, 2008, we had unrecognized tax liabilities of $47,000. The total amount of such unrecognized tax liabilities, if recognized, would not materially affect our effective tax rate.

Our practice is to recognize interest and/or penalties related to income tax matters in income tax expense. Upon adoption of FIN 48 on July 1, 2007, we did not record any interest or penalties.

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

B. Goodwill and Purchased Intangibles

Goodwill and other acquisition-related intangibles as of March 31, 2008 were as follows (dollars in thousands):

	Amortization Life in Years	Gross Amount	Accumulated Amortization	Net Amount
Goodwill [1]	N/A	$ 458	$	$ 458
Distributor relationships	13	500	(90)	410
Direct consumer relationships	9	400	(103)	297
Tradenames	20	3,300	(387)	2,913
Non-compete agreements	2	10	(10)	
		$ 4,668	$ (590)	$ 4,078

1 On June 30, 2007, as a result of our annual goodwill impairment testing in accordance with SFAS No. 142, Goodwill and Other Intangible Assets, we recorded a non-cash goodwill impairment charge of $7.0 million.

The estimated future amortization expense of purchased intangible assets as of March 31, 2008 was as follows (dollars in thousands):

Three months ending June 30, 2008	$ 58
Fiscal year 2009	247
Fiscal year 2010	247
Fiscal year 2011	247
Fiscal year 2012	247
Thereafter	2,574
	$ 3,620

C. Inventories

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

	March 31, 2008	June 30, 2007
Raw materials	$ 11,274	$ 6,997
Work in progress	4,024	3,410
Finished goods	2,494	3,692
	$ 17,792	$ 14,099

D. Property and Equipment

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

	Depreciable Life In Years	March 31, 2008	June 30, 2007
Land	N/A	$ 393	$ 393
Building and building improvements	7 39	2,732	2,726
Machinery and equipment	3 12	20,495	19,514
Office equipment and furniture	3 5	4,625	4,470
Vehicles	3	204	204
Leasehold improvements	1 15	10,430	10,325
Total property and equipment		38,879	37,632
Less: accumulated depreciation and amortization		(25,007)	(22,573)
Property and equipment, net		$ 13,872	$ 15,059

E. Debt

We amended our credit facility on December 1, 2005 and again on March 29, 2006 to increase our working capital line of credit from $8.0 million to $12.0 million, extend the maturity date from November 1, 2006 to November 1, 2007 and modify certain financial covenants. We also obtained an additional $3.8 million term loan on December 5, 2005, to fund, in part, the cash purchase price of the RHL acquisition.

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

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

As a result of the most recent amendments, our bank credit facility decreased to a total of $16.4 million, comprised of a $7.5 million working capital line of credit and $8.9 million in term loans. The working capital line of credit is secured by our accounts receivable and other rights to payment, general intangibles, inventory and equipment, has an interest rate of Prime Rate or LIBOR plus 1.75%, as elected by NAI from time to time, and borrowings are subject to eligibility requirements for current accounts receivable and inventory balances. The term loans consist of a $1.1 million, fifteen year term loan due June 2011, secured by our San Marcos building, at an interest rate of 8.25%; a $700,000, ten year term

loan with a twenty year amortization, secured by our San Marcos building, at an interest rate of LIBOR plus 2.25%; a $1.8 million, four year term loan, secured by our accounts receivable and other rights to payment, general intangibles, inventory and equipment, at an interest rate of LIBOR plus 2.10%; a $1.5 million, five year term loan, secured by equipment, at an interest rate of LIBOR plus 2.10%; and a $3.8 million, four year term loan, secured by equipment, at an interest rate of LIBOR plus 2.10%. As of March 31, 2008, there was no amount outstanding on the working capital line of credit and the amount outstanding on the term loans was $3.2 million. Monthly payments on the term loans are approximately $143,000 plus interest. As of March 31, 2008, we had $7.5 million available under the line of credit.

As of March 31, 2008 and December 31, 2007, we were not in compliance with our quarterly net after-tax income covenant under our credit facility, which requires us to have at least $1.00 of after-tax net income for each quarter. Our lender agreed to waive its default rights as a result of these covenant violations as of March 31, 2008 and December 31, 2007, respectively.

