

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, 2017

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 Drive
Carlsbad, California 92008
(Address of principal executive offices)

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

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

[X] Yes [] No

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

[X] 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 [X] No

As of November 13, 2017, 7,429,020 shares of NAI's common stock were outstanding, net of 1,052,657 treasury shares.

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SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

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

- future financial and operating results, including projections of net sales, revenue, income or loss, net income or loss per share, profit margins, expenditures, liquidity, and other financial items;
- our ability to maintain or increase our patent and trademark licensing revenues;
- 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;
- our ability to protect our intellectual property;
- our ability to improve operating efficiencies, manage costs and business risks and improve or maintain profitability;
- currency exchange rates, their effect on our results of operations, including amounts that may be reclassified 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;
- future levels of our revenue concentration risk;
- sources and availability of raw materials, including the limited number of suppliers of beta-alanine and certain other raw materials;
- inventories, including the adequacy of raw material and other inventory levels to meet future customer demand and the adequacy and intended use of our facilities;
- Manufacturing and distribution channels, product sales and performance, and timing of product shipments;
- current or future customer orders, product returns, and potential product recalls;
- the impact on our business and results of operations from variations in quarterly net sales from seasonal and other factors;
- our ability to operate within the standards set by the U.S. Food and Drug Administration’s (FDA) Good Manufacturing Practices (GMP);
- our ability to successfully expand our operations, including outside the United States (U.S.);
- the adequacy of our reserves and allowances;
- the outcome of pending litigation, regulatory and tax matters, the costs associated with such matters and the effect of such matters on our business and results of operations;
- the sufficiency of our available cash, cash equivalents, and potential cash flows from operations to fund our current working capital needs and capital expenditures through the next 12 months;
- current and future economic and political conditions;
- 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.

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

Unless the context requires otherwise, all references in this report to the “Company,” “NAI,” “we,” “our,” and “us” refer to Natural Alternatives International, Inc. and, as applicable, Natural Alternatives International Europe S.A. (NAIE).

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2017	June 30, 2017
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 27,706	\$ 27,843
Accounts receivable - less allowance for doubtful accounts of \$33 at September 30, 2017 and \$18 at June 30, 2017	9,209	8,410
Notes receivable	1,500	—
Inventories, net	18,996	13,729
Income tax receivable	548	261
Prepays and other current assets	1,825	1,456
Total current assets	59,784	51,699
Property and equipment, net	18,369	18,136
Deferred income taxes	2,002	2,002
Other noncurrent assets, net	794	774
Total assets	\$ 80,949	\$ 72,611
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 10,892	\$ 5,116
Accrued liabilities	2,351	1,931
Accrued compensation and employee benefits	990	1,594
Forward contract	1,626	422
Income taxes payable	1,345	1,207
Total current liabilities	17,204	10,270
Long-term pension liability	608	557
Deferred rent	544	537
Forward contract, noncurrent	689	99
Total liabilities	19,045	11,463
Commitments and contingencies		
Stockholders' equity:		
Preferred stock; \$.01 par value; 500,000 shares authorized; none issued or outstanding	—	—
Common stock; \$.01 par value; 20,000,000 shares authorized; issued and outstanding (net of treasury shares) 7,436,284 at September 30, 2017 and 6,937,018 at June 30, 2017	84	79
Additional paid-in capital	22,719	22,260
Retained earnings	47,222	45,788
Treasury stock, at cost, 1,045,393 shares at September 30, 2017 and 1,044,659 June 30, 2017	(6,082)	(6,074)
Accumulated other comprehensive loss	(2,039)	(905)
Total stockholders' equity	61,904	61,148
Total liabilities and stockholders' equity	\$ 80,949	\$ 72,611

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,	
	2017	2016
Net sales	\$ 28,074	\$ 34,067
Cost of goods sold	21,704	26,398
Gross profit	6,370	7,669
Selling, general and administrative expenses	4,487	4,133
Income from operations	1,883	3,536
Other income (expense):		
Interest income	250	116
Foreign exchange loss	(143)	(59)
Other, net	1	(7)
Total other income	108	50
Income before income taxes	1,991	3,586
Provision for income taxes	557	1,096
Net income	\$ 1,434	\$ 2,490
Unrealized loss resulting from change in fair value of derivative instruments, net of tax	(1,134)	(390)
Comprehensive income	\$ 300	\$ 2,100
Net income per common share:		
Basic	\$ 0.22	\$ 0.38
Diluted	\$ 0.21	\$ 0.37
Weighted average common shares outstanding:		
Basic	6,606,518	6,558,395
Diluted	6,831,230	6,646,963

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,	
	2017	2016
Cash flows from operating activities		
Net income	\$ 1,434	\$ 2,490
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	717	458
Non-cash sales discount	163	—
Non-cash compensation	301	250
Pension expense	51	50
Loss (gain) on disposal of assets	1	(19)
Changes in operating assets and liabilities:		
Accounts receivable, net	(799)	649
Inventories, net	(5,267)	(2,545)
Prepays and other assets	(389)	71
Accounts payable and accrued liabilities	5,773	(875)
Accrued compensation and employee benefits	(604)	(1,131)
Forward contracts	441	(36)
Income taxes	492	514
Net cash provided by (used in) operating activities	<u>2,314</u>	<u>(124)</u>
Cash flows from investing activities		
Purchases of property and equipment	(956)	(1,716)
Proceeds from sale of property and equipment	5	19
Issuance of notes receivable	(1,500)	—
Net cash used in investing activities	<u>(2,451)</u>	<u>(1,697)</u>
Cash flows from financing activities		
Repurchase of common stock	—	(79)
Net cash used in financing activities	<u>—</u>	<u>(79)</u>
Net decrease in cash and cash equivalents	(137)	(1,900)
Cash and cash equivalents at beginning of period	27,843	19,747
Cash and cash equivalents at end of period	<u>\$ 27,706</u>	<u>\$ 17,847</u>
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	\$ —	\$ —
Taxes	\$ 76	\$ 593
Disclosure of non-cash activities:		
Change in unrealized loss resulting from change in fair value of derivative instruments, net of tax	\$ (1,134)	\$ (390)

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 applicable rules and regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) have been condensed or omitted pursuant to such rules and regulations. In management's opinion, all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows have been included and are of a normal, recurring nature. The results of operations for the three months ended September 30, 2017 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, 2017 ("2017 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 2017 Annual Report unless otherwise noted below.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board issued Accounting Standards Update No. 2016-09, Compensation-Stock Compensation (Topic 718) (ASU 2016-09), which provides guidance improvements to employee share-based payment accounting. The standard amends several aspects of current employee share-based payment accounting including income taxes, forfeitures, earnings per share, and statutory tax withholding requirements, as well as classification in the statement of cash flows. We adopted ASU 2016-09 effective July 1, 2017. ASU 2016-09 also requires all excess tax benefits and tax deficiencies associated with employee stock compensation awards to be recognized as income tax expense or benefit as part of the Statement of Operations. Adopting this standard did not result in any significant impact to our results of operation or financial position. During the quarter ended September 30, 2017, there was no impact to the Statement of Cash Flows.

In March 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) (ASU 2016-02), which amends existing standards for leases to increase transparency and comparability among organizations by requiring recognition of lease assets and liabilities on the balance sheet and requiring disclosure of key information about such arrangements. ASU 2016-02 will be effective for us beginning in our first quarter of fiscal 2020. Early adoption is permitted. We are currently evaluating the impact of adopting the new standard on our consolidated financial statements and the timing and presentation of our adoption.

In April 2016, the FASB issued Accounting Standards Update No. 2016-10, Revenue from Contracts with Customers (Topic 606)(ASU 2016-10), which amends and adds clarity to certain aspects of the guidance set forth in the upcoming revenue standard (ASU 2014-09) related to identifying performance obligations and licensing. In May 2016, the FASB issued Accounting Standards Update No. 2016-11, Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815) (ASU 2016-11), which amends and rescinds certain revenue recognition guidance previously released within ASU 2014-09. In May 2016 the FASB issued Accounting Standards Update No. 2016-12, Revenue from Contracts with Customers (Topic 606) (ASU 2016-12), which provides narrow scope improvements and practical expedients related to ASU 2014-09. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible that more judgment and estimates may be required within the revenue recognition process than is required under present U.S. GAAP. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price, and allocating the transaction price to each separate performance obligation. The new standard also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. All of these new standards will be effective for us concurrently with ASU 2014-09, beginning in our first quarter of fiscal 2019. Early adoption is not permitted. Currently, we do not expect our annual revenue to be materially different under Topic 606. The most significant change will be to our quarterly and annual financial statement disclosures. We are continuing to evaluate the impact of adopting the new standard.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The ASU is intended to improve and simplify accounting rules around hedge accounting and improve the disclosures of hedging arrangements. We are currently evaluating the impact of adopting the new standard on our consolidated financial statements. ASU 2017-12 will be effective for us beginning in our first quarter of fiscal 2020.

Net Income per Common Share

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

	Three Months Ended September 30,	
	2017	2016
Numerator		
Net income	\$ 1,434	\$ 2,490
Denominator		
Basic weighted average common shares outstanding	6,607	6,558
Dilutive effect of stock options	224	89
Diluted weighted average common shares outstanding	6,831	6,647
Basic net income per common share	\$ 0.22	\$ 0.38
Diluted net income per common share	\$ 0.21	\$ 0.37

No shares related to stock options or restricted stock were excluded for the three months ended September 30, 2017 or September 30, 2016.

Revenue Recognition

To recognize revenue, four basic criteria must be met: 1) there is evidence that an arrangement with a buyer exists; 2) delivery has occurred; 3) the fee is fixed or determinable; and 4) collectability is reasonably assured. Revenue from sales transactions where the buyer has the right to return the product is recognized at the time of sale only if (a) the seller's price to the buyer is substantially fixed or determinable at the date of sale; (b) the buyer has paid the seller, or the buyer is obligated to pay the seller and the obligation is not contingent on resale of the product; (c) the buyer's obligation to the seller would not be changed in the event of theft or physical destruction or damage of the product; (d) the buyer acquiring the product for resale has economic substance apart from that provided by the seller; (e) the seller does not have significant obligations for future performance to directly bring about resale of the product by the buyer; and (f) the amount of future returns can be reasonably estimated. We recognize revenue upon determination that all criteria for revenue recognition have been met. The criteria are usually met at the time title passes to the customer, which usually occurs upon shipment. Revenue from shipments where title passes upon completion of delivery is deferred until the shipment has been delivered.

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We record reductions to gross revenue for estimated returns of private-label contract manufacturing products and beta-alanine raw material sales. The estimated returns are based on the trailing six months of private-label contract manufacturing gross sales and our historical experience for both private-label contract manufacturing and beta-alanine raw material sales returns. However, the estimate for product returns does not reflect the impact of a potential large product recall resulting from product nonconformance or other factors as such events are not predictable nor is the related economic impact estimable.

On August 7, 2017, we entered into three agreements (“Agreements”), with The Juice Plus+ Company LLC (“Juice Plus+”). The Agreements are an Exclusive Manufacturing Agreement, a Restricted Stock Award Agreement, and an Irrevocable Proxy. Pursuant to the Exclusive Manufacturing Agreement, Juice Plus+ has granted us exclusive rights to manufacture and supply Juice Plus+ with certain Juice Plus+ products within 24 countries where Juice Plus+ currently sells those products. Pursuant to the Restricted Stock Award Agreement, NAI has agreed to grant 500,000 shares of NAI common stock to Juice Plus+, (the “Shares”), and Juice Plus+ agreed the Shares are subject to certain restrictions and risk of forfeiture. Pursuant to the Irrevocable Proxy, Juice Plus+ has granted to the NAI Board of Directors Juice Plus+’s right to vote the Shares as long as the Shares are subject to the associated risk of forfeiture. The Agreements each are for a term of 5 years, and each may be terminated by either party only upon the occurrence of specified events. For the three months ended September 30, 2017, \$163,000 of expense associated with the shares granted to Juice Plus+ was recorded as a reduction to revenue.

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 and marketed and sold under the 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 \$5.9 million during the three months ended September 30, 2017 and \$6.7 million during the three months ended September 30, 2016. 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 \$284,000 during the three months ended September 30, 2017, and \$316,000 during the three months ended September 30, 2016.

