

Natural Alternatives International 1999 Annual Report

Mark A. Le Doux

Dear Shareholders

Nineteen years ago I started this company with the vision to research, design and develop nutritional supplements that would act as natural alternatives to drugs. My reasons for doing this are easily understandable. Over the last century we have seen one drug after another come to the marketplace, designed to cure a variety of ills. While several wonder drugs have been developed, such as antibiotics, we still need to seek ways to deal with the root causes of many diseases and not merely treat the symptoms. In the case of antibiotics, indiscriminate use of these magnificent drugs has led to serious problems, and the bacteria we once sought to destroy have become resistant. In fact, every drug found in the *Physician's Desk Reference* and the *U. S. Pharmacopoeia* has the potential for significant side effects or adverse reactions. It appears as if the vision I first articulated in 1980 is of greater value today than ever before.

In the ensuing years, NAI has engaged in the research, development and production of over 1,000 natural product formulations designed to enhance human health. We have participated in a host of clinical evaluations demonstrating the efficacy of nutritional supplements in promoting proper immune function, healthy lipid metabolism and bioavailability, many of which have been published in peer-reviewed medical and scientific journals. NAI has continued to seek ways to enhance our quality systems, as well as those required by the Food and Drug Administration for nutritional supplements. We meet or exceed all current Good Manufacturing Practices (GMP) requirements for food manufacturing establishments. NAI believes that our efforts toward achieving leadership status in the nutritional supplement field are bearing significant fruit and will pay dividends now and in the future. Fiscal Year 1999 marked a trying time, not only for NAI but for the industry at large. Anticipated growth caused many companies to increase their production capacities and inventories. When this growth did not

Senior Executives

Douglas Flaker
Vice President, Sales & Marketing

David Lough
Executive Vice President

David Shunick
Vice President of Operations

Dr. John Wise
Vice President, Science & Technology

materialize, some significant challenges were presented. In response to these challenges the NAI Board of Directors made tactical changes in management, revalued inventories, and re-evaluated plans for corporate facility expansion. These difficult but necessary changes will enable us to enter the next decade with renewed focus and direction.

This year was a time of significant transition for NAI. We initiated ambitious projects that we believe will provide significant growth in revenue and profitability for upcoming fiscal years. NAI recognized the need to consolidate many small warehouses of raw materials into a single, state-of-the-art GMP warehouse. This new facility is located in Vista, California, where material will be received, tested, quarantined and either released or rejected following proper quality procedures. In addition, we embarked on international expansion of NAI, opening a new encapsulation, compression and packaging facility in Lugano, Switzerland. We designed our European facility in conformance with Swiss and international GMP requirements. Natural Alternatives International Europe, S.A., was created to service the needs of our burgeoning client demands in Europe. Swiss-made products enjoy considerable appeal in this market, and tariffs are reduced or eliminated on sales within the European Community. Our new facility in Lugano celebrated its grand opening simultaneously with the grand opening of our facility in Vista on September 9, 1999.

In order to effectively chart a course for the future, one needs to learn from the past. The field of natural medicine has never been more promising and NAI is positioned to meet a future where demographic, clinical and scientific trends converge, creating significant demand for natural products. When I formed this company, it was with sincere belief in the concept that Hippocrates, the father of modern medicine, expounded when he said, ‘Let your food be your medicine.’ As we enter a new decade, a new century and a new millennium, NAI is prepared to meet the needs of millions of people around the world who are concerned with maintaining and enhancing their health with intelligent nutritional support. I appreciate your support and pledge to keep NAI on course to achieve this mission.

Sincerely,

Mark A. Le Doux

Founder, President and CEO

The People Who Make it Happen

Marketing & Account Management

Kathleen Primes, Tom Gardner, Kate Marshall, Nicole Hagaman, Anna Doane

Graphic Design, Product Development & Planning

Theresa Abbott, Sharon Rhodes, Jandra Thomas, Bruce Moore, Gina Reynoso, Sanpetto Ohsawa, Issmene Medina, Alan Huffington, Brad Knudsen, Peggy Gardner, Tom Riddle, Philip Tinsman (not pictured)

Purchasing, Quality Control & Warehouse

Lee Harris, Marc Parent, Victoria Koller, Danielle Willenborg, Joseph Gallegos, Damon Battista, Kerry Michel, Hugh Mann, Jennifer Gordon (not pictured)

Natural Alternatives International enjoys a long history as a leader in the field of nutritional science. The individuals who collectively make up our company are key to maintaining that record of success. We would like to focus our attention on the people working behind the scenes, whose professional spirit and sense of commitment have enabled NAI to uphold its reputation for quality products formulated with scientific integrity for the last nineteen years.

Responsible for the development of strategic new business opportunities, the *Marketing Team* interacts with potential clients, informing the marketplace of NAI's leadership position and technical capabilities. By utilizing various marketing initiatives such as trade shows, professional associations and targeted sales efforts, potential clients and channels of distribution are identified. Our *Account Management Team* provides professional customer service support to new and existing relationships. With over fifty years of collective experience in the nutritional field our Account Managers are extremely knowledgeable in the areas of supplement design, manufacturing, packaging, distribution, international product registration and regulatory compliance. Our *Graphics Design Department* consults with clients and Account Managers when creating label design and keeps current regarding changes in labeling laws and requirements. Through interaction with various departments, the *Product Development Group* designs new products and formulas which are researched, tested and piloted before being presented to the prospective client. Utilizing scientific research and clinical studies, our team of physicians and scientists design customized nutritional products supported by verified scientific rationale. Maintaining production efficiency and high productivity is the goal of the *Planning Group*. Using the recently implemented BaaN "ERP" system our planners have a state-of-the-art tool to manage all aspects of production scheduling, raw material delivery, packaging coordination, and shipment tracking. These tools enable the company to achieve greater capacity utilization with a high degree of predictability. The effectiveness of our manufacturing process is further enhanced by the personnel in our *Purchasing Department*, where agents negotiate competitive prices on raw materials from locations around the world. Raw materials are purchased and delivered to our newly completed warehouse in Vista, California, where *Quality Control Inspectors* perform rigorous tests to ensure the quality, purity and potency of all materials. After testing and quarantine procedures are completed, the materials are released to our *Warehouse Staff*, who utilize the latest scanner and bar coding technology to assure proper inventory control and product retrieval.

Production
Elias Lagunas, Alejandra Valencia, Lina Yanchulova, Gonzalo Ortiz, Charlie Smith, Janis Donis, Bill Isles, James Larsen, Scott Phillips, Jan Wilson (not pictured), Eduardo Perea (not pictured)

Laboratory
Dr. Zimin Liu, Jeff Abrahamian, Dr. Joseph Mann, Eileen Colorina, Elizabeth Tolbert, Stephanie Knudsen (not pictured)

Recent expansion of our weighing and blending facilities in Vista have increased our annual material blending capacity to more than 3 million kilos per year. The material is blended and then transported to San Marcos, California, where our *Production Staff* supervises the encapsulation and compression machinery, producing capsules or tablets to exacting standards that adhere to customer specifications. Our production capacity exceeds 10 million capsules and 11 million tablets each day. To ensure the highest quality of finished goods, our *Laboratory Staff* continuously monitors the output of the production facility. All products manufactured by NAI are meticulously examined for weight, ingredient homogeneity, color standardization and content levels. Tablets are tested for hardness, thickness, dissolution and integrity. The laboratories at NAI have been equipped with highly advanced U.S. Pharmacopoeia-approved equipment. Formulations of vitamins, minerals and herbs at NAI are assayed by batch, ensuring the potency and purity of each product. The *Finance & IS Departments* support the organization in critical areas, providing expert guidance in accounting and information systems administration. In fiscal 1999 NAI implemented a powerful information technology system to manage production and finance. This system provides complete functionality in process manufacturing, quality control, and financial management. It also includes multi-company, multi-language, and multi-currency support, providing a competitive advantage and the ability to

Finance & IS

Elena Ortiz, Peggy Gardner, Chuck Youde, Denise Pillette, Patrick Zatorski, Diana Davis, Mike Leonard (not pictured), Steve Baert (not pictured)

Human Resources & Administration

Judy Little, Pat Hammond, Joanne Gonzales, Sandy Ziegler, Jo Phillippe, Donna Peterson, Terry Doane (not pictured)

meet the needs of a growing enterprise. Meeting the staffing needs of a growing company is of critical importance to the success of any business. Recruiting, training and developing a skilled and professional work force is the task of our *Human Resources Department*. We are fortunate to have a dedicated and experienced group of people managing this important function. The *Administrative Group* acts as a liaison between clients, vendors and staff and takes care of details that are essential in maintaining an efficient organization. Their skilled efforts contribute greatly to keeping our business running smoothly and efficiently. We are very appreciative of the enthusiastic spirit all employees of NAI bring to their positions.

