

**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 September 30, 2023

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____.

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.)

1535 Faraday Ave
Carlsbad, CA 92008
(Address of principal executive offices)

(760) 736-7700
(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value per share	NAII	Nasdaq Stock Market

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

Indicate by check mark whether NAI has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that NAI was required to submit such files). Yes No

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

Large accelerated filer Accelerated filer Emerging Growth Company
Non-accelerated filer Smaller reporting company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of November 9, 2023, 6,088,813 shares of NAI's common stock were outstanding, net of 3,240,593 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,” “expect,” “plan,” “believe,” “anticipate,” “intend,” “estimate,” “approximate,” “predict,” “forecast,” “project,” “future”, or “likely”, 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 or pessimism about future operating results, are forward-looking statements. Forward-looking statements in this report may include statements about:

- our ability to develop market acceptance for and increase sales of new products, develop relationships with new customers and maintain or improve existing customer relationships;
- future financial and operating results, including projections of net sales, revenue, income or loss, net income or loss per share, profit margins, expenditures, liquidity, and other financial items;
- the sufficiency of our available cash, cash equivalents, and potential cash flows from our operations to fund our working capital and capital expenditure needs through the next 12 months and longer;
- the future adequacy and intended use of our facilities, including recommencing operations at our manufacturing facility in Carlsbad, California after a temporary closing in October 2023;
- our ability to negotiate a revision to our credit facility with Wells Fargo Bank or another financial institution;
- future customer orders and the timing thereof;
- our ability to maintain or increase our patent and trademark licensing revenues;
- our ability to attract and retain sufficient labor to successfully execute our business strategies and achieve our goals and objectives;
- inventory levels, including the adequacy of quality raw material and other inventory levels to meet future customer demand;
- our ability to price our products to achieve profit margin targets, especially in the current volatile raw material and labor environment;
- our ability to protect our intellectual property;
- future economic and political conditions;
- our ability to improve operating efficiencies, manage costs and business risks, and improve or maintain profitability;
- currency exchange rates and their effect on our results of operations (including amounts that we may reclassify as earnings), the availability of foreign exchange facilities, our ability to effectively hedge against foreign exchange risks and the extent to which we may seek to hedge against such risks;
- the outcome of litigation, regulatory and tax matters we may become involved in, the costs associated with such matters and the effect of such matters on our business and results of operations;
- sources, availability and quality of raw materials, including the limited number of suppliers of beta-alanine meeting our quality requirements;
- potential manufacturing and distribution channels, product returns, and potential product recalls;
- the impact of external factors on our business and results of operations, especially, for example, variations in quarterly net sales from seasonal and other external factors;
- our ability to operate within the standards set by the U.S. Food and Drug Administration’s (FDA) Good Manufacturing Practices (GMPs);
- the adequacy of our financial reserves and allowances;
- the sufficiency of our available cash, cash equivalents, and potential cash flows from our operations to fund our working capital and capital expenditure needs through the next 12 months and longer;
- the impact of accounting pronouncements and our adoption of certain accounting guidance; and
- other assumptions described in this Report underlying or relating to any forward-looking statements.

Forward-looking statements in this Report speak only as of the date of this Report based on information available to us at that time and caution should be taken not to place undue reliance on any such forward-looking statements. Forward-looking statements are subject to certain future events, risks, and uncertainties that are or 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 I of our fiscal 2023 Annual Report, as well as in other reports and documents we have filed and will file with the United States Securities and Exchange Commission (SEC).

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Natural Alternatives International, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except share and per share data)
(Unaudited)

	September 30, 2023	June 30, 2023
Assets		
Current assets:		
Cash and cash equivalents	\$ 16,749	\$ 13,604
Accounts receivable – less allowance for doubtful accounts of \$0 at September 30, 2023 and \$23 at June 30, 2023	9,751	7,022
Inventories, net	23,304	29,694
Income tax receivable	338	305
Forward contracts	787	390
Prepays and other current assets	6,825	5,995
Total current assets	57,754	57,010
Property and equipment, net	53,971	53,841
Operating lease right-of-use assets	45,651	20,369
Deferred tax asset – noncurrent	161	355
Other noncurrent assets, net	2,715	2,577
Total assets	\$ 160,252	\$ 134,152
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 7,614	\$ 7,778
Accrued liabilities	2,715	2,409
Accrued compensation and employee benefits	2,367	2,246
Customer deposits	405	317
Short-term liability – operating leases	1,130	2,448
Forward contracts	720	—
Income taxes payable	196	374
Mortgage note payable, current portion	290	312
Total current liabilities	15,437	15,884
Long-term liability – operating leases	45,778	18,965
Long-term pension liability	328	339
Mortgage note payable, net of current portion	9,154	9,205
Income taxes payable, noncurrent	740	987
Total liabilities	71,437	45,380
Commitments and contingencies (Notes E, F, and L)		
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 at September 30, 2023 and June 30, 2023, issued and outstanding (net of treasury shares) 6,088,813 at September 30, 2023 and 6,073,813 at June 30, 2023	91	91
Additional paid-in capital	31,738	31,436
Retained earnings	79,488	80,183
Treasury stock, at cost, 3,240,593 shares at September 30, 2023 and 3,240,593 at June 30, 2023	(22,855)	(22,855)
Accumulated other comprehensive income	353	(83)
Total stockholders' equity	88,815	88,772
Total liabilities and stockholders' equity	\$ 160,252	\$ 134,152

See accompanying notes to condensed consolidated financial statements.

Natural Alternatives International, Inc.
Condensed Consolidated Statements of Income and Comprehensive Income
(In thousands, except share and per share data)
(Unaudited)

	Three Months Ended	
	September 30,	
	2023	2022
Net sales	\$ 33,969	\$ 43,127
Cost of goods sold	30,832	37,756
Gross profit	3,137	5,371
Selling, general and administrative	3,681	3,829
(Loss) income from operations	(544)	1,542
Other (expense) income:		
Interest income	9	4
Interest expense	(93)	(75)
Foreign exchange loss	(277)	(147)
Other, net	21	(6)
Total other expense	(340)	(224)
(Loss) income before income taxes	(884)	1,318
(Benefit) provision for income taxes	(189)	265
Net (loss) income	\$ (695)	\$ 1,053
Unrealized gain resulting from change in fair value of derivative instruments, net of tax	441	545
Comprehensive (loss) income	\$ (254)	\$ 1,598
Net (loss) income per common share:		
Basic	\$ (0.12)	\$ 0.18
Diluted	\$ (0.12)	\$ 0.18
Weighted average common shares outstanding		
Basic	5,850,131	5,919,649
Diluted	5,850,131	5,943,446

See accompanying notes to condensed consolidated financial statements.

