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, 2010

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that NAI was required to submit and post such files).

¨ Yes ¨ No

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

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

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

¨ Yes x No

As of May 13, 2010, 7,094,106 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 or loss, net income or loss per share, profit margins, expenditures, liquidity, goodwill valuation and other financial items;
- our ability to develop relationships with new customers and maintain or improve existing customer relationships;
- future levels of our revenue concentration risk;
- development of new products, brands and marketing strategies;
- the effect of the discontinuance of Dr. Cherry s television program and our ability to develop a new marketing plan for, and to sustain, our Pathway to Healing® product line;
- distribution channels, product sales and performance, and timing of product shipments;
- inventories and the adequacy and intended use of our facilities;
- current or future customer orders;
- the impact on our business and results of operations and variations in quarterly net sales from cost reduction programs, seasonal and other factors;
- management s goals and plans for future operations;
- our ability to improve operational efficiencies, manage costs and business risks and improve or maintain profitability;
- growth, expansion, diversification, acquisition, divestment and consolidation strategies, the success of such strategies, and the benefits we believe can be derived from such strategies;

personnel;

the outcome of regulatory, tax and litigation matters;

our ability to operate within the standards set by the Food and Drug Administration s Good Manufacturing Practices;

sources and availability of raw materials;

operations outside the United States (U.S.);

the adequacy of reserves and allowances;

overall industry and market performance;

competition and competitive advantages resulting from our quality commitment;

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), 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, 2010 (Unaudited)	June 30, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 7,816	$ 3,995
Certificate of deposit		699
Accounts receivable - less allowance for doubtful accounts of $23 at March 31, 2010 and $27 at June 30, 2009	4,974	5,685
Inventories, net	8,336	9,320
Income tax receivable	1,142	2
Prepaids and other current assets	1,533	1,259
Assets of discontinued operations		1,187
Total current assets	23,801	22,147
Property and equipment, net	13,307	14,133
Other noncurrent assets, net	159	159
Total assets	$ 37,267	$ 36,439
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 3,029	$ 4,327
Accrued liabilities	1,017	1,001
Accrued compensation and employee benefits	1,110	1,164
Income taxes payable	331	490
Current portion of long-term debt	35	669
Liabilities of discontinued operations	78	599
Total current liabilities	5,600	8,250
Long-term debt, less current portion	461	598
Deferred rent	950	1,054
Long-term pension liability	93	505
Total liabilities	7,104	10,407
Commitments and contingencies		
Stockholders equity:		
Preferred stock; $.01 par value; 500,000 shares authorized; none issued or outstanding		
Common stock; $.01 par value; 20,000,000 shares authorized; issued and outstanding 7,273,047 at March 31, 2010 and 7,249,734 at June 30, 2009	71	71
Additional paid-in capital	19,121	18,899

Accumulated other comprehensive loss	(565)	(565)
Retained earnings	12,635	8,726
Treasury stock, at cost, 180,941 shares at March 31, 2010 and June 30, 2009	(1,099)	(1,099)
Total stockholders equity	30,163	26,032
Total liabilities and stockholders equity	$ 37,267	$ 36,439

See accompanying notes to condensed consolidated financial statements.

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NATURAL ALTERNATIVES INTERNATIONAL, INC.

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(In thousands, except share and per share data)

(Unaudited)

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009	Nine Months Ended March 31, 2010	Nine Months Ended March 31, 2009
Net sales	$ 16,975	$ 17,348	$ 51,185	$ 54,490
Cost of goods sold	14,040	14,241	42,625	48,211
Gross profit	2,935	3,107	8,560	6,279
Selling, general & administrative expenses	2,098	1,724	5,580	7,180
Operating income (loss) from continuing operations	837	1,383	2,980	(901)
Other (expense) income:				
Interest income	4	9	11	14
Interest expense	(26)	(57)	(92)	(179)
Foreign exchange loss	(137)	(83)	(139)	(427)
Other, net	8	2	52	30
	(151)	(129)	(168)	(562)
Income (loss) from continuing operations before income taxes	686	1,254	2,812	(1,463)
Benefit for income taxes	(1,206)	(183)	(940)	(3)
Income (loss) from continuing operations	1,892	1,437	3,752	(1,460)
Income (loss) from discontinued operations, net of tax	2	(1,941)	157	(3,745)
Net income (loss) and comprehensive income (loss)	$ 1,894	$ (504)	$ 3,909	$ (5,205)
Net income (loss) per common share:				
Basic:				
Continuing operations	$ 0.27	$ 0.20	$ 0.53	$ (0.21)
Discontinued operations	0.00	(0.27)	0.02	(0.53)
Net income (loss)	$ 0.27	$ (0.07)	$ 0.55	$ (0.74)
Diluted:				
Continuing operations	$ 0.27	$ 0.21	$ 0.53	$ (0.21)
Discontinued operations	0.00	(0.28)	0.02	(0.53)
Net income (loss)	$ 0.27	$ (0.07)	$ 0.55	$ (0.74)
Weighted average common shares outstanding:				
Basic	7,083,980	7,066,526	7,074,616	7,052,451
Diluted	7,106,256	7,003,895	7,104,630	7,031,574

