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 DECEMBER 31, 2003

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 92069** **(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. ☒ Yes ☐ No

Indicate by check mark whether NAI is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). ☐ Yes ☒ No

As of February 6, 2004, 5,828,292 shares of NAI's common stock were outstanding, net of 272,400 treasury shares.

TABLE OF CONTENTS

SPECIAL NOTE—FORWARD-LOOKING STATEMENTS

Certain statements in this report 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, 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," "approximates," "predicts," or "projects," or the negative or other variation of such words, and similar expressions may identify a statement as a forward-looking statement. Forward-looking statements in this report may include statements about:

- future financial and operating results, including projections of revenues, income, earnings per share, profit margins, expenditures, liquidity and other financial items;
- inventories and facilities;
- sources and availability of raw materials;
- personnel;
- operations outside the United States;
- overall industry and market performance;
- competition;
- current and future economic and political conditions;
- product development;
- growth and acquisition strategies;
- the outcome of regulatory and litigation matters;
- customers;
- management's goals and plans for future operations; 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. 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 Items 2 and 3 and elsewhere in this report, as well as in other reports and documents we file with the 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), its wholly-owned subsidiary.

PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NATURAL ALTERNATIVES INTERNATIONAL, INC.
Condensed Consolidated Balance Sheets
(In thousands, except share and per share amounts)

	December 31, 2003	June 30, 2003
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 2,886	$ 5,482
Accounts receivable, net of allowance for doubtful accounts of $55 at December 31, 2003 and $27 at June 30, 2003	5,018	5,668
Inventories, net	12,307	7,845
Prepaid expenses	1,012	502
Other current assets	377	264
Total current assets	21,600	19,761
Property and equipment, net	10,910	10,820
Other assets, net	179	143
Total assets	$ 32,689	$30,724
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 5,388	$ 5,001
Accrued liabilities	1,419	1,106
Accrued compensation and employee benefits	885	717
Line of credit	85	—
Income taxes payable	90	46
Current portion of long-term debt	573	570
Total current liabilities	8,440	7,440
Long-term debt, less current portion	2,099	2,386
Long-term pension liability	191	121
Total liabilities	10,730	9,947
Stockholders' equity:		
Preferred stock; $.01 par value; 500,000 shares authorized; none issued or outstanding	—	—
Common stock; $.01 par value; 8,000,000 shares authorized; issued and outstanding 6,094,373 at December 31, 2003 and 6,087,532 at June 30, 2003	61	61
Additional paid-in capital	11,465	11,426
Retained earnings	11,736	10,593
Treasury stock, at cost, 272,400 shares at December 31, 2003 and June 30, 2003	(1,303)	(1,303)
Total stockholders' equity	21,959	20,777
Total liabilities and stockholders' equity	$ 32,689	$30,724

See accompanying notes to condensed consolidated financial statements.

NATURAL ALTERNATIVES INTERNATIONAL, INC.
Condensed Consolidated Statements Of Operations And Comprehensive Income
(In thousands, except share and per share amounts)
(Unaudited)

	Three months ended December 31,		Six months ended December 31,	
	2003	2002	2003	2002
Net sales	$ 17,195	$ 13,010	$ 33,916	$ 26,146
Cost of goods sold	13,300	9,958	25,875	19,899
Gross profit	3,895	3,052	8,041	6,247
Selling, general & administrative expenses	3,346	2,797	6,862	5,589
Income from operations	549	255	1,179	658
Other income (expense):				
Interest income	9	21	18	28
Interest expense	(51)	(70)	(94)	(153)
Foreign exchange gain (loss)	130	(11)	145	(17)
Proceeds from vitamin antitrust litigation	—	—	—	225
Other, net	(25)	(39)	(47)	(40)
	63	(99)	22	43
Income before income taxes	612	156	1,201	701
Provision for income taxes	36	7	58	15
Net income	$ 576	$ 149	$ 1,143	$ 686
Net income per common share:				
Basic	$ 0.10	$ 0.03	$ 0.20	$ 0.12
Diluted	$ 0.09	$ 0.02	$ 0.19	$ 0.11
Weighted average common shares outstanding:				
Basic shares	5,821,973	5,804,267	5,821,341	5,803,566
Diluted shares	6,161,851	6,021,919	6,134,798	5,975,742

See accompanying notes to condensed consolidated financial statements.

