STERLING BANCORP
Form DEF 14A
April 04, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A
(RULE 14a-101)

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE SECURITIES EXCHANGE ACT OF 1934

Filed by the Registrant x

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement
o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
x Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

STERLING BANCORP
(Name of Registrant as Specified In Its Charter)

STERLING BANCORP
(Name of Person(s) Filing Proxy Statement)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

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(1) Title of each class of securities to which transaction applies:

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(4) Proposed maximum aggregate value of transaction:

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o **Fee paid previously with preliminary materials.**

o **Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.**

(1) Amount Previously Paid:

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650 FIFTH AVENUE, NEW YORK, N.Y. 10019-6108

LOUIS J. CAPPELLI

CHAIRMAN
& CHIEF EXECUTIVE OFFICER

April 4, 2008

Dear Shareholder:

Sterling s Annual Meeting of Shareholders will be held on Thursday, May 1, 2008, at 10:45 A.M. Eastern Time, at The Fox Hollow, 7725 Jericho Turnpike, Woodbury, New York 11797, for the election of directors, ratification of the appointment of independent registered public accounting firm, and transaction of any other business as may come before the meeting. You are invited to attend this Annual Meeting.

It is important that your shares be represented at the Annual Meeting whether or not you are personally able to attend. Proxy material for the meeting accompanies this letter. You may vote your shares by using a toll free telephone number or on the Internet (see the instructions on the accompanying proxy card) or you may sign, date, and mail the proxy card in the postage paid envelope provided.

Thank you for your continued interest and support.

Sincerely,

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STERLING BANCORP
650 Fifth Avenue, New York, N.Y. 10019-6108

NOTICE OF ANNUAL MEETING

MAY 1, 2008

The Annual Meeting of Shareholders of Sterling Bancorp will be held on Thursday, May 1, 2008, at 10:45 A.M. Eastern Time, at The Fox Hollow, 7725 Jericho Turnpike, Woodbury, New York 11797, to consider and act upon the following matters:

1. Election of nine (9) directors to serve until the next Annual Meeting of Shareholders and until their successors are elected.

2. Ratification of the appointment by the Audit Committee of the Board of Directors of KPMG LLP as the Company s independent registered public accounting firm for fiscal year 2008.

3. Such other matters as may properly come before the meeting or any adjournment thereof.

The close of business on March 20, 2008 has been fixed as the record date for the meeting. Only shareholders of record at that time are entitled to notice of, and to vote at, the Annual Meeting.

IMPORTANT

We urge you to sign, date, and send in the enclosed proxy at your earliest convenience, or to vote via the toll free telephone number or via the Internet as instructed on the proxy card, whether or not you expect to be present at the meeting. Sending in your proxy or voting by telephone or on the Internet will not prevent you from voting your shares personally at the meeting, since you may revoke your proxy at any time before it is voted.

By Order of the Board of Directors

Dale C. Fredston
Corporate Secretary
April 4, 2008

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STERLING BANCORP
650 Fifth Avenue,
New York, N.Y. 10019-6108

PROXY STATEMENT

April 4, 2008

This proxy statement is furnished in connection with the solicitation of proxies by the Board of Directors of Sterling Bancorp (the Company) with respect to the Annual Meeting of Shareholders of the Company to be held on May 1, 2008. Any proxy given by a shareholder may be revoked at any time before it is voted by giving appropriate notice to the Corporate Secretary of the Company or by delivering a later dated proxy or by a vote by the shareholder in person at the Annual Meeting. Proxies in the accompanying form which are properly executed by shareholders and duly returned to the Company and not revoked will be voted for all nominees listed under Election of Directors and for ratification of the appointment of KPMG LLP as the Company s independent registered public accountants for fiscal year 2008, unless the shareholder directs otherwise, and will be voted on any other matters in accordance with the Board of Directors recommendations. This proxy statement and the accompanying form of proxy are being mailed to shareholders on or about April 4, 2008.

The outstanding shares of the Company at the close of business on March 20, 2008 entitled to vote at the Annual Meeting consisted of 17,988,970 common shares, $1 par value (the Common Shares).

The Common Shares are entitled to one vote for each share on all matters to be considered at the meeting and the holders of a majority of such shares, present in person or represented by proxy, constitute a quorum for the transaction of business at the Annual Meeting of Shareholders. Only shareholders of record at the close of business on March 20, 2008 are entitled to vote at the Annual Meeting.

1 ELECTION OF DIRECTORS

Nine directors, constituting the entire Board of Directors, are to be elected at the Annual Meeting of Shareholders to be held on May 1, 2008, to serve until the next Annual Meeting and until their respective successors have been elected. It is intended that, unless authority to vote for any nominee or all nominees is withheld by the shareholder, a properly executed and returned proxy will be voted in favor of the election as directors of the nominees named below. All nominees are members of the present Board of Directors, and were elected at the 2007 Annual Meeting of Shareholders. There is no family relationship between any of the nominees or executive officers. In the event that any of the nominees shall not be a candidate, the persons designated as proxies are authorized to substitute one or more nominees, although there is no reason to anticipate that this will occur.

Assuming the presence of a quorum, directors are elected by a plurality of the votes cast. Abstentions and broker non-votes (arising from the absence of discretionary authority on the part of a broker-dealer to vote shares held in street name for a customer) will have no effect on the election of directors.

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The information set forth below has been furnished by the nominees:

Name, Principal Occupation for Last Five Years,
Business Experience, Directorship of the Company
and of Sterling National Bank (the Bank),
a Subsidiary of the Company, and Other Information

Robert Abrams
Member, Stroock & Stroock & Lavan LLP (since 1994); former Attorney General of the State of New York (1979-1993); former Bronx Borough President (1970-1978). Mr. Abrams is 69 and has been a director of the Company since 1999.

Joseph M. Adamko*
Former Managing Director, Manufacturers Hanover Trust Co. (now J.P. Morgan Chase & Co.) (1983-1992). Mr. Adamko is 75 and has been a director of the Company since 1992.

Louis J. Cappelli*
Chairman of the Board of Directors and Chief Executive Officer of the Company (since 1992); Chairman of the Board of Directors of the Bank (since 1992). Mr. Cappelli is 77 and has been a director of the Company since 1971.

Fernando Ferrer
Co-Chairman, Fleischman-Hillard Government Relations and FH Hispania; Chairman, Poder Insurance Agency, LLC; Former President, Drum Major Institute for Public Policy (2002-2004); former Bronx Borough President (1988-2002). Mr. Ferrer is 57 and has been a director of the Company since 2002.

Allan F. Hershfield
President, Resources for the 21st Century (since 1998); former President, Fashion Institute of Technology (1992-1997). Dr. Hershfield is 76 and has been a director of the Company since 1994.

Henry J. Humphreys*
Counselor-Permanent Observer, Mission of the Sovereign Military Order of Malta to the United Nations (since 1998); former Chancellor and Chief Operating Officer, American Association of the Sovereign Military Order of Malta (1991-2000). Mr. Humphreys is 79 and has been a director of the Company since 1994.

Robert W. Lazar
Senior Advisor, Independent Bankers Association of New York State (since 2006); New York Business Development Corporation (1987-2005); President and Chief Executive Officer of Empire State Certified Development Corporation (1987-2005); President and Chief Executive Officer of Statewide Zone Capital Corporation (1999-2005). Mr. Lazar is 64 and has been a director of the Company since 2005.