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, 2010	Nine Months Ended March 31, 2009
Cash flows from operating activities		
Income (loss) before discontinued operations	$ 3,752	$ (1,460)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Reduction of uncollectible accounts receivable	(4)	(2)
Depreciation and amortization	2,438	2,340
Non-cash equipment impairment charge	325	
Non-cash compensation	181	289
Tax benefit from exercise of stock options		(88)
Deferred income taxes		(61)
Pension contribution, net of expense	(412)	38
Loss on disposal of assets	16	12
Changes in operating assets and liabilities:		
Accounts receivable	715	656
Inventories, net	984	1,915
Other assets	(274)	(282)
Accounts payable and accrued liabilities	(1,386)	(1,827)
Income taxes receivable (payable)	(1,299)	1,301
Accrued compensation and employee benefits	(54)	(390)
Net cash provided by operating activities from continuing operations	4,982	2,441
Net cash provided by (used in) operating activities from discontinued operations	323	(1,657)
Net cash provided by operating activities	5,305	784
Cash flows from investing activities		
Proceeds from the sale of property and equipment		34
Capital expenditures	(1,953)	(3,871)
Certificate of deposit	699	(699)
Net cash used by investing activities from continuing operations	(1,254)	(4,536)
Net cash provided by investing activities from discontinued operations, including proceeds from the sale of the legacy RHL business assets and As We Change®	500	2,155
Net cash used by investing activities	(754)	(2,381)
Cash flows from financing activities		
Net borrowings on line of credit		1,820
Payments on long-term debt	(771)	(1,104)
Tax benefit from exercise of stock options		88
Net activity from issuance of common stock	41	(13)
Net cash (used in) provided by financing activities	(730)	791

Net increase (decrease) in cash and cash equivalents	3,821	(806)
Cash and cash equivalents at beginning of period	3,995	3,518
Cash and cash equivalents at end of period	$ 7,816	$ 2,712
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$ 89	$ 220
Taxes	$ 368	$ 60

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

A. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and applicable rules and regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In management s opinion, all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows have been included and are of a normal, recurring nature. The results of operations for the three and nine months ended March 31, 2010 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, 2009 (2009 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 2009 Annual Report unless otherwise noted below.

Net Income (Loss) per Common Share

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

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009	Nine Months Ended March 31, 2010	Nine Months Ended March 31, 2009
Numerator				
Net income (loss)	$ 1,894	$ (504)	$ 3,909	$ (5,205)
Denominator				
Basic weighted average common shares outstanding	7,084	7,067	7,075	7,052
Dilutive effect of stock options	22	(63)	30	(20)
Diluted weighted average common shares outstanding	7,106	7,004	7,105	7,032
Basic net income (loss) per common share	$ 0.27	$ (0.07)	$ 0.55	$ (0.74)
Diluted net income (loss) per common share	$ 0.27	$ (0.07)	$ 0.55	$ (0.74)

Shares related to stock options representing the right to acquire 305,354 shares of common stock for the three months ended March 31, 2010, and 426,995 shares for the nine months ended March 31, 2010, were excluded from the calculation of diluted net income per common share, as the effect of their inclusion would have been anti-dilutive.

Shares related to stock options representing the right to acquire 708,442 shares of common stock for the three months ended March 31, 2009, and 884,878 shares for the nine months ended March 31, 2009, were excluded from the calculation of diluted net (loss) income per common share, as the effect of their inclusion would have been anti-dilutive.

Stock-Based Compensation

We have a new omnibus incentive plan that was approved by our Board of Directors effective as of October 15, 2009 and approved by our stockholders at the Annual Meeting of Stockholders held on November 30, 2009. Under the plan, we may grant nonqualified and incentive stock options and other stock-based awards to employees, non-employee directors and consultants. As of March 31, 2010, no awards had been granted under the plan. Our prior equity incentive plan was terminated effective as of November 30, 2009. We also had an employee stock purchase plan that was terminated effective as of June 30, 2009.