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

	Six Months Ended December 31, 2003	Six Months Ended December 31, 2002
Cash flow from operating activities		
Net income	$ 1,143	$ 686
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for uncollectible accounts receivable	28	(80)
Depreciation and amortization	1,338	1,222
Non-cash compensation	15	51
Pension expense, net of contributions	70	(41)
Loss on disposal of asset	15	4
Changes in operating assets and liabilities:		
Accounts receivable	622	(342)
Inventories	(4,462)	553
Prepaid expenses	(510)	(490)
Other assets	(149)	24
Accounts payable and accrued liabilities	744	(492)
Accrued compensation and employee benefits	168	51
Net cash provided by (used in) operating activities	(978)	1,146
Cash flows from investing activities		
Proceeds from sale of property and equipment	—	109
Capital expenditures	(1,443)	(526)
Repayment of notes receivable	—	68
Net cash used in investing activities	(1,443)	(349)
Cash flows from financing activities		
Net borrowings on line of credit	85	—
Borrowings on long-term debt	—	2,500
Payments on long-term debt	(284)	(1,424)
Decrease in restricted cash	—	1,500
Proceeds from issuance of common stock	24	24
Net cash provided by (used in) financing activities	(175)	2,600
Net increase (decrease) in cash and cash equivalents	(2,596)	3,397
Cash and cash equivalents at beginning of period	5,482	640
Cash and cash equivalents at end of period	$ 2,886	$ 4,037
Supplemental disclosures of cash flow information		
Cash paid during the period for interest	$ 94	$ 153

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

A. Basis of Presentation and 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 accounting principles generally accepted in the United States 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 six months ended December 31, 2003 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, 2003 ("2003 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 2003 Annual Report unless otherwise noted below.

We have reclassified certain prior period amounts to conform to the current year presentation.

Stock-Based Compensation

We have stock option plans under which we have granted non-qualified and incentive stock options to employees and non-employee directors. We also have an employee stock purchase plan. We account for stock-based awards to employees in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related interpretations. We have adopted the disclosure-only alternative of SFAS 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), as amended by SFAS 148, "Accounting for Stock-Based Compensation—Transition and Disclosure" ("SFAS 148").

Pro forma information regarding net income and net income per common share is required and has been determined as if we had accounted for our stock-based awards under the fair value method, instead of the guidelines provided by APB 25. The fair value of the awards was estimated at the date of grant using the Black-Scholes option valuation model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Option valuation models require the input of highly subjective assumptions, including expected life and stock price volatility. Because our options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect fair value estimates, in the opinion of management, the existing models do not necessarily provide a reliable single measure of the fair value of our options.

For purposes of pro forma disclosures, we have amortized the estimated fair value of the options to expense over the options' vesting periods. Our pro forma information under SFAS 123 and SFAS 148 is as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2003	2002	2003	2002
	(in thousands, except per share data)			
Net income—as reported	$ 576	$ 149	$ 1,143	$ 686
Plus: Reported stock-based compensation	7	21	15	51
Less: Fair value stock-based compensation	(116)	(82)	(197)	(152)
Net income—pro forma	$ 467	$ 88	$ 961	$ 585
Reported basic net income per common share	$ 0.10	$ 0.03	$ 0.20	$ 0.12
Pro forma basic net income per common share	$ 0.08	$ 0.01	$ 0.16	$ 0.10
Reported diluted net income per common share	$ 0.09	$ 0.02	$ 0.19	$ 0.11
Pro forma diluted net income per common share	$ 0.08	$ 0.01	$ 0.16	$ 0.10

