

NATURAL ALTERNATIVES INTERNATIONAL INC  
Form 10-Q  
November 01, 2006  
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**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 SEPTEMBER 30, 2006

000-15701

(Commission file number)

**NATURAL ALTERNATIVES INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State of incorporation)

**84-1007839**  
(IRS Employer Identification No.)

**1185 Linda Vista Drive**

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

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

Indicate by check mark whether Natural Alternatives International, Inc. (NAI) (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that NAI was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes     No

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

Large accelerated filer        Accelerated filer        Non-accelerated filer     x

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

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Yes  No

As of November 1, 2006, 6,825,862 shares of NAI s common stock were outstanding, net of 70,000 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;

inventories and the adequacy and intended use of our facilities;

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

current or future customer orders;

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;

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operations outside the United States;

the adequacy of reserves and allowances;

overall industry and market performance;

competition;

current and future economic and political conditions;

the impact of accounting pronouncements; and

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

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

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

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

	<b>September 30, 2006 (Unaudited)</b>	<b>June 30, 2006</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 2,000	\$ 2,157
Accounts receivable - less allowance for doubtful accounts of \$217 at September 30, 2006 and June 30, 2006	6,408	12,839
Inventories, net	17,027	17,054
Deferred income taxes	1,059	1,059
Other current assets	2,021	1,916
Total current assets	28,515	35,025
Property and equipment, net	16,104	15,943
Goodwill and purchased intangibles, net	11,240	11,303
Other noncurrent assets, net	184	182
Total assets	\$ 56,043	\$ 62,453
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 6,073	\$ 5,221
Accrued liabilities	2,278	2,265
Accrued compensation and employee benefits	1,471	1,964
Line of credit	2,264	9,574
Income taxes payable	659	1,063
Current portion of long-term debt	1,790	1,766
Total current liabilities	14,535	21,853
Long-term debt, less current portion	4,163	4,596
Deferred income taxes	1,260	1,260
Deferred rent	1,255	1,262
Long-term pension liability	216	191
Total liabilities	21,429	29,162
Commitments and contingencies		
Stockholders equity:		
Preferred stock; \$0.01 par value; 500,000 shares authorized; none issued or outstanding		

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Common stock; \$0.01 par value; 20,000,000 shares authorized; issued and outstanding 6,895,862 at September 30, 2006 and 6,685,546 at June 30, 2006	68	67
Additional paid-in capital	16,355	15,331
Accumulated other comprehensive loss	(283)	(276)
Retained earnings	18,849	18,462
Treasury stock, at cost, 61,000 shares at June 30, 2006 and 70,000 at September 30, 2006	(375)	(293)
<b>Total stockholders' equity</b>	<b>34,614</b>	<b>33,291</b>
 Total liabilities and stockholders' equity	 \$ 56,043	 \$ 62,453

*See accompanying notes to condensed consolidated financial statements.*

**Table of Contents****NATURAL ALTERNATIVES INTERNATIONAL, INC.****Condensed Consolidated Statements Of Income And Comprehensive Income****(Dollars in thousands, except share and per share data)****(Unaudited)**

	<b>Three Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Net sales	\$ 25,161	\$ 21,900
Cost of goods sold	19,646	17,844
<b>Gross profit</b>	<b>5,515</b>	<b>4,056</b>
Selling, general & administrative expenses	4,683	3,378
<b>Income from operations</b>	<b>832</b>	<b>678</b>
Other income (expense):		
Interest income	1	10
Interest expense	(230)	(58)
Foreign exchange gain	8	21
Other, net	(9)	
	(230)	(27)
<b>Income before income taxes</b>	<b>602</b>	<b>651</b>
Provision for income taxes	215	239
<b>Net income</b>	<b>\$ 387</b>	<b>\$ 412</b>
Unrealized loss resulting from change in fair value of derivative instruments, net of tax	(7)	(45)
<b>Comprehensive income</b>	<b>\$ 380</b>	<b>\$ 367</b>
<b>Net income per common share:</b>		
Basic	\$ 0.06	\$ 0.07
Diluted	\$ 0.05	\$ 0.06
<b>Weighted average common shares outstanding:</b>		
Basic	6,720,167	6,013,390
Diluted	7,200,944	6,469,104