On September 22, 2006, NAIE, our wholly owned subsidiary, entered into a credit facility to provide it with a credit line of up to CHF 1,300,000, or approximately $1.3 million, which was the initial maximum aggregate amount that could be outstanding at any one time under the credit facility. This maximum amount was reduced by CHF 160,000, or approximately $159,000, as of December 31, 2007 and will be reduced by an additional CHF 160,000 at the end of each succeeding calendar year. On February 19, 2007, NAIE amended its credit facility to provide that the maximum aggregate amount that may be outstanding under the facility cannot be reduced below CHF 500,000, or approximately $498,000. As of March 31, 2008, there was no outstanding balance under the credit facility.

The composite interest rate on all of our outstanding debt was 8.16% at March 31, 2008, and 7.74% at March 31, 2007.

F. Defined Benefit Pension Plan

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

The components included in the net periodic benefit were as follows (dollars in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Interest cost	$ 21	$ 21	$ 63	$ 63
Expected return on plan assets	(8)	(27)	(26)	(81)
Net periodic expense (benefit)	$ 13	$ (6)	$ 37	$ (18)

G. Economic Dependency

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

	Three Months Ended March 31,				Nine Months Ended March 31,			
	2008		2007		2008		2007	
	Net Sales by Customer	% of Total Net Sales	Net Sales by Customer	% of Total Net Sales	Net Sales by Customer	% of Total Net Sales	Net Sales by Customer	% of Total Net Sales
Customer 1	$ 10,211	47%	$ 9,321	39%	$ 29,673	44%	$ 29,372	40%
Customer 2	6,338	29	7,840	33	20,152	30	22,710	31
	$ 16,549	76%	$ 17,161	72%	$ 49,825	74%	$ 52,082	71%

We buy certain products from a limited number of raw material suppliers. The loss of any of these suppliers could have a material adverse impact on our net sales and operations. 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,			
	2008		2007		2008		2007	
	Raw Material Purchases by Supplier	**% of Total Raw Material Purchases**	**Raw Material Purchases by Supplier**	**% of Total Raw Material Purchases**	**Raw Material Purchases by Supplier**	**% of Total Raw Material Purchases**	**Raw Material Purchases by Supplier**	**% of Total Raw Material Purchases**
Supplier 1	$ 1,189	15%	$ (a)	(a)	$ 3,897	15%	$ 3,189	11%
Supplier 2	1,067	13	1,928	22%	4,802	18	4,921	17
Supplier 3	973	12	1,474	17	(a)	(a)	3,815	13
	$ 3,229	40%	$ 3,402	39%	$ 8,699	33%	$ 11,925	41%

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

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H. Segment Information

Effective July 1, 2006, we changed our reporting segments to reflect the structure of our internal organization after the integration of previously outsourced fulfillment and call center activities for our Dr. Cherry Pathway to Healing® product line into RHL s existing operations. The reportable segments are as follows:

- Private label contract manufacturing, in which we primarily provide manufacturing services to companies that market and distribute nutritional supplements and other health care products; and
- Branded products, in which we market and distribute branded nutritional supplements and other lifestyle products in the following distribution channels:
  - Direct-to-consumer marketing programs, under which we develop, manufacture and market our own products and work with nationally recognized physicians and others to develop brand name products that reflect their individual approaches to restoring, maintaining or improving health. These products are sold through a variety of distribution channels, including television programs, print media and the internet. The Dr. Cherry Pathway to Healing® product line is sold under a direct-to-consumer marketing program;
  - Food, Drug and Mass Market (FDM) retail channel in which we sell the Real Health® Laboratories nutritional supplement product line; and
  - As We Change® catalog, a lifestyle catalog geared towards women between the ages of 45 and 65, in which we sell our own branded products as well as third party products. The quarterly print catalog offers a variety of high quality nutritional, beauty, skin care, exercise, lifestyle and other personal care products.

We evaluate performance based on a number of factors. The primary performance measures for each segment are net sales and income or loss from operations before corporate allocations. Operating income or loss for each segment does not include corporate general and administrative expenses, interest expense and other miscellaneous income and expense items. Corporate general and administrative expenses include, but are not limited to: human resources, legal, finance, information technology, and other corporate level related expenses, which are not allocated to either segment. The accounting policies of our segments are the same as those described in the summary of significant accounting policies in Note A above and in the consolidated financial statements included in our 2007 Annual Report.