Net Income per Common Share

We compute net income per common share in accordance with SFAS 128, "Earnings Per Share." This statement requires the presentation of basic income per common share, using the weighted average number of shares outstanding during the period, and diluted 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:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2003	2002	2003	2002
	(in thousands, except share and per share data)			
Numerator				
Net income	$ 576	$ 149	$ 1,143	$ 686
Denominator				
Basic weighted average common shares outstanding	5,821,973	5,804,267	5,821,341	5,803,566
Dilutive effect of stock options	339,878	217,652	313,457	172,176
Diluted weighted average common shares outstanding	6,161,851	6,021,919	6,134,798	5,975,742
Basic net income per common share	$ 0.10	$ 0.03	$ 0.20	$ 0.12
Diluted net income per common share	$ 0.09	$ 0.02	$ 0.19	$ 0.11

Shares related to stock options of 20,000 for the three months ended December 31, 2003, and 95,000 for the six months ended December 31, 2003, were excluded from the calculation of diluted net income per share, as the effect of their inclusion would be anti-dilutive.

Shares related to stock options of 105,000 for the three months ended December 31, 2002, and 117,500 for the six months ended December 31, 2002, were excluded from the calculation of diluted net income per share, as the effect of their inclusion would be anti-dilutive.

B. Inventories

Inventories (net) at December 31, 2003, consisted of (in thousands):

Raw materials	$ 6,932
Work in progress	2,876
Finished goods	2,499
	$12,307

C. Property and Equipment

The following is a summary of property and equipment at December 31, 2003 (in thousands):

	Depreciable Life In Years	
Land	NA	$ 393
Building and building improvements	5 – 39	3,304
Machinery and equipment	3 – 15	16,811
Office equipment and furniture	5 – 7	4,083
Vehicles	3	212
Leasehold improvements	1 – 10	4,417
Total property and equipment		29,220
Less: accumulated depreciation and amortization		(18,310)
Property and equipment, net		$ 10,910

D. Debt

We have a $6.5 million credit facility that expires on October 24, 2004. The facility is comprised of a $4.0 million working capital line of credit and a $2.5 million term loan and is secured by all of our assets. The working capital line of credit is subject to eligibility requirements for current accounts receivable and inventory balances. As of December 31, 2003, we had $85,000 outstanding and approximately $3.9 million available under the line of credit. The interest rate on the line of credit and term loan is prime plus 0.5%.

As of December 31, 2003, the outstanding amount on the term loan was approximately $2.0 million, of which $1.5 million is classified as long-term debt as we intend and, based on our receipt of proposals to refinance our credit facility from two lenders, believe we will be able to refinance our existing credit facility for a term greater than one year on or before its expiration.

On May 2, 1996, we entered into a term loan agreement for $1.1 million, secured by a building, at an annual interest rate of 8.25%. The loan is due in June 2011 and provides for principal and interest payable in monthly installments of $10,800. The outstanding amount was $714,000 at December 31, 2003.

The composite interest rate on all outstanding debt was 5.90% at December 31, 2003, and 6.84% at December 31, 2002.

E. Commitments

We lease part of our manufacturing facilities under non-cancelable operating leases.

We lease approximately 74,000 square feet of our manufacturing facilities in Vista, California, from an unaffiliated third party. We have two non-cancelable operating leases, one for approximately 54,000 square feet at 1215 Park Center Drive that we use as a warehousing and blending facility and the other for approximately 20,000 square feet at 1211C Park Center Drive that we use for packaging. Both leases expire in June 2008. However, on October 27, 2003, we entered into a new lease for both facilities, as well as for an additional 46,000 square feet contiguous to our existing space at the 1215 Park Center Drive location. We intend to use the additional space for tableting and encapsulation, which are currently located at our San Marcos, California facility. The new lease begins in April 2004 and expires in March 2014.

As required under the terms of the new lease, on January 6, 2004, we provided a letter of credit in the amount of $330,000 to the landlord as collateral. The amount of the letter of credit will automatically be reduced 33.3% each year. The amount of the outstanding letter of credit reduced the availability under our line of credit.