Natural Alternatives International, Inc.
Condensed Consolidated Statements of Stockholders' Equity
Three-Month Period Ended September 30, 2023 and 2022
(Dollars in thousands)
(Unaudited)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount			Shares	Amount		
Balance, June 30, 2023	9,314,406	\$ 91	\$ 31,436	\$ 80,183	3,240,593	\$ (22,855)	\$ (83)	\$ 88,772
Compensation expense related to stock compensation plans	—	—	302	—	—	—	—	302
Issuance of common stock for restricted stock grants	15,000	—	—	—	—	—	—	—
Change in minimum pension liability, net of tax	—	—	—	—	—	—	(5)	(5)
Unrealized gain resulting from change in fair value of derivative instruments, net of tax	—	—	—	—	—	—	441	441
Net loss	—	—	—	(695)	—	—	—	(695)
Balance, September 30, 2023	<u>9,329,406</u>	<u>\$ 91</u>	<u>\$ 31,738</u>	<u>\$ 79,488</u>	<u>3,240,593</u>	<u>\$ (22,855)</u>	<u>\$ 353</u>	<u>\$ 88,815</u>
Balance, June 30, 2022	9,191,406	\$ 89	\$ 30,423	\$ 77,661	3,061,795	\$ (21,352)	\$ 1,699	\$ 88,520
Compensation expense related to stock compensation plans	—	—	235	—	—	—	—	235
Repurchase of common stock	—	—	—	—	46,795	(497)	—	(497)
Unrealized gain resulting from change in fair value of derivative instruments, net of tax	—	—	—	—	—	—	545	545
Net income	—	—	—	1,053	—	—	—	1,053
Balance, September 30, 2022	<u>9,191,406</u>	<u>\$ 89</u>	<u>\$ 30,658</u>	<u>\$ 78,714</u>	<u>3,108,590</u>	<u>\$ (21,849)</u>	<u>\$ 2,244</u>	<u>\$ 89,856</u>

See accompanying notes to condensed consolidated financial statements.

Natural Alternatives International, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Three Months Ended September 30,	
	2023	2022
Cash flows from operating activities		
Net (loss) income	\$ (695)	\$ 1,053
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Recovery of uncollectible accounts receivable	—	(24)
Depreciation and amortization	1,148	956
Deferred income taxes	1	—
Non-cash compensation	302	235
Non-cash lease expense	1,081	454
Pension contributions, net of expense	(11)	25
Changes in operating assets and liabilities:		
Accounts receivable	(2,730)	2,625
Inventories, net	6,390	(7,515)
Prepays and other assets	(1,072)	(719)
Accounts payable and accrued liabilities	229	1,010
Forward contracts	1,057	(33)
Accrued compensation and employee benefits	121	(1,119)
Operating lease liabilities	(867)	(792)
Income taxes	(458)	(716)
Net cash provided by (used in) operating activities	<u>4,496</u>	<u>(4,560)</u>
Cash flows from investing activities		
Purchases of property and equipment	(1,278)	(7,767)
Net cash used in investing activities	<u>(1,278)</u>	<u>(7,767)</u>
Cash flows from financing activities		
Borrowings on line of credit	—	3,400
Payments on long-term debt	(73)	(68)
Repurchase of common stock	—	(497)
Net cash (used in) provided by financing activities	<u>(73)</u>	<u>2,835</u>
Net increase (decrease) in cash and cash equivalents	3,145	(9,492)
Cash and cash equivalents at beginning of period	13,604	21,833
Cash and cash equivalents at end of period	<u>\$ 16,749</u>	<u>\$ 12,341</u>
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	\$ 50	\$ 75
Income taxes	\$ 251	\$ 827

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

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and with applicable rules and regulations. Pursuant to such rules and regulations, certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) have been condensed or omitted. In management's opinion, all adjustments necessary for a fair presentation of the financial position, results of operations, stockholders' equity, and cash flows have been included and are of a normal, recurring nature. The results of operations for the three months ended September 30, 2023 are not necessarily indicative of the operating results for the full fiscal year or for any future periods.

You should read the financial statements and these notes, which notes 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, 2023 ("2023 Annual Report"). The accounting policies used to prepare the financial statements included in this Report are the same policies described in the notes to the consolidated financial statements in our 2023 Annual Report unless otherwise noted below.

Recently Adopted Accounting Pronouncements

In September 2016, the FASB issued ASU 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." ASU 2016-13 introduced a novel approach to assessing impairments known as the "current expected credit loss model" or "CECL." Unlike the previous standard, which focused on incurred losses, CECL centers on anticipated losses. Under this framework, organizations are obligated to acknowledge an allowance corresponding to their estimate of expected credit losses. The CECL model is applicable to a wide range of financial instruments, including debt instruments, trade receivables, lease receivables, financial guarantee contracts, and other loan commitments. We adopted ASU 2016-13 effective July 1, 2023. The adoption of ASU 2016-13 did not materially impact our results of operations or our financial statement presentation or related disclosures.

Recently Issued Accounting and Regulatory Pronouncements

Other recently issued accounting pronouncements are not discussed in this Report as such pronouncements did not have, and are not believed by management to have, a material impact on our present or future financial statements.

Net (Loss) Income per Common Share

We compute net (loss) 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 unvested restricted shares 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 (loss) income per common share as follows (in thousands, except per share data):

	Three Months Ended September 30,	
	2023	2022
Numerator		
Net (loss) income	\$ (695)	\$ 1,053
Denominator		
Basic weighted average common shares outstanding	5,850	5,920
Dilutive effect of restricted stock	—	23
Diluted weighted average common shares outstanding	<u>5,850</u>	<u>5,943</u>
Basic net (loss) income per common share	<u>\$ (0.12)</u>	<u>\$ 0.18</u>
Diluted net (loss) income per common share	<u>\$ (0.12)</u>	<u>\$ 0.18</u>

We exclude the impact of restricted stock from the calculation of diluted net loss per common share in periods where we have a net loss or when their inclusion would be antidilutive. During the three months ended September 30, 2023, we excluded 233,628 shares of unvested restricted stock. During the three months ended September 30, 2022, we excluded 50,377 shares of unvested restricted stock.

Revenue Recognition

We record revenue based on a five-step model which includes: (1) identifying a contract with a customer; (2) identifying the performance obligations in the contract; (3) determining the transaction price; (4) allocating the transaction price among the performance obligations; and (5) recognizing revenue as each of the various performance obligations are satisfied.

Revenue is measured as the net amount of consideration expected to be received in exchange for fulfilling one or more performance obligations. We identify purchase orders from customers as contracts. The amount of consideration expected to be received and revenue recognized includes estimates of variable consideration, including estimates for early payment discounts and volume rebates. Such estimates are calculated using historical averages adjusted for any expected changes due to current business conditions and experience. We review and update these estimates at the end of each reporting period and the impact of any adjustments is recognized in the period the adjustments are identified. In assessing whether collection of consideration from a customer is probable, we consider both the customer's ability and intent to pay that amount of consideration when it is due. Payment of invoices is due as specified in the underlying customer agreement, which is typically 30 days from the invoice date. Invoices are generally issued on the date of transfer of control of the products ordered to the customer.

Revenue is recognized at the point in time that each of our performance obligations is fulfilled, and control of the ordered products is transferred to the customer. This transfer occurs when the product is shipped, or in some cases, when the product is delivered to the customer.

We recognize revenue in certain circumstances before delivery to the customer has occurred (commonly referred to as bill-and-hold transactions). Products sold under bill-and-hold arrangements are recorded as revenue when risk of ownership has been transferred to the customer, but the product has not shipped due to a substantive reason, typically at the customer's request. The product must be separately identified as belonging to the customer, ready for physical transfer to the customer, and we cannot have the ability to redirect the product to another customer.