John C. Millman*
President of the Company (since 1992); President and Chief Executive Officer of the Bank (since 1987). Mr. Millman is 65 and has been a director of the Company since 1988.

Eugene T. Rossides*
Retired Senior Partner, Rogers & Wells LLP (now Clifford Chance US LLP) (1973-1993); former Assistant Secretary, United States Treasury Department (1969-1973). Mr. Rossides is 80 and has been a director of the Company since 1989.

* Member of the Executive Committee.

Each nominee is currently a director of the Bank.

Walter Feldesman, Esq., has served the Company as a director since 1975. After more than 33 years of dedicated service, he will not stand for re-election at the 2008 Annual Meeting. Mr. Feldesman has been Senior Counsel to Thelen Reid Brown Raysman & Steiner LLP since 2002. At the recommendation of the Corporate Governance and Nominating Committee, the Board of Directors has elected Mr. Feldesman as Honorary Director, to serve at the pleasure of the Board of Directors beginning at the end of his term at the 2008 Annual Meeting of Shareholders.

Accordingly, the Board of Directors has determined that the number of Directors to be elected at the Annual Meeting shall be nine.

Reference is made to Security Ownership of Directors and Executive Officers and Certain Beneficial Owners on page 24 for information as to the nominees holdings of the Company s equity securities.

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EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Overview

The Company s Compensation Committee (the Committee) establishes and implements the Company s compensation program for the named executive officers. The Committee also monitors how the Company follows that program, and how the program fits the Company s compensation philosophy. Throughout this proxy statement, the individuals included in the Summary Compensation Table on page 8, are referred to as the named executive officers .

Compensation Philosophy and Objectives

The Company believes that the most effective executive compensation program rewards the achievement of annual, long-term, and strategic goals. The Company believes that appropriate compensation should align the executives interests with those of the stockholders by rewarding performance, with the ultimate objective of improving stockholder value. To that end, the Committee believes executive compensation packages for named executive officers should include both cash compensation primarily designed to reward performance as measured against established goals and stock-based compensation that promotes an ownership mentality among key executives. The Committee evaluates compensation to ensure that the Company maintains its ability to attract and retain highly qualified and effective employees in key positions and that compensation provided to key employees remains competitive relative to the compensation paid to similarly situated executives.

The Committee believes that the most important factors in measuring the performance of its executive officers are improvement in the Company s net income, return on average equity, and growth in average loans, deposits, and customer repurchase agreements. The focus of the Company s strategic plan is on the growth of net income, average loans, deposits, and customer repurchase agreements. It is the Committee s view that, in order to generate net income improvement, the Company should achieve growth in average loans and in deposits and customer repurchase agreements, among other initiatives. Growth in average loans is intended generally to produce improvement in interest income. Growth in average deposits and customer repurchase agreements, depending upon the mix of deposits and customer repurchase agreements, is intended generally to impact interest expense in a lesser amount than the improvement in interest income. The Committee endeavors to set targets relating to these factors that are weighted in their importance to the Company and that are attainable but challenging to achieve.

At the core of the Company s compensation philosophy is the guiding belief that compensation should be directly linked to performance. This philosophy has guided many compensation-related decisions.

A substantial portion of executive officer compensation is contingent on, and varies with, the achievement of corporate and/or individual performance objectives.

Total compensation is higher for individuals with greater responsibility and greater ability to influence the Company s achievement of targeted results and strategic initiatives.

As position and responsibility increases, a greater portion of the executive officer s total compensation is performance-based pay contingent on the achievement of performance objectives.

The Compensation Setting Process

The Committee makes all compensation decisions for the Chief Executive Officer and the President, Messrs. Cappelli and Millman, and approves recommendations regarding equity awards to all other officers of the Company. The Chief Executive Officer and the President make recommendations regarding the non-equity compensation of other named executive officers, which are subject to the Committee s review and approval.

In the first quarter of each fiscal year, the Committee meets in executive session to evaluate the performance of the Chief Executive Officer and the President for the prior year, to determine their bonuses payable under the Key Executive Incentive Bonus Plan (Incentive Plan) based on, among other things, financial results for the prior fiscal year, to establish their Incentive Plan performance objectives for the current fiscal year, to set their base salaries for the next calendar year, to review the term of their employment agreements, and to consider and approve

any equity grants awarded to them. As part of establishing individual and corporate performance objectives for the year, the Committee engages in a dialogue with the Chief Executive Officer concerning strategic objectives and performance targets, reviews the appropriateness of the financial measures used in incentive plans, and considers the degree of difficulty in achieving specific performance targets.

Together with the performance objectives, the Committee establishes targeted incentive bonus levels (i.e., maximum achievable compensation) for each of the Chief Executive Officer and the President. In making this determination, the Committee is guided by the compensation philosophy described above. The Committee also considers historical compensation levels, competitive pay practices at the companies in the Company s peer group, and the relative compensation levels among the Company s named executive officers. The Committee may also consider industry conditions, corporate performance versus the peer group of companies, and the overall effectiveness of the compensation program in achieving desired performance levels.

Compensation decisions are generally made in the first quarter of the fiscal year, although the compensation planning process neither begins nor ends with any particular Committee meeting. Compensation decisions are designed to promote the Company s fundamental business objectives and strategy. Business and strategic planning, evaluation of management performance, and consideration of changes in the business environment are year-round processes.

The Company s management plays a significant role in the compensation setting process for the named executive officers other than that of the Chief Executive Officer and the President. The most significant aspects of management s role in the compensation setting process are evaluating employee performance of the named executive officers, other than that of the Chief Executive Officer and the President, and recommending business performance goals and objectives, salary levels, bonuses, and option awards.

The Chief Executive Officer and the Chief Financial Officer work with the Committee chair in establishing the agenda for Committee meetings. At the request of the Committee, management also prepares meeting information for each Committee meeting. The Chief Executive Officer also participates in Committee meetings at the Committee s request.

Committee Advisors

The Committee has the authority to hire and terminate any independent compensation consultants or advisors and approve their compensation. These consultants and advisors are engaged on behalf of the Committee and paid by the Company.

In 2008, the Committee engaged Total Compensation Solutions, LLC (TCS) to design a comparison group of companies based on asset size, geography, and similarity of business model. TCS is a consulting firm with expertise in executive compensation and benefits specializing in, among other areas, financial institutions including banks and thrifts. The company that had provided similar services to the Company in 2007 no longer provides such services. TCS will not do any compensation work for the Company except as authorized by the Committee. The Committee directed the Chief Financial Officer to coordinate with TCS and to provide any requested information to enable TCS to report to the Committee with the requested peer group compensation data. TCS provided a research report to the Committee regarding compensation at those companies.

Benchmarking

The Company and the Committee do not believe that it is appropriate to establish compensation levels solely based on benchmarking. The Company and the Committee do believe that reviewing other companies pay practices helps make sure that the Company pays reasonably and competitively.

The Committee reviews compensation levels for the Chief Executive Officer against compensation levels at the companies in the peer group identified by TCS. The current peer group includes financial institutions located near a major metropolitan area in the Northeastern states with total assets between $1.0 and $6.0 billion and/or having a similar business model to the Company s.