*See accompanying notes to condensed consolidated financial statements.*



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

	<b>Three Months Ended</b>	
	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 387	\$ 412
Adjustments to reconcile net income to net cash provided by operating activities:		
Reduction for uncollectible accounts receivable		(36)
Depreciation and amortization	829	724
Amortization of purchased intangibles	63	
Non-cash compensation	38	11
Tax benefit from exercise of stock options	(233)	
Pension expense, net of contributions	24	15
Loss on disposal of assets	13	
Changes in operating assets and liabilities:		
Accounts receivable	6,431	4,941
Inventories, net	27	(1,092)
Other assets	(110)	(182)
Accounts payable and accrued liabilities	685	(589)
Accrued compensation and employee benefits	(493)	(355)
Net cash provided by operating activities	7,661	3,849
<b>Cash flows from investing activities</b>		
Capital expenditures	(1,003)	(130)
Net cash used in investing activities	(1,003)	(130)
<b>Cash flows from financing activities</b>		
Net payments on line of credit	(7,310)	
Payments on long-term debt	(409)	(198)
Tax benefit from exercise of stock options	233	
Repurchase of common stock	(82)	
Proceeds from issuance of common stock	753	148
Net cash used in financing activities	(6,815)	(50)
Net increase (decrease) in cash and cash equivalents	(157)	3,669
Cash and cash equivalents at beginning of period	2,157	1,916
Cash and cash equivalents at end of period	\$ 2,000	\$ 5,585
<b>Supplemental disclosures of cash flow information</b>		
Cash paid during the period for:		
Interest	\$ 206	\$ 58

Taxes

\$ 407 \$ 185

*See accompanying notes to condensed consolidated financial statements.*

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

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and applicable rules and regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In management's opinion, all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows have been included and are of a normal, recurring nature. The results of operations for the three months ended September 30, 2006 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, 2006 ( 2006 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 2006 Annual Report unless otherwise noted below.

Certain reclassifications to prior period information have been made to conform to current presentation. In the first quarter of fiscal 2007, we reclassified \$146,000 of shipping costs for our private label contract manufacturing sales from net sales to cost of goods sold on the Statements Of Income And Comprehensive Income in accordance with the Financial Accounting Standards Board (FASB) Emerging Issue Task Force (EITF) No. 00-10, Accounting for Shipping and Handling Fees and Costs. Shipping costs of \$167,000 for the three months ended September 30, 2005, were reclassified to conform to this presentation change.

**Net Income per Common Share**

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

	<b>Three Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Numerator</b>		
Net income	\$ 387	\$ 412
<b>Denominator</b>		
Basic weighted average common shares outstanding	6,720	6,013
Dilutive effect of stock options	481	456
Diluted weighted average common shares outstanding	7,201	6,469
Basic net income per common share	\$ 0.06	\$ 0.07
Diluted net income per common share	\$ 0.05	\$ 0.06

Shares related to stock options of 25,000 for the three months ended September 30, 2006, and 202,000 for the three months ended September 30, 2005, were excluded from the calculation of diluted net income per common share, as the effect of their inclusion would have been anti-dilutive.



**Table of Contents****Stock-Based Compensation**

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

We estimated the fair value of the stock option awards at the date of grant and employee stock purchase plan shares at the beginning of the offering period using the Black-Scholes option valuation model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Option valuation models require the input of highly subjective assumptions. Black-Scholes utilizes 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 utilized in the model are based mainly on the historical volatility of our stock price and other factors. 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 and other factors. Our net income for the three months ended September 30, 2006 has been reduced by compensation expense of approximately \$38,000 and \$11,000 for the three months ended September 30, 2005.

**B. Goodwill and purchased intangibles**

Goodwill and other acquisition-related intangibles as of September 30, 2006 were as follows (dollars in thousands):

	Amortization Life in Years	Gross Amount	Accumulated Amortization	Net Amount
Goodwill	N/A	\$ 7,241	\$	\$ 7,241
Distributor relationships	13	500	(32)	468
Direct consumer relationships	9	400	(37)	363
Tradenames	20	3,300	(138)	3,162
Non-compete agreements	2	10	(4)	6
		\$ 11,451	\$ (211)	\$ 11,240

The estimated future amortization expense of purchased intangible assets as of September 30, 2006 was as follows (in thousands):

Nine months ending June 30, 2007	\$ 189
Fiscal year 2008	249
Fiscal year 2009	247
Fiscal year 2010	247
Fiscal year 2011	247
Thereafter	2,820
	\$ 3,999