We provide early payment discounts to certain customers. Based on historical payment trends, we expect that these customers will take advantage of these early payment discounts. The cost of these discounts is reported as a reduction to the transaction price. If the actual discounts differ from those estimated, the difference is also reported as a change in the transaction price. We require prepayment from certain customers. We record any payments received in advance of contract fulfillment as a contract liability and they are classified as customer deposits on the consolidated balance sheet.

Contract liabilities and revenue recognized were as follows (in thousands):

	<u>June 30, 2023</u>	<u>Additions</u>	<u>Revenue Recognized</u>	<u>Customer Refunds</u>	<u>September 30, 2023</u>
Contract Liabilities (Customer Deposits)	\$ 317	\$ 413	\$ (325)	\$ —	\$ 405
	<u>June 30, 2022</u>	<u>Additions</u>	<u>Revenue Recognized</u>	<u>Customer Refunds</u>	<u>September 30, 2022</u>
Contract Liabilities (Customer Deposits)	\$ 140	\$ 108	\$ (140)	\$ —	\$ 108

Except for product defects, no right of return exists on the sale of our products. We estimate returns based on historical experience and recognize a returns liability for any estimated returns. As of September 30, 2023, we have no estimated returns liability.

We currently own certain U.S. patents, and each patent's corresponding foreign patent applications. All of these patents and patent rights relate to the ingredient known as beta-alanine marketed and sold under our CarnoSyn® and SR CarnoSyn® trade names. We recorded beta-alanine raw material sales and royalty and licensing income as a component of revenue in the amount of \$1.8 million during the three months ended September 30, 2023. We similarly recorded \$1.4 million during the three months ended September 30, 2022. These royalty income and raw material sale amounts resulted in royalty expense paid to the original patent holders from whom NAI acquired its patents and patent rights. We recognized royalty expense as a component of cost of goods sold in the amount of approximately \$89,000 during the three months ended September 30, 2023. We recorded approximately \$27,000 of royalty expense during the three months ended September 30, 2022.

Stock-Based Compensation

The Board of Directors approved our current omnibus equity incentive plan that became effective January 1, 2021 (the “2020 Plan”), which was approved by our stockholders at the Annual Meeting of Stockholders on December 4, 2020. Under the 2020 Plan, we may grant nonqualified and incentive stock options, restricted stock grants, restricted stock units, stock appreciation rights, and other stock-based awards to employees, non-employee directors and consultants.

We did not have any option activity or options outstanding during the three months ended September 30, 2023 or September 30, 2022.

During the three months ended September 30, 2023, we granted a total of 15,000 restricted stock shares to certain new members of our management team. We did not grant any restricted stock shares during the three months ended September 30, 2022. During the three months ended September 30, 2023 and September 30, 2022, no restricted stock shares were forfeited. Our net loss included stock-based compensation expense with the vesting of prior restricted stock grants of approximately \$0.3 million for the three months ended September 30, 2023. Our net income included stock based compensation expense in connection with the vesting of prior restricted stock grants of approximately \$0.2 million for the three months ended September 30, 2022.

Deferred Compensation Plan

Effective July 16, 2020, the Board of Directors approved and adopted a Non-Qualified Incentive Plan (the “Incentive Plan”). Pursuant to the Incentive Plan, the Human Resources Committee and the Board of Directors may make deferred cash payments or other cash awards (“Awards”) to directors, officers, employees and eligible consultants of NAI (“Participants”). These Awards are made subject to conditions precedent that must be met before NAI is obligated to make the payment. The purpose of the Incentive Plan is to enhance the long-term stockholder value of NAI by providing the Human Resources Committee and the Board of Directors the ability to make deferred cash payments or other cash awards to encourage Participants to serve NAI or to remain in the service of NAI, or to assist NAI to achieve results determined by the Human Resources Committee or the Board of Directors to be in NAI’s best interest.

The Incentive Plan authorizes the Human Resources Committee or the Board of Directors to grant to, and administer, unsecured and deferred cash Awards to Participants and to subject each Award to whatever conditions are determined appropriate by the Human Resources Committee or the Board of Directors. The terms of each Award, including the amount and any conditions that must be met to be entitled to payment of the Award are set forth in an Award Agreement between each Participant and NAI. The Incentive Plan provides the Board of Directors with the discretion to set aside assets to fund the Incentive Plan although that has not been done to date.

No deferred cash awards were granted or forfeited during the three months ended September 30, 2023 and September 30, 2022.

Fair Value of Financial Instruments

Except for cash and cash equivalents, as of September 30, 2023, and June 30, 2023, we did not have any financial assets or liabilities classified as Level 1. We classify derivative forward exchange and interest rate swap contracts as Level 2 assets and liabilities. The fair values were determined by obtaining pricing from our bank and corroborating those values with a third party bank or pricing service.

Fair value of derivative instruments classified as Level 2 assets and liabilities consisted of the following (in thousands):

	September 30, 2023	June 30, 2023
Euro Forward Contract– Current Assets	\$ 787	\$ 250
Swiss Franc Forward Contract – Current Assets	—	140
Total Derivative Contracts – Current Assets	787	390
Interest Swap – Other noncurrent Assets	441	532
Euro Forward Contract– Other noncurrent Assets	—	15
Total Derivative Contracts – Other noncurrent Assets	441	547
Euro Forward Contract– Current Liabilities	—	—
Swiss Franc Forward Contract – Current Liabilities	(720)	—
Total Derivative Contracts – Current Liabilities	(720)	—
Fair Value Net Asset – all Derivative Contracts	\$ 508	\$ 937

We also classify any outstanding line of credit and term loan balance as a Level 2 liability. As of September 30, 2023, and June 30, 2023, we did not have any financial assets or liabilities classified as Level 3. We did not transfer any assets or liabilities between these levels during fiscal 2023 or the three months ended September 30, 2023.

B. Inventories, net

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

	September 30, 2023	June 30, 2023
Raw materials	\$ 16,405	\$ 20,946
Work in progress	3,622	4,504
Finished goods	3,929	4,928
Reserve	(652)	(684)
	\$ 23,304	\$ 29,694

C. Property and Equipment

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

	Depreciable Life In Years	September 30, 2023	June 30, 2023
Land	NA	\$ 8,941	\$ 8,940
Building and building improvements	7 – 39	24,723	24,712
Machinery and equipment	3 – 12	42,253	41,460
Office equipment and furniture	3 – 5	6,605	6,522
Vehicles	3	227	227
Leasehold improvements	1 – 15	23,031	22,641
Total property and equipment		105,780	104,502
Less: accumulated depreciation and amortization		(51,809)	(50,661)
Property and equipment, net		\$ 53,971	\$ 53,841

Depreciation expense was approximately \$1.1 million during the three months ended September 30, 2023. Depreciation expense was approximately \$1.0 million during the three months ended September 30, 2022. Construction in progress is included in the building and building improvements line.