Notes Receivable

On September 30, 2017, we entered into a note receivable with Kaged Muscle, LLC (“Kaged Muscle”), one of our contract manufacturing customers, converting \$1.5 million of trade receivables to a 12 month note. Kaged Muscle is one of our fastest growing sports nutrition customers and we executed this note receivable conversion to assist them with their near term financing needs. The note carries an interest rate of fifteen percent (15%) per annum and is an interest only note secured by the assets of Kaged Muscle and a personal guarantee by the co-founder and President of Kaged Muscle. Interest is due quarterly and the note can be paid down at any time without penalty.

Stock-Based Compensation

We have an omnibus incentive plan that was approved by our Board of Directors effective as of October 15, 2009 and approved by our stockholders at the Annual Meeting of Stockholders held on November 30, 2009. Under the plan, we may grant nonqualified and incentive stock options and other stock-based awards to employees, non-employee directors and consultants.

We estimate the fair value of stock option awards 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. Black-Scholes uses assumptions related to volatility, the risk-free interest rate, the dividend yield (which we assume to be zero, as to date we have not paid any cash dividends) and employee exercise behavior. Expected volatilities used in the model are based on the historical volatility of our stock price. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect on the date of grant. The expected life of stock option grants is derived from historical experience. The fair value of restricted stock shares granted is based on the market price of our common stock on the date of grant. We amortize the estimated fair value of our stock awards to expense over the related vesting periods.

The Company did not grant any options during the three months ended September 30, 2017 or the three months ended September 30, 2016. All remaining outstanding stock options are fully vested. No options were exercised during the three months ended September 30, 2017 or three months ended September 30, 2016. During the three months ended September 30, 2017, 5,000 options were forfeited. There were no forfeitures during the three months ended September 30, 2016.

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We did not grant any shares to employees during the three months ended September 30, 2017. We granted 10,000 restricted shares to a new member of management during the three months ended September 30, 2016. Our net income included stock based compensation expense of approximately \$301,000 for the three months ended September 30, 2017, and \$250,000 for the three months ended September 30, 2016.

Fair Value of Financial Instruments

Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. We use a three-level hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs are inputs that reflect our assumptions about the inputs that market participants would use in pricing the asset or liability and are developed based on the best information available under the circumstances.

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

As of September 30, 2017 and June 30, 2017, we did not have any financial assets or liabilities classified as Level 1, except for assets and liabilities related to our pension plan. We classify derivative forward exchange contracts as Level 2 assets. The fair value of our forward exchange contracts as of September 30, 2017 was a net liability of \$2.3 million. The fair value of our forward exchange contracts as of June 30, 2017 was a net liability of \$521,000. As of September 30, 2017 and June 30, 2017 we did not have any financial assets or liabilities classified as Level 3. We did not transfer any assets or liabilities between Levels during fiscal 2017 or the three months ended September 30, 2017.

B. Inventories, net

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

	September 30, 2017	June 30, 2017
Raw materials	\$ 13,828	\$ 9,469
Work in progress	3,562	1,312
Finished goods	2,269	3,562
Reserves	(663)	(614)
Inventories, net	<u>\$ 18,996</u>	<u>\$ 13,729</u>

C. Property and Equipment

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

	Depreciable Life In Years	September 30, 2017	June 30, 2017
Land	N/A	\$ 1,200	\$ 1,200
Building and building improvements	7 – 39	3,680	3,706
Machinery and equipment	3 – 12	24,900	24,194
Office equipment and furniture	3 – 5	4,073	3,954
Vehicles	3	209	209
Leasehold improvements	1 – 15	17,159	17,038
Total property and equipment		51,221	50,301
Less: accumulated depreciation and amortization		(32,852)	(32,165)
Property and equipment, net		<u>\$ 18,369</u>	<u>\$ 18,136</u>

D. Other Comprehensive Loss

Other comprehensive (loss) income (“OCL” and “OCI”) consisted of the following during the three months ended September 30, 2017 and September 30, 2016 (in thousands):

	Defined Benefit Pension Plan	Unrealized Gains (Losses) on Cash Flow Hedges	Total
Balance as of June 30, 2017	\$ (491)	\$ (414)	\$ (905)
OCI/OCL before reclassifications	—	(1,953)	(1,953)
Amounts reclassified from OCI	—	178	178
Tax effect of OCI activity	—	641	641
Net current period OCI/OCL	—	(1,134)	(1,134)
Balance as of September 30, 2017	<u>\$ (491)</u>	<u>\$ (1,548)</u>	<u>\$ (2,039)</u>
Balance as of June 30, 2016	\$ (775)	\$ 95	\$ (680)
OCI/OCL before reclassifications	—	(452)	(452)
Amounts reclassified from OCI	—	(158)	(158)
Tax effect of OCI activity	—	220	220
Net current period OCI/OCL	—	(390)	(390)
Balance as of September 30, 2016	<u>\$ (775)</u>	<u>\$ (295)</u>	<u>\$ (1,070)</u>

E. Debt

The Company has a Credit Agreement with Wells Fargo Bank, N.A. The Credit Agreement provides us with a credit line of up to \$10.0 million and matures on February 1, 2020. The line of credit may be used to finance working capital requirements.

On September 29, 2017, we executed an amendment to our credit facility with Wells Fargo Bank, N.A, which amendment now allows us to make loans or advances to third parties not exceeding \$1.5 million. We executed this amendment in order to issue a note receivable of \$1.5 million to a customer. There is no commitment fee under this agreement. There are no amounts currently drawn under the line of credit.

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 1.25 to 1.0 at any time; and (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. Any amounts outstanding under the line of credit will bear interest at a fixed or fluctuating interest rate as elected by NAI 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 1.25% above the daily one month LIBOR rate as in effect from time to time. If a fixed rate is elected, it would equal a per annum rate of 1.25% above the LIBOR 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 for each month from the month of prepayment through the month in which the then applicable fixed rate term matures.

Our obligations under the Credit Agreement are secured by our accounts receivable and other rights to payment, general intangibles, inventory, equipment and fixtures.

During the three months ended September 30, 2017, we were in compliance with all of the financial and other covenants required under the Credit Agreement.

We also have a foreign exchange facility with Wells Fargo Bank, N.A. in effect until January 31, 2019, and with Bank of America, N.A. in effect until August 15, 2019.

We did not use our working capital line of credit nor did we have any long-term debt outstanding during the three months ended September 30, 2017. As of September 30, 2017, we had \$10.0 million available under our credit facilities.

F. 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 sales to these customers, the growth rate of sales to these customers, or in these customers' ability to make payments when due, 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,	
	2017	2016
Customer 1	\$ 13,157	\$ 17,090
Customer 2	3,161	(a)
	<u>\$ 16,318</u>	<u>\$ 17,090</u>

(a) Sales were less than 10% of the respective period's total sales.

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

	Three months Ended September 30,	
	2017	2016
Supplier 1	\$ 1,967	(b)
	<u>\$ 1,967</u>	<u>(a)</u>

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

G. Segment Information

Our business consists of two segments for financial reporting purposes, 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® trade name.

We evaluate performance based on a number of factors. The primary performance measures for each segment are net sales and income or loss from operations before corporate allocations. Operating income or loss for each segment does not include corporate general and administrative expenses, interest expense and other miscellaneous income and expense items. Corporate general and administrative expenses, which are not allocated to any segment, include, but are not limited to: human resources, corporate legal, finance, information technology, and other corporate level related expenses. The accounting policies of our segments are the same as those described in Note A above and in the consolidated financial statements included in our 2017 Annual Report.

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

	Three Months Ended September 30,	
	2017	2016
Net Sales		
Private label contract manufacturing	\$ 22,222	\$ 27,379
Patent and trademark licensing	5,852	6,688
Total	<u>\$ 28,074</u>	<u>\$ 34,067</u>

	Three Months Ended September 30,	
	2017	2016
Income from Operations		
Private label contract manufacturing	\$ 2,257	\$ 3,314
Patent and trademark licensing	1,188	1,900
Income from operations of reportable segments	3,445	5,214
Corporate expenses not allocated to segments	(1,562)	(1,678)
Total net sales	<u>\$ 1,883</u>	<u>\$ 3,536</u>
	September 30, 2017	June 30, 2017
Total Assets		
Private label contract manufacturing	\$ 67,795	\$ 60,489
Patent and trademark licensing	13,154	12,122
Total assets	<u>\$ 80,949</u>	<u>\$ 72,611</u>

Our private label contract manufacturing products are sold both in the U.S. and in markets outside the U.S., including Europe, Australia and Asia, as well as Canada, Mexico and South Africa. Our primary market outside the U.S. is Europe. 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,	
	2017	2016
United States	\$ 15,194	\$ 15,225
Markets outside the United States	12,880	18,842
Total net sales	<u>\$ 28,074</u>	<u>\$ 34,067</u>

Products manufactured by NAIE accounted for 75% of net sales in markets outside the U.S. for the three months ended September 30, 2017, and 48% for the three months ended September 30, 2016. No products manufactured by NAIE were sold in the U.S. during the three months ended September 30, 2017 and 2016.

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

	Long-Lived Assets		Total Assets		Capital Expenditures Three Months Ended	
	September 30, 2017	June 30, 2017	September 30, 2017	June 30, 2017	September 30, 2017	September 30, 2016
United States	\$ 10,491	\$ 10,753	\$ 53,045	\$ 47,777	\$ 89	\$ 1,227
Europe	7,878	7,383	27,904	24,834	867	489
	<u>\$ 18,369</u>	<u>\$ 18,136</u>	<u>\$ 80,949</u>	<u>\$ 72,611</u>	<u>\$ 956</u>	<u>\$ 1,716</u>

H. Income Taxes

The effective tax rate for the three months ended September 30, 2017 was 28.0%. The rate differs from the U.S. federal statutory rate of 34% primarily due to the favorable impact of foreign earnings taxed at less than the U.S. statutory rate.

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. There were no significant discrete items for the three months ended September 30, 2017. We recognize interest and penalties related to uncertain tax positions, if any, as an income tax expense.

We record valuation allowances to reduce our deferred tax assets to an amount that 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, 2017, there was no change to our valuation allowance.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are measured using enacted tax rates, for each of the jurisdictions in which we operate, expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date.

We are subject to taxation in the U.S., Switzerland and various state jurisdictions. Our tax years for the fiscal year ended June 30, 2014 and forward are subject to examination by the U.S. tax authorities and our tax years for the fiscal year ended June 30, 2007 and forward are subject to examination by the state tax authorities. Our tax years for the fiscal year ended June 30, 2015 and forward are subject to examination by the Switzerland tax authorities.

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

It is our policy to establish reserves based on management's assessment of exposure for certain positions taken in previously filed tax returns that may become payable upon audit by tax authorities. The tax reserves are analyzed quarterly and adjustments are made as events occur that we believe warrant adjustments to the reserves. There were no adjustments to reserves in the three months ended September 30, 2017.

I. Treasury Stock

On June 2, 2011, the Board of Directors authorized the repurchase of up to \$2.0 million of our common stock. On February 6, 2015, the Board of Directors authorized a \$1.0 million increase to our stock repurchase plan bringing the total authorized repurchase amount to \$3.0 million. On May 11, 2015, the Board of Directors authorized a \$2.0 million increase to our stock repurchase plan bringing the total authorized repurchase amount to \$5.0 million. On March 28, 2017, the Board of Directors authorized a \$2.0 million increase to our stock repurchase plan bringing the total authorized repurchase amount to \$7.0 million. 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.

During the three months ended September 30, 2017 and September 30, 2016, we did not repurchase any shares under this repurchase plan.

During the three months ended September 30, 2017, we acquired 734 shares in connection with restricted stock shares that vested during that year at a weighted average cost of \$10.70 per share and a total cost of \$8,000. During the three months ended September 30, 2016, we acquired 6,037 shares from employees in connection with restricted stock shares that vested during the year at a weighted average cost of \$13.14 per share and a total cost of \$79,000. These shares were returned to the Company by the related employees and in return the Company paid each employee's required tax withholding. The valuation of the shares acquired and thereby the number of shares returned to the Company was calculated based on the closing share price on the date the shares vested.

J. 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 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, 2017, 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 August 2019. 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 interest expense. We measure effectiveness by comparing the cumulative change in the hedge contract with the cumulative change in the hedged item. During the three months ended September 30, 2017, we did not have any losses or gains related to the ineffective portion of our hedging instruments. No hedging relationships were terminated as a result of ineffective hedging or forecasted transactions no longer probable of occurring for foreign currency forward contracts. We monitor the probability of forecasted transactions as part of the hedge effectiveness testing on a quarterly basis.