**Table of Contents****C. Inventories**

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

	September 30, 2006	June 30, 2006
Raw materials	\$ 7,861	\$ 8,461
Work in progress	5,781	5,339
Finished goods	3,385	3,254
	\$ 17,027	\$ 17,054

**D. Property and Equipment**

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

	Depreciable Life In Years	September 30, 2006	June 30, 2006
Land	N/A	\$ 393	\$ 393
Building and building improvements	7 39	2,726	2,721
Machinery and equipment	3 12	20,376	20,208
Office equipment and furniture	3 5	4,123	3,843
Vehicles	3	204	204
Leasehold improvements	1 15	9,522	9,434
Total property and equipment		37,344	36,803
Less: accumulated depreciation and amortization		(21,240)	(20,860)
Property and equipment, net		\$ 16,104	\$ 15,943

**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 2006 to November 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.

As a result of the amendments and additional term loan, our bank credit facility increased to a total of \$20.9 million, comprised of a \$12.0 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 the \$3.8 million four year term loan, secured by equipment, at an interest rate of LIBOR plus 2.10%. Monthly payments on the term loans are approximately \$138,000 plus interest.

As of September 30, 2006, the amount outstanding on the working capital line of credit was \$2.3 million and the amount outstanding on the term loans was \$6.0 million. As of September 30, 2006, we had \$5.4 million available under the line of credit, net of a \$134,000 outstanding letter of credit issued to our landlord.

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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 \$1.0 million, which is the initial maximum aggregate amount that can be outstanding at any one time under the credit facility. This maximum amount will be reduced by CHF 160,000, or approximately \$128,000, at the end of each year beginning on December 31, 2007. As of September 30, 2006, there was no outstanding balance under the credit facility.

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The composite interest rate on all of our outstanding debt was 7.77% at September 30, 2006, and 6.11% at September 30, 2005.

**F. Defined Benefit Pension Plan**

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

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

	Three Months Ended September 30,	
	2006	2005
Interest cost	\$ 21	\$ 20
Expected return on plan assets	(27)	(23)
Net periodic benefit	\$ (6)	\$ (3)

**G. Economic Dependency**

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

	Three Months Ended September 30,			
	2006		2005	
	Net Sales by Customer	% of Total Net Sales	Net Sales by Customer	% of Total Net Sales
Customer 1	\$ 9,956	40%	\$ 10,332	47%
Customer 2	7,529	30	7,595	35
	\$ 17,485	70%	\$ 17,927	82%

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

	Three Months Ended September 30,			
	2006		2005	
	Raw Material Purchases by Supplier	% of Total Raw Material Purchases	Raw Material Purchases by Supplier	% of Total Raw Material Purchases
Supplier 1	\$ 1,881	18%	\$ 2,219	21%
Supplier 2	1,065	10	1,030	10
Supplier 3	(a)	(a)	1,320	13
	\$ 2,946	28%	\$ 4,569	44%



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

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**H. Segment Information**

Prior to the first quarter of fiscal 2007, our business consisted of two reportable segments, as defined by SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, identified as NAI and RHL, which was acquired on December 5, 2005.

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<sup>®</sup> product line into RHL's existing operations. The new 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:

Director-to-consumer marketing programs, under which we develop, manufacture and market our own products and work with nationally recognized physicians 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<sup>®</sup> 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<sup>®</sup> Laboratories nutritional supplement product line; and

As We Change ( AWC ) 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 being net sales and income or loss from operations (prior to 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 various other corporate level related expenses, which remain at the corporate level. The accounting policies of our segments are the same as those described in the summary of significant accounting policies in Note A to the consolidated financial statements included in our 2006 Annual Report.

Our operating results by business segment shown below for the three months ended September 30, 2005 have been restated to reflect our new reporting segments, with the exception of the information on total assets as we believe it would be impractical to restate such information. Accordingly, the total asset information is provided only for our new reporting segments for the three months ended September 30, 2006. Our operating results by business segment were as follows (in thousands):

	<b>Three Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Private label contract manufacturing	\$ 20,971	\$ 19,874
Branded products	4,190	2,026
<b>Total Net Sales</b>	<b>\$ 25,161</b>	<b>\$ 21,900</b>

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	<b>Three Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Private label contract manufacturing	\$ 2,718	\$ 2,137
Branded products	145	267
<b>Income from operations of reportable segments</b>	<b>2,863</b>	<b>2,404</b>
Corporate expenses not allocated to segments	(2,031)	(1,726)
<b>Total Income from Operations</b>	<b>\$ 832</b>	<b>\$ 678</b>