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We estimate the fair value of stock option awards at the date of grant and estimated 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 we assume to be zero, as we have not paid any cash dividends) and employee exercise behavior. Expected volatilities used in the model are based mainly on the historical volatility of our stock price. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect in the period of grant. The expected life of stock option grants is derived from historical experience.

Our net income included stock based compensation expense of approximately $69,000 for the three months ended March 31, 2010 and approximately $181,000 for the nine months ended March 31, 2010. Our net loss included stock based compensation expense of approximately $108,000 for the three months ended March 31, 2009 and approximately $289,000 for the nine months ended March 31, 2009.

Fair Value of Financial Instruments

Our financial statements include the following financial instruments: cash and cash equivalents, short-term investments, accounts receivable, accounts payable, and accrued expenses. We believe the carrying amounts of these assets and liabilities in the financial statements approximate the fair values of these financial instruments at March 31, 2010 and June 30, 2009. Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date.

We use a three-level hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs are inputs that reflect our assumptions about the inputs that market participants would use in pricing the asset or liability and are developed based on the best information available under the circumstances.

The fair value hierarchy is broken down into three levels based on the source of inputs. In general, fair values determined by Level 1 inputs use quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. We classify cash, cash equivalents, and marketable securities balances as Level 1 assets. Fair values determined by Level 2 inputs are based on quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active and models for which all significant inputs are observable or can be corroborated, either directly or indirectly by observable market data. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. These include certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs. As of March 31, 2010 and June 30, 2009, we did not have any financial assets or liabilities classified as Level 2 or 3.

Adoption of New Accounting Standards

During the first quarter of 2010, we adopted the new Accounting Standards Codification (ASC) as issued by the Financial Accounting Standards Board (FASB). The ASC has become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. The ASC is not intended to change or alter existing GAAP. The adoption of the ASC did not have a material impact on our consolidated financial statements.

Effective June 15, 2009, the Company adopted the updated guidance related to subsequent events issued by the Financial Accounting Standards Board (FASB), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The updated guidance initially required the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date that is, whether that date represents the date the financial statements were issued or were available to be issued. However, in February 2010, the FASB amended the guidance to remove the requirement to disclose the date through which subsequent events were evaluated. Adoption of the updated guidance did not have a material impact on the Company s consolidated financial condition, results of operations or statements of cash flows.

Effective January 1, 2010, the Company adopted the FASB s updated guidance related to fair value measurements and disclosures, which requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and to describe the reasons for the transfers. In addition, in the reconciliation for fair value measurements using significant unobservable inputs, or Level 3, a reporting entity should disclose separately information about purchases, sales, issuances and settlements (that is, on a gross basis rather than one net number). The updated guidance also requires that an entity should provide fair value measurement disclosures for each class of assets and liabilities and disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements for Level 2 and Level 3 fair value measurements. The guidance is effective for interim or annual financial reporting periods beginning after

December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. Therefore, the Company has not yet adopted the guidance with respect to the roll forward activity in Level 3 fair value measurements. The Company has updated its disclosures to comply with the updated guidance, however, adoption of the updated guidance did not have an impact on the Company s consolidated financial condition, results of operations or statements of cash flows.

B. Discontinued Operations

In an effort to enhance stockholder value, improve working capital and enable us to focus on our core contract manufacturing business, during the fourth quarter of fiscal 2008 we undertook a careful review of our branded products portfolio and operations. As a result, we decided to narrow our branded products focus and portfolio and developed a plan to do so, which included a decision to sell the legacy business of Real Health Laboratories, Inc. (RHL). On August 4, 2008, RHL sold certain assets related to its catalog and internet business conducted under the name As We Change® to Miles Kimball Company for a cash purchase price of $2.3 million. We recorded a loss of $226,000 as a result of this sale and recognized $221,000 in severance and related payroll costs during fiscal 2009.