As of September 30, 2017, the notional amounts of our foreign exchange contracts designated as cash flow hedges were approximately \$62.7 million (EUR 54.2 million). As of September 30, 2017, a net loss of approximately \$2.4 million related to derivative instruments designated as cash flow hedges was recorded in OCI. It is expected that \$1.6 million will be reclassified into earnings in the next 12 months along with the earnings effects of the related forecasted transactions.

As of September 30, 2017, the fair value of our cash flow hedges was a liability of \$2.3 million, of which \$1.6 million was classified as a current liability, and \$689,000 was classified in other noncurrent liabilities in our Consolidated Balance Sheets. During the three months ended September 30, 2017, we recognized \$2.2 million of net losses in OCI and reclassified \$422,000 of gains from OCI to revenue. As of June 30, 2017, \$422,000 of the fair value of our cash flow hedges was classified in accrued liabilities, and \$99,000 was classified other noncurrent liabilities, net in our Consolidated Balance Sheets. During the three months ended September 30, 2016, we recognized \$452,000 of net gains in OCI and reclassified \$58,000 of losses from OCI to revenue.

K. Contingencies

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

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, 2017. 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 2017 Annual Report and other reports and documents we file with the SEC. Our future financial condition and results of operations will vary from our historical financial condition and results of operations described below based on a variety of factors.

Executive Overview

The following overview does not address all of the matters covered in the other sections of this Item 2 or other items in this report or contain all of the information that may be important to our stockholders or the investing public. 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, herbs 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 one or two private label contract manufacturing customers and subject to variations in the timing of such customers' orders, which in turn is impacted by such customers' internal marketing programs, supply chain management, entry into new markets, new product introductions, 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 our patent estate pursuant to license and supply agreements with third parties for 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, contract manufacturing, and license agreements.

During the first three months of fiscal 2018, our net sales were 18% lower than in the first three months of fiscal 2017. Private label contract manufacturing sales decreased 19% due primarily to the timing and shipments of orders of existing products to existing customers and discontinued customer relationships. The current quarter contract manufacturing sales decline resulted primarily from reduced orders from our largest customer for specific products associated with an inventory reduction program. During our second quarter of fiscal 2018 we expect sales of these products to increase to historical levels as we believe this excess inventory has been effectively sold through to consumers. Additionally, we expect our Fiscal Q2 2018 sales to our largest customer to increase as we begin shipping products under our previously announced expanded relationship. Revenue concentration risk for our largest private label contract manufacturing customer as a percentage of our total net sales decreased to 47% for the three months ended September 30, 2017 compared to 50% for the three months ended September 30, 2016. We expect our annualized fiscal 2018 revenue concentration for this customer to be higher than fiscal 2017.

During the first three months of fiscal 2018, CarnoSyn® beta-alanine revenue decreased 13% to \$5.9 million as compared to \$6.7 million for the first three months of fiscal 2017. The decrease in beta-alanine revenue was primarily due to decreased material shipments as a result of market and seasonal factors and lower average material sales prices. While we still have active patents covering instant release CarnoSyn® beta-alanine we are beginning to see increased competition from companies selling generic beta-alanine. In addition to legal actions we have prosecuted and others we may institute, to offset this decline, we have increased 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® beta-alanine. We have also recently seen improved activity with our efforts to further commercialize our SR CarnoSyn® patent estate with multiple customers having launched or in the process of launching products containing SR CarnoSyn®. There can be no assurance that our sales and marketing efforts will reverse or decelerate potential future declines of CarnoSyn® beta-alanine sales.

To protect our CarnoSyn® business and its underlying patent estate, we incurred litigation and patent compliance expenses of approximately \$972,000 during the first quarter of fiscal 2018 and \$994,000 during the comparable period in fiscal 2017. We describe our efforts to protect our patent estate in more detail under Item 1 of Part II of our 2017 Annual Report. 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, maintenance of our patent rights, the availability of the raw material beta-alanine when and in the amounts needed, the ability to expand distribution of beta-alanine to new and existing customers, the ability to further commercialize our existing patents, and the continued compliance by third parties with our license agreements and patent and trademark rights.

During the remainder of fiscal 2018, 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 develop relationships with additional quality oriented customers;
- Expanding the commercialization of our beta-alanine patent estate through raw material sales, developing a market for our sustained release form of beta-alanine marketed under our SR Carnosyn® trademark, developing new contract manufacturing opportunities, and license agreements and protecting our proprietary rights;
- Improving operational efficiencies and managing costs and business risks to improve profitability.

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 2017 Annual Report and recent accounting pronouncements are discussed under Item A to our Notes to Condensed Consolidated Financial Statements contained in this Quarterly Report. There have been no significant changes to these policies or pronouncements during the three months ended September 30, 2017.

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,		Change
	2017	2016	
Private label contract manufacturing	\$ 22,222	\$ 27,379	(19)%
Patent and trademark licensing	5,852	6,688	(13)%
Total net sales	28,074	34,067	(18)%
Cost of goods sold	21,704	26,398	(18)%
Gross profit	6,370	7,669	(17)%
Gross Profit %	22.7%	22.5%	
Selling, general & administrative expenses	4,487	4,133	9%
% of net sales	16.0%	12.1%	
Income from operations	1,883	3,536	(47)%
% of net sales	6.7%	10.4%	
Other income, net	108	50	116%
Income before income taxes	1,991	3,586	(44)%
% of net sales	7.1%	10.5%	
Income tax expense	557	1,096	(49)%
Net income	\$ 1,434	\$ 2,490	(42)%
% of net sales	5.1%	7.3%	

Private label contract manufacturing net sales decreased 19% primarily due to the timing and shipments of orders of existing products to existing customers and discontinued customer relationships. Net sales to our largest customer represented a majority of our decrease in private label contract manufacturing sales and was primarily the result of timing and shipments of orders.

Net sales from our patent and trademark licensing segment decreased 13% during the first quarter of fiscal 2018. The decrease in beta-alanine raw material sales was primarily due to decreased material shipments as a result of market and seasonal factors and lower average material sales prices.

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Gross profit margin increased 0.2 percentage points as follows:

Contract manufacturing ⁽¹⁾	(1.4)%
Patent and trademark licensing ⁽²⁾	1.6
Total change in gross profit margin	0.2%

- 1 Private label contract manufacturing gross profit margin as a percentage of consolidated net sales decreased 1.4 percentage points during the first quarter of fiscal 2018 as compared to the comparable period in fiscal 2017. The decrease in gross profit as a percentage of sales was primarily due to a nominal increase in overhead costs as a percentage of net revenues partially offset by favorable product sales mix.
- 2 Patent and trademark licensing gross profit margin as a percentage of consolidated net sales increased 1.6 percentage points during the first quarter of fiscal 2018 as compared to the comparable prior year period primarily due to decreased raw material costs.

Selling, general and administrative expenses increased \$354,000, or 9%, during the first quarter of fiscal 2018 primarily due to increased marketing, advertising and research and development costs supporting our CarnoSyn® and SR CarnoSyn® brands partially offset by lower employee compensation costs.

Other income, net increased \$58,000 during the first quarter of fiscal 2018 as compared to the same period in the prior fiscal year primarily due to favorable interest income associated with our foreign currency hedge contracts.

Our income tax expense decreased \$539,000 during the first quarter of fiscal 2018 as compared to the same period in the prior fiscal year. The decrease was primarily due to the lower pre-tax income in the first quarter of fiscal 2018 as compared to the comparable prior year period, as well as a lower estimated annual effective tax rate for fiscal 2018.

Liquidity and Capital Resources

Our primary sources of liquidity and capital resources are cash flows provided by operating activities and the availability of borrowings under our credit facility. Net cash provided by operating activities was \$2.3 million for the three months ended September 30, 2017 compared to net cash used in operating activities of \$0.1 million in the comparable quarter last year.

At September 30, 2017, changes in accounts receivable, consisting of amounts due from our private label contract manufacturing customers and our patent and trademark licensing activities, used \$799,000 in cash compared to providing \$649,000 of cash in the comparable prior year quarter. The decrease in cash used in/provided by accounts receivable during the quarter ended September 30, 2017 primarily resulted from timing of sales and the related collections. Days sales outstanding was 29 days during the three months ended September 30, 2017 as compared to 35 days for the prior year period.

At September 30, 2017, changes in inventory used \$5.3 million in cash during the three months ended September 30, 2017 compared to \$2.5 million in the comparable prior year quarter. The change in cash used by inventory during the quarter ended September 30, 2017 was primarily related to inventory purchased to support an anticipated increase in private label contract manufacturing sales. Changes in accounts payable and accrued liabilities provided \$5.8 million in cash during the three months ended September 30, 2017 compared to using \$875,000 during the three months ended September 30, 2016. The change in cash flow activity related to accounts payable and accrued liabilities is primarily due to the timing of inventory receipts and payments.

During the three months ended September 30, 2017, NAIE's operations used \$2.0 million of operating cash flow primarily due to the timing of inventory receipts, payments and sales. As of September 30, 2017, NAIE's undistributed retained earnings were considered indefinitely reinvested.

Cash used in investing activities in the three months ended September 30, 2017 was \$2.5 million compared to \$1.7 million in the comparable quarter last year. The primary reason for the change was due to capital equipment purchases of \$1.7 million in the first quarter of fiscal 2017 as compared to capital equipment purchases of \$1.0 million in the first quarter of fiscal 2018. In addition, we converted \$1.5 million of accounts receivable into a note receivable during the first quarter of fiscal 2018. Capital expenditures for both years were primarily for manufacturing equipment used in our Vista, California and Manno, Switzerland facilities.

We did not have any consolidated debt as of September 30, 2017 or June 30, 2017.

The Company has a Credit Agreement with Wells Fargo Bank, N.A. The Credit Agreement provides us with a credit line of up to \$10.0 million and matures on February 1, 2020. The line of credit may be used to finance working capital requirements. On September 29, 2017, we executed an amendment to our credit facility with Wells Fargo Bank, N.A, which amendment now allows us to make loans or advances to third parties not exceeding \$1.5 million. We executed this amendment in order to issue a note receivable of \$1.5 million to a customer. There was no commitment fee required as part of this amendment. There are no amounts currently drawn under the line of credit.

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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 1.25 to 1.0 at any time; and (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. Any amounts outstanding under the line of credit will bear interest at a fixed or fluctuating interest rate as elected by NAI 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 1.25% above the daily one month LIBOR rate as in effect from time to time. If a fixed rate is elected, it would equal a per annum rate of 1.25% above the LIBOR 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 for each month from the month of prepayment through the month in which the then applicable fixed rate term matures.

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 a foreign exchange facility with Wells Fargo Bank, N.A. in effect until January 31, 2019, and with Bank of America, N.A. in effect until August 15, 2019.

During the three months ending on September 30, 2017, we were in compliance with all of the financial and other covenants required under the Credit Agreement.

As of September 30, 2017, we had \$27.7 million in cash and cash equivalents and \$10.0 million available under our credit facilities. We believe our available cash, cash equivalents and potential cash flows from operations will be sufficient to fund our current working capital needs and capital expenditures through at least the next 12 months.

Off-Balance Sheet Arrangements

As of September 30, 2017, 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 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 is: (1) gathered and communicated to our management, including our principal executive and financial officers, in a manner that allows for timely decisions regarding required disclosures; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the 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, 2017. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective for their intended purpose described above as of September 30, 2017.

There were no changes to our internal control over financial reporting during the quarterly period ended September 30, 2017 that have materially affected, or that 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 generally do not believe the resolution of these matters will result in a material adverse effect on our business, consolidated financial condition, or results of operations. However, a settlement payment or unfavorable outcome could adversely impact our results of operations. Our evaluation of the likely impact of these actions could change in the future and we could have unfavorable outcomes we do not expect.

As of November 13, 2017, except as described below, neither NAI nor its subsidiary were a party to any material pending legal proceeding nor was any of our property the subject of any material pending legal proceeding.

In 2011, NAI filed a lawsuit against Woodbolt Distribution, LLC, also known as Cellucor (“Woodbolt”), and both NAI and Woodbolt filed additional lawsuits and countersuits against each other. NAI and Woodbolt subsequently settled all of the lawsuits between them, but not before the United States Patent and Trademark Office (“USPTO”) at Woodbolt’s request rejected the claims of two NAI patents. The rulings rejecting the claims of two NAI patents were subsequently confirmed by the Patent Trial and Appeal Board (PTAB) at the USPTO. NAI filed Notices of Appeal with the U.S. Court of Appeals for the Federal Circuit requesting that certain findings of the PTAB’s be reversed. No hearing date has been set by the Court. Both NAI patents rejected by the USPTO expired in August 2017.