Looking Ahead

Natural Alternatives International will be focusing on several key areas of development over the year ahead. Developing the infrastructure to support future growth is essential to achieving the goals of geographically expanding facilities, diversifying channels of distribution, and increasing manufacturing capacity. On September 9, 1999, we celebrated the grand opening of a new manufacturing facility in Lugano, Switzerland as well as the new Vista, California warehouse and blending facility. We also recently announced the opening of our first sales office in Tokyo, Japan. Geographic expansion of our facilities has facilitated the ease with which we are able to provide our customers around the world with high quality products. NAI is working to diversify and expand the channels through which we service clients and will continue to do so over the upcoming year. We are entering several new channels including direct mail, eCommerce and several joint venture partnerships. Development of these areas will be important to NAI's future growth as the market for nutritional supplements continues to grow worldwide.

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

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of
The Securities Exchange Act of 1934

For the fiscal year ended **June 30, 1999** Commission file number **0-15701**

NATURAL ALTERNATIVES INTERNATIONAL, INC.

Incorporated in Delaware	84-1007839
1185 Linda Vista Drive, San Marcos, California 92069	(I.R.S. Employer Identification No.)
(760) 744-7340	

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

Common Stock - $.01 par value Nasdaq Stock Market

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

Yes__X___ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of 3,429,077 shares of voting stock held by non-affiliates (assuming for this purpose that all officers and directors, and affiliates of directors, are affiliates) of the Registrant was approximately $16,074,000 based on the closing sale price as of September 22, 1999.

At September 22, 1999, the Registrant had outstanding 5,759,875 shares of Common Stock, $.01 par value.

Documents Incorporated by Reference

NONE

PART I

ITEM 1. BUSINESS

Natural Alternatives International, Inc. and its subsidiaries (referred to collectively herein as the “Company”) is engaged in the formulation and production of encapsulated and tablet vitamins and related nutrients including phytochemicals derived from botanicals and foods. The Company provides clinical studies assessment, assistance with international product registration, packaging and delivery system design, customer-specific nutritional product formulation and a host of other marketing related services for its clients. The Company seeks to further its customers' objectives by assisting them in expanding their market share through a variety of special programs and services. There are no fees charged or revenues generated from these marketing related services, which are generally provided before orders for product are obtained.

Management believes its technically advanced facilities, laboratory and quality control capabilities are a major factor in solidifying existing customer relationships and adding new customers. The recognized standards for manufacturing nutritional products should, in the opinion of management, assist the Company in serving its present and future customers. The United States Pharmacopeia compendia (USP) contain specifications for vitamin and mineral supplements. This USP monograph has long been the basis for determining the strength, quality, purity, packaging and labeling of drugs and related articles. The Company currently has the technical and quality control expertise to conform to all aspects of USP specifications. Conformance with USP specifications allows the Company to use the USP designation on products manufactured for its customers, which have the USP designation.

The Company’s growth strategy is to introduce new products, attract and retain preferred customers, and enter new markets. The Company believes that it can successfully implement this growth strategy by continuing to capitalize on its operating strengths: science-based products; a strong research and development program; in-house manufacturing; and an experienced management team.

RECENT MANAGEMENT CHANGES

The Company experienced a significant change in its management during fiscal 1999. Mark LeDoux, founder and CEO of the Company, assumed the role of President in January 1999. David Lough was appointed Executive Vice President with responsibility for all corporate operations. Douglas E. Flaker was appointed Vice President of Marketing, Business Development and Strategic Planning. David K. Shunick was appointed Vice President of Operations.

William P. Spencer, who served as a Director, President and Chief Financial Officer of the Company, and Jane Schlosberg, formerly Director of Marketing and Corporate Relations are no longer employed by the Company. Mr. Spencer resigned as a director of the Company on June 29, 1999.

PRODUCTS AND MANUFACTURING

The Company is engaged in the research, design and manufacture of nutritional supplements for others engaged in commerce in a variety of distribution channels – both domestic and international. The Company purchases raw materials in bulk from qualified vendors, and, after quality control testing, encapsulates or compresses them into solid dosage forms of either chewable wafers or tablets. The Company utilizes contract manufacturers, in accordance with the Company’s specifications and standards, to package the product for shipment.

RESEARCH AND DEVELOPMENT

The primary emphasis of the Company’s research and development activities is the development of new products and enhancement of existing products. In addition, the Company continuously produces pilot or sample runs of products to ensure stability or efficacy and to determine ingredient interaction and prospective customer acceptance. The Company has implemented stringent quality control procedures to verify that all products comply with established specifications and standards. Research of this type is a part of the operating expenses incurred by the Company, and the associated costs have not been significant.

ITEM 1. BUSINESS *(continued)*

COMPETITION AND BUSINESS RISKS

The Company's products are sold in domestic and foreign markets in competition with other companies. The vitamin and nutritional supplement industry is highly competitive, and competition continues to increase. Competition for the sale of vitamins and supplements comes from many sources, including companies which sell vitamins to supermarkets, large chain discount retailers, drug store chains and independent drug stores, health food stores, pharmaceutical companies and others which sell to wholesalers, mail order vendors and network marketing companies. The Company does not believe it is possible to accurately estimate the number or size of its many competitors since the vitamin industry is largely privately held.

The Company believes that competition among manufacturers of vitamin and supplement products is based, among other things, on price, timely delivery, product quality, safety, availability, product innovation and assistance in marketing and customer service. The competitive position of the Company will also depend upon continued acceptance of its products, its ability to attract and retain qualified personnel, future governmental regulations affecting vitamins and nutritional supplements, and publication of vitamin product safety and efficacy studies by the government and authoritative health and medical authorities.

The Company's operations are subject to the risks normally associated with manufacturing vitamins and nutritional products, including shortage of certain raw materials and damage to property or injury to persons.

SOURCE AND AVAILABILITY OF RAW MATERIALS

Raw materials used in the Company's products consist of nutrient powders, empty gelatin capsules, and necessary components for packaging and distribution of finished vitamin and nutritional supplement products. The nutrient powders and the empty gelatin capsules are purchased from manufacturers in the United States, including foreign entities, some of which have operations in the United States. To date, the Company has not experienced any difficulty in obtaining adequate sources of supply. Although there can be no assurance that the Company will continue to be able to obtain adequate sources in the future, the Company believes that it will be able to do so.

MAJOR CUSTOMERS

Nu Skin International, NSA International and Pharmavite together represented 71% of the Company's sales for the year ended June 30, 1999. Loss of any of these customers could have an adverse impact on the Company's revenues and earnings until the Company could replace these sales. If the Company was unable to replace the sales to any of these customers, it would have a material adverse impact on the business and operations of the Company. No other customer represented 10% or more of the Company's sales for the year ended June 30, 1999.