On July 29, 2009, we entered into an Asset Purchase Agreement with PharmaCare US Inc. and PharmaCare Laboratories Pty Ltd. for the sale of substantially all of the remaining assets of RHL related to its wholesale and direct-to-consumer business. The sale closed on July 31, 2009 for a cash purchase price of $500,000. NAI provided a guarantee of RHL s indemnity obligations under the Asset Purchase Agreement, which potential liability is capped at the amount of the purchase price paid by the buyers to RHL. We recorded a loss of $6,000 as a result of this sale during the first quarter of fiscal 2010. RHL agreed to provide certain transition services and support to the buyers for a period of up to six months and received an amount equal to $9,000 per month for such services. Following the sale of substantially all of the assets of RHL, we changed the name of RHL to Disposition Company, Inc.

As part of the original Asset Purchase Agreement, we had the potential to receive up to an additional $500,000 from the buyers as a conditional earn-out if the RHL business acquired by the buyers met or exceeded certain budgeted profitability criteria during the period August 1, 2009 through July 31, 2010. Effective as of February 12, 2010, based on the loss of one or more customers, the results of operation of the RHL business since the closing date of the sale, the anticipated results of operation of the RHL business through July 31, 2010, and the corresponding anticipated reduction and/or elimination in the conditional earn-out amount, and in an effort to avoid the time and expense associated with the procedures required in connection with the earn-out, including, without limitation, the time and expense associated with the preparation of the required reports and a review of the books and records of PharmaCare US and PharmaCare Australia, we amended the Asset Purchase Agreement to eliminate the potential earn-out compensation.

As a result of our decision to sell the legacy RHL business, we initiated an operational consolidation program during the first quarter of fiscal 2009 that transitioned the remaining branded products business operations to our corporate offices. We substantially completed this operational consolidation program as of September 30, 2008. The program resulted in a charge to discontinued operations of $866,000 in severance and other business related exit costs during the nine months ended March 31, 2009.

As the plan to dispose of the legacy RHL business met the criteria of accounting for the impairment or disposal of long-lived assets, the current and prior periods presented in this report have been reclassified to reflect the legacy RHL business as discontinued operations.

During the third quarter of fiscal 2009, RHL s wholesale operation experienced a decline in sales activity from one of its largest customers as a result of the discontinuance of certain RHL product lines. Historically these product sales represented a significant portion of RHL s overall annual sales to this customer. Additionally, during this same period we received feedback from multiple parties related to their preliminary interest in acquiring the then remaining RHL operations. Due in part to the expected decline in future RHL sales as noted above and the current depressed worldwide economic conditions, the preliminary purchase price valuations provided by these third parties provided us with an indication that an impairment of the RHL net asset carrying values may exist.

We performed an analysis that compared the fair value of RHL s net assets as indicated by the third party purchase price valuations noted above to the current carrying amounts to determine if an impairment of value was evident. As a result of this analysis, we determined that as of the related measurement date the book value of RHL s net assets exceeded the fair value by approximately $1.8 million and recorded an impairment charge for this amount to discontinued operations during the third quarter of fiscal 2009.

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The following table presents the activity and the reserve balances related to these restructuring programs for the nine months ended March 31, 2010 (in thousands):

	Balance at June 30, 2009	Charges to Expense	Cash Payments	Balance at March 31, 2010
Employee termination costs	$ 19	$ 1	$ (20)	$
Lease liabilities and related facility closure costs	15	1	(16)	
Total	$ 34	$ 2	$ (36)	$

The following table summarizes the results of the legacy RHL business, classified as discontinued operations, for the periods ended March 31 (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2010	2009	2010	2009
Net sales	$	$ 415	$ 323	$ 2,589
Cost of goods sold and operating expense	30	495	155	3,186
Restructuring expenses		37	(2)	1,087
Impairment of goodwill and intangible assets		1,804		1,804
Loss on the sale of As We Change®				226
Loss on the sale of remaining legacy RHL assets			6	
Other expense		20	7	31
(Loss) income before income taxes	(30)	(1,941)	157	(3,745)
Income tax benefit	(32)			
Income (loss) from discontinued operations	$ 2	$ (1,941)	$ 157	$ (3,745)

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

	March 31, 2010	June 30, 2009
Assets		
Cash	$	$ 144
Accounts receivable, net		510
Inventory, net		286
Other current assets		39
Goodwill and intangible assets		208
Total assets	$	$ 1,187
Liabilities		
Accrued liabilities	78	599
Total liabilities	78	599

Net (liabilities) assets of discontinued operations	$ (78)	$ 588

C. Inventories

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

	March 31, 2010	June 30, 2009
Raw materials	$ 5,947	$ 6,368
Work in progress	1,826	1,445
Finished goods	1,451	2,287
Reserves	(888)	(780)
	$ 8,336	$ 9,320