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	September 30,
	2006
Private label contract manufacturing	\$ 41,807
Branded products	14,236
<b>Total Assets</b>	<b>\$ 56,043</b>

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

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

	Three Months Ended September 30,	
	2006	2005
United States	\$ 20,442	\$ 17,130
Markets Outside the United States	4,719	4,770
<b>Total Net Sales</b>	<b>\$ 25,161</b>	<b>\$ 21,900</b>

Products manufactured by NAIE accounted for 50% of net sales in markets outside the United States for each of the three month periods ended September 30, 2006 and 2005. No products manufactured by NAIE were sold in the United States during the three months ended September 30, 2006 and 2005.

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 follow (in thousands):

	Capital Expenditures					
	Long-Lived Assets June 30,		Total Assets June 30,		Three Months Ended September 30,	
	September 30, 2006	2006	September 30, 2006	2006	September 30, 2006	2005
United States	\$ 27,345	\$ 27,735	\$ 51,146	\$ 57,661	\$ 447	\$ 66
Europe	1,690	1,202	4,897	4,792	556	64
	\$ 29,035	\$ 28,937	\$ 56,043	\$ 62,453	\$ 1,003	\$ 130

**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 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.

As of November 1, 2006, 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 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis is intended to help you understand our financial condition and results of operations for the three months ended September 30, 2006. 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 2006 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.

#### **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 has been to provide private label contract manufacturing services to companies that market and distribute vitamins, minerals, herbs and other nutritional supplements, as well as other health care products, to consumers both within and outside the 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 and growing our own line of branded products. To that end, during fiscal 2006, we established relationships with two new private label contract manufacturing customers, and completed our acquisition of RHL, an integrated direct marketer of its own and third party branded nutritional supplements and other lifestyle products.

During the first quarter of fiscal 2007, we achieved a 15% increase in our net sales over the comparable quarter last year. While we are pleased with our revenue growth, we also believe the source of the growth is important in the context of our overall business strategy. We saw sales from our branded products contribute approximately two-thirds of the 15% growth we achieved, primarily as a result of our acquisition of RHL, and saw sales to Arbonne International, one of the new private label contract manufacturing relationships we established in fiscal 2006, contribute to an increase in our overall private label contract manufacturing sales. As a result, net sales to our two largest private label contract manufacturing customers as a percentage of our total net sales decreased to 70% from 82% in the comparable quarter last year.

We completed our integration of previously outsourced call center activities for our Dr. Cherry Pathway to Healing<sup>®</sup> product line into RHL's existing operation during the first quarter of fiscal 2007. While we expect to realize cost savings from the integration of previously outsourced activities, we anticipate any future savings will be invested in further expanding and marketing our branded products.

Income from operations increased 23% over the comparable quarter last year primarily due to incremental sales in our private label contract manufacturing business. However, net income decreased 6% over the comparable quarter last year due to additional interest expense relating to the acquisition of RHL and carrying costs of accounts receivable and inventory for one of the new private label contract manufacturing customers.

We believe our acquisition of RHL marked a significant advance towards our goal of developing and growing our own branded products and expanding our distribution channels. In addition to the cost savings we hope to achieve through our integration efforts and the elimination of duplicative costs, we also hope to achieve benefits related to the leading branded products in the FDM retail channel, the additional expertise in the direct marketing and retail channels, and the access to additional direct marketing and mass-market channels for our products and concepts that we acquired in the acquisition.

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During the remainder of fiscal 2007, 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 market our own branded products through RHL's distribution channels;

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

Identifying and evaluating additional acquisition opportunities that could increase product lines, expand distribution channels, enhance manufacturing capabilities or reduce risk associated with a variety of factors.

Looking forward, while there can be no assurance we will be able to continue to diversify our sales, that our new customer relationships will generate future sales or that we will realize all of the benefits we hope to realize from our RHL acquisition, we remain optimistic and expect to continue our long-term trend of annual revenue growth. However, we anticipate quarterly revenue fluctuations due to, among other things, the timing of customer orders and other factors.

**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 2006 Annual Report. There have been no significant changes to these policies during the three months ended September 30, 2006.