EMPLOYEES

The Company employs 121 individuals, with five employed in executive positions, eleven in the area of research, laboratory and quality control, eleven in sales and marketing, while the remaining employees are engaged in production and administration. The Company has never experienced a work stoppage, and none of its employees are currently represented by a union or any other form of collective bargaining unit. The Company believes its relations with its employees are excellent.

ITEM 1. BUSINESS *(continued)*

GOVERNMENT REGULATION

The formulation, manufacturing, packaging, labeling, advertising and distribution of the Company's products are subject to regulation by one or more federal agencies, including the Federal Drug Administration (FDA), the Federal Trade Commission (FTC), the Consumer Product Safety Commission (CPSC), the United States Department of Agriculture (DOA) and the Environmental Protection Agency (EPA). These activities are also regulated by various agencies of the states and localities in which the Company's products are sold, including without limitation the California Department of Health Services, Food and Drug branch. The FDA in particular regulates the advertising, labeling and sales of vitamin and mineral supplements and may take regulatory action concerning medical claims, misleading or untruthful advertising, and product safety issues. These regulations include the FDA's Good Manufacturing Practices (GMPs) for foods. Detailed dietary supplement GMPs have been proposed but no regulations have been adopted. Additional regulations for the implementation of the Dietary Supplement Health and Education Act of 1994 (DSHEA) requirements for dietary supplement labeling were adopted.

The Company may be subject, from time to time, to additional laws or regulations administered by the FDA or other Federal, State or foreign regulatory authorities, or more stringent interpretations of current laws or regulations in the future. The Company is unable to predict the nature of such future laws, regulations, interpretations or applications, nor can it predict what effect additional governmental regulations or administrative orders, when and if promulgated, would have on its business in the future. They could, however, require the Company to: reformulate certain products to meet new standards; recall or discontinue certain products not able to be reformulated; expand documentation of the properties of certain products; expand or provide different labeling and scientific substantiation; or, impose additional recordkeeping requirements. Any or all such requirements could have a material adverse effect on the Company's results of operations and financial position.

ITEM 2. PROPERTIES

The Company's corporate and manufacturing facilities consist of approximately 123,000 square feet and are located in San Marcos and Vista, California. Of this space, the Company owns approximately 29,500 square feet and leases the remaining space. Approximately 68,000 square feet is used for production related activities, 35,000 square feet is used for warehousing, 5,000 square feet is used for laboratory and product development, and 15,000 square feet is used for offices.

In August 1997, the Company entered into a 15-year lease agreement under which the lessor was to construct a build-to-suit 82,000 square foot office and manufacturing facility in Carlsbad, California. In March 1999, the Company made the decision to sublease, and not occupy, the partially completed facility. In the third quarter of fiscal 1999, the Company recorded a $2.3 million charge for impairment of leasehold assets and an accrual of $2.7 million representing the present value of the excess of future lease payments over estimated sub-lease income. The Company is seeking tenants for the facility.

The Company entered into two new lease agreements during fiscal year 1999 for two adjacent buildings located in Vista, California. The facilities are leased from an unaffiliated third party and consist of a total of approximately 74,000 square feet. The lease for the first building commenced in August 1998 under a 5-year lease agreement and consists of approximately 54,000 square feet to be utilized as a warehousing and blending facility. The lease for the second building commenced in March 1999 under a 3.5-year lease agreement for the rental of approximately 20,000 square feet to be utilized as a warehouse and packaging facility. The consolidation of warehousing space is expected to increase operating efficiencies to allow the Company to meet demand for its products. The Company will continue to utilize its facilities in San Marcos for production.

PART I

ITEM 3. LEGAL PROCEEDINGS

The Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with its legal counsel, the ultimate disposition of these matters will not have a material adverse effect on the Company’s consolidated financial position, results of operations or liquidity.

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

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's common stock trades on the Nasdaq National Market tier of The Nasdaq Stock Market under the Symbol: NAII. The common stock of the Company had previously been traded on the American Stock Exchange (AMEX) since November 17, 1992, under the stock symbol NAI. The table below sets forth the high and low sales prices of the Company's stock for fiscal 1999 and 1998.

	High	Low
First Quarter Ended September 30, 1998	$26.625	$12.125
Second Quarter Ended December 31, 1998	$15.063	$9.125
Third Quarter Ended March 31, 1999	$14.000	$4.188
Fourth Quarter Ended June 30, 1999	$5.125	$3.125
First Quarter Ended September 30, 1997	$9.750	$7.000
Second Quarter Ended December 31, 1997	$10.813	$7.250
Third Quarter Ended March 31, 1998	$22.500	$17.625
Fourth Quarter Ended June 30, 1998	$24.500	$16.000

As of June 30, 1999, the approximate number of holders of common stock was 4,000.

The Company has never paid a dividend on its common stock. It is the Company's present policy to retain all earnings to provide funds for the future growth of the Company.

PART II

ITEM 6. SELECTED FINANCIAL DATA

Five-Year Summary
(Not Covered by Independent Auditors' Report)

Year Ended June 30

	1999	1998	1997	1996	1995
Net Sales	$57,429,898	$67,894,305	$49,444,221	$47,621,804	$37,388,254
Income (Loss) from Operations	($4,937,345)	$9,622,478	$1,815,072	$5,263,376	$3,637,522
Net Earnings (Loss)	($2,923,340)	$5,871,765	$1,119,920	$3,222,317	$2,028,059
Net Earnings (Loss) Per Common Share:					
Basic	($0.50)	$1.06	$0.21	$0.61	$0.39
Diluted	($0.50)	$1.00	$0.20	$0.58	$0.37
Current Assets	$23,240,014	$30,642,121	$18,857,979	$15,710,135	$14,722,929
Total Assets	$38,596,023	$42,987,279	$28,108,756	$23,561,191	$21,193,780
Long-Term Debt and Capital Lease Obligations, Less Current Installments	$926,864	$977,375	$1,123,898	$1,324,920	$1,114,828
Stockholders' Equity	$25,090,460	$27,659,141	$18,699,487	$17,159,586	$13,278,255

PART II

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Form 10-K contains certain “forward-looking statements” as such term is defined in the Private Securities Litigation Reform Act of 1995 or by the Securities and Exchange Commission in its rules, regulations and releases. These statements represent the Company’s expectations or beliefs, including, but not limited to, statements concerning future financial and operating results, anticipated growth in revenues and profit margins, improvements in management personnel, the impact of European operations, and the utilization of inventories and facilities, statements concerning industry performance, the Company’s operations, economic performance, financial condition, growth and acquisition strategies, margins and growth in sales of the Company’s products. For this purpose, any statements contained in this Report that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the generality of the foregoing, words such as “may”, “will”, “expect”, “believe”, “anticipate”, “intend”, “could”, “estimate” or “continue” or the negative or other variations thereof or comparable terminology are intended to identify forward-looking statements. These statements by their nature involve substantial risks and uncertainties, certain of which are beyond the Company’s control, and actual results may differ materially depending on a variety of important factors, including uncertainty related to government regulation, the effect of adverse publicity, litigation, the centralized location of the Company’s manufacturing operations, availability of raw materials, risks associated with international operations, competition, product liability claims, volatility of stock price and those factors described in this and other Company filings with the Securities and Exchange Commission.

RESULTS OF OPERATIONS

FISCAL 1999 COMPARED TO FISCAL 1998

Net sales decreased 15.4% or $10.5 million to $57.4 million in fiscal 1999 from $67.9 million in 1998. Management believes the decrease in sales is attributable to increased product and price competition in the nutritional supplement market as well as increased competition for new distributors. In addition, sales growth was negatively impacted by the reduction in market demand for several herbal products, resulting in depressed market prices. The Company expects competition to remain strong for the foreseeable future.