On January 22, 2004, we signed a letter of intent to execute an option under the new lease to expand the premises to include an additional 42,000 square feet, for a total of 162,000 square feet of leased space. We intend to initially sublease the additional space to the current tenant on a monthly basis and to eventually use the space for additional packaging operations

Minimum rental commitments as of December 31, 2003, (exclusive of property tax, insurance and maintenance) under all non-cancelable operating leases, (with initial or remaining lease terms in excess of one year) are set forth below (dollars in thousands):

2004	$ 540
2005	1,327
2006	1,324
2007	1,300
2008	1,314
Thereafter	6,938
	$12,743

F. Economic Dependency

We had substantial net sales to two customers during the periods shown in the following table. The loss of any of these customers could have a material adverse impact on our net sales and earnings. Sales by customer, representing 10% or more of the respective period's total sales, were (dollars in thousands):

	Three Months Ended December 31,				Six Months Ended December 31,			
	2003		2002		2003		2002	
	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	$ 7,741	45%	$ 5,782	44%	$ 14,669	43%	$ 11,750	45%
Customer 2	4,124	24	3,599	28	8,682	26	6,413	24
	$ 11,865	69%	$ 9,381	72%	$ 23,351	69%	$ 18,163	69%

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 sales and earnings.

Raw material purchases from any one supplier representing 10% or more of the respective period's raw material purchases are shown below (dollars in thousands):

	Three Months Ended December 31,				Six Months Ended December 31,			
	2003		2002		2003		2002	
	Raw Material Purchases by Supplier	% of Total Raw Material Purchases	Raw Material Purchases by Supplier	% of Total Raw Material Purchases	Raw Material Purchases by Supplier	% of Total Raw Material Purchases	Raw Material Purchases by Supplier	% of Total Raw Material Purchases
Supplier 1	$ 1,980	24%	$ 1,628	34 %	$ 5,131	17 %	$ 3,163	32 %
Supplier 2	891	11	601	13	(a)	(a)	1,108	11
Supplier 3	861	11	(a)	(a)	(a)	(a)	(a)	(a)
	$ 3,732	46%	$ 2,229	47 %	$ 5,131	17 %	$ 4,271	43 %

(a) Purchases were less than 10% of total raw material purchases.

G. Segment Information

Our segment information by geographic area was (dollars in thousands):

	Net Sales for the Three Months Ended December 31,		Net Sales for the Six Months Ended December 31,	
	2003	2002	2003	2002
United States	$14,951	$11,112	$29,734	$22,339
Europe	2,244	1,898	4,182	3,807
	$17,195	$13,010	$33,916	$26,146

	Long Lived Assets		Total Assets	
	December 31, 2003	June 30, 2003	December 31, 2003	June 30, 2003
United States	$ 10,186	$ 9,996	$ 28,081	$26,724
Europe	1,261	1,362	4,608	4,000
	$ 11,447	$11,358	$ 32,689	$30,724

H. Contingencies

We were a plaintiff in an anti-trust lawsuit against several manufacturers of vitamins and other raw materials that we purchased. Other similarly situated companies filed a number of similar lawsuits against some or all of the same manufacturers. Our lawsuit was consolidated with some of the others and captioned *In re: Vitamin Antitrust Litigation*. As of June 30, 2003 all of the Company's claims under the *Vitamin Antitrust Litigation* were settled. Settlement payments received by the Company of $225,000 are included in proceeds from vitamin antitrust litigation in the accompanying statements of operations for the six months ended December 31, 2002.

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. While unfavorable outcomes are possible, we believe the resolution of these matters, individually or in the aggregate, will not result in a material adverse effect on our business, financial condition or results of operations.

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 six months ended December 31, 2003. You should read the following discussion and analysis together with our unaudited financial statements and the notes to the financial statements included under Item 1 in this report, as well as the information included in our 2003 Annual Report. Our future financial condition and results of operations will vary from our historical financial condition and results of operations as described below.

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 2003 Annual Report. There have been no significant changes to these policies during the six months ended December 31, 2003.

Recent Developments

On January 22, 2004, in an effort to enhance our long-term manufacturing capacity and improve efficiency of our operations, we signed a letter of intent to execute our option to expand the premises contiguous to our packaging operations. The additional 42,000 square feet will initially be subleased to the current tenant on a monthly basis. We intend to utilize the space for additional packaging operations.

Additionally, we continue to evaluate expansion opportunities that could increase product lines, enhance our manufacturing capabilities or reduce risks associated with reliance on a limited number of customers.