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Net Sales				
Private label contract manufacturing	$ 17,960	$ 19,480	$ 57,165	$ 60,597
Branded products	3,969	4,311	10,693	12,404
	$ 21,929	$ 23,791	$ 67,858	$ 73,001

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007

(Loss) Income from Operations				
Private label contract manufacturing	$ 1,388	$ 2,467	$ 6,051	$ 8,189
Branded products	(495)	188	(971)	406
Income from operations of reportable segments	893	2,655	5,080	8,595
Corporate expenses not allocated to segments	(1,839)	(2,059)	(5,629)	(6,202)
	$ (946)	$ 596	$ (549)	$ 2,393

	March 31, 2008	June 30, 2007
Total Assets		
Private label contract manufacturing	$ 41,843	$ 39,583
Branded products	7,189	7,797
	$ 49,032	$ 47,380

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

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	**2007**	**2008**	**2007**
United States	$ 15,655	$ 18,480	$ 50,194	$ 57,486
Markets outside the United States	6,274	5,311	17,664	15,515
Total net sales	$ 21,929	$ 23,791	$ 67,858	$ 73,001

Products manufactured by NAIE accounted for approximately 51% of net sales in markets outside the United States for the three months ended March 31, 2008, and 41% for the three months ended March 31, 2007. NAIE accounted for 50% of net sales in markets outside the United States for the nine months ended March 31, 2008, and 44% for the nine months ended March 31, 2007. No products manufactured by NAIE were sold in the United States during the nine months ended March 31, 2008 and 2007.

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

	Long-Lived Assets		Total Assets		Capital Expenditures Nine Months Ended	
	March 31, 2008	**June 30, 2007**	**March 31, 2008**	**June 30, 2007**	**March 31, 2008**	**March 31, 2007**
United States	$ 16,115	$ 17,362	$ 41,749	$ 41,493	$ 1,202	$ 1,227
Europe	1,835	1,965	7,283	5,887	114	993
	$ 17,950	$ 19,327	$ 49,032	$ 47,380	$ 1,316	$ 2,220

I. Contingencies

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

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

ITEM 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, 2008. You should read the following discussion and analysis together with our unaudited condensed consolidated financial statements and the notes to the condensed consolidated financial statements included under Item 1 in this report, as well as the risk

factors and other information included in our 2007 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

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outside the United States. Historically, our revenue has been largely dependent on sales to one or two private label contract manufacturing customers and subject to variations in the timing of such customers orders, which in turn is impacted by such customers internal marketing programs, supply chain management, entry into new markets and new product introductions.

A cornerstone of our business strategy is to achieve long-term growth and diversify our sales. We have sought and expect to continue to seek to diversify our sales both by developing relationships with additional, quality-oriented, private label contract manufacturing customers, and developing our own line of branded products.

During the nine months ended March 31, 2008, our net sales were 7.0% lower than in the comparable period last year. Private label contract manufacturing sales declined 6.0% due to lower volumes of existing products in existing markets sold to one of our largest customers. We also experienced a 14.0% decrease in branded products sales. The decrease in branded products sales was primarily attributed to the continued softening of our Dr. Cherry Pathway to Healing® product line.

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

During the remainder of fiscal 2008, we plan to continue to focus on:

- Leveraging our state of the art, certified facilities to increase the value of the goods and services we provide to our highly valued private label contract manufacturing customers, and assist us in developing relationships with additional quality oriented customers;
- Implementing focused initiatives to improve the operations of our branded product business and to sustain our Pathway to Healing® product line; and
- Improving operational efficiencies and managing costs and business risks to improve profitability.

Our third quarter sales and profits were significantly impacted by the reduction in volume from one of our largest private label customers. Looking forward, during the remainder of fiscal 2008 we anticipate sales to this customer will trend towards sales levels experienced during the comparable period of fiscal 2007. Additionally, we anticipate initial shipments during the fourth quarter of this year to one of our new customers and have made limited shipments to another of our new customers with whom we expect to continue to work to establish an ongoing customer relationship. We also expect our fourth quarter branded product sales to be consistent with the same quarter in the prior year.

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 2007 Annual Report. There have been no significant changes to these policies during the nine months ended March 31, 2008.