Sales of products by our customers into international markets increased 18.8% to $17.7 million in 1999 from $14.9 million in 1998. The increase is primarily the result of existing customers continued expansion into Asian and European markets through their international distribution channels. Management believes that the expansion into international markets should continue and net sales to these markets should increase as a percentage of total net sales.

For the year ended June 30, 1999, the Company experienced an increase in cost of goods sold, as a percentage of sales, to 78.4% compared to 72.4% for the prior year. The increase was primarily due to liquidation of excess or slow moving inventories at or below cost and inventory write-downs to net realizable values, caused by depressed market prices due to reduced industry demand. The increase in cost of goods sold resulted in a reduction of gross profit margins to 21.6% in fiscal 1999 compared to 27.6% in fiscal 1998.

Selling, general and administrative expenses increased as a percentage of net sales to 21.4% in 1999 from 13.4% in 1998, increasing in absolute dollars to $12.3 million in fiscal 1999 from $9.1 million in 1998. The percentage increase was due primarily to the fixed nature of selling, general and administrative expenses and the decrease in net sales as noted above. The increase in absolute dollars was due to: upgrades in systems and computers related to Y2K compliance; expenses related to management restructuring; and higher rents in connection with entering into additional leases for new blending, warehousing and packaging facilities. Additionally, professional fees increased because of increased activity in seeking additional manufacturing agreements.

(continued)

PART II

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS *(continued)*

RESULTS OF OPERATIONS

FISCAL 1999 COMPARED TO FISCAL 1998 *(continued)*

The Company recorded charges related to a lease obligation of approximately $5,000,000 during the fiscal year ended June 30, 1999. The expense relates to the Company's decision to sublease, and not occupy, a partially completed office and manufacturing facility in Carlsbad, California. In the third quarter of fiscal 1999, the Company recorded a $2.3 million charge for impairment of leasehold assets and an accrual of $2.7 million representing the present value of the excess of future lease payments over estimated sub-lease income. The Company is seeking tenants for the facility.

The Company's loss from operations was approximately $4.9 million compared to income from operations of $9.6 million in 1998. This was due to an approximate $6.3 million decrease in gross profit, approximately $3.2 million increase in selling, general and administrative expenses, and the approximate $5 million provision for loss on lease obligation and other expense.

The Company incurred a net loss for fiscal 1999 of approximately $2.9 million compared to net income of $5.9 million in fiscal 1998. This loss was due to the reasons described above. Diluted loss per common share was ($.50) in fiscal 1999 compared to diluted earnings per common share of $1.00 in 1998.

FISCAL 1998 COMPARED TO FISCAL 1997

Net sales increased 37.3% or $18.5 million to $67.9 million in fiscal 1998. The Company added several new customers in the latter part of fiscal 1997 and sales to these and other new customers was the primary reason for the increase. A decrease in sales to certain existing customers was offset by increases in international sales to other existing customers through their international distribution channels.

Sales of products into international markets increased to $14.9 million in 1998 from $1.9 million in 1997. The increase was primarily the result of existing customers expanding into Asian and European markets.

Income from operations increased 430% to $9.6 million in 1998. This was due to a $8.3 million increase in gross profit offset by a $.5 million increase in selling, general and administrative expenses.

Gross profit margins were 27.6% and 21.1% in fiscal 1998 and 1997, respectively. The 1997 gross profit margin was substantially below historical margins because of the following factors: shifts in product sales mix toward lower profit margin products, rising costs of certain raw materials, increased costs for subcontracted packaging, change in ownership of a customer that resulted in a substantial write-off of packaging materials, and the write-off of raw materials that became obsolete because of customer discontinuance of certain products. The 1998 gross profit margin was slightly higher than historical margins experienced before 1997. The increase is principally due to negotiated raw material savings and improved manufacturing cost efficiencies.

Selling, general and administrative expenses decreased as a percentage of sales to 13.4% in 1998 from 17.4% in 1997, while increasing in absolute dollars to approximately $9.1 million in fiscal 1998 from $8.6 million in 1997. The majority of this increase in selling, general and administrative expenses is due to an increase in employee benefits expense which increased because the defined benefit pension plan adopted as of January 1, 1997 was in effect for a full year in 1998. Additionally, professional fees increased in part because of increased activity in the registration of foreign products. These increases in selling, general and administrative expenses were partially offset by a decline in bad debt expense, which was attributable to a related party customer write-off in fiscal 1997, and a decline in royalty expense because the Company's agreement with the United States Olympic Committee expired in March 1997.

Net other income (expense) was approximately $44,000 in fiscal 1998 compared approximately $25,000 in fiscal 1997.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS *(continued)*

FISCAL 1998 COMPARED TO FISCAL 1997 *(continued)*

Net earnings increased by 424% or $4.8 million to $5.9 million in fiscal 1998. This increase was due primarily to the reasons given above and was partially offset by a higher effective income tax rate. The higher effective income tax rate, from 39.1% in 1997 to 39.3% in 1998, was the result of a smaller investment credit applicable to California franchise taxes.

Diluted earnings per share increased 400% to $1.00 per share in 1998 from $.20 per share in 1997.

YEAR 2000 ISSUES

The year 2000 issue ("Year 2000 Issue") is the result of computer programs being written using two digits rather than four digits to represent the year and affects both information technology (IT) and non-IT systems. Thus, computer software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failures or miscalculations causing disruptions of operations, including among others, a temporary inability to process certain data or engage in similar normal business activities.

STATUS: The Company's plan to resolve the Year 2000 Issue involved four phases: assessment, remediation, testing and implementation. The Company completed its assessment of its IT systems and implemented its new computer software system during the fourth quarter of its 1999 fiscal year. The manufacturer represents this system as Year 2000 compliant. The Company also completed its assessment of non-IT systems, most of which are equipment used in production. Systems identified as not being Year 2000 compliant were brought into compliance by upgrading either the software or hardware. The Company fully implemented these upgrades by the end of its 1999 fiscal year. The Company has determined that its production equipment and alarm, heating, and air-conditioning systems will not be affected by the Year 2000.

The Company’s computer staff has queried its significant suppliers, vendors and other outside parties and none of the responses received thus far have indicated any significant deficiencies. The Company will continue to monitor their Year 2000 compliance status, but has no means of ensuring that suppliers, vendors and other outside parties will be Year 2000 ready. The Company’s most likely worst case scenario is the inability of suppliers, vendors and other outside parties (including the government) to complete their Year 2000 resolution process in a timely fashion, which could materially impact the Company. The effect of non-compliance by suppliers, vendors and outside parties is not determinable.

COSTS: The Company incurred approximately $1 million in costs, of which approximately $150,000 was charged directly to expense in the1999 fiscal year to replace its financial and manufacturing software systems and to remediate or replace embedded microprocessors in its production equipment. The Company funded its costs from current funds available from operations. If, however, additional unanticipated costs are incurred, this could have a material adverse effect on the Company's business, results of operations and financial condition.

RISKS: While management of the Company believes it effectively implemented its program to resolve the Year 2000 Issue in a timely manner, as noted above, disruptions in the economy generally resulting from Year 2000 Issues could also materially adversely effect the Company. The Company is unable to estimate if it has any potential liability or potential lost revenue at this time. There can be no assurance that the Company will not discover Year 2000 compliance issues that will have a material adverse effect on the Company's business, results of operations and financial condition.

PART II

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS *(continued)*

LIQUIDITY AND CAPITAL RESOURCES

The Company has historically met its working capital and capital expenditure requirements, including funding for expansion of operations, mainly through net cash provided by operating activities. In addition, the Company has utilized revolving lines of credit and equipment financing and leases. Management plans to pursue additional financing during its fiscal year 2000 to provide the resources necessary to meet currently anticipated funding requirements. There can be no assurance such financing will be available or if it is, on what terms, and if obtained, that it will be adequate to provide resources necessary to meet current requirements.