Results of Operations—Three Months Ended December 31, 2003 vs. Three Months Ended December 31, 2002

Net Sales

	Three Months Ended December 31,	
	2003	2002
	(in thousands)	
Private Label Contract Manufacturing	$ 14,731	$ 10,595
Direct-to-Consumer Marketing Program	2,464	2,415
Total Net Sales	$ 17,195	$ 13,010

Total net sales for the quarter ended December 31, 2003 increased $4.2 million, or 32% over the comparable quarter last year. The net sales growth resulted from a $4.1 million, or 39%, increase in private label contract manufacturing sales and a $49,000, or 2%, increase in net sales from our direct-to-consumer marketing program. The increase in private label contract manufacturing sales was due primarily to an increase of $2.5 million in net sales for our two largest customers due to new product sales and an increase in volumes of established products. Additionally, we had net sales of $1.8 million of new products formulated for new private label contract manufacturing customers. Looking forward we anticipate moderate growth in private label contract manufacturing sales, partially offset by a slight to moderate decline in net sales from our direct-to-consumer marketing program.

Gross Profit

	Three Months Ended December 31,	
	2003	2002
	(in thousands)	
Gross Profit	$3,895	$3,052
As a Percentage of Net Sales	22.7%	23.5%

The decrease in gross profit margin to 22.7% from 23.5% was primarily due to an increase in material cost. Our material cost as a percentage of net sales was 52.3% ($9.0 million) in the three months ended December 31, 2003 and 51.5% ($6.7 million) in the comparable quarter last year. The increase in material cost as a percentage of net sales was primarily due to recording additional inventory reserves of $300,000 during the three months ended December 31, 2003 for specific inventory realization risks, partially offset by a favorable shift in sales mix from lower to higher margin products. The inventory allowance as a percentage of gross inventory at December 31, 2003 remained consistent with June 30, 2003. Our direct and indirect manufacturing expenses were consistent at 25.0% of net sales for the three months ended December 31, 2003 compared to 25.1% in the comparable quarter last year. Looking forward we anticipate gross margin to improve slightly.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $3.3 million (19.5% of net sales) in the three months ended December 31, 2003, compared to $2.8 million (21.5% of net sales) in the comparable quarter last year. The increase in absolute dollars was primarily due to additional direct-to-consumer media and production costs of $156,000 to market the Dr. Cherry's Pathway to Healing™ brand in several new television markets, sales personnel costs of $82,000, insurance premiums of $115,000 and $65,000 for additional pension expense. Our investment in expanding the Dr. Cherry's Pathway to Healing™ brand to new television markets produced results that did not meet our expectations. We are evaluating our marketing plan in the fiscal third quarter in an effort to strengthen the Dr. Cherry's Pathway to Healing™ brand. Looking forward we anticipate selling, general and administrative expenses to increase modestly due to incentive compensation costs.

Income from Operations

Our income from operations was $549,000 for the three months ended December 31, 2003, compared to $255,000 in the comparable quarter last year. The improvement in our income from operations was due to the increase in gross profit of $843,000 from higher net sales, partially offset by incremental selling, general and administrative expenses of $549,000.

Other income (expense)

Other income (expense) was $63,000 for the three months ended December 31, 2003, compared to ($99,000) in the comparable quarter last year. The improvement was primarily due to the increase of $141,000 in foreign exchange gains on the translation of Euro denominated cash and receivables.

Net Income

Our net income was $576,000 ($0.09 per diluted share) for the three months ended December 31, 2003 compared to $149,000 ($0.02 per diluted share) in the comparable quarter last year. The net income improvement was due to the increase in income from operations of $294,000 combined with an increase in other income of $162,000.

Results of Operations—Six Months Ended December 31, 2003 vs. Six Months Ended December 31, 2002

Net Sales

	Six Months Ended December 31,	
	2003	2002
	(in thousands)	
Private Label Contract Manufacturing	$28,449	$21,120
Direct-to-Consumer Marketing Program	5,467	5,026
Total Net Sales	$33,916	$26,146

Total net sales for the six months ended December 31, 2003 increased $7.8 million, or 30%, over the comparable period last year. The net sales growth resulted from a $7.3 million, or 35%, increase in private label contract manufacturing sales and a $441,000, or 9%, increase in net sales from our direct-to-consumer marketing program. The increase in private label contract manufacturing sales was due primarily to an increase of $5.2 million in net sales for our two largest customers due to new product sales and an increase in volumes of established products. Additionally, we had net sales of $2.5 million of new products formulated for new private label contract manufacturing customers.