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D. Property and Equipment

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

	Depreciable Life In Years	March 31, 2010	June 30, 2009
Land	N/A	$ 393	$ 393
Building and building improvements	7 39	2,751	2,679
Machinery and equipment	3 12	25,196	23,681
Office equipment and furniture	3 5	3,405	3,419
Vehicles	3	204	204
Leasehold improvements	1 15	9,996	10,067
Total property and equipment		41,945	40,443
Less: accumulated depreciation and amortization		(28,638)	(26,310)
Property and equipment, net		$ 13,307	$ 14,133

E. Debt

We have a bank credit facility of $8.0 million as of March 31, 2010, comprised of a $7.5 million working capital line of credit and $496,000 in an outstanding term loan. The working capital line of credit has a maturity date of November 1, 2011 and is secured by our accounts receivable and other rights to payment, general intangibles, inventory and equipment, has a fluctuating or fixed interest rate as elected by NAI from time to time and borrowings are subject to eligibility requirements for current accounts receivable and inventory balances. As of March 31, 2010, the outstanding balance on the term loan consisted of a $496,000, 10 year term loan due May 2014 with a twenty year amortization, secured by our San Marcos building, at an interest rate of LIBOR plus 2.25%. As of March 31, 2010, our monthly payments on the term loan is approximately $3,000 plus interest. As of March 31, 2010 and June 30, 2009, our working capital line of credit balance was zero.

On March 31, 2010, we were in compliance with all of the financial and other covenants required under our credit facility.

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 1.3 million, or approximately $1.2 million, which is the initial maximum aggregate amount that can be outstanding at any one time under the credit facility. This maximum amount was reduced by CHF 160,000, or approximately $150,000, as of December 31, 2007, and was reduced an additional CHF 160,000, or approximately $150,000, as of December 31, 2008 and December 31, 2009, 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 $470,000. As of March 31, 2010, 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 $940), whichever is greater. The bank reserves the right to refuse individual requests for an advance under the credit facility, although its exercise of such right will not have the effect of terminating the credit facility as a whole.

The composite interest rate on all of our outstanding debt was 14.79% at March 31, 2010 and 6.70% at March 31, 2009. The composite interest rate includes interest from our term debt, interest from the use of our working capital line of credit, amortization of annual loan fees and loan modification fess, as applicable, divided by the average balance of our outstanding borrowings during the period.

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

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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. For the nine months ended March 31, 2010, we contributed $450,000 to our defined benefit pension plan.

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

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009	Nine Months Ended March 31, 2010	Nine Months Ended March 31, 2009
Interest cost	$ 21	$ 20	$ 63	$ 60
Expected return on plan assets	(13)	(7)	(39)	(21)
Net periodic expense	$ 8	$ 13	$ 24	$ 39

G. Economic Dependency

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

	Three Months Ended March 31, 2010		Three Months Ended March 31, 2009		Nine Months Ended March 31, 2010		Nine Months Ended March 31, 2009	
	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	$ 9,421	55%	$ 8,209	47%	$ 25,697	50%	$ 27,115	50%
Customer 2	4,362	26	6,185	36	16,840	33	15,718	29
	$ 13,783	81%	$ 14,394	83%	$ 42,537	83%	$ 42,833	79%

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 March 31, 2010		Three Months Ended March 31, 2009		Nine Months Ended March 31, 2010		Nine Months Ended March 31, 2009	
	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	$ 651	11%	$ 874	14%	$ 2,360	11%	(a)	(a)
Supplier 2	673	11	786	12	2,638	12	$ 2,553	11%
Supplier 3	689	11	(a)	(a)	3,300	15	2,403	10
	$ 2,013	33%	$ 1,660	26%	$ 8,298	38%	$ 4,956	21%

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

H. Segment Information

Our business consists of two segments, identified as private label contract manufacturing, which primarily provides private label contract manufacturing services to companies that market and distribute nutritional supplements and other health care products, and branded products, which markets and distributes branded nutritional supplements.

In an effort to enhance stockholder value, improve working capital and enable us to focus on our core contract manufacturing business, during the fourth quarter of fiscal 2008 we developed a plan to narrow our branded products focus and portfolio and to sell our legacy RHL business. On August 4, 2008, RHL sold certain assets related to its catalog and internet business conducted under the name As We Change® to Miles Kimball Company for a cash purchase price of $2.3 million. We recorded a loss of $226,000 as a result of this sale and recognized $221,000 in severance and related payroll costs during fiscal 2009.