At June 30, 1999, the Company had working capital of $14,098,000 and borrowings available under revolving lines of credit of $3,000,000. As of June 30, 1999, there were no borrowings under these lines.

In 1999, net cash provided by operating activities was approximately $3,148,000 compared to approximately $3,330,000 for 1998. The net loss was offset by the cumulative effect of a provision for loss on a lease obligation, a decrease in accounts receivable, and a decrease in inventories less the cumulative effect of an increase in deferred income taxes, an increase in tax refund receivable, and a decrease in accounts payable. Current maturities of long-term debt amounted to $50,000, which the Company expects to pay out of working capital.

The Company has revolving lines of credit permitting borrowings up to $3,000,000, which are secured by the Company’s receivables, inventory, equipment, and vehicles and bear interest at the bank’s prime rate. These agreements contain financial covenants concerning limitations on maintenance of debt, certain financial ratios and other matters. The lines of credit expire on January 19, 2000; management expects such lines to be renewed in the normal course of business. The Company received a waiver for certain debt covenants for which it was not compliant as of June 30, 1999.

Capital expenditures for 1999 amounted to approximately $5.7 million. These expenditures relate to building improvements for the Company’s new warehouse and blending facility, the purchase of production and packaging equipment to expand the Company's output capacity, and leasehold improvements in the Carlsbad facility, which were written off in the third quarter. The Company anticipates capital expenditures of approximately $5.4 million during fiscal 2000. These expenditures are expected to be paid from a combination of cash holdings, net cash provided by operating activities in fiscal 2000, borrowings under the Company's lines of credit with its bank, and anticipated additional financings. If these financing alternatives become unavailable, the Company may be required to defer or restrict certain commercial activities or delay or eliminate expenditures for certain of its potential products and/or markets.

New Accounting Pronouncements

In June 1999, the Company adopted Statement of Financial Accounting Standards No. 132, "Employers’ Disclosures about Pensions and Other Postretirement Benefits." This Statement standardizes the disclosure requirements for pensions and other postretirement benefits, requires additional information on changes in the benefit obligations and fair values of plan assets and eliminates certain disclosures. Prior years have been restated to conform to the new standard.

In fiscal 1999, the Company adopted Statements of Financial Accounting Standards No. 130, “Reporting Comprehensive Income” (“SFAS 130”) and No. 131, “Disclosures about Segments of an Enterprise and Related Information” (“SFAS 131”). SFAS 130 establishes standards for the reporting and display of comprehensive income and its components in the financial statements. SFAS 131 establishes standards for the manner in which public business enterprises report information about operating segments and also establishes standards for related disclosures about products and services, geographic areas, and major customers.

PART II

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS *(continued)*

New Accounting Pronouncements *(continued)*

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Statement establishes accounting and reporting standards requiring that derivative instruments be recorded in the balance sheet as either an asset or liability measured at its fair value and that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. SFAS No. 133, as amended, is effective for fiscal years beginning after June 15, 2000. The adoption of this Statement will not have a material effect on the Company's consolidated financial statements as the Company does not currently hold any derivative or hedging instruments.

In April, 1998, the American Institute of Certified Public Accountants issued Statement of Position ("SOP") 98-5, "Reporting on the Cost of Start-up Activities." This Statement requires that all start-up activities, including organizational costs, be expensed as incurred. The Company adopted SOP98-5 for the year ended June 30, 1999. The effects of adopting this SOP did not have a material impact on consolidated financial position, results of operations or liquidity.

ITEM 7a. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to risks relating to changes in interest rates and stock market fluctuations. At June 30, 1999, the Company maintains a portion of its cash and cash equivalents in financial instruments with original maturities of three months or less. These financial instruments, principally comprised of government backed money market funds, are subject to interest rate risk and will decline in value if interest rates increase. The Company also maintains a short-term investment portfolio containing common stocks that are subject to market risk. The Company has not used derivative financial instruments in its investment portfolio. The Company believes that its investment in market-risk-sensitive instruments is not material.

Market rate risk related to Long Term Debt is diminimus due to the fixed interest rate and fixed payment structure of the debt.

RISK FACTORS

Government Regulation

The manufacturing, processing, formulation, packaging, labeling and advertising of the Company's products are subject to regulation by one or more federal agencies, including the United States Food and Drug Administration ("FDA"), the Federal Trade Commission ("FTC"), the Consumer Product Safety Commission, the United States Department of Agriculture, the United States Postal Service, the United States Environmental Protection Agency and the Occupational Safety and Health Administration. These activities are also regulated by various agencies of the states and localities in which the Company's products are sold. In particular, the FDA regulates the safety, labeling and distribution of dietary supplements, including vitamins, minerals, herbs food, OTC and prescription drugs and cosmetics. The regulations that are promulgated by the FDA relating to the manufacturing process are known as food products. In addition, the FTC has overlapping jurisdiction with the FDA to regulate the labeling, promotion and advertising of vitamins, OTC drugs, cosmetics and foods.

The Dietary Supplement Health and Education Act of 1994 ("DSHEA") was enacted on October 25, 1994. DSHEA amends the Federal Food, Drug and Cosmetic Act by defining dietary supplements which include vitamins, minerals, nutritional supplements and herbs, as a new category of food separate from conventional food. DSHEA provides a regulatory framework to ensure safe, quality dietary supplements and the dissemination of accurate information about such products. Under DSHEA, the FDA is generally prohibited from regulating the active ingredients in dietary supplements as drugs unless product claims, such as claims that a product may heal, mitigate, cure or prevent an illness, disease or malady, trigger drug status.

PART II

RISK FACTORS *(continued)*

DSHEA provides for specific nutritional labeling requirements for dietary supplements and the FDA's final regulations require that all dietary supplements must be labeled in compliance with the regulations by no later than March 23, 1999. DSHEA permits substantiated, truthful and non-misleading statements of nutritional support to be made in labeling, such as statements describing general well-being resulting from consumption of a dietary ingredient or the role of a nutrient or dietary ingredient in affecting or maintaining a structure or function of the body. The Company anticipates the FDA will finalize CGMPs that are specific to dietary supplements and require at least some of the quality control provisions contained in the CGMPs for drugs. The Company currently manufactures its vitamins and nutritional supplement products in compliance with the applicable food CGMPs.

The FDA has finalized some of its regulations, including those relating to nutritional labeling requirements. The FDA also has under development additional regulations to implement DSHEA. Final labeling regulations may require expanded or different labeling for the Company's vitamin and nutritional products. The Company cannot determine what effect such regulations, when fully implemented, will have on its business in the future. Such regulations could, among other things, require the recall, reformulation or discontinuance of certain products, additional recordkeeping, warnings, notification procedures and expanded documentation of the properties of certain products or scientific substantiation regarding ingredients, product claims, safety or efficacy. Failure to comply with applicable FDA requirements can result in sanctions being imposed on the Company or the manufacturers of its products, including warning letters, fines, product recalls and seizures.

Governmental regulations in foreign countries where the Company plans to commence or expand sales may prevent or delay entry into a market or prevent or delay the introduction, or require the reformulation of, certain of the Company's products. In addition, the Company cannot predict whether new domestic or foreign legislation regulating its activities will be enacted. Such new legislation could have a material adverse effect on the Company.

Effect of Adverse Publicity

The Company's products consist of vitamins, minerals, herbs and other ingredients that the Company regards as safe when taken as suggested by the Company. In addition, various scientific studies have suggested the ingredients in some of the Company's products may involve health benefits. The Company believes the growth in the vitamin product business of the last several years may be based on material media attention and various scientific research suggesting potential health benefits for the consumption of certain vitamin products. The Company is highly dependent upon its customers' and consumers' perception of the overall integrity of its business, as well as the safety and quality of its products and similar products distributed by other companies which may not adhere to the same quality standards as the Company. The Company could be adversely affected if any of the Company's products or any similar products distributed by other companies should prove or be asserted to be harmful to consumers or should scientific studies provide unfavorable findings regarding the effectiveness of products similar to those produced by the Company.