Gross Profit

	Six Months Ended December 31,	
	2003	2002
	(in thousands)	
Gross Profit	$8,041	$6,247
As a Percentage of Net Sales	23.7%	23.9%

Gross profit margin was consistent at 23.7% for the six months ended December 31, 2003 compared to 23.9% for the comparable period last year. Our direct and indirect manufacturing expenses were 23.1% of net sales for the six months ended December 31, 2003 and 24.0% of net sales in the comparable period last year. The decrease in direct and indirect manufacturing expenses was due to improved fixed cost leverage on higher net sales. Our material cost as a percentage of net sales was 53.2% ($18.0 million) for the six months ended December 31, 2003 and 52.1% ($13.6 million) in the comparable period last year. The increase in material cost as a percentage of net sales was primarily due to recording additional inventory reserves of $653,000 during the six months ended December 31, 2003 for specific inventory realization risks, partially offset by a favorable shift in sales mix. The inventory allowance as a percentage of gross inventory at December 31, 2003 remained consistent with June 30, 2003.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $6.9 million (20.2% of net sales) in the six months ended December 31, 2003, compared to $5.6 million (21.4% of net sales) in the comparable period last year. The increase in absolute dollars was primarily due to additional direct-to-consumer media and production costs of $354,000 to market the Dr. Cherry's Pathway to Healing™ brand in several new television markets, sales personnel costs of $117,000, research and development personnel and professional costs of $202,000 for strengthening regulatory compliance, insurance premiums of $187,000, public company reporting and compliance matters of $71,000, bad debt allowance of $60,000 and $89,000 for additional pension expense.

Income from Operations

Our income from operations was $1.2 million for the six months ended December 31, 2003 compared to $658,000 in the comparable period last year. The improvement in our income from operations was due to the increase in gross profit of $1.8 million from higher net sales, partially offset by incremental selling, general and administrative expenses of $1.3 million.

Other income (expense)

Other income (expense) was $22,000 for the six months ended December 31, 2003, compared to $43,000 in the comparable period last year. The decrease in other income (expense) was primarily due to the prior year proceeds from the settlement of claims associated with the vitamin antitrust litigation of $225,000, partially offset by $162,000 increase in foreign exchange gains on the translation of Euro denominated cash and receivables.

Net Income

Our net income was $1.1 million ($0.19 per diluted share) for the six months ended December 31, 2003 compared to $686,000 ($0.11 per diluted share) in the comparable period last year. The net income improvement was due to the increase in income from operations of $521,000.

Liquidity and Capital Resources

Our working capital increased in the six months ended December 31, 2003 to $13.2 million versus $12.3 million at June 30, 2003. Cash and cash equivalents decreased $2.6 million primarily as a result of an increase of $4.5 million in inventory. Inventory increased primarily due to customer requirements and anticipated revenue growth.

Accounts receivable decreased $650,000 at December 31, 2003 compared to June 30, 2003 due to a reduction in the number of days sales outstanding from 26 days to 24 days. Accounts payable as a percentage of inventory was 44% at December 31, 2003 versus 64% at June 30, 2003 due to timing of disbursements to vendors.

Approximately $950,000 of our operating cash flow was generated by NAIE in the six months ended December 31, 2003. There are currently no material restrictions on the transfer of these funds within the Company.

Capital expenditures for the six months ended December 31, 2003 were approximately $1.4 million. These expenditures were primarily for the continuing investment in our domestic manufacturing equipment of approximately $1.1 million. We plan on significantly increasing capital expenditures in the remaining six months of fiscal 2004 to expand manufacturing capacity and improve efficiency in encapsulation, tableting and packaging operations.