Compensation should be Reasonable and Responsible

It is essential that the Company s overall compensation levels be sufficiently competitive to attract and retain talented executives and motivate those executives to achieve superior results. At the same time, the Company and the Committee believe that compensation should be set at responsible levels. The Company s executive compensation programs are intended to be consistent with the Company s constant focus on controlling costs.

Performance-Based Incentive Compensation

The Incentive Plan is designed to provide incentive compensation for designated key executives of the Company that is directly related to the performance of the Company and of such employees. The Incentive Plan was first adopted by the Board of Directors in 2001 and approved by shareholders at the 2001 Annual Meeting of Shareholders, and was re-approved by the Company s stockholders at the 2006 Annual Meeting of Shareholders.

The purpose of the Incentive Plan is to ensure that bonus payments made to certain key executive employees will be tax deductible to the Company under the Internal Revenue Code (the Code). Section 162(m) of the Code generally does not allow publicly held companies to obtain tax deductions for compensation of more than $1 million paid in any year to certain executive officers unless such payments are performance-based in accordance with the conditions specified under Section 162(m) and the related Treasury Regulations. The Committee, however, reserves the right to pay discretionary bonuses to named executive officers that are not deductible under Section 162(m) of the Code. The maximum bonus award payable to any single named executive officer participating in the Incentive Plan that is intended to qualify for the performance-based compensation exception to Section 162(m) of the Code is $2.0 million.

Incentive Awards and Performance Goals for Chief Executive Officer and the President. Under the terms of the Incentive Plan, the Committee has the authority to establish performance goals each year based on certain objective performance criteria set forth in the Incentive Plan. The Committee will establish for each performance period a maximum award and goals relating to the Company, subsidiary, divisional, departmental, and/or functional performance for each participant (the Performance Goals) within the time frame permitted under Section 162(m) of the Code (the first 90 days of the Company s fiscal year) and communicate such Performance Goals to each participant. Participants will earn bonus awards based only upon the attainment of the applicable Performance Goals during the applicable performance period.

The Performance Goals for Messrs. Cappelli and Millman are based on attainment of specific levels of performance of the Company with reference to one or more of the following criteria:

(i) Average total loans

(ii) Average deposits and customer repurchase agreements

(iii) Net income

(iv) Return on average assets

(v) Return on average equity

For each fiscal year, the Committee establishes Performance Goals for each criterion identified above based upon the Company s average performance over the immediately preceding five years. To establish each Performance Goal, the average for each Performance Goal over the immediately preceding five years is multiplied by a target growth percentage determined by the Committee based upon the Company s strategic plan for the year. The Committee then

allocates performance points for each Performance Goal based upon the Committee s determination of the relative importance of each Performance Goal. The allocation of performance points to each Performance Goal can change from year to year. The Committee also establishes a maximum bonus for each participant for the applicable year.

Incentive Awards and Performance Goals for Other Named Executive Officers. For named executive officers other than the Chairman and the President, the Company uses a bonus system that evaluates the officer s performance. The amount of the bonus award is based in part on the Company s financial performance for the year relative to past performance. The Chairman and the President recommend bonus awards for the other named executive officers to the Committee for approval.

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Determination of Performance Levels and Award Amounts. As soon as practicable following the end of each fiscal year, the Committee evaluates the attainment of the Performance Goals, based upon information supplied by management of the Company, and calculates the bonus award, if any, payable to each participant. If any one of the Performance Goals for the year is attained, a bonus up to the maximum established at the beginning of the year may be paid. In determining the actual amount of bonus paid the Committee also evaluates at its discretion such other criteria as corporate responsibilities, overall management and achievement, including the initiation and implementation of successful business strategies, leadership, formation of an effective management team, personal qualities, and other factors. Bonus awards are paid in a lump sum cash payment as soon as practicable after the Committee determines the awards.

If the Committee determines that a change in the business, operations, corporate structure or capital structure of the Company, or the manner in which it conducts its business, or other events or circumstances, render the performance criteria to be unsuitable, the Committee may modify such performance criteria or the related minimum acceptable level of achievement, as the Committee deems appropriate or equitable. No such modification shall be made if the effect would be to cause a bonus award to fail to qualify as performance-based compensation under Section 162(m) of the Code. The Committee also retains the right in its discretion to reduce any bonus award and to pay bonuses not covered by the Incentive Plan.

Equity Compensation

The Company s stockholders approved the Stock Incentive Plan (SIP) at the 1992 Annual Meeting of Shareholders, with amendments approved by shareholders at the various Annual Meetings of Shareholders between 1995 and 2002. The SIP is intended to strengthen the Company s ability to attract and retain directors and employees of high competence and to increase the identity of interest of such directors and employees with those of the Company s shareholders. Under the SIP, the Committee may grant awards in the form of Incentive Stock Options (ISOs), within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the Code), Non-Qualified Stock Options (NQSOs), Stock Appreciation Rights, Restricted Stock, or a combination of these forms of awards.

On March 15, 2007, the Board of Directors granted non-qualified stock options under the SIP to certain officers at $17.99 per share, the closing price on March 15, 2007. Messrs. Applebaum and Robinson were the only named executive officers who were granted such options. The options become vested and exercisable five years after the date of grant. No other awards were made under the SIP in 2007. The exercise price for all options granted is based on the closing price on the date of the grant. The Committee generally considers stock option awards in the annual compensation review process. In making recommendations of stock awards, the Committee considers the impact of the expense of such awards on the Company.

Retirement Plans

Qualified Plan. The Sterling Bancorp/Sterling National Bank Employees Retirement Plan (the qualified plan) is a defined benefit plan that covers eligible employees of Sterling Bancorp and Sterling National Bank and certain of its subsidiaries, who were hired prior to January 1, 2006. The qualified plan gives credit for credited service under terminated predecessor plans but provides, in substance, for a participant s vested benefits under such plans to be offset against the benefits to be provided to the participant under the qualified plan. Accordingly, the retirement benefits for a continuing employee can be determined simply by reference to the provisions of the qualified plan. An employee becomes eligible for participation in the qualified plan upon the attainment of age 21 and the completion of one year of service. All contributions required by the qualified plan are made by the employers and no employee contributions are required or permitted.

Supplemental Plan. The Internal Revenue Code imposes compensation and benefit limits on the retirement benefits payable to highly compensated employees under a qualified plan. The Company has a Supplemental Executive Retirement Plan for designated employees (the SERP), which provides for supplemental retirement payments to such persons in amounts equal to the difference between retirement benefits such persons actually receive under the qualified plan and the amount such individuals would have received if such Internal Revenue Code limitations were not in effect.

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Employment Contracts and Change in Control Agreements

The Company has agreements with Messrs. Cappelli and Millman providing for employment terms extending until December 31, 2012 and December 31, 2010, respectively. In addition to providing an annual base salary, a discretionary annual bonus as determined by the Committee, and allowing participation in the health and benefit plans available to other executives of the Company, these agreements contain severance provisions and change in control provisions. These agreements were entered into upon the recommendation of the Board s Committee in 1993, and approved by the Board of Directors. They were amended and restated in 2002 and were further amended, solely to extend the term by one additional year, in February 2003, February 2004, March 2005, March 2006, March 2007, and March 2008.