Centralized Location of Manufacturing Operations

The Company currently manufactures the vast majority of its products at its manufacturing facilities in San Marcos, California. Accordingly, any event resulting in the slowdown or stoppage of the Company's manufacturing operations or distribution facilities in San Marcos could have a material adverse effect on the Company. The Company maintains business interruption insurance. There can be no assurance, however, that such insurance will continue to be available at a reasonable cost or, if available, will be adequate to cover any losses that may be incurred from an interruption in the Company's manufacturing and distribution operations.

RISK FACTORS *(continued)*

Reliance on Certain Customers and Certain Products

In fiscal 1999, NuSkin International, NSA International and Pharmavite accounted for approximately 71% of the Company's sales. Each of the Company's other major customers accounted for less than 10% of the Company's sales for fiscal 1999. If one or more of the Company's major customers substantially reduced their volume of purchases from the Company, or if consumer's purchases of vitamins were substantially reduced, the Company's results of operations could be materially adversely affected.

Distribution and Management of Operations

In fiscal 1999, the Company leased and initiated development of two additional facilities comprising 74,000 square feet in Vista, California, to be used as warehousing, mixing, blending and packaging facilities. The Company also elected to sublease and not occupy an 82,000 square foot building in Carlsbad, California developed specifically for the Company. In addition, the Company organized a European subsidiary that leased and developed a 15,000 square foot manufacturing facility in Lugano, Switzerland. During fiscal 1999, the Company also implemented an entirely new software system to manage its materials and manufacturing operations. While the Company believes that these activities will increase the Company's manufacturing and distribution capabilities, there can be no assurance the expected operating improvements will be realized or that these efforts will result in improved sales profit margins or earnings. A significant, unexpected disruption during the implementation of these systems and facilities could have a material adverse effect on the Company's results of operations.

Potential for Increased Competition

The market for the Company's products is highly competitive. The Company competes with other vitamin product and OTC pharmaceuticals manufacturers. Among other factors, competition among these manufacturers is based upon price. If one or more manufacturers significantly reduce their prices in an effort to gain market share, the Company's results of operations or market position could be adversely affected. Certain of the Company's competitors, particularly manufacturers of nationally advertised brand name products, are larger and have resources substantially greater than those of the Company. Much speculation has also been made about the potential for increased participation in these markets by major international pharmaceutical companies. In the future, one or more of these companies could seek to compete more directly with the Company by manufacturing and distributing their own or others products or by significantly lowering the prices of their national brand products.

The Company sells substantially all of its vitamin products to customers who sell and distribute the products. Although the Company does not currently participate significantly in other channels such as health food stores, direct mail, internet sales and direct sales, the Company may expand its operations and its products may face competition from such alternative channels as more customers utilize these channels of distribution to obtain vitamin products.

Reliance on Certain Suppliers; Availability and Cost of Purchased Materials

The Company purchases from third party suppliers raw materials and certain products that the Company does not manufacture. Although the Company currently has supply arrangements with several suppliers of these ingredients and products, and the Company's purchased materials are generally available from numerous sources; an unexpected interruption of supply could materially adversely affect the Company's results of operations.

RISK FACTORS *(continued)*

Exposure to Product Liability Claims

The Company, like other retailers, distributors and manufacturers of products that are ingested, faces a risk of exposure to product liability claims in the event that, among other things, the use of its products results in injury. The Company maintains product liability coverage in the amount of $25 million, including primary product liability and excess liability coverage with deductibles of $25,000 per claim. There can be no assurance product liability insurance will continue to be available at an economically reasonable cost or that the Company's insurance will be adequate to cover liability the Company incurs in respect to product liability claims. See also "Item 3. Legal Proceedings and Product Liability."

Reliance on Key Management

The operation of the Company requires managerial and operational expertise. The Company does not have long term employment contracts with any of its executives. If, for any reason, key personnel do not continue to be active in the Company management, operations could be adversely affected.

Risks Associated with International Markets

The Company's growth may be dependent in part upon its ability to expand its operations and those of its customers into new markets, including international markets. The Company may experience difficulty entering new international markets due to greater regulatory barriers, the necessity of adapting to new regulatory systems and problems related to entering new markets with different cultural bases and political systems. Operating in international markets exposes the Company to certain risks, including, among other things, (1) changes in or interpretations of foreign import, currency transfer and other restrictions and regulations that among other things may limit the Company's ability to sell certain products or repatriate profits to the United States, (2) exposure to currency fluctuations, (3) the potential imposition of trade or foreign exchange restrictions or increased tariffs, and (4) economic and political instability. As the Company continues to expand its international operations, these and other risks associated with international operations are likely to increase.

Litigation Involving Products Containing Certain Raw Materials

There can be no assurance that the Company will not be named in actions in the future seeking damages for alleged personal injuries resulting from the ingestion of certain products, and result in the Company becoming a defendant in multiple actions and such an event could have a material adverse impact on the Company.

Concentration of Ownership; Certain Anti-Takeover Considerations

The Company's directors and executive officers beneficially own approximately 27% of the outstanding Common Stock. Accordingly, these shareholders will continue to have the ability to substantially influence the management, policies and business operations of the Company. The Company's Board of Directors has the authority to approve the issuance of 5,000,000 shares of preferred stock and to fix the rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the Company's shareholders. The rights of the holders of Common Stock will be subject to, and may be adversely affected by, the rights of holders of any preferred stock that may be issued in the future. Certain provisions of Delaware law, as well as the issuance of preferred stock, and other "anti-takeover" provisions in the Company's Articles and Bylaws, could delay or inhibit the removal of incumbent directors and could delay, defer, make more difficult or prevent a merger, tender offer or proxy contest, or any change in control involving the Company, as well as the removal of management, even if such events would be beneficial to the interests of the Company's shareholders, and may limit the price certain investors may be willing to pay in the future for shares of Common Stock.

PART II

RISK FACTORS *(continued)*

Volatility of Stock Price

The Company's stock price has experienced significant volatility over the past two fiscal years. Moreover, the stock market has from time to time experienced extreme price and volume fluctuations that may be unrelated to the operating performance of particular companies. Market conditions in the vitamin and nutritional supplement industry and factors such as announcements of new products by the Company, its competitors or third parties, and changes in earnings estimates by analysts, may have a significant effect on the price of the Common Stock.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and supplementary data as required by this item are set forth on pages 19 through 43.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this item is included under the caption “Directors and Executive Officers of the Registrant” in the Registrant’s Proxy Statement for the 1999 Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is included under the caption “Executive Compensation” in the Registrant’s Proxy Statement for the 1999 Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this item is included under the caption “Security Ownership of Certain Beneficial Owners and Management” in the Registrant’s Proxy Statement for the 1999 Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is included under the caption “Certain Relationships and Related Transactions” in the Registrant’s Proxy Statement for the 1999 Annual Meeting of Stockholders and is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) 1. **Financial Statements**

The financial statements listed in the accompanying index to consolidated financial statements are filed as part of this report.

2. **Financial Statement Schedules**

The financial statement schedule listed in the accompanying index to the consolidated financial statements is filed as part of this annual report. Schedules not included have been omitted because they are not applicable or the information required is included in the financial statements and notes thereto.