Our consolidated debt decreased to $2.8 million at December 31, 2003 from $3.0 million at June 30, 2003. Our consolidated debt of $2.8 million includes a $714,000 term loan secured by a building. Additionally, we have outstanding a $2.0 million term loan and $85,000 line of credit balance that are part of a credit facility that expires in October 2004. The credit facility is secured by all of our assets. The working capital line of credit is subject to eligibility requirements for current accounts receivable and inventory balances. As of December 31, 2003, we had $3.9 million available under the line of credit. The interest rate on the term loan and line of credit is prime plus 0.5%.

As of December 31, 2003, approximately $1.5 million of the outstanding balance on our term loan was classified as long-term debt as we intend and, based on our receipt of proposals to refinance our credit facility from two lenders, believe we will be able to refinance our existing credit facility for a term greater than one year on or before its expiration. There is no assurance, however, that we will in fact be able to refinance the credit facility. If we are unable to do so, we would need to pay the outstanding balance on the credit facility on or before October 24, 2004 from our available cash balance at that time. While we believe we would be able to do so, there can be no guarantee that we will have sufficient available cash when and if needed.

On January 6, 2004, as required by our new lease, we provided a letter of credit to the landlord, as collateral, in the amount of $330,000. The amount of the letter of credit will automatically reduce by 33.3% per year. The amount outstanding on the letter of credit reduced the availability under our line of credit.

We plan on funding our current working capital needs, capital expenditures and debt payments using cash flow from operations and our existing credit facility. Additionally, we are evaluating expanding our credit facility to provide sufficient capital for our long-term growth strategies.

At December 31, 2003, we had no outstanding option contracts. There are no other derivative financial instruments at December 31, 2003. On January 6, 2004 we purchased option contracts designated as cash flow hedges to protect against the foreign currency exchange risk inherent in our forecasted transactions denominated in Euros. The option contracts had a notional amount of $8.3 million and a purchase price of $55,000. The premium associated with each option contract is marked-to-market and realized gains or losses are recognized on the settlement date in cost of goods sold. The risk of loss associated with purchased options is limited to premium amounts paid for the option contracts.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet debt nor do we have any transactions, arrangements or relationships with any special purposes entities.

Contractual Obligations

This table summarizes our known contractual obligations and commercial commitments at December 31, 2003 (in thousands).

Contractual Obligations	Total	Fiscal 2004	Fiscal 2005	Fiscal 2006	Fiscal 2007	Fiscal 2008	Thereafter
Long-term Debt	$ 2,672	$ 286	$1,784	$ 83	$ 90	$ 97	$ 332
Operating Leases	12,743	540	1,327	1,324	1,300	1,314	6,938
Purchase Obligation [1]	457	276	181	—	—	—	—
Total Obligations	$15,872	$1,102	$3,292	$1,407	$1,390	$1,411	$ 7,270

[1] On October 20, 2003 we entered into a purchase obligation for certain raw materials from a supplier for one year. Raw materials are to be delivered by the supplier as needed. This obligation is not recorded in our consolidated financial statements until delivery of raw material has occurred.

Recent Accounting Pronouncements

Recent accounting pronouncements are discussed under Item 7 of our 2003 Annual Report. As of December 31, 2003, we are not aware of any additional pronouncements that materially effect our financial position or results of operations.

Risks

You should carefully consider the risks described under Item 7 of our 2003 Annual Report, as well as the other information in our 2003 Annual Report and in this report, 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 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 December 31, 2003, we had fixed rate debt of $714,000 and variable rate debt of approximately $2.1 million. The interest rate on our variable rate debt is equal to prime plus 0.5%, and was 4.5% as of December 31, 2003. An immediate one hundred basis point (1%) increase in the interest rate on our variable rate debt, holding other variables constant, would increase our interest expense by $11,000 for the six months ended December 31, 2003. We intend to refinance our credit facility on or before October 24, 2004. If we do refinance our credit facility, the new facility may have different terms than our existing facility, which may include different interest rates. Interest rates have been at or near historic lows in recent years. There can be no guarantee that interest rates will not rise. 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 will 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 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.