**Results of Operations**

The results of our operations for the three months ended September 30 were as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		%
	2006	2005	Change
Private label contract manufacturing	\$ 20,971	\$ 19,874	6
Branded products	4,190	2,026	107
Total net sales	25,161	21,900	15
Cost of goods sold	19,646	17,844	10
Gross profit	5,515	4,056	36
Gross profit %	21.9%	18.5%	
Selling, general & administrative expenses	4,683	3,378	39

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% of net sales	18.6%	15.4%	
Income from operations	832	678	23
% of net sales	3.3%	3.1%	
Other expense, net	230	27	752
Income before taxes	602	651	(8)
% of net sales	2.4%	3.0%	
Net income	\$ 387	\$ 412	(6)
% of net sales	1.5%	1.9%	
Diluted net income per common share	\$ 0.05	\$ 0.06	(17)



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

Arbonne International <sup>(1)</sup>	8%
NSA International, Inc. <sup>(2)</sup>	(2)
Mannatech, Incorporated <sup>(3)</sup>	
Total	6%

<sup>1</sup> During fiscal 2006, we established a relationship with Arbonne International for initial shipments of a single new product. During the first quarter of fiscal 2007, we had residual sales from the initial order of approximately \$1.5 million.

<sup>2</sup> A reduction in net sales to NSA International, Inc. over the comparable quarter last year resulted primarily from lower volumes of established products in existing markets, which reduced our net sales growth by four percentage points, partially offset by higher average prices per unit, which contributed two percentage points of net sales growth.

<sup>3</sup> Net sales to Mannatech, Incorporated remained consistent primarily from higher volumes of established products in existing markets contributing two percentage points of net sales growth, offset by a shift in sales mix to lower priced products, which reduced net sales growth by two percentage points.

The percentage increase in net sales of our branded products was attributed to the acquisition of RHL on December 5, 2005.

Gross profit margin increased 3.4 percentage points to 21.9% for the three months ended September 30, 2006 from 18.5% for the three months ended September 30, 2005. The increase in gross profit margin was primarily due to the following:

	% Change
RHL operations	4.4%
Shift in sales mix	(0.5)
Lower inventory reserves	1.1
Incremental direct and indirect labor	(0.1)
Incremental overhead expenses	(1.5)
Total	3.4%

Selling, general and administrative expenses increased \$1.3 million, or 39%, from the comparable quarter last year primarily due to incremental selling, general and administrative expenses for our branded products of \$1.6 million as a result of the RHL acquisition.

Other expense, net increased \$203,000 primarily due to an increase in interest expense of \$172,000 resulting from the additional \$3.8 million term loan obtained in December 2005 to partially fund the RHL acquisition, an increase in our weighted average interest rate on our variable rate debt, and the incremental utilization of our line of credit to fund the carrying costs of accounts receivable and inventory purchases for one of our new private label contract manufacturing customers.

**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 \$7.7 million for the three months ended September 30, 2006 compared to \$3.8 million in the comparable quarter in the prior year.

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At September 30, 2006, changes in accounts receivable, consisting primarily of amounts due from our private label contract manufacturing customers, provided \$6.4 million in cash during the three months ended September 30, 2006 compared to \$4.9 million in the comparable quarter in the prior year. Cash provided by accounts receivable in the three months ended September 30, 2006 and 2005 was due to the collection of receivables from fourth quarter sales, which for each such period represented then record quarterly sales. Days sales outstanding was 69 days during the three months ended September 30, 2006 compared to 60 days in the comparable quarter in the prior year.

Approximately \$794,000 of our operating cash flow was generated by NAIE in the three months ended September 30, 2006. As of September 30, 2006, NAIE's undistributed retained earnings were considered indefinitely reinvested.

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Capital expenditures were \$1.0 million during the three months ended September 30, 2006 compared to \$130,000 in the comparable quarter in the prior year. Capital expenditures during the three months ended September 30, 2006 were primarily for manufacturing equipment in our Vista, California and Manno, Switzerland facilities and call center computer software and hardware for our RHL facility.

Our consolidated debt decreased to \$8.2 million at September 30, 2006 from \$15.9 million at June 30, 2006 primarily due to payments made on our outstanding working capital line of credit.

We have a bank credit facility of \$20.9 million, comprised of a \$12.0 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 the \$3.8 million four year term loan, secured by equipment, at an interest rate of LIBOR plus 2.10%. Monthly payments on the term loans are approximately \$138,000 plus interest.