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Results of Operations

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

	Three Months Ended March 31,			Nine Months Ended March 31,		
	2008	2007	% Change	2008	2007	% Change
Private label contract manufacturing	$ 17,960	$ 19,480	(8)	$ 57,165	$ 60,597	(6)
Branded products	3,969	4,311	(8)	10,693	12,404	(14)
Total net sales	21,929	23,791	(8)	67,858	73,001	(7)
Cost of goods sold	17,856	18,394	(3)	54,239	56,387	(4)
Gross profit	4,073	5,397	(25)	13,619	16,614	(18)
Gross profit %	18.6%	22.7%		20.1%	22.8%	
Selling, general & administrative expenses	5,019	4,801	5	14,168	14,221	(0)
% of net sales	22.9%	20.2%		20.9%	19.5%	
(Loss) income from operations	(946)	596	(259)	(549)	2,393	(123)
% of net sales	(4.3%)	2.5%		(0.8%)	3.3%	
Other income (expense), net	153	(117)	(231)	98	(466)	(121)
(Loss) income before taxes	(793)	479	(266)	(451)	1,927	(123)
% of net sales	(3.6%)	2.0%		(0.7%)	2.6%	
Net (loss) income	$ (446)	$ 369	(221)	$ (203)	$ 1,310	(115)
% of net sales	(2.0%)	1.6%		(0.3%)	1.8%	
Diluted net (loss) income per common share	$ (0.06)	$ 0.05	(220)	$ (0.03)	$ 0.18	(117)

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

	Three Months Ended	Nine Months Ended
Mannatech, Incorporated [(1)]	(8)%	(4)%
NSA International, Inc. [(2)]	5	
Other customers [(3)]	(5)	(2)
Total	(8)%	(6)%

(1) A decrease in net sales to Mannatech, Incorporated resulted primarily from the sale of lower volumes of established products in existing markets.

(2) An increase in net sales to NSA International, Inc. in the three months ended March 31, 2008 resulted primarily from the sale of higher volumes of established products in existing markets.

(3) A decrease in net sales to various customers and the discontinuation of certain other customer relationships.

The percentage change in net sales of our branded products was primarily attributed to the following distribution channels:

	Three Months Ended	Nine Months Ended
As We Change® catalog	4%	2%
FDM retail channel	(4)	(3)
Direct-to-consumer marketing programs [(1)]	(8)	(13)
Total	(8)%	(14)%

(1) Net sales from our direct-to-consumer marketing programs decreased primarily from lower sales of the Dr. Cherry Pathway to Healing® product line.

Gross profit margin decreased 4.1 percentage points from the comparable quarter and 2.7 percentage points 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:

	Three Months Ended	Nine Months Ended
Branded products operations	(0.4)%	0.2%
Contract manufacturing:		
Shift in sales and material mix	2.2	1.6
Incremental overhead expenses	(0.7)	(0.7)
Incremental direct and indirect labor[1]	(5.2)	(3.8)
Total	(4.1)%	(2.7)%

(1) The increase in our direct and indirect labor costs was the result of increased product testing associated with new product offerings and system and process validation expenses related to improving our existing processes and implementing newly required good manufacturing practices (GMPs).

Selling, general and administrative expenses increased $218,000, or 5%, from the comparable quarter last year and decreased $53,000, or 0.4%, from the comparable year to date period last year. The current quarter increase was primarily associated with the costs of performing system and process documentation, evaluation and testing required for management to provide an assessment of the effectiveness of our internal controls over financial reporting as of June 30, 2008.

Other expense, net decreased $270,000 from the comparable quarter, and $564,000 from the comparable nine month period, last year primarily due to a decrease in interest expense of $69,000 and $253,000, respectively, resulting from lower utilization of our line of credit. Additionally, foreign exchange gains increased $242,000 during the nine month period due to the strengthening of the Euro and the related impact on the translation of Euro denominated cash and receivables.

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 $1.7 million for the nine months ended March 31, 2008 compared to $13.4 million in the comparable period in the prior year.

At March 31, 2008, changes in accounts receivable, consisting primarily of amounts due from our private label contract manufacturing customers, provided $490,000 in cash during the nine months ended March 31, 2008 compared to providing $9.0 million in the comparable period in the prior year. The difference in cash provided by accounts receivable in the nine months ended March 31, 2008 was due to the timing of collections of receivables as compared to the comparable period in the prior year. Days sales outstanding was 20 days as of March 31, 2008 compared to 32 days as of March 31, 2007.

Approximately $1.4 million of our operating cash flow was generated by NAIE in the nine months ended March 31, 2008. As of March 31, 2008, NAIE s undistributed retained earnings were considered indefinitely reinvested.