The Company has change in control severance agreements with certain other officers, including Messrs. Tietjen and Applebaum, providing for severance payments if the officer is terminated by the Company without cause or by the executive for good reason (which includes notice by the executive of termination within 30 days of the first anniversary of a change in control) within two years following a change in control. The Company has change in control severance and retention agreements with certain other officers, including Mr. Robinson. Upon the commencement of a transaction that could result in a change in control, Mr. Robinson agrees that he will not voluntarily leave the employ of the Company, other than for good reason, until such change in control occurs or such action is terminated or abandoned.

The employment and the change in control agreements provide for the payment of severance in the event of certain terminations and/or in connection with a change in control. A change in control means such events as the acquisition of more than 20% of the outstanding common shares of the Company unless directly from the Company, a reorganization, merger or consolidation of the Company, or the sale or disposition of all or substantially all of the assets of the Company. To retain the executive officers and ensure that executive officers can act in the best interests of the Company without distraction due to their personal employment situation, the Committee determined that certain severance payments were appropriate in the event of a change in control.

These severance arrangements are discussed in detail in Potential Payments upon Termination or Change in Control, beginning on page 13 of this proxy statement.

Perquisites and Other Personal Benefits

The Company provides the named executive officers with benefits that the Company and the Committee believe are reasonable and consistent with its overall compensation program. The Company and the Committee believe that these benefits are beneficial to the Company in attracting and retaining qualified executives.

Tax and Accounting Implications

In determining executive compensation, the Committee takes into consideration the deductibility of executive compensation under Section 162(m) of the Code that provides that the Company may not deduct compensation of more than $1,000,000 that is paid to certain individuals. The Company believes that the compensation paid to the named executive officers for 2007 was fully deductible for federal income tax purposes.

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SUMMARY COMPENSATION TABLE

and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)(1)	Option Awards ($)(1)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earning ($)(2)	All Other Compensation ($)(3)	Tot ($
. Cappelli	2007	770,270				450,000	1,444,020	39,665	2,70
an of the Board, and	2006	745,555		18,339		500,000	1,504,526	37,541	2,80
Executive Officer,									
g Bancorp									
an of the Board,									
g National Bank									
. Millman	2007	476,909				194,000	437,788	156,727	1,26
nt,	2006	461,607		3,668		215,000	510,640	103,662	1,29
g Bancorp									
nt and Chief Executive									
,									
g National Bank									
7. Tietjen	2007	249,500	45,500				102,781	38,110	43
ive Vice President and	2006	239,500	50,600				146,977	30,237	46
Financial Officer,									
g Bancorp									
ive Vice President,									
g National Bank									
d M. Applebaum	2007	290,000	59,000		38,000		47,134	36,890	47
Vice President,	2006	240,000	65,500				61,105	22,124	38
g Bancorp									
ive Vice President,									
g National Bank									
. Robinson	2007	260,500	41,100		38,000		67,324		40
ive Vice President,	2006	250,500	45,700				91,079		38
g National Bank									

(1) These columns reflect the financial statement expense recognized for the grant of stock awards and stock options, computed in accordance with FAS 123R, using the methods and assumptions described in Note 16 of the financial statements filed with the Company s Form 10-K for fiscal year 2007.

(2) This amount is comprised solely of the change in actuarial present value of the named executive officers accumulated benefits under all defined benefit plans, using the assumptions described in Note 17 of the financial statements filed with the Company s Form 10-K for fiscal year 2007.

(3) Amounts in this column reflect life insurance premiums. The amount for Mr. Millman includes $13,000 of incremental cost for the personal use of a corporate car. Pursuant to their employment contracts, Messrs. Cappelli and Millman are entitled to the use of an automobile for business use, and in the case of Mr. Cappelli, the use of a driver for business purposes. Messrs. Cappelli and Millman are entitled to reimbursement for ordinary and necessary business expenses, memberships and use of clubs as a source of business origination and maintenance of customer relationships for the Company, and travel and entertainment incurred in the performance of their duties. Since the club memberships are used only for business entertainment, the Company does not consider the cost of the memberships to be perquisites. For business purposes, Mr. Cappelli has the use of an apartment located near the Company s headquarters (which costs the Company about $46,000 annually). While he may occasionally make personal use of the apartment, there is no incremental cost to the Company. The incremental cost of Mr. Cappelli s perquisites in 2007 (consisting of personal use of the car and driver) was less than $10,000.

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2007 Executive Compensation Components

For the fiscal year ended December 31, 2007, the principal components of compensation for named executive officers were:

base salary;

2		(1)	(1)		
Foreign exchange (loss) gain		(45)	(137)	158	(241)
Other, net		(6)	1,611	(21)	1,601
		57	1,502	494	1,441
Income before income taxes		1,050	4,607	8,136	9,009
Provision for income taxes		305	1,584	2,435	2,905
Net income	$	745	$3,023	$5,701	$6,104
Unrealized (loss) gain resulting from change in fair value of derivative instruments, net of tax		(451)	(473)	401	(199)
Comprehensive income	$	294	$2,550	$6,102	$5,905
Net income per common share:					
Basic	$	0.11	$0.46	$0.87	$0.94
Diluted	$	0.11	$0.46	$0.86	$0.92
Weighted average common shares outstanding:					
Basic		6,581,632	6,510,902	6,569,165	6,513,821
Diluted		6,613,955	6,562,577	6,648,091	6,628,883

See accompanying notes to condensed consolidated financial statements.

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NATURAL ALTERNATIVES INTERNATIONAL, INC.

Condensed Consolidated Statements Of Cash Flows

(In thousands)

(Unaudited)

	Nine Months Ended March 31, 2017	2016
Cash flows from operating activities		
Net income	$5,701	$6,104
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,711	1,364
Non-cash compensation	729	463
Pension expense	149	38
Gain on disposal of assets	(23)	(1,848)
Deferred taxes	-	645
Changes in operating assets and liabilities:		
Accounts receivable	5,298	(2,473)
Inventories, net	4,802	(7,164)
Prepaids and other assets	182	380
Accounts payable and accrued liabilities	(8,579)	3,514
Income taxes	(291)	749
Accrued compensation and employee benefits	(1,813)	588
Net cash provided by operating activities	7,866	2,360
Cash flows from investing activities		
Purchases of property and equipment	(4,332)	(6,959)
Proceeds from sale of property and equipment	24	3,000
Net cash used in investing activities	(4,308)	(3,959)
Cash flows from financing activities		
Repurchase of common stock	(712)	(648)
Net cash used in financing activities	(712)	(648)
Net increase (decrease) in cash and cash equivalents	2,846	(2,247)
Cash and cash equivalents at beginning of period	19,747	18,551
Cash and cash equivalents at end of period	$22,593	$16,304
Supplemental disclosures of cash flow information		
Cash paid during the period for:		

Interest	$-	$-
Taxes	$2,761	$1,929
Disclosure of non-cash activities:		
Change in unrealized gain (loss) resulting from change in fair value of derivative instruments, net of tax	$401	$(199)

See accompanying notes to condensed consolidated financial statements.

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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 and nine months ended March 31, 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, 2016 ("2016 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 2016 Annual Report unless otherwise noted below.

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 account for the additional weighted average shares of common stock outstanding for our diluted net income per common share computation. We calculated basic and diluted net income per common share as follows (in thousands, except per share data):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2017	**2016**	**2017**	**2016**
Numerator				
Net income	$745	$3,023	$5,701	$6,104
Denominator				
Basic weighted average common shares outstanding	6,582	6,511	6,569	6,514

Dilutive effect of stock options	32	52	79	115
Diluted weighted average common shares outstanding	6,614	6,563	6,648	6,629
Basic net income per common share	$0.11	$0.46	$0.87	$0.94
Diluted net income per common share	$0.11	$0.46	$0.86	$0.92

No shares related to stock options were excluded for the three or nine months ended March 31, 2017 and March 31, 2016.