On September 18, 2015, the Company filed a complaint against Creative Compounds, LLC, alleging various claims including (1) violation of Section 43 of the Lanham Act, (2) violation of California’s Unfair Competition Law, (3) violation of California’s False Advertising Law, (4) Trade Libel and Business Disparagement and (5) Intentional Interference with Prospective Economic Advantage. Subsequently, the Company and defendant resolved their disputes and entered into settlement and the case was dismissed.

On August 24, 2016, the Company filed a separate complaint against Creative Compounds, LLC, alleging infringement of U.S. patent 7,825,084. On October 5, 2016, Creative filed its answer and counterclaims. On January 19, 2017, the Company filed a Motion to Amend the Complaint, to add allegations of infringement of U.S. patents 5,965,596, 7,504,376, 8,993,610 and 8,470,865, and additional parties, Core Supplement Technology, Inc., Honey Badger LLC, and Myopharma, Inc. The Court granted the Company’s motion. On May 2, 2017, the Court issued a revised scheduling order and set a trial date for July 31, 2018. On July 19, 2017, Creative filed a motion for judgment on the pleadings to dismiss the patent infringement claims with prejudice. On September 5, 2017, the Court granted Creative’s motion, which is a non-final decision and subject to later appeal to the U.S. Court of Appeals for the Federal Circuit. The Company has stated it will appeal the District Court rulings. The remaining non-patent claims pending against other defendants were not affected. On October 16, 2017, defendant Core Supplement Technology, Inc., filed a Notification of Bankruptcy with the Court. On October 17, 2017, the Company and defendant Honey Badger LLC filed a voluntary stipulation of dismissal, which the Court granted on October 20, 2017. On October 31, 2017, the Company and defendant Myopharma, Inc. filed a voluntary stipulation of dismissal, which the Court has not yet granted so that a final judgment can be entered.

On July 6, 2016, the Company filed a complaint against Allmax Nutrition, Inc. in U.S. District Court for the Southern District of California, alleging (1) infringement of U.S. patents 5,965,596, 6,172,098, 7,825,084 and RE 45,947, (2) violation of Section 32 of the Lanham Act, and (3) copyright infringement. On October 19, 2016, the Company filed an amended complaint adding HBS International Corp., Allmax’s exclusive distributor, as a co-defendant and to add a civil conspiracy claim. On May 2, 2017, the Court issued a scheduling order setting a trial date for July 31, 2018. On April 25, 2017, defendants filed a motion for judgment on the pleadings and a motion to dismiss as to the Company’s trademark and patent infringement and civil conspiracy claims. On June 26, 2017, the Court granted Defendants’ motions, dismissing the Company’s patent infringement claim with prejudice and dismissing the trademark and civil conspiracy claims without prejudice. The Company filed a Second Amended Complaint on July 10, 2017. On August 29, 2017, the Court denied the Company’s motion to partially reconsider the dismissal of the patent infringement claim, which is a non-final decision and subject to later appeal to the U.S. Court of Appeals for the Federal Circuit. The Company has stated it will appeal the District Court rulings. On August 30, 2017, the Court denied Defendants’ motion to dismiss the Company’s trademark and conspiracy claims. On September 29, 2017, both defendants filed their amended answers. Defendant HBS International Corp. also asserted a counterclaim for tortious interference with contract. The Company has not yet filed its response to the asserted counterclaim.

On September 16, 2016, the Company filed a complaint against Hi-Tech Pharmaceuticals, Inc. d/b/a ALR Industries, APS Nutrition, Innovative Laboratories, Formutech Nutrition, LG Sciences and Sports 1 in U.S. District Court for the Southern District of California, alleging (1) infringement of U.S. patents 5,965,596, 7,825,084, 8,993,610 and RE 45,947, (2) violation of Section 32 of the Lanham Act and (3) breach of contract. On May 2, 2017, the Court issued a scheduling order setting a trial date for July 31, 2018. On July 10, 2017, Defendants filed a motion for judgment on the pleadings to dismiss the patent infringement claims with prejudice. On September 5, 2017, the Court granted Defendants' motion, which is a non-final decision and subject to later appeal to the U.S. Court of Appeals for the Federal Circuit. The Company has stated it will appeal the District Court rulings. The remaining non-patent claims pending against the Defendants were not affected. On September 28, 2017, in a separate matter not involving the Company, the United States of America filed a First Superseding Criminal Indictment against defendants Hi-Tech Pharmaceuticals, Inc and its Chief Executive Officer, Jared Wheat. *United States v. Hi-Tech Pharmaceuticals, et al.*, No.1:17-CR-0229 (N.D. Ga. 2017). On or about October 4, 2017, items in the possession of Hi-Tech were seized pursuant to a search warrant, including the documentation relevant to this case. In light of this development, the parties moved the Court on November 3, 2017, seeking an order staying all proceedings in the pending action until disposition of *United States v. Hi-Tech Pharmaceuticals, et al.*, 1:17-CR-00229 (N.D. Ga 2017), or at a minimum, until the documents relevant to this case can be retrieved by the defendants. The Court has not yet ruled on the parties' pending motion.

Although we believe our claims in the above litigation matters are valid, there is no assurance we will prevail in these litigation matters or in proceedings we may initiate or that our 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 2017 Annual Report, as well as the other information in our 2017 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.

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

Repurchases

During the quarter ended September 30, 2017, we did not repurchase any shares of our common stock.

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 September 8, 2005
10.1	Third amendment to the Credit agreement by and between NAI and the Wells Fargo Bank N.A. effective as of September 30, 2017	Filed herewith
10.2	Loan and Security agreement by and between NAI and Kaged Muscle, LLC effective as of September 30, 2017	Filed herewith
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed herewith
32	Section 1350 Certification	Filed herewith
101.INS	XBRL Instance Document	Filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	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 13, 2017

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)

THIRD AMENDMENT TO CREDIT AGREEMENT

THIS AMENDMENT TO CREDIT AGREEMENT (this "Amendment") is entered into as of September 29, 2017, by and between NATURAL ALTERNATIVES INTERNATIONAL, INC., a Delaware corporation ("Borrower"), and WELLS FARGO BANK, NATIONAL ASSOCIATION ("Bank").

RECITALS

WHEREAS, Borrower is currently indebted to Bank pursuant to the terms and conditions of that certain Credit Agreement between Borrower and Bank dated as of November 1, 2014, as amended from time to time ("Credit Agreement").

WHEREAS, Bank and Borrower have agreed to certain changes in the terms and conditions set forth in the Credit Agreement and have agreed to amend the Credit Agreement to reflect said changes.

NOW, THEREFORE, for valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree that the Credit Agreement shall be amended as follows:

1. Section 5.7. is hereby deleted in its entirety, and the following substituted therefor:

"SECTION 5.7. LOANS, ADVANCES, INVESTMENTS. Make any loans or advances to or investments in any person or entity, except (a) any of the foregoing existing as of, and disclosed to Bank prior to, the date hereof; and (b) additional loans, advances or investments in amounts not to exceed an aggregate of \$1,500,000.00 at any time outstanding."

2. Except as specifically provided herein, all terms and conditions of the Credit Agreement remain in full force and effect, without waiver or modification. All terms defined in the Credit Agreement shall have the same meaning when used in this Amendment. This Amendment and the Credit Agreement shall be read together, as one document.

3. Borrower hereby remakes all representations and warranties contained in the Credit Agreement and reaffirms all covenants set forth therein. Borrower further certifies that as of the date of this Amendment there exists no Event of Default as defined in the Credit Agreement, nor any condition, act or event which with the giving of notice or the passage of time or both would constitute any such Event of Default.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed as of the day and year first written above.

NATURAL ALTERNATIVES INTERNATIONAL, INC.

WELLS FARGO BANK, NATIONAL ASSOCIATION

By: /s/ Kenneth Wolf
KENNETH E. WOLF,
PRESIDENT

By: /s/ Glenn Burton
GLENN BURTON,
VICE PRESIDENT

By: /s/ Michael Fortin
MICHAEL FORTIN,
CHIEF FINANCIAL OFFICER

LOAN AND SECURITY AGREEMENT

This LOAN AND SECURITY AGREEMENT (this "**Agreement**") is entered into as of September 30, 2017, (the "**Effective Date**"), by and between **NATURAL ALTERNATIVES INTERNATIONAL, INC.**, a Delaware corporation, (the "**Lender**") on the one hand, and **KAGED MUSCLE LLC**, a Delaware limited liability company ("**Borrower**"), and **MICHAEL MCCLANE**, an individual resident in Idaho (the "**Guarantor**" and together with Borrower, the "**Debtor Parties**") on the one hand. Each of Lender, Borrower and Guarantor may be referred to individually as a "**Party**", and collectively as the "**Parties**", and.

RECITALS:

1. Lender and Borrower are parties to a Supply Agreement dated July 31, 2014 (the "**Supply Agreement**").
2. The Supply Agreement is personally guaranteed by Michael McClane, officer and part owner of Borrower pursuant to a Guaranty dated March 10, 2016 (the "**Supply Guaranty**").
3. Borrower has asked for an extension of its credit terms under the Supply Agreement.
4. As part of Lender's agreement to so extend such credit terms, Lender and Borrower have agreed to loan \$1,500,000 of the amount due Lender by Borrower under the Supply Agreement to Borrower for the purpose of paying down such amount due (the "**Loan**").
5. As of the Effective Date the amount outstanding and currently due to Lender from Borrower under the Supply Agreement will be reduced by crediting the Borrower with payment of \$1,500,000 of the amounts that have been outstanding for the longest time.
6. The Loan will be made pursuant to an Interest only 12 month term cognovit promissory note bearing Interest at 15% per annum, with such Note being secured by all of the assets of Borrower and by the personal guarantee of Michael McClane (the "**Guarantor**"), and Borrower and Guarantor wishes to accept the Loan from Lender, all on the terms and conditions contained in this Agreement.
7. Each of the provisions of these Recitals are fully incorporated into this Agreement as if fully rewritten therein.

AGREEMENT:

FOR VALUE RECEIVED, and in consideration of the granting by Lender of financial accommodations to or for the benefit of the Borrower, including without limitation respecting the Obligations (as hereinafter defined), Borrower represents and agrees with Lender, as of the date hereof and as of the Closing Date, as follows:

Article 1

Loan.

Section 1.1 **Loan.** Subject to the terms and conditions of this Agreement, Lender hereby agrees to make a loan to Borrower in the original Principal amount of One Million Five Hundred Thousand and No/100 Dollars (\$1,500,000.00) (the "**Loan**"). The Loan shall be evidenced by that certain Cognovit Promissory Note of even date herewith (the "**Note**"), to be issued by Borrower in favor of Lender in the original Principal amount of One Million Five Hundred Thousand and No/100 Dollars (\$1,500,000.00). A copy of the Note is attached hereto as Exhibit A and incorporated herein. This Agreement, the Note, the Security Documents (defined below) and any and all other documents, amendments or renewals executed and delivered in connection with any of the foregoing are collectively hereinafter referred to as the "**Loan Documents**".

Section 1.2 **Term.** The Loan shall expire on September 30, 2018, (the "**Maturity Date**").

Article 2

Grant of Security Interest

Section 2.1 **Grant of Security Interest.** In consideration of Lender's extending credit and other financial accommodations to or for the benefit of Borrower, Borrower hereby and pursuant to the Security Documents grants to Lender a security interest in, a lien on and pledge and assignment of (the "**Security Interest**"), the Collateral (as hereinafter defined) owned by such entity. The Security Interest granted by this Agreement and by each Security Document is given to and shall be held by Lender as security for the payment and performance of all Obligations (as hereinafter defined).

Section 2.2 **Security Documents.** As further security for the payment and performance of all Obligations, Borrower shall execute and deliver or cause to be executed and delivered the following documents in a form satisfactory to Lender (the "**Security Documents**"):

(a) **Guaranty.** A personal guarantee, by Michael McLane, of all of the Obligations (the "**Guaranty**") in substantially the form attached hereto as **Exhibit A**;

(b) **Other Agreements.** Such other agreements and instruments as reasonably requested by Lender to secure Lender.