Capital expenditures were $1.3 million during the nine months ended March 31, 2008 compared to $2.2 million in the comparable period in the prior year. Capital expenditures during the nine months ended March 31, 2008 and March 31, 2007 were primarily for manufacturing equipment in our Vista, California and Manno, Switzerland facilities and computer software and hardware expenditures for our RHL facility.

Cash used in financing activities for the nine months ended March 31, 2008 included $724,000 of cash used to repurchase our common stock. Included in this amount was the repurchase of 100,000 shares of our common stock, at a total cost of $650,000, from Mark LeDoux, our Chief Executive Officer and the Chairman of the Board, his wife, their family limited partnership and related children s trust. This transaction was approved on June 29, 2007 by the independent members of the Board of Directors conditioned on a purchase price equal to a 10% discount from the closing price on such date and was completed on July 6, 2007.

Our consolidated debt decreased to $3.2 million at March 31, 2008 from $4.6 million at June 30, 2007 primarily due to payments on our term loans.

As of March 31, 2008, we have a bank credit facility of $16.4 million, comprised of a $7.5 million working capital line of credit and $8.9 million in term loans. The working capital line of credit is secured by our accounts receivable and other rights to payment, general intangibles, inventory and equipment, has an interest rate of Prime Rate or LIBOR plus 1.75%, as elected by NAI from time to time, and borrowings are subject to eligibility requirements for current accounts receivable and inventory balances. The term loans consist of a $1.1 million, fifteen year term loan due June 2011, secured by our San Marcos building, at an interest rate of 8.25%; a $700,000, ten year term loan with a twenty year amortization, secured by our San Marcos building, at an interest rate of

LIBOR plus 2.25%; a $1.8 million, four year term loan, secured by our accounts receivable and other rights to payment, general intangibles, inventory and equipment, at an interest rate of LIBOR plus 2.10%; a $1.5 million, five year term loan, secured by equipment, at an interest rate of LIBOR plus 2.10%; and a $3.8 million, four year term loan, secured by equipment, at an interest rate of LIBOR plus 2.10%. As of March 31, 2008, there was no amount outstanding on the working capital line of credit and the amount outstanding on the term loans was $3.2 million. Monthly payments on the term loans are approximately $143,000 plus interest. The maturity date of the line of credit is November 1, 2009.

As of March 31, 2008 and December 31, 2007, we were not in compliance with our quarterly net after-tax income covenant under our credit facility, which requires us to have at least $1.00 of after-tax net income for each quarter. Our lender agreed to waive its default rights as a result of these covenant violations as of March 31, 2008 and December 31, 2007, respectively.

As of March 31, 2008, NAIE, our wholly owned subsidiary, had a credit facility to provide it with a credit line of up to CHF 1,140,000, or approximately $1.1 million, which amount will be reduced by CHF 160,000, or approximately $159,000, at the end of each calendar year. On February 19, 2007, NAIE amended its credit facility to provide that the maximum aggregate amount that may be outstanding under the facility cannot be reduced below CHF 500,000, or approximately $498,000. As of March 31, 2008, there was no outstanding balance under the credit facility.

Under its credit facility, NAIE may draw amounts either as current account loan credits to its current or future bank accounts or as fixed loans with a maximum term of 24 months. Current account loans will bear interest at the rate of 5% per annum. Fixed loans will bear interest at a rate determined by the parties based on current market conditions and must be repaid pursuant to a repayment schedule established by the parties at the time of the loan. If a fixed loan is repaid early at NAIE s election or in connection with the termination of the credit facility, NAIE will be charged a pre-payment penalty equal to 0.1% of the principal amount of the fixed loan or CHF 1,000 (approximately $1,000), 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, 2008, we had $3.8 million in cash and cash equivalents and $7.5 million available under our line of credit. We believe our available cash, cash equivalents and potential cash flows from operations will be sufficient to fund our current working capital needs, capital expenditures and debt payments through at least the next 12 months.

Off-Balance Sheet Arrangements

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

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). This new standard provides guidance for using fair value to measure assets and liabilities and information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards that permit, or in some cases require, estimates of fair market value. SFAS 157 also expands financial statement disclosure requirements about a company s use of fair value measurements, including the effect of such measures on earnings. The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007. We are in the process of determining the effects, if any, the adoption of SFAS 157 will have on our consolidated financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statements No. 115 (SFAS 159). SFAS 159 allows the irrevocable election of fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities and other items on an instrument-by-instrument basis. Changes in fair value would be reflected in earnings as they occur. The objective of SFAS 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective as of the beginning of the first fiscal year beginning after November 15, 2007. We are in the process of determining the effects, if any, the adoption of SFAS 159 will have on our consolidated financial position or results of operations.