On July 31, 2009, we sold substantially all of the remaining assets of RHL related to its wholesale and direct-to-consumer business to PharmaCare US Inc. and PharmaCare Laboratories Pty Ltd. for a cash purchase price of $500,000. The financial information presented in this report has been reclassified to reflect the legacy RHL business as discontinued operations. We recorded a loss of $6,000 as a result of this sale.

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Following the completion of the sale of substantially all of the assets of RHL, our branded products segment consists primarily of the products sold under our Pathway to Healing product line.

We evaluate performance based on a number of factors. The primary performance measures for each segment are net sales and income or loss from operations before corporate allocations. Operating income or loss for each segment does not include corporate general and administrative expenses, interest expense and other miscellaneous income and expense items. Corporate general and administrative expenses include, but are not limited to: human resources, legal, finance, information technology, and other corporate level related expenses, which are not allocated to either segment. The accounting policies of our segments are the same as those described in Note A above and in the consolidated financial statements included in our 2009 Annual Report.

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2010	2009	2010	2009
Net Sales				
Private label contract manufacturing	$ 16,439	$ 16,721	$ 49,487	$ 52,441
Branded products	536	627	1,698	2,049
	$ 16,975	$ 17,348	$ 51,185	$ 54,490

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2010	2009	2010	2009
Income (Loss) from Operations				
Private label contract manufacturing	$ 2,276	$ 2,396	$ 6,627	$ 3,795
Branded products	164	211	394	329
Income from operations of reportable segments	2,440	2,607	7,021	4,124
Corporate expenses not allocated to segments	(1,603)	(1,224)	(4,041)	(5,025)
	$ 837	$ 1,383	$ 2,980	$ (901)

	March 31, 2010	June 30, 2009
Total Assets		
Private label contract manufacturing	$ 36,943	$ 34,774
Branded products	324	478
	$ 37,267	$ 35,252

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 March 31,		Nine Months Ended March 31,	
	2010	2009	2010	2009
United States	$ 9,325	$ 12,254	$ 31,273	$ 37,117
Markets outside the United States	7,650	5,094	19,912	17,373
Total net sales	$ 16,975	$ 17,348	$ 51,185	$ 54,490

Products manufactured by NAIE accounted for approximately 69% of net sales in markets outside the United States for the three months ended March 31, 2010, and 55% for the three months ended March 31, 2009. NAIE accounted for 58% of net sales in markets outside the United States for the nine months ended March 31, 2010, and 54% for the nine months ended March 31, 2009. No products manufactured by NAIE were sold in the United States during the nine months ended March 31, 2010 and 2009.

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

	Long-Lived Assets		Total Assets		Capital Expenditures Nine Months Ended	
	March 31, 2010	June 30, 2009	March 31, 2010	June 30, 2009	March 31, 2010	March 31, 2009
United States	$ 11,189	$ 11,991	$ 27,965	$ 27,106	$ 1,601	$ 3,059
Europe	2,277	2,301	9,302	8,146	352	812
	$ 13,466	$ 14,292	$ 37,267	$ 35,252	$ 1,953	$ 3,871

I. Restructuring Costs

During the first six months of fiscal 2009, the continued decline in economic conditions in the United States and the various foreign markets we service negatively impacted our customers businesses and our operations. As a result, during the second quarter of fiscal 2009 we implemented a cost reduction program that resulted in the elimination of certain personnel and business activities. The cost reduction program is expected to reduce the financial impact of the anticipated reduction in future sales. This program resulted in a charge to our operations of $558,000 in severance from a reduction in force during the second quarter of fiscal 2009. All payments related to this cost reduction program were completed by December 31, 2009.

The following table presents the activity and the reserve balance related to this restructuring program for the nine months ended March 31, 2010 (in thousands):

	Balance at June 30, 2009	Charges to Expense	Cash Payments	Balance at March 31, 2010
Employee termination costs recorded to selling, general and administrative expenses	$ 76	$	$ (76)	$
Total	$ 76	$	$ (76)	$

J. Income Taxes

We account for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates, for each of the jurisdictions in which we operate, expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date.

During fiscal 2009, we recorded a valuation allowance against deferred income tax assets of $1.8 million, representing the amount of our deferred income tax assets in excess of our deferred income tax liabilities. We recorded the valuation allowance because management was unable to conclude, in light of the cumulative loss we realized related to our US-based operations for the three year period ended June 30, 2009, that realization of the net deferred income tax asset was more likely than not. The valuation allowance recorded during fiscal 2009 primarily related to fiscal 2009 net operating loss carry forwards and changes in other deferred tax items recognized during fiscal 2009.