D. Other Comprehensive (Loss) Income

Other comprehensive (loss) income (“OCL” and “OCI”) consisted of the following during the three months ended September 30, 2023 and September 30, 2022 (in thousands):

	Three Months Ended September 30, 2023			Total
	Defined Benefit Pension Plan	Unrealized (Losses) Gains on Cash Flow Hedges	Unrealized Gains (Losses) on Swap Derivative	
Beginning Balance	\$ (380)	\$ (110)	\$ 407	\$ (83)
OCI/OCL before reclassifications	—	670	(91)	579
Amounts reclassified from OCI to Sales	—	50	—	50
Tax effect of OCI activity	(5)	(218)	30	(193)
Net current period OCI/OCL	(5)	502	(61)	436
Ending Balance	<u>\$ (385)</u>	<u>\$ 392</u>	<u>\$ 346</u>	<u>\$ 353</u>

	Three Months Ended September 30, 2022			Total
	Defined Benefit Pension Plan	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Swap Derivative	
Beginning Balance	\$ (444)	\$ 1,795	\$ 348	\$ 1,699
OCI/OCL before reclassifications	—	1,788	174	1,962
Amounts reclassified from OCI to Sales	—	(1,262)	—	(1,262)
Tax effect of OCI activity	—	(118)	(37)	(155)
Net current period OCI/OCL	—	408	137	545
Ending Balance	<u>\$ (444)</u>	<u>\$ 2,203</u>	<u>\$ 485</u>	<u>\$ 2,244</u>

E. Leases

We currently lease our Vista, California and Lugano, Switzerland product manufacturing and support facilities.

On July 18, 2023, we entered into a Fourth Amendment to our Vista, California manufacturing facilities lease. The Fourth Amendment extends the term of the lease by an additional ten years and five months commencing April 1, 2024. The amended lease covering two buildings and approximately 162,000 square feet will result in an increase in base rent to \$1.50 per square foot, after five free months of base rent beginning at the commencement of the extended term. NAI intends to construct substantial improvements to the facilities including but not limited to installation of an approximately \$2.3 million solar electrical generating system on both buildings, and other substantial improvements. Pursuant to the Fourth Amendment, the Landlord will reimburse NAI for up to \$1.1 million of these tenant improvements to the buildings. Our lease liability and Right of Use asset were both increased by approximately \$25.9 million as a result of this lease extension effective on the date that the lease was executed.

Our leases are classified as operating leases. Substantially all our operating leases are comprised of payments for the use of manufacturing and office space. We have no leases classified as finance leases. As of September 30, 2023, the weighted average remaining lease term for our operating leases was 10.1 years and the weighted average discount rate for our operating leases was 5.89%. As of June 30, 2023, the weighted average remaining lease term for our operating leases was 5.3 years and the weighted average discount rate was 4.12%.

Other information related to leases as of September 30, 2023 and September 30, 2022 was as follows (in thousands):

Supplemental Cash Flow Information	Three Months	Three Months
	Ended	Ended
	September 30, 2023	September 30, 2022
Cash paid for amounts included in the measurement of operating lease liabilities	\$ 832	\$ 811
Increase in operating lease liabilities and right-of-use assets due to lease remeasurement	25,916	\$ —

F. Debt

On May 24, 2021, we entered into a new credit facility with Wells Fargo Bank, N.A (“Wells Fargo”) to extend the maturity for our working line of credit from November 1, 2022 to May 24, 2024. This credit facility provides total lending capacity of up to \$20.0 million and allows us to use the credit facility for working capital as well as potential acquisitions. On August 18, 2021, we entered into an amendment of our credit facility with Wells Fargo. The amended credit facility added a \$10.0 million term loan to the existing \$20.0 million credit facility and permitted us to use the \$10.0 million term loan as part of the \$17.5 million purchase consideration for the acquisition of our manufacturing and warehouse property in Carlsbad, California. The amended credit agreement also increased the allowed capital expenditures from \$10.0 million to \$15.0 million for fiscal 2022 (exclusive of the amount paid for the acquisition of the new Carlsbad property noted above). In addition, the new credit notes now reflect a change in the interest rate reference from LIBOR to Secured Overnight Financing Rate (SOFR). The Credit Agreement was amended and a new Revolving Line of Credit Note, and Security Agreement were entered into. A Term Note and real property security documents were added to secure the Term Note by the Carlsbad property. Additionally, we entered into a second amendment to our credit facility with Wells Fargo on February 8, 2022 that was effective January 31, 2022 and modified the annual limit imposed upon our ability to repurchase stock and issue dividends. This amendment increased this limit from \$5.0 million annually to \$7.0 million annually. Effective September 19, 2022, we entered into a third amendment to our credit facility with Wells Fargo. The third amendment extended the maturity date from May 24, 2024 to May 23, 2025 and also increased the allowed capital expenditures from \$7.5 million to \$25.0 million for the fiscal year ending June 30, 2023.

Under the terms of the Credit Agreement, borrowings are subject to eligibility requirements including maintaining (i) a ratio of total liabilities to tangible net worth of not greater than 1.50 to 1.0 at any time; (ii) a ratio of total current assets to total current liabilities of not less than 1.75 to 1.0 at each fiscal quarter end (iii) net income after taxes not less than \$1.00, determined on a trailing four quarter basis with no two consecutive quarterly losses, determined as of each quarter end and (iv) a rolling 4-quarter fixed charge coverage ratio not less than 1.25 to 1.0 as of each fiscal quarter end. The credit agreement also includes a limitation on the amount of capital expenditures that can be made in a given fiscal year, with such limitation set at \$25.0 million for our fiscal year ending June 30, 2023 and \$7.5 million for all fiscal years thereafter. Any amounts outstanding under the line of credit will bear interest at a fixed or fluctuating interest rate as elected by us from time to time; provided, however, that if the outstanding principal amount is less than \$100,000 such amount shall bear interest at the then applicable fluctuating rate of interest. If elected, the fluctuating rate per annum would be equal to 1.29% above the daily simple SOFR rate as in effect from time to time. If a fixed rate is elected, it would equal a per annum rate of 1.29% above the SOFR rolling 30-day average rate in effect on the first day of the applicable fixed rate term. Any amounts outstanding under the line of credit must be paid in full on or before the maturity date. Amounts outstanding that are subject to a fluctuating interest rate may be prepaid at any time without penalty. Amounts outstanding that are subject to a fixed interest rate may be prepaid at any time in minimum amounts of \$100,000, subject to a prepayment fee equal to the sum of the discounted monthly differences between payment under a fixed rate versus payment under the variable rate for each month from the month of prepayment through the month in which the then applicable fixed rate term matures. There is an unused commitment fee of 0.125% required as part of the line of credit.

The Term Note used as part of the purchase consideration of our manufacturing and warehouse property in Carlsbad, California referenced above, is for the original principal amount of \$10.0 million, and is a seven year term note with payments fully amortized based on a twenty five year assumed term. Installment payments under this loan commenced October 1, 2021 and continue through August 1, 2028 with a final installment consisting of all remaining amounts due to be paid in full on September 1, 2028. Amounts outstanding on this note during the term of the agreement will bear interest equal to 1.8% above the SOFR rolling 30-day average. In connection with our term loan, we entered into an interest rate swap with Wells Fargo that effectively fixes our interest rate on our term loan at 2.4% for the first three years of the term of the note.

Our obligations under the Credit Agreement are secured by our accounts receivable and other rights to payment, general intangibles, inventory, equipment and fixtures. We also have credit approval with Wells Fargo Bank, which allows us to hedge foreign currency exposures up to 30 months in the future. We also have credit approval with Bank of America which allows us to hedge foreign currency exposures up to 24 months in the future.