In December 2007, the FASB revised SFAS No. 141, Business Combinations (SFAS 141), which establishes principles and requirements for how the acquirer in a business combination (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree, (ii) recognizes and measures the goodwill

acquired in the business combination or a gain from a bargain purchase, and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141 (Revised 2007) is effective for fiscal years beginning on or after December 15, 2008 and early adoption and retrospective application is prohibited. We do not expect the adoption of this statement will have a material impact on our consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements: an Amendment to ARB No. 51 (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, it requires the recognition of a noncontrolling interest as equity in the consolidated financial statements, which will be separate from the parent s equity. SFAS 160 is effective for fiscal years and interim periods in those fiscal years beginning on or after December 15, 2008 and early adoption is prohibited. We do not expect the adoption of this statement will have a material impact on our consolidated financial position or results of operations.

Certain additional recent accounting pronouncements are discussed under Item 7 of our 2007 Annual Report. As of March 31, 2008, other than the pronouncements described above or discussed in our 2007 Annual Report, we are not aware of any other pronouncements that materially affect our financial position or results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, which is the potential loss arising from adverse changes in market rates and prices, such as foreign currency exchange and interest rates. We generally do not enter into derivatives or other financial instruments for trading or speculative purposes. We may, however, enter into financial instruments to try to manage and reduce the impact of changes in foreign currency exchange rates. We cannot predict with any certainty our future exposure to fluctuations in foreign currency exchange and interest rates or other market risks or the impact, if any, such fluctuations may have on our future business, product pricing, consolidated financial condition, results of operations or cash flows. The actual impact of any fluctuations in foreign currency exchange or interest rates may differ significantly from those discussed below.

Interest Rates

At March 31, 2008, we had fixed rate debt of $357,000 and variable rate debt of approximately $3.1 million. The interest rates on our variable rate debt range from LIBOR plus 1.75% to LIBOR plus 2.25%. As of March 31, 2008, the weighted average effective interest rate on our variable rate debt was 8.0%. An immediate one hundred basis point (1.0%) increase in the interest rates on our variable rate debt, holding other variables constant, would have increased our interest expense by $33,000 for the nine months ended March 31, 2008. Interest rates have been at or near historic lows in recent years and generally have decreased during the past nine months. There can be no guarantee that interest rates will continue to decline. Any increase in interest rates may adversely affect our results of operations and financial condition.

Foreign Currencies

To the extent our business continues to expand outside the United States, an increasing share of our net sales and cost of sales may be transacted in currencies other than the United States dollar. Accounting practices require that our non-United States dollar-denominated transactions be converted to United States dollars for reporting purposes. Consequently, our reported net earnings may be significantly affected by fluctuations in currency exchange rates. When the United States dollar strengthens against currencies in which products are sold or weakens against currencies in which we incur costs, net sales and costs could be adversely affected.

Our main exchange rate exposures are with the Swiss Franc and the Euro against the United States dollar. This is due to NAIE s operations in Switzerland and the payment in Euros by our largest customer for finished goods. Additionally, we pay our NAIE employees and certain operating expenses in Swiss Francs. We may enter into forward exchange contracts, foreign currency borrowings and option contracts to hedge our foreign currency risk. Our goal in seeking to manage foreign currency risk is to provide reasonable certainty to the functional currency value of foreign currency cash flows and to help stabilize the value of non-United States dollar-denominated earnings.

From time to time, we purchase option contracts designated and effective as cash flow hedges to protect against the foreign currency exchange risk inherent in a portion of our forecasted transactions denominated in Euros. The risk of loss associated with the options is limited to the purchase price paid for the option contracts. Option contracts outstanding at any time during the quarter ended March 31, 2008 were as follows:

Number of Option Contracts Purchased	**Purchase Date**	**Expiration Dates**	**Notional Amount**	**Weighted Average Strike Price**	**Purchase Price**
Three (3)	April 3, 2007	Monthly from November 2007 to January 2008	$ 1.9 million	$ 1.29	$ 18,000
Three (3)	August 14, 2007	Monthly from February 2008 to April 2008	$ 1.9 million	$ 1.29	$ 10,000
Three (3)	September 7, 2007	Monthly from May 2008 to July 2008	$ 1.9 million	$ 1.29	$ 12,000

On March 31, 2008, the Swiss Franc closed at 1.00 to 1.00 United States dollar and the Euro closed at 0.63 to 1.00 United States dollar. A 10% adverse change to the exchange rates between the Swiss Franc and the Euro against the United States dollar, holding other variables constant, would have increased our net loss for the nine months ended March 31, 2008 by $681,000.