During the nine months ended March 31, 2010, we recorded U.S.-based federal tax expense of $621,000 on U.S.-based income from continuing operations before income taxes, which was fully offset by a tax benefit of $3.2 million that was recorded as a result of the write-off of our tax basis in RHL s stock which we determined had become worthless during the third quarter of fiscal 2010. The remaining net tax benefit was partially offset by a deferred tax asset valuation adjustment of $1.4 million leaving a net tax benefit of $1.1 million for the nine months ended March 31, 2010. This tax benefit was recognized based on our intent to carry back our current year tax loss in accordance with the Worker, Homeownership, and Business Assistance Act of 2009 signed by the President on November 6, 2009, which increases the allowable carry back period to five years (previously limited to a two-year carry back). In addition, during the nine months ended March 31, 2010, we recorded state tax expense of $136,000 on U.S.-based income from continuing operations before income taxes, which was fully offset by a tax benefit of $545,000 that was recorded as a result of the write-off of our tax basis in RHL s stock. This net tax benefit was fully offset by a deferred tax asset valuation adjustment of $409,000 resulting in $0 net state tax expense for the nine months ended March 31, 2010.

As a result of the recognition of these adjustments, we had a $4.5 million gross deferred tax asset offset by a deferred tax liability of $272,000 and a valuation allowance of $4.2 million resulting in a net deferred tax asset of $0 as of March 31, 2010. This valuation allowance did not have any affect on the tax expense and related liability recorded for operating income recognized by our foreign subsidiary during the three and nine months ended March 31, 2010.

We account for uncertain tax positions using the more-likely-than-not recognition threshold. Our practice is to recognize interest and/or penalties related to income tax matters in income tax expense. As of March 31, 2010 and June 30, 2009, we had not recorded any tax liabilities for uncertain tax positions.

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

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

It is our policy to establish reserves based on management s assessment of exposure for certain positions taken in previously filed tax returns that may become payable upon audit by tax authorities. The tax reserves are analyzed at least annually, generally in the fourth quarter of each year, and adjustments are made as events occur that warrant adjustments to the reserve.

K. 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, 2010, 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.

On July 31, 2009 RHL sold substantially all of the remaining assets of RHL related to its wholesale and direct-to-consumer business to PharmaCare US Inc. and PharmaCare Laboratories Pty Ltd. for a cash purchase price of $500,000. NAI provided a guarantee of RHL s indemnity obligations under the asset purchase agreement, which potential liability is capped at the amount of the purchase price paid by the buyers to RHL.

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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 and nine months ended March 31, 2010. 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 2009 Annual Report and other reports and documents we file with the SEC. Our future financial condition and results of operations will vary from our historical financial condition and results of operations described below based on a variety of factors.

Executive Overview

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

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

A cornerstone of our business strategy is to achieve long-term growth and profitability and to diversify our sales base. We have sought and expect to continue to seek to diversify our sales by developing relationships with additional, quality-oriented, private label contract manufacturing customers, developing and growing our own line of branded products and commercializing our licensed patent estate through contract manufacturing, royalty and sub-license agreements.

In an effort to enhance stockholder value, improve working capital and enable us to focus on our core contract manufacturing business, during the fourth quarter of fiscal 2008 we developed a plan to narrow our branded products focus and portfolio and to sell our legacy RHL business. On August 4, 2008, we sold certain assets related to RHL s catalog and internet business conducted under the name As We Change® to Miles Kimball Company for a cash purchase price of $2.3 million. We recorded a loss of $226,000 as a result of this sale and recognized $221,000 in severance and related payroll costs during fiscal 2009.

On July 31, 2009, we sold substantially all of the remaining assets of RHL related to its wholesale and direct-to-consumer business to PharmaCare US Inc. and PharmaCare Laboratories Pty Ltd. for a cash purchase price of $500,000. We had the potential to receive up to an additional $500,000 from the buyers as a conditional earn-out if the RHL business acquired by the buyers met or exceeded certain budgeted profitability criteria during the period August 1, 2009 through July 31, 2010. Effective as of February 12, 2010, based on the loss of one or more customers, the results of operation of the RHL business since the closing date of the sale, the anticipated results of operation of the RHL business through July 31, 2010, and the corresponding anticipated reduction and or elimination in the conditional earn-out amount, and in an effort to avoid the time and expense associated with the procedures required in connection with the earn-out, including, without limitation, the time and expense associated with the preparation of the required reports and a review of the books and records of PharmaCare US and PharmaCare Australia, we entered into an agreement with PharmaCare to eliminate the potential earn-out compensation. We recorded a loss of $6,000 as a result of this sale. The financial information presented in this report has been reclassified to reflect the legacy RHL business as discontinued operations.