As of September 30, 2023, we had \$9.4 million outstanding under the Term Note used in August 2021 for the purchase of our Carlsbad, California powder processing and warehouse property.

On September 30, 2023, we were in compliance with all of the financial and other covenants required under the Amended Credit Agreement. As a result of reduced sales overall, and the impact of temporary closure of our Carlsbad, California high-speed powder processing facility, we anticipate we will not comply with all of the covenants required under the Credit Agreement in the second quarter of fiscal 2024. We have advised the lender and are currently negotiating a potential revised credit facility. There can be no assurance we will be able to successfully complete the negotiation of a revised credit facility, or what the impact of differences in amount, cost and other factors may be.

As of September 30, 2023, we had the full \$20.0 million available for borrowing under our credit facility with Wells Fargo Bank.

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 (i) sales to these customers, (ii) the growth rate of sales to these customers, or (iii) these customers' ability to make payments when due, each individually 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 consolidated net sales were as follows (in thousands):

	Three Months Ended	
	September 30,	
	2023	2022
Customer 1	\$ 12,131	15,005
Customer 2	10,119	\$ 15,152
Customer 3	4,102	6,328
	<u>\$ 26,352</u>	<u>\$ 36,485</u>

Accounts receivable from these customers totaled \$6.1 million at September 30, 2023 and \$3.3 million at June 30, 2023.

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

	Three Months Ended	
	September 30,	
	2023	2022
Supplier 1	\$ 2,780	2,832
	<u>\$ 2,780</u>	<u>2,832</u>

H. Segment Information

Our business consists of two segments for financial reporting purposes. The two segments are identified as (i) private-label contract manufacturing, which primarily relates to the provision of private-label contract manufacturing services to companies that market and distribute nutritional supplements and other health care products, and (ii) patent and trademark licensing, which primarily includes direct raw material sales and royalty income from our license and supply agreements associated with the sale and use of beta-alanine under our CarnoSyn® and SR CarnoSyn® trade names.

We evaluate performance of these segments based on a number of factors. The primary performance measures for each segment are net sales and income or loss from operations before the allocation of certain corporate level expenses. 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, corporate legal, finance, information technology, and other corporate level related expenses, which are not allocated to any segment. Transfers of raw materials between segments are recorded at cost. The accounting policies of our segments are the same as those described in the summary of significant accounting policies in Note A above and in the consolidated financial statements included in our 2023 Annual Report.

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

	Three Months Ended September 30,	
	2023	2022
Net Sales		
Private label contract manufacturing	\$ 32,189	\$ 41,776
Patent and trademark licensing	1,780	1,351
Total Net Sales	\$ 33,969	\$ 43,127
	Three Months Ended September 30,	
	2023	2022
(Loss) Income from Operations		
Private label contract manufacturing	\$ 1,011	\$ 3,244
Patent and trademark licensing	443	347
(Loss) income from operations of reportable segments	1,454	3,591
Corporate expenses not allocated to segments	(1,998)	(2,049)
Total (Loss) Income from Operations	\$ (544)	\$ 1,542
	September 30, 2023	June 30, 2023
Total Assets		
Private-label contract manufacturing	\$ 127,827	\$ 102,495
Patent and trademark licensing	32,425	31,657
	\$ 160,252	\$ 134,152

Our private-label contract manufacturing products are sold both in the U.S. and in markets outside the U.S., including Europe, Canada, Australia, New Zealand, Mexico, and Asia. Our primary markets outside the U.S. are Europe and Asia. Our patent and trademark licensing activities are primarily based in the U.S.

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

	Three Months Ended September 30,	
	2023	2022
United States	\$ 24,947	\$ 29,832
Markets outside of the United States	9,022	13,295
Total	\$ 33,969	\$ 43,127

Products manufactured by our Swiss subsidiary ("NAIE") accounted for 89% of net sales in markets outside the U.S. for the three months ended September 30, 2023. Products manufactured by our Swiss subsidiary ("NAIE") accounted for 77% of net sales in markets outside the U.S. for the three months ended September 30, 2022.

Long-lived assets by geographic region, based on the location of the company or subsidiary at which they were located or made, were as follows (in thousands):

	September 30, 2023	June 30, 2023
United States	\$ 79,854	\$ 53,536
Europe	19,768	20,674
Total Long-Lived Assets	\$ 99,622	\$ 74,210

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

	September 30, 2023	June 30, 2023
United States	\$ 115,299	\$ 89,167
Europe	44,953	44,985
Total Assets	\$ 160,252	\$ 134,152

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):

	Three Months Ended September 30,	
	2023	2022
United States	\$ 1,376	\$ 7,720
Europe	(98)	47
Total Capital Expenditures	\$ 1,278	\$ 7,767

Capital expenditures for Europe were negative during the three months ended September 30, 2023 due to a vendor credit received related to a capital expenditure that was accrued in a prior period.

I. Income Taxes

To determine our quarterly provision for income taxes, we use an estimated annual effective tax rate, which is based on expected annual income, statutory tax rates and tax planning opportunities available in the various jurisdictions to which we are subject. Certain significant or unusual items are separately recognized in the quarter in which they occur and can be a source of variability in the effective tax rate from quarter to quarter. We recognize interest and penalties related to uncertain tax positions, if any, as an income tax expense.

Our effective tax rate for the three months ended September 30, 2023 was 21.4% and our effective tax rate for the three months ended September 30, 2022 was 20.1%. Our effective tax rate for the three months ended September 30, 2023 differ from the fiscal 2023 U.S. federal statutory rate of 21% primarily due to due to forecasted research and development tax credits.

We record valuation allowances to reduce our deferred tax assets to an amount we believe is more likely than not to be realized. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. During the three months ended September 30, 2023, there was no change to our valuation allowance for our deferred tax assets.

J. Treasury Stock

We purchase shares under a stock repurchase plan (“Repurchase Plan”) authorized by the Board of Directors. The total authorized repurchase amount is \$18.0 million and as of September 30, 2023, we had approximately \$716,000 remaining available under the Repurchase Plan. Under the Repurchase Plan, we may, from time to time, purchase shares of our common stock, depending upon market conditions, in open market or privately negotiated transactions.

There were no stock repurchases for the three months ended September 30, 2023.

Stock repurchases for the three months ended September 30, 2022, were as follows:

	<u>Shares</u>	<u>Average Cost</u>	<u>Total Cost (in thousands)</u>
Shares purchased under Repurchase Plan	46,795	\$ 10.62	\$ 497
Shares acquired from employees for restricted stock vesting	—	—	—
Total	<u>46,795</u>		<u>\$ 497</u>

Stock repurchase costs include commissions and fees.

Shares acquired from employees for restricted stock vesting are returned to us by the related employees and in return we pay each employee’s required tax withholding resulting from the vesting of restricted shares. The valuation of the shares acquired and thereby the number of shares returned to us is calculated based on the closing share price on the date the shares vested. We did not receive any shares associated with the vesting of employee restricted stock during either of the three month periods ending September 30, 2023, or 2022.