Section 2.3 **Definitions.** The following definitions shall apply:

(a) "**Code**" shall mean the Delaware Uniform Commercial Code, Codified at 6 Del. C. § 9-101 *et seq* as amended from time to time.

(b) "Collateral" shall mean the following, each, if capitalized, as defined in the Code:

(i) All of the Borrower's present and future right, title and interest in and to any and all of the assets and personal property of Borrower used in the operation of its business, whether such property is now existing or hereafter created, acquired or arising and wherever located from time to time, including without limitation:

(A) any and all Accounts, and all cash, certificates, interest, dividends, deposits, Deposit Accounts, Instruments, Credits, Investments, Claims, Contract Rights, Chattel Paper (whether tangible or electronic), money market certificates, repurchase agreements, savings instruments, securities, securities entitlements, investment property, commercial paper, letter-of- credit rights (whether or not the letter of credit is evidenced by a writing), Commercial Tort Claims, General Intangibles and other

property at any time and from time to time now or hereafter in the Accounts and all such property received, receivable or otherwise distributed in respect of, in substitution or in exchange for, or in replacement of the foregoing, and all supporting obligations accounts;

- (B) Goods;
- (C) Inventory;
- (D) Equipment;
- (E) Fixtures
- (F) documents; and
- (G) records of, accession to and proceeds and products of the foregoing.

(c) "**Disclosure Schedule**" shall mean the schedule attached to this Agreement, which schedule shall contain the information required by this Agreement.

(d) "**Obligation(s)**" shall mean, without limitation, the Loan and all loans arising under this Agreement and under any of the other Loan Documents. Said term shall also include all Interest and other charges chargeable to Borrower or due from Borrower to Lender from time to time and all costs and expenses referred to in this Agreement.

(e) "**Person**" or "**party**" shall mean individuals, partnerships, corporations, limited liability companies and all other entities.

All words and terms used in this Agreement other than those specifically defined herein shall have the meanings accorded to them in the Code.

Section 2.4 **Inspection.** The Lender, or its representatives, at any time and from time to time but not more often than once every twelve (12) months, shall have the right at the sole cost and expense of Lender, and Borrower will permit the Lender and/or its representatives: (a) to examine, check, make copies of or extracts from any of Borrower's books, records and files (including, without limitation, orders and original correspondence); (b) to perform field exams or otherwise inspect and examine the Collateral and to check, test or appraise the same as to quality, quantity, value and condition; and (c) to verify the Collateral or any portion or portions thereof or Borrower's compliance with the provisions of this Agreement.

Section 2.5 **Search Reports.** Lender shall receive prior to the date of this Agreement, UCC search results under all names used by Borrower during the prior five (5) years, from each jurisdiction where any Collateral is located, from the State, if any, where Borrower is organized and registered (as such terms are used in the Code), and the State where Borrower's chief executive office is located, all of which names, locations and registrations are shown on the attached **Disclosure Schedule**. The search results shall confirm that the Security Interest in the Collateral granted Lender hereunder is prior to all other Security Interests in favor of any other person.

Article 3

Closing; Closing Obligations

Section 3.1 **Closing.** The consummation of the Loan and related transactions contemplated by and provided for in this Agreement (the "**Closing**") will take place simultaneously with execution of this Agreement by an exchange of documents on or before September 30, 2017 (the "**Closing Date**").

Section 3.2 **Closing Obligations.** On or before the Closing Date:

- (a) Borrower will deliver, or cause to be delivered, to Lender, the following:
 - (i) this Agreement, executed by Borrower
 - (ii) the Note, executed by Borrower; and
 - (iii) the Guaranty.
- (b) Lender will deliver, or cause to be delivered, to Borrower the
 - (i) this Agreement, executed by Lender.

Article 4

Representations and Warranties

Any exceptions to the representations and warranties made below shall be set forth on the attached Disclosure Schedule, identified by Section Number and including a description of each exception. Borrower represents, warrants and covenants as follows:

Section 4.1 **Organization and Good Standing.** It is a limited liability company duly organized, validly existing and in good standing under the laws of its jurisdiction of organization, with full power and authority as a limited liability company to conduct its business as it is now being conducted, to own or use the properties and assets that it purports to own or use, and to perform all its obligations under the Loan Documents. In addition, Borrower is duly qualified to do business as a foreign limited liability company and is in good standing under the laws of each state or other jurisdiction in which either the ownership or use of the properties owned or used by it, or the nature of the activities conducted by it, requires such qualification. It has provided to Lender current, complete and accurate copies of its Certificate of Formation, Operating Agreement and all of its other governing documents. Except as disclosed on the attached Disclosure Schedule, it has no subsidiaries and does not own any shares of capital stock or other securities of any other entity.

Section 4.2 **Places of Business.** It shall, during the term of this Agreement, keep Lender currently and accurately informed in writing of each of its places of business, and shall not open or close, move or change any existing or new place of business without giving Lender at least thirty (30) days prior written notice thereof.

Section 4.3 **Title to Collateral.** At the date hereof it is (and as to Collateral that it may acquire after the date hereof, it will be) the lawful owner of the Collateral owned by it, and the Collateral owned by it and each item thereof is, will be and shall continue to be free of all restrictions, liens, encumbrances or other rights, title or interests (other than the Security Interest therein granted to Lender), credits, defenses, recoupments, set-offs or counterclaims whatsoever. It has and will have full power and authority to grant to Lender a Security Interest in the Collateral owned by it and it has not transferred, assigned, sold, pledged, encumbered, subjected to lien or granted any Security Interest in, and will not transfer, assign, sell (except sales or other dispositions in the ordinary course of business in respect to inventory as expressly permitted in this Agreement), pledge, encumber, subject to lien or grant any Security Interest in any of the Collateral owned by it (or any of its right, title or interest therein), to any person other than Lender. The Collateral owned by it is and will be valid and genuine in all respects. It will warrant and defend Lender's right to and interest in the Collateral owned by it against all claims and demands of all persons whatsoever.

Section 4.4 **Location of Collateral.** Except for sale, processing, use, consumption or other disposition in the ordinary course of business, it will keep all equipment only at locations specified in this Agreement or specified to Lender in writing. It shall, during the term of this Agreement, keep Lender currently and accurately informed in writing of each location where its records relating to its accounts and contract rights, respectively, are kept, and shall not remove such records or any of them to another location without giving Lender at least thirty (30) days prior written notice thereof.

Section 4.5 **Valid Obligations.** The Loan Documents represent legal, valid and binding obligations of it and are fully enforceable according to their terms, except as limited by laws relating to the enforcement of creditors' rights.

Section 4.6 **Conflicts.** There is no provision in any indenture, contract or agreement to which it is a party which prohibits, limits or restricts the execution, delivery or performance of the Loan Documents by it.

Section 4.7 **Governmental Approvals.** The execution, delivery and performance of the Loan Documents does not require any approval of or filing with any governmental agency or authority other than to perfect Lender's Security Interest.

Section 4.8 **Litigation, etc.** There are no actions, claims or proceedings pending or to the knowledge of it threatened against it, which might materially adversely affect the ability of it to conduct its business or to pay or perform the Obligations.

Section 4.9 **Accounts and Contract Rights.** All of its accounts arise out of legally enforceable and existing contracts.

Section 4.10 **Third Parties.** The Lender shall not be deemed to have assumed any liability or responsibility to any of the Borrowers or any third person for the correctness, validity or genuineness of any instruments or documents that may be released or endorsed to it by the Lender (which shall automatically be deemed to be without recourse to the Lender in any event) or for the existence, character, quantity, quality, condition, value or delivery of any goods purporting to be represented by any such documents; and the Lender, by accepting such Security Interest in the Collateral, or by releasing any Collateral to it, shall not be deemed to have assumed any obligation or liability to any supplier or debtor or to any other third party, and it agrees to indemnify and defend the Lender and hold Lender harmless in respect to any claim or proceeding arising out of any matter referred to in this paragraph.

Section 4.11 **Taxes.** It has filed all Federal, state and other tax returns required to be filed (except for such returns for which current and valid extensions have been filed), and all taxes, assessments and other governmental charges due from it have been fully paid. It has properly established on its books reserves adequate for the payment of all Federal, state and other tax liabilities (if any).

Section 4.12 **Use of Proceeds.** No portion of the Loan is to be used for (i) the purpose of purchasing or carrying any "margin security" or "margin stock" as such terms are used in Regulations U and X of the Board of Governors of the Federal Reserve System, 12 C.F.R. 221 and 224 or (ii) primarily personal, family or household purposes. The Collateral is not used or acquired primarily for personal, family or household purposes.

Article 5

Affirmative Covenants

Section 5.1 **Payments and Performance.** Borrower will duly and punctually pay all Obligations becoming due to the Lender and will duly and punctually perform all Obligations on its part to be done or performed under this Agreement or any other Loan Document.

Section 5.2 **Books and Records; Inspection.** Borrower will at all times keep proper books of account in which full, true and correct entries will be made of its transactions in accordance with generally accepted accounting principles, consistently applied and which are, in the opinion of a Certified Public Accountant acceptable to Lender, adequate to determine fairly the financial condition and the results of operations of Borrower. Borrower will from time to time furnish the Lender with such information and statements as the Lender may request in its sole and absolute discretion with respect to the Obligations or the Lender's Security Interest in the Collateral owned by it. Borrower shall, during the term of this Agreement, keep the Lender currently and accurately informed in writing of each location where its records relating to its accounts and contract rights are kept, and shall not remove such records to another location without giving the Lender at least thirty (30) days prior written notice thereof.

Section 5.3 **Conduct of Business.** Borrower will comply with all laws and regulations of the United States and of any state or states thereof and of any political subdivision thereof, and of any governmental authority which may be applicable to it or to its business; provided that this covenant shall not apply to any tax, assessment or charge which is being contested in good faith and with respect to which reserves have been established and are being maintained.

Section 5.4 **Contact with Accountant.** Borrower hereby authorizes the Lender to directly contact and communicate with any accountant employed by Borrower in connection with the review and/or maintenance of Borrower's books and records or preparation of any financial reports delivered by or at the request of Borrower to Lender.

Section 5.5 **Taxes.** Borrower will promptly pay all real and personal property taxes, assessments and charges and all franchise, income, unemployment, retirement benefits, withholding, sales and other taxes assessed against it or payable by it before delinquent; provided that this covenant shall not apply to any tax assessment or charge which is being contested in good faith and with respect to which reserves have been established and are being maintained. The Lender may, at its option, from time to time, discharge any taxes, liens or encumbrances of any of the Collateral, and Borrower shall then pay to the Lender on demand or the Lender in its sole discretion may charge to Borrower all amounts so paid or incurred by it.

Section 5.6 **Maintenance.** Borrower will keep and maintain the Collateral owned by it and its other properties, if any, in good repair, working order and condition. Borrower will immediately notify the Lender of any loss or damage to or any occurrence which would adversely affect the value of any Collateral owned by it. The Lender may, at its option, from time to time, take any other action that the Lender may deem proper to repair, maintain or preserve any of the Collateral, and Borrower will pay to the Lender on demand or the Lender in its sole discretion may charge to Borrower all amounts so paid or incurred by it.

Section 5.7 **Insurance.** Borrower will maintain in force property and casualty insurance on all Collateral and any other property of Borrower, if any, against risks customarily insured against by companies engaged in businesses similar to that of Borrower containing such terms and written by such companies as may be satisfactory to the Lender, such insurance to be payable to the Lender as its interest may appear in the event of loss and to name the Lender as insured pursuant to a standard loss payee clause; no loss shall be adjusted thereunder without the Lender's approval; and all such policies shall provide that they shall endeavor to provide thirty (30) days' written notice to Lender prior to cancellation. In the event that Borrower fails to provide evidence of such insurance, the Lender may, at its option, secure such insurance and charge the cost thereof to Borrower. At the option of the Lender, all insurance proceeds received from any loss or damage to any of the Collateral shall be applied either to the replacement or repair thereof or as a payment on account of the Obligations. From and after the occurrence of an Event of Default, the Lender is authorized to cancel any insurance maintained hereunder and apply any returned or unearned premiums, all of which are hereby assigned to the Lender, as a payment on account of the Obligations.

Section 5.8 **Notification of Default.** Immediately upon becoming aware of the existence of any condition or event which constitutes an Event of Default, or any condition or event which would upon notice or lapse of time, or both, constitute an Event of Default, Borrower shall give Lender written notice thereof specifying the nature and duration thereof and the action being or proposed to be taken with respect thereto.