Revenue Recognition

To recognize revenue, four basic criteria must be met: (1) there is evidence that an arrangement 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 delivery is deferred until the shipment has been delivered.

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 product 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.

We currently own certain U.S. patents, and each patent's corresponding foreign patent applications. All of these patents and patent rights relate to the ingredient known as beta-alanine marketed and sold under the CarnoSyn® and SR Carnosyn® trademarks. We recorded royalty and licensing income as a component of revenue in the amount of $6.6 million during the three months ended March 31, 2017 and $20.0 million during the nine months ended March 31, 2017. We recorded beta-alanine raw material sales and royalty and licensing income as a component of revenue in the amount of $5.5 million during the three months ended March 31, 2016 and $16.1 million during the nine months ended March 31, 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 its patent rights. We recognized royalty expense as a component of cost of goods sold in the amount of $233,000 during the three months ended March 31, 2017 and $799,000 during the nine months ended March 31, 2017. We recognized royalty expense as a component of cost of goods sold in the amount of $193,000 during the three months ended March 31, 2016 and $666,000 during the nine months ended March 31, 2016.

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 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 in the period 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.

On March 28, 2017, the Board of Directors approved the grant of 140,000 shares of restricted stock to the members of our Board of Directors and certain key members of our management team pursuant to our 2009 Omnibus Incentive Plan. On March 23, 2016, the Board of Directors approved the grant of 130,000 shares of restricted stock to the members of our Board of Directors and certain key members of our management team pursuant to our 2009 Omnibus Incentive Plan. These restricted stock grants will vest over three years and the unvested shares cannot be sold or otherwise transferred and the rights to receive dividends, if declared by our Board of Directors, are forfeitable until the shares become vested.

Our net income included stock based compensation expense of approximately $223,000 for the three months ended March 31, 2017 and approximately $729,000 for the nine months ended March 31, 2017. Our net income included stock based compensation expense of approximately $183,000 for the three months ended March 31, 2016 and approximately $463,000 for the nine months ended March 31, 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 at the measurement date. We use a three-level hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs are inputs that reflect our assumptions about the inputs that market participants would use in pricing the asset or liability and are developed based on the best information available under the circumstances.

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

As of March 31, 2017 and June 30, 2016, we did not have any financial assets or liabilities classified as Level 1. We classify derivative forward exchange contracts as Level 2 assets. The fair value of our forward exchange contracts as of March 31, 2017 was a net asset of $1.1 million. The fair value of our forward exchange contracts as of June 30, 2016 was a net asset of $250,000. As of March 31, 2017 and June 30, 2016, 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 2016 or the three and nine month periods ended March 31, 2017.

B. Inventories, net

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

	March 31, 2017	**June 30, 2016**
Raw materials	$10,043	$14,751
Work in progress	3,019	3,487
Finished goods	3,014	2,832
Reserves	(110)	(302)
Inventories, net	$15,966	$20,768

C. Property and Equipment, net

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

	Depreciable Life In Years	**March 31, 2017**	**June 30, 2016**
Land	N/A	$1,200	$1,200
Building and building improvements	7 – 39	3,675	3,324
Machinery and equipment	3 – 12	24,450	23,846
Office equipment and furniture	3 – 5	3,749	2,994
Vehicles	3	209	209
Leasehold improvements	1 – 15	17,008	15,261
Total property and equipment		50,291	46,834
Less: accumulated depreciation and amortization		(32,503)	(31,667)
Property and equipment, net		$17,788	$15,167

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D. Accumulated Other Comprehensive (Loss) Income

Accumulated other comprehensive (loss) income (“OCL” and “OCI”) consisted of the following during the three and nine months ended March 31, 2017 and March 31, 2016 (dollars in thousands):

	Three Months Ended March 31, 2017		
	Defined Benefit Pension Plan	**Unrealized Gains (losses) on Cash Flow Hedges**	**Total**
Beginning balance	$(775)	$ 947	$172
OCI/OCL before reclassifications	—	(322)	(322)
Amounts reclassified from OCI	—	(383)	(383)
Tax effect of OCI activity	—	254	254
Net current period OCI/OCL	—	(451)	(451)
Ending balance	$(775)	$ 496	$(279)

	Nine Months Ended March 31, 2017		
	Defined Benefit Pension Plan	**Unrealized Gains (Losses) on Cash Flow Hedges**	**Total**
Beginning balance	$(775)	$ 95	$(680)
OCI/OCL before reclassifications	—	1,512	1,512
Amounts reclassified from OCI	—	(884)	(884)
Tax effect of OCI activity	—	(227)	(227)
Net current period OCI/OCL	—	401	401
Ending balance	$(775)	$ 496	$(279)

	Three Months Ended March 31, 2016		
	Defined Benefit Pension Plan	Unrealized Gains (Losses) on Cash Flow Hedges	Total
Beginning balance	$(643)	$ 151	$(492)
OCI/OCL before reclassifications	—	(613)	(613)
Amounts reclassified from OCI	—	(120)	(120)
Tax effect of OCI activity	—	260	260
Net current period OCI/OCL	—	(473)	(473)
Ending balance	$(643)	$ (322)	$(965)

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	Nine Months Ended March 31, 2016		
	Defined Benefit Pension Plan	Unrealized Gains (Losses) on Cash Flow Hedges	Total
Beginning balance	$(643)	$ (123)	$(766)
OCI/OCL before reclassifications	—	(131)	(131)
Amounts reclassified from OCI	—	(178)	(178)
Tax effect of OCI activity	—	110	110
Net current period OCI/OCL	—	(199)	(199)
Ending balance	$(643)	$ (322)	$(965)

During the three months ended March 31, 2017, the amounts reclassified from OCI were comprised of $278,000 of gains reclassified to net revenues and $106,000 related to the amortization of forward points reclassified to other income. During the nine months ended March 31, 2017, the amounts reclassified from OCI were comprised of $549,000 of gains reclassified to net revenues and $336,000 related to the amortization of forward points reclassified to other income.

During the three months ended March 31, 2016, the amounts reclassified from OCI were comprised of $118,000 of gains reclassified to net revenues and $2,000 related to the amortization of forward points reclassified to other income. During the nine months ended March 31, 2016, the amounts reclassified from OCI were comprised of $125,000 of gains reclassified to net revenues and $53,000 related to the amortization of forward points reclassified to other income.

E. Debt

On March 28, 2017, we executed an amendment to our credit facility with Wells Fargo Bank, N.A. to extend the maturity date for our working line of credit from January 31, 2019 to February 1, 2020. The Credit Agreement provides us with a credit line of up to $10.0 million. The line of credit may be used to finance working capital requirements. There was no commitment fee required as part of this amendment. 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. 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, 2017.

On March 31, 2017, we were in compliance with all of the financial and other covenants required under the Credit agreement.