K. Derivatives and Hedging

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

As of September 30, 2023, we had forward contracts designated as cash flow hedges primarily to protect against the foreign exchange risks inherent in our forecasted sales of products at prices denominated in currencies other than the U.S. Dollar. These contracts are expected to be settled through September 2024. For derivative instruments that are designated and qualify as cash flow hedges, we record the effective portion of the gain or loss on the derivative in accumulated other comprehensive income (“OCI”) as a separate component of stockholders’ equity and subsequently reclassify these amounts into earnings in the period during which the hedged transaction is recognized in earnings.

For foreign currency contracts designated as cash flow hedges, hedge effectiveness is measured using the spot rate. Changes in the spot-forward differential are excluded from the test of hedge effectiveness and are recorded currently in earnings as revenue. We measure effectiveness by comparing the cumulative change in the hedge contract with the cumulative change in the hedged item. No hedging relationships were terminated as a result of ineffective hedging for the three months ended September 30, 2023, and September 30, 2022.

We monitor the probability of forecasted transactions as part of the hedge effectiveness testing on a quarterly basis. During the three months ended September 30, 2023, and September 30, 2022, we did not have any losses or gains related to the ineffective portion of our hedging instruments.

As of September 30, 2023, the notional amounts of our foreign exchange contracts designated as cash flow hedges were approximately \$23.0 million (EUR 20.8 million). As of September 30, 2023, a net gain of approximately \$0.5 million, offset by \$0.1 million of deferred taxes, related to derivative instruments designated as cash flow hedges was recorded in OCI. It is expected that the entire amount will be reclassified into earnings in the next 12 months along with the earnings effects of the related forecasted transactions.

For foreign currency contracts not designated as cash flow hedges, changes in the fair value of the hedge are recorded directly to foreign exchange gain or loss in other income in an effort to offset the change in valuation of the underlying hedged item. During the three months ended September 30, 2023, we entered into forward contracts in order to hedge foreign exchange risk associated with our lease liability at NAIE, which is denominated in Swiss Francs (CHF). As of September 30, 2023, the notional amounts of our foreign exchange contracts not designated as cash flow hedges were approximately \$14.6 million (CHF 12.6 million).

We are exposed to interest rate fluctuations related to our \$10.0 million Term Note with Wells Fargo, which carries a variable interest rate of 1.80% above the SOFR rolling 30-day average. To manage our exposure to this variable rate, on August 23, 2021, we entered into a floored interest rate swap that fixes our all-in rate on this loan to 2.4% for the first three years of the term loan. Fluctuations in the relation of our contractual swap rate to current market rates are recorded as an asset or liability with an offset to OCI at the end of each reporting period. Interest expense is adjusted for the difference between the actual SOFR spread and the swap contractual rate such that our effective interest expense for each period is equal to our hedged rate of 2.4%.

L. Contingencies

From time to time, we become involved in various investigations, claims and legal proceedings that arise in the ordinary course of our business. These matters may relate to product liability, employment, intellectual property, regulatory, contract or other matters. The resolution of these matters as they arise may 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 currently 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 be greater than we currently anticipate and if so, 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 we do not expect.

Israel-Hamas War

In October 2023, armed conflict escalated between Israel and Hamas. Management is monitoring the conflict in Israel and Gaza and any broader economic effects from the crisis. Israel accounts for a small portion of our global net sales, but we also source multiple raw materials that come from Israel. While we do not anticipate this conflict will have a significant impact on our net sales, we are currently communicating with the customers and suppliers that may be impacted by this conflict and we are evaluating options for alternative ingredient sources or holding safety stock of impacted materials to limit the affect that this conflict may have on our ability to obtain the ingredients sourced from this region. There are further concerns regarding consumer purchasing and consumption behavior, increases in global shipping expenses, greater volatility in foreign exchange and interest rates, and other unforeseen business disruptions due to the current global geopolitical tensions, including relating to this new conflict between Israel and Hamas and the continued conflict in Ukraine. We will continue to evaluate impacts of the conflict on our customers, suppliers, employees, and 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 three months ended September 30, 2023. 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 2023 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 nor does it contain all of the information that may be important to our stockholders or the investing public. You should read this overview 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, herbal and other nutritional supplements, as well as other health care products, to consumers both within and outside the U.S. Historically, our revenue has been largely dependent on sales to two or three private-label contract manufacturing customers and subject to variations in the timing of such customers' orders, which in turn is impacted by such customers' internal marketing programs, supply chain management, entry into new markets, new product introductions, the demand for such customers' products, and general industry and economic conditions. Our revenue also includes raw material sales and royalty and licensing revenue generated from license and supply agreements with third parties, granting them the right to use our patents, trademarks and other intellectual property in connection with the distribution and use of the ingredient known as beta-alanine sold under our CarnoSyn® and SR CarnoSyn® trademarks.

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, and commercializing our patent estate through sales of beta-alanine under our CarnoSyn® and SR CarnoSyn® trade names, royalties from license agreements, and potentially additional contract manufacturing opportunities with licensees.

During the three months ended September 30, 2023, our net sales were 21% lower than in the three months ended September 30, 2022. Private-label contract manufacturing sales decreased 23% primarily due to reduced orders from several of our larger customers associated with their efforts to reduce excess on-hand inventories. Revenue concentration for our largest private-label contract manufacturing customer as a percentage of total net sales for the three months ended September 30, 2023 was 36%, and revenue concentration for our largest private-label contract manufacturing customer as a percentage of total net sales for the three months ended September 30, 2022 was 35%. We expect our annualized fiscal 2024 revenue concentration for our largest customer to be flat to slightly lower as compared to our revenue concentration for our largest customer in fiscal 2023.

During the three months ended September 30, 2023, patent and trademark licensing revenue increased 32% to \$1.8 million, compared to revenue of \$1.4 million for the three months ended September 30, 2022. The increase in patent and trademark licensing revenue during the three months ended September 30, 2023, was primarily due to an increase in orders from existing customers and increased royalty income, partially offset by increased volume rebates.

We continue to invest in research and development for our SR CarnoSyn® sustained release delivery system. We believe SR CarnoSyn® may provide a unique opportunity within the growing Wellness and Healthy Aging markets. We believe our recent efforts to refine our formulations and product offerings will be positively received and result in significant opportunity for increased SR CarnoSyn® sales.

To protect our CarnoSyn® business and our patents, trademarks and other intellectual property, we incurred legal expenses of approximately \$71,000 during the first three months of fiscal 2024 as compared to approximately \$30,000 during the comparable period in fiscal 2023. Our legal expense associated with our CarnoSyn® business has remained relatively low as we have not had any active litigation in recent periods, and our current run-rate of expenses is primarily related to maintenance of our patent and trademark estate. Our ability to maintain or further increase our beta-alanine royalty and licensing revenue will depend in large part on our ability to develop a market for our sustained release form of beta-alanine marketed under our SR CarnoSyn® trademark, maintain our patent rights, obtain the raw material beta-alanine when and in the amounts needed, expand distribution of beta-alanine to new and existing customers, and continued compliance by third parties with our license agreements and our patent, trademark and other intellectual property rights. During the remainder of fiscal 2024, we will continue our sales and marketing activities to consumers, customers, potential customers, and brand owners on multiple platforms to promote and reinforce the features and benefits of utilizing CarnoSyn® and SR CarnoSyn® beta-alanine.