(b) **Exhibits**

Exhibit 23	Re: Consent of KPMG LLP
Exhibit 27	Financial Data Schedule

(c) **Reports Form 8-K**

Not Applicable

NATURAL ALTERNATIVES INTERNATIONAL, INC. AND SUBSIDIARIES
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AND FINANCIAL STATEMENT SCHEDULE
JUNE 30, 1999

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INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
NATURAL ALTERNATIVES INTERNATIONAL, INC.:

We have audited the consolidated financial statements of Natural Alternatives International, Inc. and subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Natural Alternatives International, Inc. and subsidiaries as of June 30, 1999 and 1998, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended June 30, 1999, in conformity with generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG LLP

San Diego, California
September 10, 1999

NATURAL ALTERNATIVES INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
JUNE 30, 1999 AND 1998

ASSETS

	June 30 1999	June 30 1998
Current Assets:		
Cash and cash equivalents	$1,062,894	$4,714,212
Accounts receivable - less allowance for doubtful accounts of $472,000 at June 30, 1999 and $1,073,000 at June 30, 1998 (Notes F and M)	7,515,320	12,558,731
Inventories (Notes C and F)	9,875,961	11,504,936
Income tax refund receivable (Note I)	2,229,260	-
Notes receivable - current portion (Note L)	127,037	399,307
Prepaid expenses	370,918	399,341
Deposits	1,265,061	641,573
Other current assets	793,563	424,021
Total Current Assets	23,240,014	30,642,121
Property and equipment, net (Notes D, F, G, H, and L)	12,274,065	10,531,865
Other Assets:		
Deferred income taxes (Note I)	1,979,000	854,000
Investments (Note E)	383,515	61,971
Notes receivable, less current portion (Note L)	650,617	443,088
Other noncurrent assets, net	68,812	454,234
Total Other Assets	3,081,944	1,813,293
TOTAL ASSETS	$38,596,023	$42,987,279

(continued)

NATURAL ALTERNATIVES INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS *(continued)*
JUNE 30, 1999 AND 1998

LIABILITIES AND STOCKHOLDERS' EQUITY

	June 30 1999	June 30 1998
Current Liabilities:		
Accounts payable	$8,305,333	$12,301,859
Current installments of long-term debt (Note G)	50,486	46,501
Current installments of capital lease obligation (Note H)	-	23,542
Income taxes payable (Note I)	-	378,055
Accrued compensation and employee benefits	786,306	438,242
Total Current Liabilities	9,142,125	13,188,199
Deferred income taxes (Note I)	593,000	500,000
Long-term debt, less current installments (Note G)	926,864	977,375
Accrual for loss on lease obligation and other (Note L)	2,433,526	-
Long-term pension liability (Note J)	410,048	662,564
Total Liabilities	13,505,563	15,328,138
Stockholders' Equity (Note K):		
Preferred stock; $.01 par value; 500,000 shares authorized; none issued or outstanding	-	-
Common stock; $.01 par value; 8,000,000 shares authorized; issued and outstanding 6,002,375 at June 30, 1999 and 5,768,209 at June 30, 1998	60,024	57,682
Additional paid-in capital	11,236,812	9,756,822
Retained earnings	14,969,438	17,892,778
Treasury stock, at cost, 212,500 shares at June 30, 1999	(1,116,250)	-
Accumulated other comprehensive loss (Note E)	(59,564)	(48,141)
Total Stockholders' Equity	25,090,460	27,659,141
Commitments and contingencies (Notes L and N)		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$38,596,023	$42,987,279

See accompanying notes to consolidated financial statements.

NATURAL ALTERNATIVES INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED JUNE 30, 1999, 1998 AND 1997

	1999	1998	1997
Net sales	$57,429,898	$67,894,305	$49,444,221
Cost of goods sold	45,010,301	49,157,717	39,019,224
GROSS PROFIT	12,419,597	18,736,588	10,424,997
Selling, general & administrative expenses	12,309,275	9,114,110	8,609,925
Provision for loss on lease obligation	5,047,667	-	-
INCOME (LOSS) FROM OPERATIONS	(4,937,345)	9,622,478	1,815,072
Other income (expense):			
Interest income	185,128	194,781	163,368
Interest expense	(85,158)	(110,337)	(147,373)
Other, net	15,035	(40,157)	8,853
	115,005	44,287	24,848
EARNINGS (LOSS) BEFORE INCOME TAXES	(4,822,340)	9,666,765	1,839,920
Provision for income taxes (benefit) (Note I)	(1,899,000)	3,795,000	720,000
NET EARNINGS (LOSS)	(2,923,340)	5,871,765	1,119,920
Unrealized gain (loss) on investments	(11,423)	3,109	(36,028)
Comprehensive Income (loss)	($2,934,763)	$5,874,874	$1,083,892
NET EARNINGS (LOSS) PER COMMON SHARE:			
Basic	$ (0.50)	$ 1.06	$ 0.21
Diluted	$ (0.50)	$ 1.00	$ 0.20

See accompanying notes to consolidated financial statements.

NATURAL ALTERNATIVES INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED JUNE 30, 1999, 1998 AND 1997

	Common Stock		Additional Paid-in	Retained	Treasury	Accumulated Other Comprehensive	
	Shares	Amount	Capital	Earnings	Stock	Income (Loss)	Total
Balance, June 30, 1996	5,351,875	$53,519	$6,220,196	$10,901,093	$ -	$ (15,222)	$17,159,586
Issuance of common stock upon exercise of employee stock options	77,889	779	369,630	-	-	-	370,409
Income tax benefit from stock options exercised	-	-	85,600	-	-	-	85,600
Net unrealized loss on investments	-	-	-	-	-	(36,028)	(36,028)
Net earnings	-	-	-	1,119,920	-	-	1,119,920
Balance, June 30, 1997	5,429,764	54,298	6,675,426	12,021,013	-	(51,250)	18,699,487
Issuance of common stock upon exercise of employee stock options	338,445	3,384	1,646,202	-	-	-	1,649,586
Income tax benefit from stock options exercised	-	-	1,435,194	-	-	-	1,435,194
Net unrealized gains on investments	-	-	-	-	-	3,109	3,109
Net earnings	-	-	-	5,871,765	-	-	5,871,765
Balance, June 30, 1998	5,768,209	57,682	9,756,822	17,892,778	-	(48,141)	27,659,141
Issuance of common stock upon exercise of stock options	234,166	2,342	1,105,676	-	-	-	1,108,018
Income tax benefit from stock options exercised	-	-	374,314	-	-	-	374,314
Treasury stock purchased	-	-	-	-	(1,116,250)	-	(1,116,250)
Net unrealized loss on investments	-	-	-	-	-	(11,423)	(11,423)
Net loss	-	-	-	(2,923,340)	-	-	(2,923,340)
Balance, June 30, 1999	6,002,375	$60,024	$11,236,812	$14,969,438	($1,116,250)	$ (59,564)	$25,090,460

See accompanying notes to consolidated financial statements.