As of December 31, 2003, we had no outstanding purchased options. On January 6, 2004, we bought option contracts designated as cash flow hedges to protect against the foreign currency exchange risk inherent in a portion of our forecasted transactions denominated in Euros. The option contracts had a notional amount of $8.3 million and a purchase price of $55,000. The risk of loss associated with the options is limited to premium amounts paid for the option contracts.

On December 31, 2003, the Swiss Franc closed at 1.24 to 1.00 United States dollar and the Euro closed at 0.80 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 would have decreased our earnings for the six months ended December 31, 2003 by $555,000.

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 December 31, 2003. Based on their evaluation, they 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 December 31, 2003 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. While unfavorable outcomes are possible, we believe the resolution of these matters, individually or in the aggregate, will not result in a material adverse effect on our business, financial condition or results of operations.

As of February 6, 2004, neither NAI nor its subsidiaries were a party to any material pending legal proceedings nor was any of their property the subject of any material pending legal proceedings.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

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

EXHIBIT INDEX

Exhibit Number	Description	Incorporated By Reference To
3(i)	Restated Certificate of Incorporation of Natural Alternatives International, Inc. filed with the Delaware Secretary of State on July 31, 1996	Exhibit 3(i) of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2003, filed with the commission on September 17, 2003
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
10.1	1999 Omnibus Equity Incentive Plan as adopted effective May 10, 1999	Exhibit A of NAI's definitive Proxy Statement filed with the commission on October 21, 1999
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	Form of Executive Employment Agreement dated as of September 13, 2003, by and between NAI and Mark Zimmerman	Exhibit 10.4 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
10.5	Form of Executive Employment Agreement dated as of September 13, 2003, by and between NAI and Randell Weaver	Exhibit 10.5 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
10.6	Form of Executive Employment Agreement dated as of September 13, 2003, by and between NAI and Mark A. LeDoux	Exhibit 10.6 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
10.7	Form of Executive Employment Agreement dated as of September 13, 2003, by and between NAI and John Wise	Exhibit 10.7 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
10.8	Form of Executive Employment Agreement dated as of September 13, 2003, by and between NAI and John Reaves	Exhibit 10.8 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
10.9	Form of Executive Employment Agreement dated as of September 13, 2003, by and between NAI and Timothy E. Belanger	Exhibit 10.9 of NAI's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2003, filed with the commission on November 5, 2003
10.10	Lease of Facilities in Vista, California between NAI and Calwest Industrial Properties, LLC, a California limited liability company dated October 27, 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
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

(b) Reports on Form 8-K

On October 27, 2003, we filed a Current Report on Form 8-K with the SEC that included a press release issued on October 27, 2003, announcing our financial results for the first quarter ended September 30, 2003. This report was the only report on Form 8-K that we filed during the quarterly period ended December 31, 2003.

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: February 6, 2004

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.

Exhibit 31.1

Certification of Chief Executive Officer
Pursuant to
Rule 13a-14(a)/15d-14(a)

I, Mark A. LeDoux, Chief Executive Officer of Natural Alternatives International, Inc., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Natural Alternatives International, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 6, 2004

/s/ Mark A. LeDoux

Mark A. LeDoux, Chief Executive Officer

Exhibit 31.2

Certification of Chief Financial Officer
Pursuant to
Rule 13a-14(a)/15d-14(a)

I, John R. Reaves, Chief Financial Officer of Natural Alternatives International, Inc., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Natural Alternatives International, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 6, 2004

/s/ John R. Reaves

John R. Reaves, Chief Financial Officer

Exhibit 32

Certification
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of Natural Alternatives International, Inc., a Delaware corporation, does hereby certify, to such officer's knowledge, that the Quarterly Report on Form 10-Q for the period ended December 31, 2003 of Natural Alternatives International, Inc. fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in such report fairly presents, in all material respects, the financial condition and results of operations of Natural Alternatives International, Inc.

Date:	February 6, 2004	/s/ Mark A. LeDoux
		Mark A. LeDoux, Chief Executive Officer
Date:	February 6, 2004	/s/ John R. Reaves
		John R. Reaves, Chief Financial Officer

The foregoing certification is furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and is not being filed as part of the Form 10-Q or as a separate disclosure document.