We experienced a loss from operations during the three months ended September 30, 2023. This was primarily due to a slowdown in sales across our private label contract manufacturing segment. On August 16, 2023, we announced the temporary closure of our high-speed powder processing facility in Carlsbad, California due to excess inventory on hand at one of our largest customers and their efforts to rebalance supply and demand. We now expect this facility will re-open and our prior level of operations will resume in our fourth fiscal quarter of 2024, but there can be no assurance this customer will resolve its supply and demand issues in the timeframe expected, what their future purchases may be, or what level of other business we may acquire that will utilize this facility. If this customer is unable to resolve its inventory issues in this timeframe, or our sales forecast is not realized, we will likely experience a continuing material decrease in revenues and profit during fiscal year 2024.

Subject to this uncertainty, and our overall sales forecast, we currently anticipate we will experience a net loss in the first half of fiscal 2024, net income in the second half and an overall net loss in fiscal 2024.

During fiscal 2024, we plan to continue our focus on:

- Leveraging our state-of-the-art, certified facilities to increase the value of the goods and services we provide to our highly valued private-label contract manufacturing customers, and assist us in developing relationships with additional quality-oriented customers;
- Expanding the commercialization of our beta-alanine patent estate through raw material sales, developing a new sales distribution channel under the Wellness and Healthy Aging category for our sustained release form of beta-alanine marketed under our SR CarnoSyn® trademark, exploiting new contract manufacturing opportunities, license and royalty agreements, and protecting our proprietary rights; and
- Improving operational efficiencies and managing costs and business risks to improve profitability.

Impact of COVID-19 on Our Business

The COVID-19 pandemic resulted in significant economic disruption and may have some effect on our business in the future. Our facilities, located both in the United States and Europe, maintained operations throughout the duration of the COVID-19 pandemic, however, there can be no assurance our facilities will continue to operate without interruption.

Discussion of Critical Accounting Estimates

We have identified the following as our most critical accounting estimates, which are those that are most important to the portrayal of the Company's financial condition and results, and that require management's most subjective and complex judgments. Information regarding our other significant accounting estimates and policies is disclosed in Note 1 of Item 1 of this report and as disclosed in the 2023 Annual Report.

Revenue Recognition — Revenue is measured as the net amount of consideration expected to be received in exchange for fulfilling one or more performance obligations. For certain contracts with volume rebates and discounts, our estimates of future sales used to assess the volume rebate and discount estimates are subject to a high degree of judgement and may differ from actual sales due to, among other things, changes in customer orders and raw material availability.

Results of Operations

The results of our operations for the three months ended September 30 were as follows (dollars in thousands):

	Three Months Ended		
	September 30,		
	2023	2022	% Change
Private label contract manufacturing	\$ 32,189	\$ 41,776	(23)%
Patent and trademark licensing	1,780	1,351	32%
Total net sales	33,969	43,127	(21)%
Cost of goods sold	30,832	37,756	(18)%
Gross profit	3,137	5,371	(42)%
Gross profit %	9.2%	12.5%	
Selling, general and administrative expenses	3,681	3,829	(4)%
% of net sales	10.8%	8.9%	
(Loss) income from operations	(544)	1,542	(135)%
% of net sales	(1.6)%	3.6%	
Other expense	(340)	(224)	52%
(Loss) income before income taxes	(884)	1,318	(167)%
% of net sales	(2.6)%	3.1%	
(Benefit) provision for income taxes	(189)	265	(171)%
Net (loss) income	\$ (695)	\$ 1,053	(166)%
% of net sales	(2.0)%	2.4%	

Private-label contract manufacturing net sales decreased 23% during the three months ended September 30, 2023, when compared to the same period in the prior year. The decrease in sales during the three months ended September 30, 2023 was primarily due to reduced orders from several of our larger customers associated with their efforts to reduce excess on-hand inventories.

Net sales from our patent and trademark licensing segment increased 32% during the three months ended September 30, 2023, when compared to the same period in the prior year. The increase in patent and trademark licensing revenue during the three months ended September 30, 2023 was primarily due to an increase in orders from existing customers and increased royalty income, partially offset by increased volume rebates.

The change in gross profit margin for the three months ended September 30, 2023, was as follows:

	Three Months Ended
Contract manufacturing ⁽¹⁾	(4.0)%
Patent and trademark licensing ⁽²⁾	0.7%
Total change in gross profit margin	(3.3)%

- 1 Private-label contract manufacturing gross profit margin as a percentage of consolidated net sales decreased 4.0 percentage points during the three months ended September 30, 2023 when compared to the comparable prior year period. The decrease in gross profit as a percentage of sales for private-label contract manufacturing during the three months ended September 30, 2023 is primarily due to lower sales and unfavorable sales mix and increased overhead costs, partially offset by reduced labor and third party processing costs.
- 2 Patent and trademark licensing gross profit margin as a percentage of consolidated net sales increased 0.7 percentage points during the three months ended September 30, 2023 when compared to the comparable prior year period. The increase in margin contribution was primarily due to increased patent and trademark licensing net sales as a percentage of total consolidated net sales, as patent and trademark licensing historically provides higher profit margins than our private-label contract manufacturing business.

Selling, general and administrative expenses decreased approximately \$0.1 million, or 4%, during the three months ended September 30, 2023. The decrease during the three months ended September 30, 2023 as compared to the same period in the prior fiscal year is primarily related to reduced salary and wage expenses, and reduced advertising and marketing costs associated with our patent and trademark licensing segment.

Other expense increased \$0.1 million during the three months ended September 30, 2023, when compared to the comparable period during the prior year. The increase in the three month period is primarily associated with increased expenses related to our CHF balance sheet hedge, currency revaluations and interest expense related to usage of our line of credit.

Our income tax (benefit) expense changed to reflect a benefit of \$0.2 million for the three months ended September 30, 2023, when compared to an expense of \$0.3 million in the same period in fiscal 2023. The change in tax amount is primarily due to recognition of a pretax loss in the first quarter of fiscal 2024 as compared to pretax income in fiscal 2023.

Liquidity and Capital Resources

Our primary sources of liquidity and capital resources are cash flows provided by operating activities and the availability of borrowings under our credit facilities. Net cash provided by operating activities was \$4.5 million for the three months ended September 30, 2023, compared to net cash used in operating activities of \$4.6 million in the comparable period during the prior fiscal year.

At September 30, 2023, changes in accounts receivable, consisting of amounts due from our private-label contract manufacturing customers and our patent and trademark licensing activities, used \$2.7 million in cash compared to providing \$2.6 million of cash during the comparable three month period in the prior year. The increase in cash used in accounts receivable during the three months ended September 30, 2023, primarily resulted from the timing of sales and related collections. Days sales outstanding was 23 days during the three months ended September 30, 2023, as compared to 34 days for the prior year period.

Changes in inventory provided \$6.4 million in cash during the three months ended September 30, 2023, compared to using \$7.5 million in the comparable prior year period. The change in cash related to inventory during the three months ended September 30, 2023, was primarily related to the difference in the amount and timing of orders and anticipated sales as compared to same period in the prior year. Changes in accounts payable and accrued liabilities provided \$0.2 million in cash during the three months ended September 30, 2023, compared to providing \$1.0 million during the three months ended September 30, 2022. The change in cash flow activity related to accounts payable and accrued liabilities was primarily due to the timing of inventory receipts and payments.