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 and modify certain financial covenants. The amendments included (i) an increase in our ratio of total liabilities/tangible net worth covenant from 1.25/1.0 to 1.75/1.0 through June 30, 2006 (the ratio returns to 1.25/1.0 from July 1, 2006 through June 30, 2007 and to 1.0/1.0 thereafter); (ii) a limit on capital expenditures of \$5,500,000 for fiscal years 2006 and 2007; (iii) an extension of the maturity date for the working capital line of credit from November 2006 to November 2007; (iv) an increase in our ability to incur additional aggregate annual operating lease expenses from \$100,000 to \$500,000 without prior approval from the lender; (v) an increase in our ability to create specific indebtedness other than with our current lender from \$0 to \$1,000,000; (vi) replacement of the EBITDA coverage ratio with a fixed charge coverage ratio (aggregate of net profit after taxes, depreciation and amortization expenses and net contributions/aggregate current maturity of long-term debt and capitalized lease payments) not less than 1.25/1.0 as of each fiscal quarter end; (vii) an increase in borrowings against eligible inventory from \$3.0 million to \$6.0 million, provided the outstanding borrowings shall not at any time exceed eligible accounts receivable; (viii) a change in permissible accounts receivable concentration to allow up to 35% for a new customer acceptable to the lender; and (ix) a change in the calculation of the fixed charge coverage ratio (aggregate of net profit after taxes, depreciation and amortization expenses and net contributions/aggregate current maturity of long-term debt and capitalized lease payments) to a rolling 4-quarter basis from each fiscal quarter end.

As of September 30, 2006 the amount outstanding on the working capital line of credit was \$2.3 million and the amount outstanding on the term loans was \$6.0 million.

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 \$1.0 million, which is the initial maximum aggregate amount that can be outstanding at any one time under the credit facility. This maximum amount will be reduced by CHF 160,000, or approximately \$128,000, at the end of each year beginning on December 31, 2007. As of September 30, 2006, there was no outstanding balance under the credit facility.

Under the 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. In the event that 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 \$800), 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.

On July 7, 2005, we purchased 12 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 12 options expire monthly beginning January 2006 and ending December 2006. The option contracts had a notional

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amount of \$7.0 million, a weighted average strike price of \$1.16, and a purchase price of \$152,000. The risk of loss associated with the options is limited to the purchase price paid for the option contracts.

On April 6, 2006, we purchased seven 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 seven options expire monthly beginning January 2007 and ending July 2007. The option contracts had a notional amount of \$4.9 million, a weighted average strike price of \$1.16, and a purchase price of \$62,000. The risk of loss associated with the options is limited to the purchase price paid for the option contracts.

On July 6, 2006, we sold the remaining options purchased on July 7, 2005 and April 6, 2006 for \$13,000. The proceeds were used to purchase 12 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 12 options expire monthly beginning August 2006 and ending July 2007. The option contracts had a notional amount of \$8.9 million, a weighted average strike price of \$1.24, and a purchase price of \$103,000. The risk of loss associated with the options is limited to the purchase price paid for the option contracts. As of September 30, 2006, two of the options had expired. The unrealized losses associated with the options sold were \$136,000 and will be recognized in cost of goods sold under the original monthly option contract expiration dates.

There were no other derivative financial instruments at September 30, 2006.

As of September 30, 2006, we had \$2.0 million in cash and cash equivalents and \$5.4 million available under our line of credit, net of \$134,000 outstanding letter of credit issued to our landlord. 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**

We do not have any off-balance sheet debt nor do we have any transactions, arrangements, obligations (including contingent obligations) or other relationships with any unconsolidated entities or other persons that may 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.

## **Recent Accounting Pronouncements**

Recent accounting pronouncements are discussed under Item 7 of our 2006 Annual Report. As of September 30, 2006, other than the pronouncements discussed in our 2006 Annual Report, we are not aware of any other pronouncements that materially affect our financial position or results of operations.

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**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 September 30, 2006, we had fixed rate debt of \$497,000 and variable rate debt of approximately \$7.7 million. The interest rates on our variable rate debt range from LIBOR plus 1.75% to LIBOR plus 2.25%. As of September 30, 2006, the weighted average effective interest rate on our variable rate debt was 7.90%. An immediate one hundred basis point (1.0%) increase in the interest rate on our variable rate debt, holding other variables constant, would have increased our interest expense by \$29,000 for the three months ended September 30, 2006. Interest rates have been at or near historic lows in recent years but have been increasing during the past year. There can be no guarantee that interest rates will not rise further. 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.