We did not use our working capital line of credit nor did we have any long-term debt outstanding during the nine months ended March 31, 2017. As of March 31, 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 (dollars in thousands):

	Three Months Ended March 31,		**Nine Months Ended March 31,**	
	2017	**2016**	**2017**	**2016**
	Net Sales by Customer	**Net Sales by Customer**	**Net Sales by Customer**	**Net Sales by Customer**
Customer 1	$11,046	$ 13,023	$43,198	$ 31,714
Customer 2	(a)	3,367	(a)	9,705
Customer 3	(a)	3,196	(a)	(a)
	$11,046	$ 19,586	$43,198	$ 41,419

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

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 (dollars in thousands):

	Three Months Ended March 31,				**Nine Months Ended March 31,**			
	2017		**2016**		**2017**		**2016**	
	Raw Material Purchases by Supplier	**% of Total Raw Material Purchases**	**Raw Material Purchases by Supplier**	**% of Total Raw Material Purchases**	**Raw Material Purchases by Supplier**	**% of Total Raw Material Purchases**	**Raw Material Purchases by Supplier**	**% of Total Raw Material Purchases**
Supplier 1	$1,683	16 %	(a)	(a)	(a)	(a)	(a)	(a)
Supplier 2	1,646	16	(a)	(a)	(a)	(a)	(a)	(a)
Supplier 3	1,317	13	(a)	(a)	(a)	(a)	(a)	(a)
	$4,646	45 %	(a)	(a)	(a)	(a)	(a)	(a)

(a) 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. The two segments are identified as (i) private label contract manufacturing, which primarily relates to the provision of private label contract manufacturing services to companies that market and distribute nutritional supplements and other health care products, and (ii) patent and trademark licensing, which primarily includes direct raw material sales and royalty income from our license and supply agreements associated with the sale and use of beta-alanine under our CarnoSyn® 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 include, but are not limited to: human resources, corporate legal, finance, information technology, and other corporate level related expenses, which are not allocated to any segment. 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 2016 Annual Report.

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

	Three Months Ended March 31,		**Nine Months Ended March 31,**	
	2017	**2016**	**2017**	**2016**
Net Sales				
Private label contract manufacturing	$18,544	$24,493	$69,787	$62,377
Patent and trademark licensing	6,591	5,513	19,974	16,125
	$25,135	$30,006	$89,761	$78,502

	Three Months Ended March 31,		**Nine Months Ended March 31,**	
	2017	**2016**	**2017**	**2016**
Income from Operations				
Private label contract manufacturing	$749	$2,915	$6,182	$7,518
Patent and trademark licensing	1,786	1,750	6,026	4,440
Income from operations of reportable segments	2,535	4,665	12,208	11,958
Corporate expenses not allocated to segments	(1,542)	(1,560)	(4,566)	(4,390)
	$993	$3,105	$7,642	$7,568

	March 31, 2017	**June 30, 2016**
Total Assets		
Private label contract manufacturing	$58,867	$66,375
Patent and trademark licensing	11,120	7,800
	$69,987	$74,175

Our private label contract manufacturing products are sold both in the U.S. and in markets outside the U.S., including Europe, Australia, Asia, 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. and our branded products were only sold in

the U.S.

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

	Three Months Ended March 31,		**Nine Months Ended March 31,**	
	2017	**2016**	**2017**	**2016**
Net Sales				
United States	$14,605	$13,374	$43,484	$38,665
Markets outside the United States	10,530	16,632	46,277	39,837
	$25,135	$30,006	$89,761	$78,502

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Products manufactured by NAIE accounted for approximately 62% of consolidated net sales in markets outside the U.S. for the three months ended March 31, 2017 and 57% for the three months ended March 31, 2016. Products manufactured by NAIE accounted for 55% of consolidated net sales in markets outside the U.S. for the nine months ended March 31, 2017 and 67% for the nine months ended March 31, 2016. No products manufactured by NAIE were sold in the U.S. during the nine months ended March 31, 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 Nine Months Ended**	
	March 31, 2017	**June 30, 2016**	**March 31, 2017**	**June 30, 2016**	**March 31, 2017**	**March 31, 2016**
United States	$10,827	$9,678	$45,599	$49,755	$2,090	$5,004
Europe	6,961	5,489	24,388	24,420	2,242	1,955
	$17,788	$15,167	$69,987	$74,175	$4,332	$6,959

H. Income Taxes

The effective tax rate for the three months ended March 31, 2017 was an expense of 29.0% and the effective tax rate for the nine months ended March 31, 2017 was an expense of 29.9%. 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 and nine months ended March 31, 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 and nine months ended March 31, 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 in income 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, 2013 and forward are subject to examination by the U.S. tax authorities and our years for the fiscal year ended June 30, 2008 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 Swiss 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. Currently 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 nine months ended March 31, 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. When we do so we may purchase the shares in open market or privately negotiated transactions.

During the nine months ended March 31, 2017, we purchased 39,547 shares under this plan at a weighted average cost of $8.74 per share and a total cost of $345,000 including commissions and fees. During the nine months ended March 31, 2016, we purchased 52,603 shares under this plan at a weighted average cost of $6.26 per share and a total cost of $329,000 including commissions and fees.

During the nine months ended March 31, 2017, we acquired 38,729 shares from employees in connection with restricted stock that vested during the year. During the nine months ended March 31, 2016, we acquired 27,195 shares from employees in connection with restricted stock that vested during the year. 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 amount of shares returned to the Company was calculated based on the closing price on the date the shares vested.

Unvested restricted stock grants that are forfeited are returned to treasury stock. During the nine months ended March 31, 2017, employees forfeited 7,000 shares of unvested restricted stock grants. During the nine months ended March 31, 2016, employees forfeited 2,667 shares of unvested restricted stock grants.

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 March 31, 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 February 2018. 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 March 31, 2017, we recorded a $97,000 gain related to the ineffective portion of our hedging instruments to other income. During the nine months ended March 31, 2017, we recorded a $189,000 gain related to the ineffective portion of our hedging instruments to other income. We did not have any losses or gains related to the ineffective portion of our hedging instruments during the three and nine months ended March 31, 2016. 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 March 31, 2017, the notional amounts of our foreign exchange contracts designated as cash flow hedges were approximately $23.1 million (EUR 20.4 million). As of March 31, 2017, a net gain of approximately $776,000 related to derivative instruments designated as cash flow hedges was recorded in OCI. It is expected that a majority of the OCI balance will be reclassified into earnings in the next 12 months along with the earnings effects of the related forecasted transactions.

As of March 31, 2017, the fair value of our cash flow hedges was a net asset of $1.1 million, which was classified as prepaids and other current assets in our Condensed Consolidated Balance Sheets. During the three months ended March 31, 2017 we recognized $322,000 of losses in OCI and reclassified $278,000 of gains from OCI to revenue. During the nine months ended March 31, 2017 we recognized $1.5 million of gains in OCI and reclassified $549,000 of gains from OCI to revenue. As of June 30, 2016, $226,000 of the fair value of our cash flow hedges was classified in prepaids and other current assets in our Consolidated Balance Sheets. During the three months ended March 31, 2016 we recognized $118,000 of gains in OCI and reclassified $2,000 of gains from OCI to revenue. During the nine months ended March 31, 2016 we recognized $125,000 of gains in OCI and reclassified $53,000 of gains 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 operation. However, a settlement payment or unfavorable outcome could adversely impact our results of operation. Our evaluation of the likely impact of these actions could change in the future and we could have unfavorable outcomes 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 and nine months ended March 31, 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 2016 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, 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® 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 licensing agreements.