Section 5.9 **Notification of Material Litigation.** Borrower will immediately notify the Lender in writing of any litigation or of any investigative proceedings of a governmental agency or authority commenced or threatened against it which would or might be materially adverse to the financial condition of Borrower.

Article 6

Negative Covenants

Section 6.1 **Limitations on Indebtedness.** So long as the Loan is outstanding, Borrower shall not issue any evidence of indebtedness or create, assume, guarantee, become contingently liable for, or suffer to exist indebtedness in addition to indebtedness to the Lender (including any debt to the Lender in which Lender only has a participation), except indebtedness or liabilities of Borrower, other than for money borrowed, incurred or arising in the ordinary course of business.

Section 6.2 **Loans or Advances.** So long as the Loan is outstanding, Borrower shall not make any loans in excess of \$10,000.00 or advances to any individual, partnership, corporation, limited liability company, trust, or other organization or person, including without limitation its employees; provided, however, that Borrower may make advances to its employees, with respect to expenses incurred or to be incurred by such employees in the ordinary course of business which expenses are reimbursable by Borrower.

Section 6.3 **Capital Expenditures.** Borrower shall not, directly or indirectly, make or commit to make capital expenditures by lease, purchase, or otherwise, except in the ordinary and usual course of business.

Section 6.4 **Sale of Assets.** Borrower shall not sell, lease or otherwise dispose of any of its assets, except in the ordinary and usual course of business and except for the purpose of replacing machinery, equipment or other personal property which, as a consequence of wear, duplication or obsolescence, is no longer used or necessary in Borrower's business, provided that fair consideration is received therefore.

Section 6.5 **Restriction on Liens.** Borrower shall not grant any Security Interest in the Collateral. Borrower shall not enter into any agreement with any person other than the Lender that prohibits Borrower from granting any Security Interest in, or mortgage of, the Collateral.

Section 6.6 **Other Business.** Borrower shall not engage in any business other than the business in which it is currently engaged or a business reasonably allied thereto.

Section 6.7 **Change of Name, etc.** Borrower shall not change its legal name or its primary place of business, without giving the Lender at least 30 days prior written notice thereof.

Article 7

Default

Section 7.1 **Default.** "Event of Default" shall mean the occurrence of one or more of any of the following events:

(a) default of any liability, obligation, covenant or undertaking of Borrower or Guarantor to Lender, hereunder or under any of the other Loan Documents including without limitation failure to pay in full and when due any installment of Principal or Interest or default of Borrower or Guarantor, continuing for over 30 days from delivery to Borrower of a Default Notice as required under the Note, or under any other Loan Document; provided, however, that nothing herein or in any of the Loan Documents shall be deemed to supersede, or to render invalid the Supply Agreement or the Supply Guarantee both of which the parties hereby confirm continue in full force and effect according to the terms and conditions stated therein;

(b) failure to pay any monetary obligation of Borrower pursuant to the Supply Agreement within thirty days of the date due, or any failure of the Guarantor to make any payment due to Lender under the Supply Guarantee within thirty days of the date due, and any failure of Borrower pursuant to the Supply Agreement or Guarantor pursuant to the Supply Guarantee, to purchase excess inventory upon the expiration or termination of the Supply Agreement in the amounts and when required pursuant to the Supply Agreement;

(c) default of any liability, obligation, covenant or undertaking of Borrower or Guarantor to Lender, under any agreement between them (if any) in addition to the Loan Documents and the Supply Agreement and Supply Guarantee, whether written or unwritten, including without limitation failure to pay in full and when due any amount or default of Borrower or Guarantor under any such agreement; provided, however, that nothing herein or in any of the Loan Documents shall be deemed to supersede or to render invalid any such agreement;

(d) if any statement, representation or warranty heretofore, now or hereafter made by Borrower or Guarantor in connection with this Agreement or in any supporting financial statement of Borrower or Guarantor shall be determined by the Lender to have been false or misleading in any material respect when made;

(e) if Borrower or Guarantor is a corporation, trust, partnership or limited liability company, the liquidation, termination or dissolution of any such organization, or the merger or consolidation of such organization into another entity, or its ceasing to carry on actively its present business or the appointment of a receiver for its property;

(f) if Guarantor is an individual, the death of Guarantor;

(g) the institution by or against Borrower or Guarantor of any proceedings under the Bankruptcy Code 11 USC §101 et seq. or any other law in which Borrower or Guarantor is alleged to be insolvent or unable to pay its debts as they mature, or the making by Borrower or Guarantor of an assignment for the benefit of creditors or the granting by Borrower or Guarantor of a trust mortgage for the benefit of creditors;

(h) the service upon the Lender of a writ in which the Lender is named as trustee of Borrower or Guarantor;

(i) a final, unappealable judgment or judgments for the payment of money shall be rendered against Borrower or Guarantor, and any such judgment shall remain unsatisfied and in effect for any period of thirty (30) consecutive days without a stay of execution;

(j) any levy, lien (including mechanics lien), seizure, attachment, execution or similar process shall be issued or levied on any of the property of Borrower or Guarantor;

(k) the termination or revocation of any guaranty of the Obligations, including but not limited to the Guaranty;

(l) if the control or management of Borrower changes such that Michael McClane, does not directly or indirectly own more than 50% of the voting interests of Borrower and its parents and subsidiaries.

Section 7.2 "**Possible Default**" means any event which, with the giving of notice, the passage of time, or both, would constitute an Event of Default.

Section 7.3 **Acceleration**. If an Event of Default shall occur, at the election of the Lender, all Obligations shall become immediately due and payable without notice or demand.

Section 7.4 Lender is hereby authorized, at its election, after an Event of Default or after demand, without any further demand or notice except to such extent as notice may be required by applicable law, to take possession and/or sell or otherwise dispose of all or any of the Collateral at public or private sale; and Lender may also exercise any and all other rights and remedies of a secured party under the Code or which are otherwise accorded to it in equity or at law, all as Lender may determine, and such exercise of rights in compliance with the requirements of law will not be considered adversely to affect the commercial reasonableness of any sale or other disposition of the Collateral. If notice of a sale or other action by Lender is required by applicable law, unless the Collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, Borrower agrees that ten

(10) days' written notice to Borrower, or the shortest period of written notice permitted by such law, whichever is smaller, shall be sufficient notice; and that to the extent permitted by law, Lender, its officers, attorneys and agents may bid and become purchasers at any such sale, if public, and may purchase at any private sale any of the Collateral that is of a type customarily sold on a recognized market or which is the subject of widely distributed standard price quotations. Any sale (public or private) shall be without warranty and free from any right of redemption, which Borrower shall waive and release after default upon Lender's request therefore, and may be free of any warranties as to the Collateral if Lender shall so decide. No purchaser at any sale (public or private) shall be responsible for the application of the purchase money. Any balance of the net proceeds of sale remaining after paying all Obligations of Borrower to Lender shall be returned to such other party as may be legally entitled thereto; and if there is a deficiency, Borrower shall be responsible for repayment of the same, with Interest. Upon demand by Lender, Borrower shall assemble the Collateral and make it available to Lender at a place designated by Lender which is reasonably convenient to Lender and Borrower. Borrower hereby acknowledges that Lender has extended credit and other financial accommodations to the Borrower upon reliance of Borrower's granting Lender the rights and remedies contained in this Agreement including without limitation the right to take immediate possession of the Collateral upon the occurrence of an Event of Default and Borrower hereby acknowledges that Lender is entitled to equitable and injunctive relief to enforce any of its rights and remedies hereunder or under the Code and Borrower hereby waives any defense to such equitable or injunctive relief based upon any allegation of the absence of irreparable harm to Lender.

Section 7.5 Lender shall not be required to marshal any present or future security for (including but not limited to this Agreement and the Collateral subject to the Security Interest created hereby), or guarantees of, the Obligations or any of them, or to resort to such security or guarantees in any particular order; and all of its rights hereunder and in respect of such securities and guaranties shall be cumulative and in addition to all other rights, however existing or arising. To the extent that it lawfully may do so, Borrower hereby agrees that it will not invoke and irrevocably waives the benefits of any law relating to the marshaling of collateral which might cause delay in or impede the enforcement of Lender's rights under this Agreement or under any other instrument evidencing any of the Obligations or under which any of the Obligations is outstanding or by which any of the Obligations is secured or guaranteed. Except as required by applicable law, Lender shall have no duty as to the collection or protection of the Collateral or any income thereon, nor as to the preservation of rights against prior parties, nor as to the preservation of any rights pertaining thereto beyond the safe custody thereof.

Section 7.6 **Power of Attorney.** Borrower hereby irrevocably constitutes and appoints Lender as Borrower's true and lawful attorney-in-fact, with full power of substitution, at the sole cost and expense of Borrower but for the sole benefit of Lender, upon the occurrence of an Event of Default, to convert the Collateral into cash, including, without limitation, completing the manufacture or processing of work in process, and the sale (either public or private) of all or any portion or portions of the inventory and other Collateral; to enforce collection of the Collateral, either in its own name or in the name of Borrower, including, without limitation, executing releases or waivers, compromising or settling with any debtors and prosecuting, defending, compromising or releasing any action relating to the Collateral; to receive, open and dispose of all mail addressed to Borrower and to take therefrom any remittances or proceeds of Collateral in which Lender has a Security Interest; to notify Post Office authorities to change the address for delivery of mail addressed to Borrower to such address as Lender shall designate; to endorse the name of Borrower in favor of Lender upon any and all checks, drafts, money orders, notes, acceptances or other instruments of the same or different nature; to sign and endorse the name of Borrower on and to receive as secured party any of the Collateral, any invoices, freight or express receipts, or bills of lading, storage receipts, warehouse receipts, or other documents of title of the same or different nature relating to the Collateral; to sign the name of Borrower on any notice of the Debtor Parties or on verification of the Collateral; and to sign, if necessary, and file or record on behalf of Borrower any financing or other statement in order to perfect or protect Lender's Security Interest. Lender shall not be obliged to do any of the acts or exercise any of the powers hereinabove authorized, but if Lender elects to do any such act or exercise any such power, it shall not be accountable for more than it actually receives as a result of such exercise of power, and it shall not be responsible to Borrower except for its own gross negligence or willful misconduct. All powers conferred upon Lender by this Agreement, being coupled with an interest, shall be irrevocable so long as any Obligation of Borrower or any guarantor or surety to Lender shall remain unpaid or Lender is obligated under this Agreement to extend any credit to Borrower.

Section 7.7 **Nonexclusive Remedies.** All of the Lender's rights and remedies not only under the provisions of this Agreement but also under any other agreement or transaction shall be cumulative and not alternative or exclusive, and may be exercised by the Lender at such time or times and in such order of preference as the Lender in its sole discretion may determine.

Article 8

Miscellaneous

Section 8.1 **Severability.** If any provision of this Agreement or portion of such provision or the application thereof to any person or circumstance shall to any extent be held invalid or unenforceable, the remainder of this Agreement (or the remainder of such provision) and the application thereof to other persons or circumstances shall not be affected thereby.

Section 8.2 **Counterparts.** This Agreement may be executed in two or more counterparts, each of which shall be an original, but all of which shall constitute but one agreement.

Section 8.3 **Complete Agreement.** This Agreement and the other Loan Documents constitute the entire agreement and understanding between and among the parties hereto relating to the subject matter hereof, and supersedes all prior proposals, negotiations, agreements and understandings among the parties hereto with respect to such subject matter.

Section 8.4 **Binding Effect of Agreement.** This Agreement shall be binding upon and inure to the benefit of the respective heirs, executors, administrators, legal representatives, successors and assigns of the parties hereto, and shall remain in full force and effect (and Lender shall be entitled to rely thereon) until released in writing by Lender. Lender may transfer and assign this Agreement and deliver the Collateral to the assignee, who shall thereupon have all of the rights of Lender; and Lender shall then be relieved and discharged of any responsibility or liability with respect to this Agreement and the Collateral. Borrower may not assign or transfer any of its rights or obligations under this Agreement. Except as expressly provided herein or in the other Loan Documents, nothing, expressed or implied, is intended to confer upon any party, other than the parties hereto, any rights, remedies, obligations or liabilities under or by reason of this Agreement or the other Loan Documents.