ITEM 4. CONTROLS AND PROCEDURES

We maintain certain disclosure controls and procedures as defined under the Securities Exchange Act of 1934, as amended (1934 Act). 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 1934 Act and within the time periods specified by the SEC.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2008. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective for their intended purpose described above as of March 31, 2008 because of the material weakness previously identified (as described below), for which remediation efforts are ongoing.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. In connection with management s evaluation of our disclosure controls and procedures as of June 30, 2007, management determined that a material weakness in internal control over financial reporting existed regarding our annual goodwill impairment analysis necessary for the preparation of our 2007 Annual Report. In particular, management determined that we did not have an appropriate process in place to develop and support the forecasts and plans necessary to complete our annual goodwill impairment analysis in a timely manner. As a result, we were unable to timely file our 2007 Annual Report.

There were no changes to our internal controls during the quarter ended March 31, 2008 that have materially affected, or that are reasonably likely to materially affect, our internal controls. The matter identified above and the steps necessary to remediate such weakness remain under review by management and our Board of Directors. In addition, at the end of our 2008 fiscal year, management will be required to provide an assessment of the effectiveness of our internal control over financial reporting. We are in the process of performing the system and process documentation, evaluation and testing required for management to make this assessment. We have not completed this process or our assessment. In the course of evaluation and testing, management may identify additional deficiencies that will need to be addressed and remediated. There can be no assurance that our remediation efforts will be successful or that our control procedures will be effective in accomplishing their objectives at all times.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

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

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ITEM 1A. RISK FACTORS

You should carefully consider the risks described under Item 1A of our 2007 Annual Report, as well as the other information in our 2007 Annual Report, this report and other reports and documents we file with the SEC, when evaluating our business and future prospects. If any of the identified risks actually occur, our business, financial condition and results of operations could be seriously harmed. In that event, the market price of our common stock could decline and you could lose all or a portion of the value of your investment in our common stock.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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

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EXHIBIT INDEX

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

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Exhibit Number	Description	Incorporated By Reference To
10.10	Credit Agreement dated as of May 1, 2004 by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.11 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2004, filed with the commission on May 17, 2004
10.11	First Amendment to Credit Agreement dated as of February 1, 2005 by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.1 of NAI s Current Report on Form 8-K dated February 1, 2005, filed with the commission on February 7, 2005
10.12	Form of Indemnification Agreement entered into between NAI and each of its directors	Exhibit 10.15 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2004, filed with the commission on September 14, 2004
10.13	Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated May 9, 2005 (English translation)	Exhibit 10.19 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005, filed with the commission on May 13, 2005
10.14	Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated July 25, 2003 (English translation)	Exhibit 10.19 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.15	Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated June 8, 2004 (English translation)	Exhibit 10.20 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.16	Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated February 7, 2005 (English translation)	Exhibit 10.21 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.17	License Agreement effective as of April 28, 1997 by and among Roger Harris, Mark Dunnett and NAI	Exhibit 10.22 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.18	Amendment to License Agreement effective as of March 17, 2001 by and among Roger Harris, Mark Dunnett and NAI	Exhibit 10.23 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on September 8, 2005
10.19	Amendment effective as of September 15, 2005 to Lease of Facilities in Manno, Switzerland between NAIE and Mr. Silvio Tarchini dated May 9, 2005 (English translation)	Exhibit 10.24 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2005, filed with the commission on November 4, 2005
10.20	Employment Agreement effective as of December 5, 2005, by and between RHL and John F. Dullea*	Exhibit 10.3 of NAI s Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005
10.21	Lease of RHL Facilities in San Diego, California between RHL and Lessor dated February 5, 2003	Exhibit 10.4 of NAI s Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005
10.22	Promissory Note made by NAI for the benefit of Wells Fargo Equipment Finance, Inc. in the amount of $3,800,000	Exhibit 10.5 of NAI s Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005