On March 29, 2017 we received a Notice of Allowance from the U.S. Patent and Trademark Office related to a new patent application directed to a broad range of improved methods of beta-alanine intake. These 28 allowed patent claims target such benefits as delaying muscle fatigue, increasing anaerobic capacity, increasing muscle strength and increasing muscle endurance. This patent when issued will not only become part of our global portfolio covering our CarnoSyn® beta-alanine and SR CarnoSyn® products, but more importantly, we believe it significantly lengthens the

patent coverage around our instant release CarnoSyn® beta-alanine to 2023. Following this Notice of Allowance we intend to seek a significant number of additional patent claims to further broaden our intellectual property protection.

During the first nine months of fiscal 2017, our net sales were 14% higher than in the first nine months of fiscal 2016. Private label contract manufacturing sales increased 12% due primarily to the sale of higher volumes of existing products to existing customers and new products sales to existing customers. Our sales for the first nine months of fiscal 2017 were favorably impacted due to the timing and shipments of orders and new product launches. Revenue concentration risk for our largest private label contract manufacturing customer as a percent of total net sales increased to 48% for the first nine months of fiscal 2017 compared to 40% in the first nine months of fiscal 2016.

During the first nine months of fiscal 2017, CarnoSyn® beta-alanine revenue increased 24% to $20.0 million as compared to $16.1 million for the first nine months of fiscal 2016. The increase in CarnoSyn® beta-alanine revenue was primarily due to the addition of new customers and increased material shipments to existing customers.

On an annualized basis, we continue to expect our consolidated fiscal 2017 revenue growth percentage to be approximately 5% to 10% due to reductions in contract manufacturing orders and customer forecasts from Australia, Asia, and Europe. A majority of this expected decline occurred in our third fiscal quarter ending March 31, 2017. We expect a smaller decline in our fourth fiscal quarter. We believe this international revenue decline will reverse during fiscal 2018. With respect to our CarnoSyn® beta-alanine business, we expect our current sales levels to continue for the balance of this fiscal year and the foreseeable future as we continue to expand our research, our patent estate and our client base.

To protect our CarnoSyn® business and its underlying patent estate, we incurred litigation, patent compliance, and new patent application expenses of approximately $3.0 million during the first nine months of fiscal 2017 and $1.3 million during the comparable period of fiscal 2016. The increase in these legal expenses on a year over year basis is primarily due to our efforts to enforce compliance with our existing patents, fees and expenses related to new patent applications and to protect our trade name in the marketplace against parties who are using it without our consent. We describe our efforts to protect our patent estate in more detail under Item 1 of Part II of our 2016 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 enforce compliance of our instant release CarnoSyn® patents, maintain our patent rights and develop a market for our sustained release form of beta-alanine marketed under our SR Carnosyn® trademark.

During the remainder of fiscal 2017, we plan to continue to focus on:

- Leveraging our state-of-the-art, certified facilities to increase the value of the goods and services we provide to our highly valued private label contract manufacturing customers, and assist us in developing relationships with additional quality oriented customers;
- 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, new contract manufacturing opportunities, 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 2016 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 nine months ended March 31, 2017 other than as listed under Item A to our Notes to Condensed Consolidated Financial Statement contained in this Quarterly Report.

Results of Operations

The results of our operations for the three- and nine-month periods ended March 31 were as follows (dollars in thousands):

	Three Months Ended March 31,			Nine Months Ended March 31,		
	2017	2016	% Change	2016	2016	% Change
Private label contract manufacturing	$18,544	$24,493	-24 %	$69,787	$62,377	12 %
Patent and trademark licensing	6,591	5,513	20 %	19,974	16,125	24 %
Total net sales	25,135	30,006	-16 %	89,761	78,502	14 %
Cost of goods sold	20,017	23,549	-15 %	70,479	61,643	14 %
Gross profit	5,118	6,457	-21 %	19,282	16,859	14 %
Gross profit %	20.4 %	21.5 %		21.5 %	21.5 %	
Selling, general & administrative expenses	4,125	3,352	23 %	11,640	9,291	25 %
% of net sales	16.4 %	11.2 %		13.0 %	11.8 %	
Income from operations	993	3,105	-68 %	7,642	7,568	1 %
% of net sales	4.0 %	10.3 %		8.5 %	9.6 %	
Other income, net	57	1,502	-96 %	494	1,441	-66 %
Income before income taxes	1,050	4,607	-77 %	8,136	9,009	-10 %
% of net sales	4.2 %	15.4 %		9.1 %	11.5 %	
Income tax expense	305	1,584	-81 %	2,435	2,905	-16 %
Net income	$745	$3,023	-75 %	$5,701	$6,104	-7 %
% of net sales	3.0 %	10.1 %		6.4 %	7.8 %	

Private label contract manufacturing net sales decreased 24% during the three months ended March 31, 2017 and increased 12% during the nine months ended March 31, 2017, compared to the same periods in prior year. The decrease in the three months ended March 31, 2017 is primarily due to reductions in orders related to the Asian and European markets. The increase during the first nine months of fiscal 2017 is primarily due to the sale of higher volumes of existing products to existing customers and new products sales to existing customers.

Net sales from our patent and trademark licensing segment increased 20% during the three months ended March 31, 2017 and 24% during the nine months ended March 31, 2017, compared to the same periods in the prior year. These increases were primarily the result of growth in our customer base and increased material shipments.

The change in gross profit margin between the three and nine month periods ended March 31, 2017 was as follows:

	Three Months Ended	Nine Months Ended
Contract manufacturing[(1)]	(5.6)%	(2.4)%
Patent and trademark licensing[(2)]	4.5	2.4
Total change in gross profit margin	(1.1)%	0.0 %

1 Private label contract manufacturing gross profit margin as a percentage of consolidated net sales decreased 5.6 percentage points during the three months ended March 31, 2017 and decreased 2.4 percentage points during the nine months ended March 31, 2017 as compared to the comparable prior year periods. The decrease during the three months ended March 31, 2017 is primarily due to shift in product sales mix and increased per unit manufacturing costs. The decrease during the nine months ended March 31, 2017 is primarily due to a nominal increase in labor and overhead costs as a percentage of net revenues.

2 Patent and trademark licensing gross profit margin as a percentage of consolidated net sales increased 4.5 percentage points during the three months ended March 31, 2017 and increased 2.4 percentage points during the nine months ended March 31, 2017 as compared to the comparable prior year periods. These increases were primarily due to increased revenues and decreased supply chain costs.

Selling, general and administrative expenses increased $0.8 million, or 23%, during the third quarter of fiscal 2017 as compared to the comparable prior year period. During the first nine months of fiscal 2017, selling, general, and administrative expenses increased $2.4 million, or 25%, as compared to comparable prior year period. These increases were primarily due to increased litigation and patent compliance expenses and increased compensation costs associated with the growth in sales. The increase in expenses associated with our patent and trademark licensing segment are primarily associated with our efforts to enforce compliance with our patents related to instant release CarnoSyn®, new patent applications, and to protect our trade name in the marketplace against parties who are using them without our consent.

The changes in other income, net for both the three and nine month periods ended March 31, 2017, as compared to the same periods in the prior year, primarily relate to the sale of our domestic corporate headquarters in San Marcos, CA during the third quarter of fiscal 2017, which resulted in a one-time pre-tax gain of $1.6 million.