Section 8.5 **Further Assurances.** Borrower will from time to time execute and deliver to Lender such documents, and take or cause to be taken, all such other or further action, as Lender may reasonably request in order to effect and confirm or vest more securely in Lender all rights contemplated by this Agreement and the other Loan Documents (including, without limitation, to correct clerical errors) or to vest more fully in or assure to Lender the Security Interest in the Collateral granted to Lender by this Agreement or to comply with applicable statute or law and to facilitate the collection of the Collateral (including, without limitation, the execution of stock transfer orders and stock powers, endorsement of promissory notes and instruments and notifications to obligors on the Collateral). To the extent permitted by applicable law, Borrower authorizes Lender to file financing statements, continuation statements or amendments, and any such financing statements, continuation statements or amendments may be filed at any time in any jurisdiction. Lender may at any time and from time to time file financing statements, continuation statements and amendments thereto which contain any information required by the Code for the sufficiency or filing office acceptance of any financing statement, continuation statement or amendment, including whether Borrower is an organization, the type of organization and any organization identification number issued to Borrower. Borrower agrees to furnish any such information to Lender promptly upon request. In addition, Borrower shall at any time and from time to time take such steps as Lender may reasonably request for Lender (i) to obtain an acknowledgment, in form and substance satisfactory to Lender, of any bailee having possession of any of the Collateral that the bailee holds such Collateral for Lender, and (ii) otherwise to insure the continued perfection and priority of Lender's Security Interest in any of the Collateral and the preservation of its rights therein. Borrower hereby constitutes Lender its attorney-in-fact to execute, if necessary, and file all filings required or so requested for the foregoing purposes, all acts of such attorney being hereby ratified and confirmed; and such power, being coupled with an interest, shall be irrevocable until this Agreement terminates in accordance with its terms, all Obligations are irrevocably paid in full and the Collateral is released.

Section 8.6 **Amendments and Waivers.** This Agreement may be amended and Borrower may take any action herein prohibited, or omit to perform any act herein required to be performed by it, if Borrower shall obtain Lender's prior written consent to each such amendment, action or omission to act. No course of dealing and no delay or omission on the part of Lender in exercising any right hereunder shall operate as a waiver of such right or any other right and waiver on any one or more occasions shall not be construed as a bar to or waiver of any right or remedy of Lender on any future occasion.

Section 8.7 **Terms of Agreement.** This Agreement shall continue in full force and effect so long as any Obligations or obligation of Borrower or Guarantor to Lender shall be outstanding, or Lender shall have any obligation to extend any financial accommodation hereunder, and is supplementary to each and every other agreement between Borrower and Lender and shall not be so construed as to limit or otherwise derogate from any of the rights or remedies of Lender or any of the liabilities, obligations or undertakings of Borrower under any such agreement, nor shall any contemporaneous or subsequent agreement between Borrower and Lender be construed to limit or otherwise derogate from any of the rights or remedies of Lender or any of the liabilities, obligations or undertakings of Borrower hereunder, unless such other agreement specifically refers to this Agreement and expressly so provides.

Section 8.8 **Notices.** Any notice under or pursuant to this Agreement shall be a signed writing or other authenticated record (within the meaning of Article 9 of the Code). Any notices under or pursuant to this Agreement shall be deemed duly received and effective if delivered in hand to any officer or agent of Borrower or Lender, or if mailed by registered or certified mail, return receipt requested, addressed to Borrower or Lender at the address set forth in this Agreement or as any party may from time to time designate by written notice to the other party.

Section 8.9 **Governing Law.** This Agreement and all transactions hereunder or pursuant hereto shall be governed as to interpretation, validity, effect, rights, duties and remedies of the parties thereunder and in all other respects by the laws of the state of Delaware.

Section 8.10 **Reproductions.** This Agreement and all documents which have been or may be hereinafter furnished by Borrower to Lender may be reproduced by Lender by any photographic, photostatic, microfilm, xerographic or similar process, and any such reproduction shall be admissible in evidence as the original itself in any judicial or administrative proceeding (whether or not the original is in existence and whether or not such reproduction was made in the regular course of business).

Section 8.11 **Jurisdiction and Venue.** Borrower irrevocably submits to the nonexclusive jurisdiction of any Federal or state court sitting in San Diego County California, over any suit, action or proceeding arising out of or relating to this Agreement. Borrower irrevocably waives, to the fullest extent it may effectively do so under applicable law, any objection it may now or hereafter have to the laying of the venue of any such suit, action or proceeding brought in any such court and any claim that the same has been brought in an inconvenient forum. Borrower hereby consents to any and all process which may be served in any such suit, action or proceeding, (i) by mailing a copy thereof by registered and certified mail, postage prepaid, return receipt requested, to Borrower's address shown in this Agreement or as notified to Lender and (ii) by serving the same upon Borrower in any other manner otherwise permitted by law, and agrees that such service shall in every respect be deemed effective service upon Borrower.

Section 8.12 **JURY WAIVER.** THE BORROWER AND LENDER EACH HEREBY KNOWINGLY, VOLUNTARILY AND INTENTIONALLY, AND AFTER AN OPPORTUNITY TO CONSULT WITH LEGAL COUNSEL, (A) WAIVES ANY AND ALL RIGHTS TO A TRIAL BY JURY IN ANY ACTION OR PROCEEDING IN CONNECTION WITH THIS AGREEMENT, THE OBLIGATIONS, ALL MATTERS CONTEMPLATED HEREBY AND DOCUMENTS EXECUTED IN CONNECTION HERewith AND (B) AGREES NOT TO SEEK TO CONSOLIDATE ANY SUCH ACTION WITH ANY OTHER ACTION IN WHICH A JURY TRIAL CANNOT BE, OR HAS NOT BEEN, WAIVED. THE BORROWER CERTIFIES THAT NEITHER LENDER NOR ANY OF ITS REPRESENTATIVES, AGENTS OR COUNSEL HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT LENDER WOULD NOT IN THE EVENT OF ANY SUCH PROCEEDING SEEK TO ENFORCE THIS WAIVER OF RIGHT TO TRIAL BY JURY.

In Witness Whereof the parties have entered into this Loan Agreement on the date set forth in the first paragraph hereinabove.

LENDER:

NATURAL ALTERNATIVES INTERNATIONAL, INC.,
a Delaware corporation

By: /s/Kenneth E. Wolf
Kenneth E. Wolf, President

BORROWER:

KAGED MUSCLE LLC,
a Delaware limited liability company

By: /s/Michael McClane
Michael McClane, its President

GUARANTOR:

/s/Michael McClane
Michael McClane

Exhibit A

Cognovit Promissory Note

COGNOVIT PROMISSORY NOTE

\$1,500,000.00

September 30, 2017

FOR VALUE RECEIVED, **KAGED MUSCLE LLC**, a Delaware limited liability company ("**Borrower**") with an address for purposes of this Cognovit Promissory Note (this "**Note**") at 101 Main Street, Suite 360, Huntington Beach, CA 92646, promises to pay to **NATURAL ALTERNATIVES INTERNATIONAL, INC.**, a Delaware corporation ("**Lender**"), or its order, at 1535 Faraday Avenue, Carlsbad, CA 92008, or at such other place as the holder hereof may designate, in lawful money of the United States of America, the maximum principal sum of One Million Five Hundred Thousand and No/100 Dollars (\$1,500,000.00) (the "**Principal**"), together with Interest (defined below), until paid in full in accordance with the terms, conditions and provisions as hereinafter set forth in this Note

OBLIGATION; SECURITY AGREEMENT. This Note shall evidence Borrower's indebtedness for the Loan made pursuant to that certain Loan and Security Agreement of even date herewith, entered into by and between Borrower and Lender (as it may be amended from time to time, the "**Loan Agreement**"). Interest will accrue from the date of the Loan Agreement, and the liability of the undersigned is limited to the outstanding Principal balance from time to time deemed disbursed pursuant to the Loan Agreement, plus unpaid Interest accrued on such Principal, plus any expenses or other charges as more fully provided in this Note or in the Loan Agreement. All capitalized terms in this Note shall have the same meaning as set forth in the Loan Agreement unless otherwise defined herein. In the event of a conflict between the terms of this Note and the Loan Agreement, the terms of this Note shall prevail.

APPLICABLE INTEREST RATE. Interest ("**Interest**") on the outstanding Principal balance of this Note shall accrue at the Applicable Interest Rate (as defined below). The "**Applicable Interest Rate**" means fifteen percent (15.00%) per annum compounded quarterly. Interest on this Note is computed on a 360 day basis, i.e., by applying the ratio of the annual interest rate over a year of 360 days, multiplied by the outstanding Principal balance, multiplied by the actual number of days the Principal balance is outstanding.

PRINCIPAL AND INTEREST PAYMENTS. Interest shall be due and payable quarterly, in arrears, based upon the actual number of days elapsed for that quarterly period, commencing on December 31, 2017, and shall continue to be due and payable, in arrears, on the last day of each and every calendar quarter (March, June, September, December) thereafter until the Maturity Date (as hereinafter defined).

Upon the Maturity Date, the entire unpaid obligation outstanding under this Note, the Loan Agreement, and any other "Loan Documents" as defined in the Loan Agreement shall become due and payable in full.

BORROWER UNDERSTANDS AND ACKNOWLEDGES THAT THIS NOTE DOES NOT PROVIDE FOR FULL AMORTIZATION OF THE BALANCE, AND THEREFORE, UPON THE MATURITY DATE, A BALLOON PAYMENT OF PRINCIPAL AND ACCRUED AND UNPAID INTEREST WILL BE DUE AND PAYABLE. BORROWER ALSO ACKNOWLEDGES THAT UNPAID INTEREST SHALL BE ADDED TO PRINCIPAL

QUARTERLY FROM THE DATE OF THIS NOTE AND THEREAFTER SHALL BEAR INTEREST ON A COMPOUNDED BASIS.

All payments due hereunder, including payments of Principal and/or Interest, shall be made to Lender in United States Dollars and shall be in the form of immediately available funds acceptable to the holder of this Note.

APPLICATION OF PAYMENTS. All payments received by Lender from, or for the account of, Borrower due hereunder shall be applied by Lender, in its sole and absolute discretion, in the following manner, or in any other order or manner as Lender chooses:

- a. First. To pay any and all reasonable costs, advances, expenses or fees due, owing and payable to Lender, or paid or incurred by Lender, arising from or out of this Note, the Loan Agreement, and any Loan Documents;
- b. Second. To pay any and all Interest due, owing and accrued; and
- c. Third. To pay the outstanding Principal balance of this Note.

All records of payments received by Lender shall be maintained at Lender's office, and the records of Lender shall, absent manifest error, be binding and conclusive upon Borrower. The failure of Lender to record any payment or expense shall not limit or otherwise affect the obligations of Borrower under this Note.

MATURITY DATE. On September 30, 2018 ("**Maturity Date**"), the entire unpaid Principal balance, and all unpaid accrued Interest thereon shall be due and payable without demand or notice. In the event that Borrower does not pay this Note in full on the Maturity Date then, as of the Maturity Date and thereafter until paid in full, the Interest accruing on the outstanding Principal balance hereunder shall be computed, calculated and accrued at the Default Rate (as hereinafter defined).

UNPAID INTEREST, CHARGES AND COSTS. Interest, Late Charges (defined below), reasonable costs or expenses (including, without limitation, reasonably incurred out-of-pocket attorneys' fees) that are not received by Lender within ten (10) calendar days from the date such Interest, late charges, reasonable costs, or expenses become due, shall, at the sole discretion of Lender, be added to the Principal balance and shall from the date due bear Interest at the Default Rate.

HOLIDAY. Whenever any payment to be made under this Note shall be due on a day other than a Business Day, including Saturdays, Sundays and legal holidays generally recognized by banks doing business in Delaware, then the due date for such payment shall be automatically extended to the next succeeding Business Day, and such extension of time shall in such cases be included in the computation of the Interest portion of any payment due hereunder.

NO OFFSETS OR DEDUCTIONS. All payments under this Note shall be made by Borrower without any offset, decrease, reduction or deduction of any kind or nature whatsoever, including, but not limited to, any decrease, reduction or deduction for, or on account of, any offset, present or future taxes, present or future reserves, imposts or duties of any kind or nature, that are imposed or levied by or on behalf of any government or taxing agency, body or authority by or for any municipality, state or country. If at any time, present or future, Lender shall be compelled, by any Applicable Law, rule, regulation or any other such requirement which on its face or by its application requires or establishes reserves, or payment, deduction or withholding of taxes, imposts or duties, to act such that it causes or results in a decrease, reduction or deduction (as described above) in payment received by Lender, then Borrower shall pay to Lender such additional amounts, as Lender shall deem necessary and appropriate, such that every payment received under this Note, after such decrease, reserve, reduction, deduction, payment or required withholding, shall not be reduced in any manner whatsoever.