Cash used in investing activities in the three months ended September 30, 2023, was \$1.3 million compared to \$7.8 million in the comparable prior year period. The increase during the first quarter of fiscal 2023 in capital purchases was associated with retrofitting our new powder manufacturing and warehouse facility. Construction on this new facility was completed during the fourth quarter of fiscal 2023. Capital equipment purchase activity during the first quarter of fiscal 2024 was primarily for manufacturing equipment and solar power generation equipment for our Vista and Carlsbad, California production facilities.

Cash used by financing activities for the three months ended September 30, 2023, was \$0.1 million, compared to \$2.8 million provided in the comparable prior year period. The difference is primarily due to borrowings on our line of credit during the first quarter of fiscal 2023 used to finance capital purchases associated with construction activities on our new manufacturing and warehousing facility in Carlsbad, California, while the first quarter of fiscal 2024 only included principal payments made to reduce the balance due on the term loan secured by our new manufacturing and warehouse facility.

At September 30, 2023, we had no outstanding balances due on our line of credit with \$20.0 million available, and we owed \$9.4 million on the term loan borrowed as part of the purchase of our Carlsbad, California manufacturing facility in August 2021. At June 30, 2023, we also had no outstanding balances due and \$20.0 million available in connection with our line of credit.

As of September 30, 2023, we were in compliance with all of the financial and other covenants required under our Credit Agreement.

As of September 30, 2023, we had \$16.7 million in cash and cash equivalents. Of these amounts, \$14.2 million of cash and cash equivalents were held by NAIE. Overall, we believe our available cash, cash equivalents, potential cash flows from operations, and our credit facility will be sufficient to fund our current working capital needs and capital expenditures through at least the next 12 months. As a result of reduced sales overall, and the impact of temporary closure of our Carlsbad, California high-speed powder processing facility, we anticipate we will not be able to comply with all of the covenants required under the Credit Agreement in the second quarter of fiscal 2024. We have advised the lender and are currently negotiating a potential revised credit facility. There can be no assurance we will be able to successfully complete the negotiation of a revised credit facility, or if we do, what the differences in amount, cost and other factors may be. Please see Note F in Item 1 of this report for terms of our credit facility.

Off-Balance Sheet Arrangements

As of September 30, 2023, we did not have any off-balance sheet debt nor did we have any transactions, arrangements, obligations (including contingent obligations) or other relationships with any unconsolidated entities or other persons that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenue or expenses material to investors.

Recent Accounting Pronouncements

Recent accounting pronouncements are discussed in the notes to our consolidated financial statements included under Item 1, Note A. of this Report. Other than those pronouncements, we are not aware of any other pronouncements that materially affect our financial position or results of operations.

ITEM 4. CONTROLS AND PROCEDURES

We maintain certain disclosure controls and procedures as defined under the Securities Exchange Act of 1934. They are designed to help ensure that material information: (1) is gathered and communicated to our management, including our principal executive and financial officers, in a manner that allows for timely decisions regarding required disclosures; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the Securities Exchange Act of 1934 and within the time periods specified by the SEC.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer (principal financial and accounting officer), evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2023. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective for their intended purpose as of September 30, 2023.

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarterly period ended September 30, 2023 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we become involved in various investigations, claims and legal proceedings that arise in the ordinary course of our business. These matters may relate to intellectual property, product liability, employment, tax, regulation, contract or other matters. The resolution of these matters as they arise will be subject to various uncertainties and, even if such claims are without merit, could result in the expenditure of significant financial and managerial resources. While unfavorable outcomes are possible, based on available information, we currently do not believe the resolution of these matters, even if unfavorable, 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 we do not expect. An unexpected settlement expense or an unexpected unfavorable outcome of a matter could adversely impact our results of operations.

As of November 9, 2023, neither NAI nor NAIE were a party to any material pending legal proceeding nor was any of our property the subject of any material pending legal proceeding. We are often involved in up to several matters in the ordinary course of our business.

There is no assurance NAI will prevail in litigation matters or in similar proceedings NAI or others may initiate or that litigation expenses will not be greater than anticipated.

ITEM 1A. RISK FACTORS

When evaluating our business and future prospects you should carefully consider the risks described under Item 1A of our 2023 Annual Report, as well as the other information in our 2023 Annual Report, this Report and other reports and documents we file with the SEC. If any of the identified risks actually occur, our business, financial condition and results of operations could be seriously harmed. In that event, the market price of our common stock could decline, and you could lose all or a portion of the value of your investment in our common stock.

Geopolitical Instability and Conflict in the Region

Our business operations may be adversely affected by ongoing geopolitical instability and conflict in Ukraine or the Middle East, particularly the Israel-Hamas conflict. These regional tensions may lead to increased political, economic, and security risks, including disruptions in the global supply chain, fluctuations in energy prices, and financial market volatility. Such uncertainties could impact our ability to operate efficiently, access markets, and secure resources. Our financial performance and results may be influenced by these external factors, and we cannot predict the future impact of geopolitical events on our business with certainty.

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

We did not sell any unregistered equity securities during the three month periods ended September 30, 2023 and September 30, 2022.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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

EXHIBIT INDEX		
Exhibit Number	Description	Incorporated By Reference To
3(i)	Amended and Restated Certificate of Incorporation of Natural Alternatives International, Inc. filed with the Delaware Secretary of State on January 14, 2005	Exhibit 3(i) of NAI's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2004, filed with the commission on February 14, 2005
3(ii)	Amended and Restated By-laws of Natural Alternatives International, Inc. dated as of February 9, 2009	Exhibit 3(ii) of NAI's Current Report on Form 8-K dated February 9, 2009, filed with the commission on February 13, 2009
4(i)	Form of NAI's Common Stock Certificate	Exhibit 4(i) of NAI's Annual Report on Form 10-K for the fiscal year ended June 30, 2005, filed with the commission on December 8, 2005
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed herewith
32	Section 1350 Certification	Filed herewith
101.INS	Inline XBRL Instance Document	Filed herewith
101.SCH	Inline XBRL Taxonomy Extension Schema Document	Filed herewith
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document	Filed herewith
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)	Filed herewith

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, duly authorized officers.

Date: November 9, 2023

NATURAL ALTERNATIVES INTERNATIONAL, INC.

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

By: /s/ Michael E. Fortin
Michael E. Fortin, Chief Financial Officer
(principal financial and accounting officer)

**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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) 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
 - d) 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; and
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:
 - 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: November 9, 2023

/s/ Mark A. LeDoux

Mark A. LeDoux, Chief Executive Officer

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

I, Michael Fortin, 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. (the "Report");
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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) 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
 - d) 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; and
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:
 - 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: November 9, 2023

/s/ Michael E. Fortin

Michael E. Fortin, Chief Financial Officer

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, that the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2023 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: November 9, 2023

/s/ Mark A. LeDoux

Mark A. LeDoux, Chief Executive Officer

Date: November 9, 2023

/s/ Michael E. Fortin

Michael E. Fortin, 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.