As a result of our decision to sell the legacy RHL business, we initiated an operational consolidation program during the first quarter of fiscal 2009 that transitioned the remaining branded products business operations to our corporate offices. We substantially completed this operational consolidation program as of September 30, 2008. The program resulted in a charge to discontinued operations of $823,000 in severance and other business related exit costs during fiscal 2009.

During the first nine months of fiscal 2010, our net sales from continuing operations were 6.1% lower than in the first nine months of fiscal 2009. Private label contract manufacturing sales declined 5.6% due primarily to lower volumes of existing products in existing markets sold to one of our largest customers and the discontinuance of a relationship with one of our smaller customers. This decline was partially offset by increased sales to other existing customers and income related to our sub-license agreement for the distribution of Beta-Alanine. Net sales from our branded products declined 17.1% in the first nine months of fiscal 2010 as compared to the first nine months of fiscal 2009 due to the continued softening of our Pathway to Healing® product line. During early fiscal 2011 we intend to increase our Dr. Cherry marketing and advertising efforts and plan to re-launch certain Dr. Cherry products with new formulations, labeling and packaging in an effort to expand our future sales opportunities.

Our revenue concentration risk for our two largest customers increased to 83% as a percentage of our total sales from continuing operations for the first nine months of fiscal 2010 compared to 79% in the first nine months of fiscal 2009. We expect our contract

manufacturing revenue concentration percentage for our two largest customers to remain relatively consistent for the remainder of fiscal 2010.

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Beginning in fiscal 2008 and continuing through fiscal 2009, we invested substantial time and incurred substantial costs associated with hiring and training new quality assurance and other manufacturing support personnel, increased testing activity, and documentation and validation processes related to our Good Manufacturing Practices (GMPs) compliance programs. These additional expenses negatively impacted our operating income from continuing operations during fiscal 2008 and fiscal 2009. Although the cost of GMP compliance is significant, we believe the majority of our implementation investment costs have been incurred. Going forward, our commitment to quality and our steadfast support of the Food and Drug Administration s (FDA) mandated GMPs makes us well positioned to operate within the higher standards of such GMPs and we believe differentiates us from our competitors.

During fiscal 2009, the continued decline in economic conditions in the United States and the various foreign markets we service negatively impacted our customers businesses and our operations. As a result, during the second quarter of fiscal 2009 we implemented a cost reduction program that resulted in the elimination of certain personnel and business activities. This program resulted in a charge to our continuing operations of $558,000 during the second quarter of fiscal 2009. During the second half of fiscal 2009, our cost reduction program resulted in a savings of $3.0 million compared to the cost structure in the comparable prior year period. This cost reduction program reduced our operating overhead costs during the first nine months of fiscal 2010 by approximately $2.5 million and we expect it will further reduce our remaining fiscal 2010 operating overhead by approximately $500,000 as compared to fiscal 2009.

Following the completion of the sale of substantially all of the assets of RHL, our branded products segment consists primarily of the products sold under our Pathway to Healing® product line. Beginning in April 2007, Dr. Cherry ceased airing his weekly television program, which had served as the primary customer acquisition vehicle in marketing the Pathway to Healing® product line. While sales of the product line have been primarily generated by continuity orders from long-standing repeat customers, the loss of the television program has had a negative impact on our ability to acquire new customers and retain existing customers. During fiscal 2009, we revamped our Dr. Cherry website and increased our direct-to-consumer marketing and advertising efforts. These activities helped reduce the decline in our Dr. Cherry sales volumes during the first nine months of fiscal 2010.

During the remainder of fiscal 2010, we plan to continue to focus on:

Leveraging our state of the art, certified facilities to increase the value of the goods and services we provide to our highly valued private label contract manufacturing customers, and assist us in developing relationships with additional quality oriented customers;

Implementing focused initiatives to grow our Pathway to Healing® product line;

Commercializing our licensed patent estate through contract manufacturing, royalties and sublicense agreements and protecting our proprietary rights; and

Improving operational effi