On July 7, 2005, we purchased 12 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 12 options expire monthly beginning January 2006 and ending December 2006. The option contracts had a notional amount of \$7.0 million, a weighted average strike price of \$1.16, and a purchase price of \$152,000. The risk of loss associated with the options is limited to the purchase price paid for the option contracts.

On April 6, 2006, we purchased seven 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 seven options expire monthly beginning January 2007 and ending July 2007. The option contracts had a notional amount of \$4.9 million, a weighted average strike price of \$1.16, and a purchase price of \$62,000. The risk of loss associated with the options is limited to the purchase price paid for the option contracts.

On July 6, 2006, we sold the remaining options purchased on July 7, 2005 and April 6, 2006 for \$13,000. The proceeds were used to purchase 12 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 12 options expire monthly beginning August 2006 and ending July 2007. The option contracts had a notional amount of \$8.9 million, a weighted average strike price of \$1.24, and a purchase price of \$103,000. The risk of loss associated with the options is limited to the purchase price paid for the option contracts. As of September 30, 2006, two of the options had expired. The unrealized losses associated with the options sold were \$136,000 and will be recognized in cost of goods sold under the original monthly option contract expiration dates.

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On September 30, 2006, the Swiss Franc closed at 1.25 to 1.00 United States dollar and the Euro closed at 0.79 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 decreased our net income for the three months ended September 30, 2006 by \$93,000.

### **ITEM 4. CONTROLS AND PROCEDURES**

We maintain certain disclosure controls and procedures. They are designed to help ensure that material information is: (1) gathered and communicated to our management, including our principal executive and financial officers, on a timely basis; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the Securities Exchange Act of 1934.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2006. 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. There were no changes to our internal controls during the quarterly period ended September 30, 2006 that have materially affected, or that are reasonably likely to materially affect, our internal controls.

## **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 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.

As of November 1, 2006, neither NAI nor its subsidiaries were a party to any material pending legal proceeding nor was any of their property the subject of any material pending legal proceeding.

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

You should carefully consider the other risks described under Item 1A of our 2006 Annual Report, as well as the other information in our 2006 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.

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None.

**ITEM 6. EXHIBITS**

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

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>	<b>Incorporated By Reference To</b>
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
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 Employment Agreement dated as of January 30, 2004, by and between NAI and John Wise*	Exhibit 10.7 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	Amended and Restated Employment Agreement dated as of January 30, 2004, by and between NAI and John Reaves*	Exhibit 10.8 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	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



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10.9	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
10.10	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
10.11	Lease of Facilities in Vista, California between NAI and Calwest Industrial Properties, LLC, a California limited liability company (lease reference date June 12, 2003)	Exhibit 10.10 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2003, filed with the commission on November 5, 2003
10.12	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
10.13	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
10.14	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
10.15	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
10.16	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
10.17	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
10.18	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
10.19	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
10.20	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
10.21	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

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10.22	Stock Purchase Agreement effective as of December 5, 2005, by and among NAI and William H. Bunten II and/or Elizabeth W. Bunten, as the trustees of The Bunten Family Trust dated April 14, 2001, John F. Dullea and Carolyn A. Dullea, as the trustees of The John F. and Carolyn A. Dullea Trust dated June 20, 2001, Lincoln Fish, and Michael L. Irwin, as trustee of The Michael L. Irwin Trust u/t/a June 25, 1991	Exhibit 10.1 of NAI's Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005
10.23	Form of Lock-Up Agreement effective as of December 5, 2005 entered into between NAI and each Selling Stockholder	Exhibit 10.2 of NAI's Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005
10.24	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
10.25	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
10.26	Promissory Note made by NAI for the benefit of Wells Fargo Equipment Finance, Inc. in the amount of \$3,800,000	Exhibit 10.5 of NAI's Current Report on Form 8-K dated December 5, 2005, filed with the commission on December 9, 2005
10.27	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
10.28	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
10.29	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
10.30	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
10.31	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
10.32	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
10.33	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
10.34	Revolving Line of Credit Note (as revised) made by NAI for the benefit of Wells Fargo Bank, National Association in the amount of \$12,000,000	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

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10.35	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
10.36	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)	Filed herewith
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed herewith
32	Section 1350 Certification	Filed herewith

\* Indicates management contract or compensatory plan or arrangement.

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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: November 1, 2006

NATURAL ALTERNATIVES INTERNATIONAL,  
INC.

By: /s/ John R. Reaves  
John R. Reaves, Chief Financial Officer

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