Exhibit

Number	**Description**	**Incorporated By Reference To**
10.23	Patent License Agreement by and between Unither Pharma, Inc. and RHL dated May 1, 2002	Exhibit 10.6 of NAI s Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005
10.24	Second Amendment to Credit Agreement dated as of December 1, 2005 by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.30 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006
10.25	Exclusive License Agreement by and between NAI and Richard Linchitz, M.D. effective as of August 23, 2005	Exhibit 10.32 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006
10.26	Letter amendment to Lease of RHL Facilities in San Diego, California between RHL and Lessor dated January 10, 2006	Exhibit 10.33 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006
10.27	First Amendment to Lease of Facilities in Vista, California between NAI and Calwest Industrial Properties, LLC, a California limited liability company, effective December 21, 2004	Exhibit 10.34 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006
10.28	Second Amendment to Lease of Facilities in Vista, California between NAI and Calwest Industrial Properties, LLC, a California limited liability company, effective January 13, 2006	Exhibit 10.35 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2005, filed with the commission on February 14, 2006
10.29	Third Amendment to Credit Agreement dated as of March 15, 2006 by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.35 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, filed with the commission on May 9, 2006
10.30	Standard Sublease Multi-Tenant by and between J. Gelt Corporation dba Casa Pacifica and RHL (lease reference date March 6, 2006)	Exhibit 10.37 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2006, filed with the commission on September 18, 2006
10.31	Loan Agreement between NAIE and Credit Suisse dated as of September 22, 2006, including general conditions (portions of the Loan Agreement have been omitted pursuant to a request for confidential treatment)	Exhibit 10.36 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2006, filed with the commission on November 1, 2006
10.32	Employment Agreement effective as of November 20, 2006, by and between NAI and Alvin McCurdy*	Exhibit 10.1 of NAI s Current Report on Form 8-K dated November 20, 2006, filed with the commission on November 21, 2006
10.33	Fourth Amendment to Credit Agreement dated as of November 1, 2006, and entered into on January 24, 2007, by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.37 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2006, filed with the commission on January 30, 2007
10.34	Sublease Contract for facilities in Manno, Switzerland, between NAIE and Vertime SA effective as of April 1, 2007 (portions of the Sublease Contract have been omitted pursuant to a request for confidential treatment) (English translation)	Exhibit 10.39 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, filed with the commission on May 14, 2007

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Exhibit

Number	**Description**	**Incorporated By Reference To**
10.35	Second Amendment to License Agreement Amending The First Amendment Dated March 17, 2001 to License Agreement Dated April 28, 1997 by and among Roger Harris, Mark Dunnett and NAI dated as of March 26, 2007	Exhibit 10.40 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007, filed with the commission on May 14, 2007
10.36	First Amendment to Loan Agreement between NAIE and Credit Suisse dated as of February 19, 2007	Exhibit 10.41 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007, filed with the commission on May 14, 2007
10.37	Settlement Agreement and Release of Claims and Rights between NAI and DHL Express, Inc. dated April 16, 2007	Exhibit 10.42 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007, filed with the commission on May 14, 2007
10.38	Settlement Agreement executed as of June 26, 2006, by and between Novogen Research Pty. Ltd. and NAI	Exhibit 10.36 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2006, filed with the commission on September 18, 2006
10.39	Consulting Agreement effective as of July 1, 2007, by and between Dr. John A. Wise and NAI	Exhibit 10.44 of NAI s Annual Report on Form 10-K for the fiscal year ended June 30, 2007, filed with the commission on October 15, 2007
10.40	Fifth Amendment to Credit Agreement dated as of November 1, 2007, and entered into on December 18, 2007, by and between NAI and Wells Fargo Bank, National Association	Exhibit 10.40 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2007, filed with the commission on February 8, 2008
10.41	Revolving Line of Credit Note made by NAI for the benefit of Wells Fargo Bank, National Association in the amount of $7,500,000	Exhibit 10.41 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2007, filed with the commission on February 8, 2008
10.42	Separation Agreement and General Release of Claims effective as of November 27, 2007, by and between NAI and John Reaves	Exhibit 10.42 of NAI s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2007, filed with the commission on February 8, 2008
10.43	Employment Agreement effective as of February 11, 2008, by and between NAI and Kenneth Wolf*	Exhibit 10.1 of NAI s Current Report on Form 8-K dated February 11, 2008, filed with the commission on February 14, 2008
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed herewith
32	Section 1350 Certification	Filed herewith

* Indicates management contract or compensatory plan or arrangement.

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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, 2008

NATURAL ALTERNATIVES INTERNATIONAL, INC.

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

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