Our income tax expense decreased $1.3 million during the third quarter of fiscal 2017 and $0.5 million during the nine months ended March 31, 2017 as compared to the same periods in fiscal 2016. The decrease during the three months ended March 31, 2017 is primarily related to approximately $0.6 million of tax expense related to the sale of our domestic headquarters recorded in the third quarter of fiscal 2016 and lower pre-tax income in the third quarter of fiscal 2017 as compared to the same period in fiscal 2016. The decrease during the first nine months of fiscal 2017 as compared to the same period in fiscal 2016 primarily relates to approximately $0.6 million of tax expense related to the sale of our domestic headquarters partially offset by increased tax expense on pre-tax income before the impact of the gain recorded on the sale of our corporate headquarters in San Marcos, CA in fiscal 2016.

Liquidity and Capital Resources

Our primary sources of liquidity and capital resources are cash flows provided by operating activities and the availability of borrowings under our credit facility. Net cash provided by operating activities was $7.9 million for the nine months ended March 31, 2017, compared to $2.4 million provided by operating activities in the comparable period in the prior year.

At March 31, 2017, changes in accounts receivable, consisting primarily of amounts due from our private label contract manufacturing customers and our patent and trademark licensing activities, provided $5.3 million in cash compared to using $2.5 million in the comparable period in the prior year. The increase in cash provided by accounts receivable during the nine months ended March 31, 2017, was primarily due to increased sales and the timing and collection of sales year over year. Days sales outstanding was 32 days as of March 31, 2017, compared to 39 days as of March 31, 2016.

At March 31, 2017, changes in inventory provided $4.8 million in cash compared to $7.2 million of cash used in the comparable prior year period. The change in cash activity from inventory during the nine months ended March 31, 2017 was primarily related to the conversion of private label contract manufacturing inventory into sales during the first nine months of fiscal 2017 versus inventory growth during the first nine months of fiscal 2017 related to private label contract manufacturing growth. Changes in accounts payable and accrued liabilities used $8.6 million in cash during the nine months ended March 31, 2017 compared to providing $3.5 million during the nine months ended March 31, 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.

NAIE provided approximately $4.3 million of our operating cash flow in the nine months ended March 31, 2017. As of March 31, 2017, NAIE's undistributed retained earnings were considered indefinitely reinvested.

Cash used in investing activities during the nine months ended March 31, 2017 was $4.3 million as compared to $4.0 million used during the nine months ended March 31, 2016. Capital expenditures decreased to $4.3 million during the nine months ended March 31, 2017 compared to $7.0 million in the comparable period in the prior year. Capital expenditures during both periods included purchases of manufacturing equipment used in our Vista, California and Manno, Switzerland facilities while capital expenditures during the nine months ended March 31, 2016 also included the purchase of our new corporate headquarters located in Carlsbad, CA following the sale of our former headquarters located in San Marcos, CA. The capital expenditures during the first nine months of fiscal 2016 were partially offset by proceeds from the sale of equipment and sale of our former headquarters of $3.0 million as compared to $24,000 in the first nine months of fiscal 2016.

Cash used in financing activities for the nine months periods ending March 31, 2017 and March 31, 2016 related to share purchases of our common stock as part of our share repurchase program.

We did not have any consolidated debt as of either March 31, 2017 or June 30, 2016.

On March 28, 2017, we executed an amendment to our credit facility with Wells Fargo Bank, N.A. to extend the maturity date for our working line of credit from January 31, 2019 to February 1, 2020. The Credit Agreement provides us with a credit line of up to $10.0 million. The line of credit may be used to finance working capital requirements. There was no commitment fee required as part of this amendment. 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 January 31, 2020. 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, 2017.

On March 31, 2017, we were in compliance with all of the financial and other covenants required under the Credit agreement.

As of March 31, 2017, we had $22.6 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 March 31, 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 (principal 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 March 31, 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 March 31, 2017.

There were no changes to our internal control over financial reporting during the quarterly period ended March 31, 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 May 12, 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. We are currently involved in several matters in the ordinary course of our business, each of which is related to enforcing our intellectual property rights. Some of these matters are summarized below.

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 was subsequently confirmed by the Patent Trial and Appeal Board (PTAB) at the USPTO. NAI has filed a Notice of Appeal with the U.S. Court of Appeals for the Federal Circuit requesting that certain findings of the PTAB's be reversed. Both NAI patents rejected by the USPTO expire in August 2017.

On September 18, 2015, the Company filed a complaint against Creative Compounds, Inc., 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. A trial date is currently set for October 3, 2017. On August 24, 2016, the Company filed a separate complaint against Creative Compounds, Inc., 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 1, 2016, the Company filed a complaint in U.S. District Court for the Southern District of California against Cenegenics, LLC, alleging infringement of U.S. patents 7,504,376 and 7,825,084. On August 3, 2016, the Company filed an amended complaint to assert infringement of the same patents against Cenegenics' contract manufacturer, Atlantic-Pro Nutrients d/b/a Xymogen, LLC. Subsequently the Company and defendants resolved their disputes and entered into settlement and license agreements, and the case was dismissed.

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. On May 2, 2017, the Court issued a scheduling order setting a trial date for July 31, 2018.

On August 2, 2016, the Company filed a complaint against Muscle Sports Products, LLC in U.S. District Court for the Southern District of California, alleging infringement of its CarnoSyn® and CarnoSyn Beta Alanine® trademarks. Subsequently the Company and defendant resolved their disputes and entered into settlement and license agreements, and the case was dismissed.

On September 15, 2016, the Company filed a complaint against Arnet Pharmaceutical Corporation in the U.S. District Court for the Southern District of California alleging Breach of Contract. On May 2, 2017, the Court issued a scheduling order setting a trial date for July 31, 2018.

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.

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 2016 Annual Report, as well as the other information in our 2016 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 our stockholders could lose all or a portion of the value of their investment in our common stock.

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

Repurchases

During the quarter ended March 31, 2017, we repurchased 39,547 shares of our common stock at a total cost of $345,000 (including commissions and transaction fees) as set forth below:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[1]	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (as of March 31, 2017)
January 1, 2017 to January 31, 2017	—	—	—	—

February 1, 2017 to February 29, 2017	—	—	—	—
March 1, 2017 to March 31, 2017	39,547	$ 8.74	39,547	$ 2,844,000
Total	39,547		39,547	$ 2,844,000

1. On June 3, 2011, we announced a plan to repurchase up to $2 million in shares of our common stock.
2. On February 6, 2015, the Board of Directors authorized a $1 million increase to our stock repurchase plan bringing the total authorized repurchase amount to $3 million.
3. On May 11, 2015, the Board of Directors authorized a $2 million increase to our stock repurchase plan bringing the total authorized repurchase amount to $5 million.
4. On March 28, 2017, the Board of Directors authorized a $2 million increase to our stock repurchase plan bringing the total authorized repurchase amount to $7 million.

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 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	Second Amendment to the Credit agreement by and between NAI and the Wells Fargo Bank N.A. effective as of March 28, 2017	Filed herewith
10.2	Revolving Line of Credit Note made by NAI for the benefit of Wells Fargo Bank N.A. dated March 28, 2017 in the amount of $10,000,000	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

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, Natural Alternatives International, Inc., has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 15, 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)

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