DEFAULT. An Event of Default under the Loan Agreement shall constitute a default under this Note (hereinafter "**Default**").

Upon the occurrence of a Default hereunder, Lender shall deliver a notice (each, a "**Default Notice**") to Borrower, stating the nature of the Event of Default and demanding a cure of such Event of Default within thirty (30) days of such Default Notice. If in such case the Event of Default is not cured within such thirty (30) day period, in addition to any other rights and remedies available to Lender, Lender may, in its sole and absolute discretion, declare the entire unpaid Principal balance, together with all accrued and unpaid Interest thereon, and all other amounts and payments due hereunder, immediately due and payable, without additional notice or demand.

DEFAULT INTEREST. From and after the occurrence of any Default in this Note whether by non-payment, maturity, acceleration, non-performance or otherwise, and until such Default has been cured, all outstanding amounts under this Note (including, but not limited to, Interest, costs and late charges) shall bear Interest at a per annum rate equal to eighteen percent (18%) (the "**Default Rate**").

PREPAYMENT. Borrower shall have the right at any time to prepay the full Principal amount of this Note. Any prepayment of the Principal amount of the Note must include: (i) all accrued and unpaid Interest to and including the date of prepayment, (ii) any and all late payment fees, and (iii) all reasonable fees and expenses reasonably incurred by Lender in connection with the Loan. Any such prepayment shall not result in a reamortization, deferral, postponement, suspension, or waiver of any and all Principal or other payments due under this Note.

LATE CHARGES. Time is of the essence for all payments and other obligations due under this Note. Borrower acknowledges that if any payment required under this Note is not received by Lender in full within seven (7) business days after the same becomes due and payable, Lender will incur extra administrative expenses (i.e., in addition to expenses incident to receipt of timely payment) and the loss of the use of funds in connection with the delinquency in payment. Because, from the nature of the case, the actual damages suffered by Lender by reason of such administrative expenses and loss of the use of funds would be impracticable or extremely difficult to ascertain, Borrower agrees that a sum equal to five percent (5%) of the amount of the delinquent payment (or portion thereof), together with Interest accruing on the entire Principal balance of this Note at the Default Rate, as provided above (in either case, a "**Late Charge**"), shall be the amount of damages which Lender is entitled to receive upon Borrower's failure to make a payment of Principal or Interest (or portion thereof) when due, in compensation therefor. Therefore, Borrower shall, in such event, without further demand or notice, pay to Lender, as Lender's monetary recovery for such extra administrative expenses and loss of use of funds, liquidated damages in the amount of the Late Charge (in addition to Interest at the Default Rate), unless waived by Lender in writing. The provisions of this paragraph are intended to govern only the determination of damages in the event of a breach in the performance of Borrower to make timely payments hereunder. Nothing in this Note shall be construed as in any way giving Borrower the right, express or implied, to fail to make timely payments hereunder, whether upon payment of such damages or otherwise. The right of Lender to receive payment of such Late Charge, and receipt thereof, are without prejudice to the right of Lender to collect such delinquent payments and any other amounts provided to be paid hereunder or under any of the other Loan Documents, or to declare a default hereunder or under any of the Loan Documents.

SECURITY AND ACCELERATION. This Note is secured by, among other things, the Collateral, as set forth and defined and described in the Loan Agreement. The Loan Agreement contains, among other provisions, a provision for the immediate acceleration of this Note upon the occurrence of any Default hereunder, any Event of Default under the Loan Agreement, or upon any sale, transfer, conveyance, encumbrance and/or alienation of Borrower's right, title or interest (or any portion thereof) in the personal property described in the Loan Agreement. Reference is made to the Loan Agreement for the specific provisions thereof.

COSTS AND EXPENSES. Borrower hereby agrees to pay any and all reasonable costs or expenses paid or incurred by Lender by reason of, as a result of, or in connection with this Note, the Loan Agreement or any other Loan Documents, including, but not limited to, any and all reasonably incurred attorneys' fees and related costs whether such costs or expenses are paid or incurred in connection with the enforcement of this Note, the Loan Agreement and any of the other Loan Documents, or any of them, the protection or preservation of the Collateral or security for this Note or any other rights, remedies or interests of Lender, whether or not suit is filed. Borrower's agreement to pay any and all such reasonably incurred costs and expenses includes, but is not limited to, costs and expenses incurred in or in connection with any bankruptcy proceeding, in enforcing any judgment obtained by Lender and in connection with any and all appeals therefrom, and in connection with the monitoring of any bankruptcy proceeding and its effect on Lender's rights and claims for recovery of the amounts due hereunder, any proceeding concerning relief from the automatic stay, use of cash Collateral, proofs of claim, approval of a disclosure statement or confirmation of, or objections to confirmation of, any plan of reorganization. All such reasonably incurred costs and expenses are immediately due and payable to Lender by Borrower whether or not demand therefor is made by Lender.

WAIVERS. Except as otherwise expressly set forth in the Loan Documents, to the extent permitted under applicable law, Borrower hereby waives grace, diligence, presentment, demand, notice of demand, dishonor, notice of dishonor, protest, notice of protest, any and all exemption rights against the indebtedness evidenced by this Note and the right to plead any statute of limitations as a defense to the repayment of all or any portion of this Note, and Interest thereon, to the fullest extent allowed by law, and all compensation of cross-demands pursuant to California Code of Civil Procedure Section 431.70. No delay, omission or failure on the part of Lender in exercising any right or remedy hereunder shall operate as a waiver of such right or remedy or any other right or remedy of Lender.

MAXIMUM LEGAL RATE. This Note is subject to the express condition that at no time shall Borrower be obligated, or required, to pay Interest on the Principal balance at a rate which could subject Lender to either civil or criminal liability as a result of such rate being in excess of the maximum rate which Lender is permitted to charge. If, by the terms of this Note, Borrower is, at any time, required or obligated to pay Interest on the Principal balance at a rate in excess of such maximum rate, then the rate of Interest under this Note shall be deemed to be immediately reduced to such maximum rate and Interest payable hereunder shall be computed at such maximum rate and any portion of all prior Interest payments in excess of such maximum rate shall be applied, or shall retroactively be deemed to have been payments made, in reduction of the Principal balance, as the case may be.

AMENDMENT; GOVERNING LAW. This Note may be amended, changed, modified, terminated or canceled only by a written agreement signed by the party against whom enforcement is sought for any such action. This Note shall be governed by, and construed under, the Laws of the State of Delaware, irrespective of the application of any conflicts of laws rules.

AUTHORITY. Borrower, and each person executing this Note on Borrower's behalf, hereby represents and warrants to Lender that, by its execution below, Borrower has the full power, authority and legal right to execute and deliver this Note and that the indebtedness evidenced hereby constitutes a valid and binding obligation of Borrower without exception or limitation. In the event that this Note is executed by more than one person or entity, the liability hereunder shall be joint and several. Any married person who is obligated on this Note, directly or indirectly, agrees that recourse may be had to such person's separate property in addition to any and all community property of such person.

WAIVER OF TRIAL BY JURY. BORROWER FURTHER HEREBY WAIVES ANY RIGHT TO TRIAL BY JURY WITH RESPECT TO ANY ACTION OR PROCEEDING BROUGHT BY BORROWER, LENDER OR ANY OTHER PERSON RELATING TO (i) THE INDEBTEDNESS EVIDENCED BY THIS NOTE OR (ii) THE LOAN AGREEMENT, OR (iii) ANY OF THE OTHER LOAN DOCUMENTS. BORROWER HEREBY AGREES THAT THIS NOTE CONSTITUTES A WRITTEN CONSENT TO WAIVER OF TRIAL BY JURY AND BORROWER DOES HEREBY CONSTITUTE AND APPOINT LENDER ITS TRUE AND LAWFUL ATTORNEY- IN-FACT, WHICH APPOINTMENT IS COUPLED WITH AN INTEREST, AND BORROWER AUTHORIZES AND EMPOWERS LENDER, IN THE NAME, PLACE AND STEAD OF BORROWER, TO FILE THIS NOTE WITH THE CLERK OR JUDGE OF ANY COURT OF COMPETENT JURISDICTION AS STATUTORY WRITTEN CONSENT TO WAIVER OF TRIAL BY JURY.

SOPHISTICATED BORROWER. The Borrower represents to Lender that the Borrower and its officers, directors, members, managers and controlling persons have a "preexisting personal or business relationship" and that the Borrower, by reason of its own business and financial experience or that of its professional advisers, has the "capacity to protect its own interests in connection with the transactions" contemplated by this Note, the other Loan Documents and all other documents and agreements executed in connection therewith.

LENDER'S RIGHTS; NO WAIVER BY LENDER. The rights, powers and remedies of Lender under this Note shall be in addition to all rights, powers and remedies given to Lender under the Loan Agreement, the Loan Documents, and any other agreement or document securing or evidencing the indebtedness evidenced hereby or by virtue of any statute or rule of law, including, without limitation, the Delaware Uniform Commercial Code. All such rights, powers and remedies shall be cumulative and may be exercised successively or concurrently in Lender's sole discretion without impairing Lender's Security Interest, rights or available remedies. Any forbearance, failure or delay by Lender in exercising any right, power or remedy shall not preclude further exercise thereof, and every right, power or remedy of Lender shall continue in full force and effect until such right, power or remedy is specifically waived in a writing executed by Lender. Borrower waives any right to require the Lender to proceed against any person or to pursue any remedy in Lender's power.

MISCELLANEOUS. (a) Any notice to Borrower under this Note shall be as provided in the Loan Agreement. (b) This Note shall bind the successors and assigns of Borrower and all endorsers hereto and shall inure to the benefit of Lender, and Lender's successors and assigns.

CONFESSION OF JUDGMENT. After delivery of Default Notice as indicated above and if the Event of Default is not cured within the thirty (30) day period, Lender irrevocably authorizes and empowers any attorney-at-law (including, without limitation, any attorney who has represented or does represent the holder of this Note) to appear for it, in the name and on behalf of Lender, before any court in the State of Delaware, and through the process described in and authorized by Delaware law to render a cognovit judgment against Lender and/or any endorser, guarantor or surety, and waive process and service thereof, and without notice, confess judgment against Borrower in favor of the payee or holder, for the amount that may appear to be due hereon for Principal, Interest, damages and costs of suit, release all errors in judgments so confessed, and waive all right and benefit of appeal and stays of execution. In the event the attorney-at-law who confesses judgment hereon has represented or does represent the holder of this Note, Lender specifically waives any conflict of interest on the part of such confessing attorney and specifically consents to the payment by the holder of this Note of the legal fee of confessing attorney for confessing judgment hereon. Borrower expressly acknowledges that the within warrant of attorney is joint and several and shall be deemed a continuing warrant of attorney and shall not be extinguished or terminated by reason of its having been utilized once or more than once against Borrower, and that the within warrant of attorney shall survive the entry of any judgment hereon and shall remain in effect as long as any amounts due thereon remain unpaid. This provision and the rights herein granted shall not be affected by the dissolution or liquidation of Borrower. Borrower additionally consents to the personal jurisdiction venue of any state or federal court located in San Diego County, California including without limitation the Superior Court of the State of California in San Diego County and the U.S. District Court for the Southern District of California

"WARNING - BY SIGNING THIS PAPER YOU GIVE UP YOUR RIGHT TO NOTICE AND COURT TRIAL. IF YOU DO NOT PAY ON TIME A COURT JUDGMENT MAY BE TAKEN AGAINST YOU WITHOUT YOUR PRIOR KNOWLEDGE AND THE POWERS OF A COURT CAN BE USED TO COLLECT FROM YOU REGARDLESS OF ANY CLAIMS YOU MAY HAVE AGAINST THE CREDITOR WHETHER FOR RETURNED GOODS, FAULTY GOODS, FAILURE ON HIS PART TO COMPLY WITH THE AGREEMENT, OR ANY OTHER CAUSE."

By: /s/ Michael McClane

Michael McClane, as authorized Manager of, and
on behalf of, **KAGED MUSCLE LLC**, a Delaware limited liability company and the Borrower

**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 (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: November 13, 2017

/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.;
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 (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: November 13, 2017

/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, to such officer's knowledge, that the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2017 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 13, 2017

/s/ Mark A. LeDoux

Mark A. LeDoux, Chief Executive Officer

Date: November 13, 2017

/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.