NATURAL ALTERNATIVES INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 1999, 1998 AND 1997

	1999	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings (loss)	($2,923,340)	$5,871,765	$1,119,920
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:			
Bad debt provision	566,537	360,000	725,000
Write-off of notes receivable	353,017	-	-
Tax benefit on option exercise	374,314	1,435,194	85,600
Depreciation and amortization	1,637,837	1,515,402	1,276,355
Deferred income taxes	(1,032,000)	10,000	(296,000)
Pension expense, net of contributions	162,649	88,839	158,560
Loss on disposal of assets	4,634	54,727	3,601
Loss on investments	675	-	-
Provision for loss on lease obligation, net of amounts paid	4,739,193	-	-
Other	9,764	(36,808)	(18,105)
Changes in operating assets and liabilities:			
(Increase) decrease in:			
Accounts receivable	4,476,874	(6,028,610)	(1,747,544)
Inventories	1,628,975	(5,814,086)	708,742
Tax refund receivable	(2,229,260)	842,209	(842,209)
Prepaid expenses	28,423	(189,155)	107,812
Deposits	(623,488)	(319,304)	(221,756)
(Decrease) increase in:			
Accounts payable	(3,996,526)	5,044,941	2,785,720
Income taxes payable	(378,055)	378,055	(520,246)
Accrued compensation and employee benefits	348,064	116,905	40,997
Customer deposits	-	-	(2,606)
Net Cash Provided by Operating Activities	$3,148,287	$3,330,074	$3,363,841

(continued)

NATURAL ALTERNATIVES INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
FOR THE YEARS ENDED JUNE 30, 1999, 1998 AND 1997

	1999	1998	1997
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sale of property and equipment	$ 10,000	$ 65,000	$ 10,000
Proceeds from sale of investments	225	-	-
Capital expenditures	(5,700,338)	(3,474,569)	(2,236,165)
Issuance of notes receivable	(640,748)	(4,625)	(183,909)
Repayment of notes receivable	342,708	142,966	109,262
Investment purchases	(333,867)	-	(20,000)
Other assets	(399,285)	(198,024)	438,037
Net Cash Used in Investing Activities	(6,721,305)	(3,469,252)	(1,882,775)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Borrowings on lines of credit	700,000	-	443,959
Payments on lines of credit	(700,000)	-	(443,959)
Payments on long-term debt and capital leases	(70,068)	(265,935)	(269,163)
Issuance of common stock	1,108,018	1,649,586	370,409
Treasury stock acquisitions	(1,116,250)	-	-
Net Cash Provided by Financing Activities	(78,300)	1,383,651	101,246
Net Increase (Decrease) in Cash and Cash Equivalents	(3,651,318)	1,244,473	1,582,312
Cash and Cash Equivalents at Beginning of Year	4,714,212	3,469,739	1,887,427
Cash and Cash Equivalents at End of Year	$ 1,062,894	$ 4,714,212	$ 3,469,739
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	$ 84,494	$ 99,602	$ 147,373
Income taxes	1,196,000	1,494,000	2,289,959
Disclosure of non-cash activities:			
Net unrealized gains (losses) on investments	$ (11,423)	$ 3,109	$ (36,028)
Fixed asset purchases in accounts payable	-	432,720	-
Issuance of note receivable for payment of account receivable	-	100,000	-
Write-off of notes receivable through the allowance for doubtful accounts	-	-	15,504

See accompanying notes to consolidated financial statements.

A. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Natural Alternatives International, Inc., (the Company) manufactures vitamins, micronutrients and related nutritional supplements, and provides innovative private-label products for specialized corporate, institutional and commercial accounts worldwide. The Company operates as a single business segment.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, NAIE Natural Alternatives International Europe, SA. All significant intercompany accounts and transactions have been eliminated.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The carrying amount reported in the balance sheet for cash and cash equivalents approximates its fair value.

Inventories

Inventories are recorded at the lower of cost (first-in, first-out) or market (net realizable value). Such costs include raw materials, labor and production overhead.

Property and Equipment

Property and equipment are stated at cost. Property and equipment under capital leases are recorded at the lower of fair market value or the present value of future minimum lease payments and are amortized using the straight-line method over the shorter of the estimated useful life of the asset or the lease term. Depreciation of property and equipment is provided using the straight-line method over their estimated useful lives, generally ranging from 3 to 39 years. Leasehold improvements are amortized using the straight-line method over the shorter of the life of the improvement or the remaining term of the lease. Maintenance and repairs are expensed as incurred. Significant expenditures that increase useful lives are capitalized.

Impairment of Long-Lived Assets

The Company accounts for its long-lived assets in accordance with SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. This Statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceed the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. In 1999, the Company recorded a $2.3 million charge for the impairment of certain assets. See Note L for discussion.

(continued

A. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investments

The Company accounts for its investments in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The Company’s investments, which consist of equity securities, are classified as available for sale and are carried at fair value, with unrealized gains and losses excluded from net earnings and included in Accumulated Other Comprehensive Loss.

Revenue Recognition

Revenue from sales of product, and related cost of products sold, is recognized upon shipment of product at which time title passes to the customer. Customers generally do not have the right to return product unless damaged or defective.

Cost of Goods Sold

Cost of goods sold includes raw material, labor and overhead.

Marketing Costs

In order to attract and retain its customer base, the Company provides a wide range of marketing services to its customers. The Company does not generate fees or revenues from these services and the related costs are expensed as incurred.

Income Taxes

The Company accounts for income taxes using the asset and liability method in accordance with SFAS No. 109 “Accounting for Income Taxes.” Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date.

Stock Option Plans

The Company accounts for its stock-based employee compensation for stock options using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations, as allowed under SFAS 123. Accordingly, compensation cost is measured as the excess, if any, of the fair value of the Company's stock at the date of the grant over the price the employee must pay to acquire the stock.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, notes receivable, investments, and accounts approximates fair value due to the relatively short maturity of such instruments. The carrying amounts for long-term debt approximate fair value as the interest rates and terms are substantially similar to rates and terms that could be obtained currently for similar instruments.

(continued)

A. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities, revenue and expenses, and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

Net Earnings (Loss) per Share

The Company computes net earnings (loss) per share in accordance with Statement of Financial Accounting Standards No. 128, “Earnings Per Share” (“SFAS 128”). This statement requires the presentation of basic earnings (loss) per share, computed using the weighted average number of shares outstanding during the period, and diluted earnings (loss) per share, computed 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 the Company’s diluted earnings (loss) per share computation. Basic and diluted earnings (loss) per share have been calculated as follows:

For the Years Ended June 30, 1999, 1998, and 1997

	1999	1998	1997
Numerator:			
Net earnings (loss) - Numerator for basic and diluted earnings (loss) per share - earnings (loss) available to common shareholders	($2,923,340)	$ 5,871,765	$ 1,119,920
Denominator:			
Denominator for basic earnings (loss) per share - weighted average shares	5,868,159	5,544,337	5,395,438
Effect of dilutive securities - employee stock options	-	322,303	197,638
Denominator for diluted earnings (loss) per share - adjusted weighted average shares with assumed conversions	5,868,159	5,866,640	5,593,076
Basic earnings (loss) per share	$ (0.50)	$ 1.06	$ 0.21
Diluted earnings (loss) per share	$ (0.50)	$ 1.00	$ 0.20

Options totaling 142,147 shares were excluded from the calculation of diluted earnings (loss) per share for the year ended June 30, 1999 as the effect of their inclusion would be anti-dilutive.

(continued)

A. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Concentrations of Credit Risk

Financial instruments that subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company places its cash and cash equivalents with highly rated financial institutions. Credit risk with respect to receivables is concentrated with the Company's three largest customers (see Note M). These three customers' receivable balances collectively represent 55% of gross accounts receivable at June 30, 1999 and 57% at June 30, 1998. Concentrations of credit risk related to the remaining accounts receivable balance are limited due to the number of customers comprising the Company's remaining customer base.

Reclassifications

Certain amounts in prior years' consolidated financial statements have been reclassified to conform to the 1999 presentation.

B. INTERNATIONAL SUBSIDIARY

On January 22, 1999, NAIE Natural Alternatives International Europe, SA was incorporated as a wholly-owned subsidiary of the Company, which is based in Switzerland. Operations are expected to commence in the first quarter of fiscal 2000.

C. INVENTORIES

Inventories are comprised of the following at June 30:

	1999	1998
Raw materials	$6,722,040	$7,049,954
Work in progress	269,961	3,971,315
Finished goods	2,883,960	483,667
	$9,875,961	$11,504,936

D. PROPERTY AND EQUIPMENT

The following is a summary of property and equipment at June 30:

	Life Used For Depreciation	1999	1998
Land	NA	$392,600	$392,600
Building and building improvements	5 - 39 years	3,232,805	3,140,655
Machinery and equipment	3 - 15 years	12,784,168	10,077,375
Office equipment and furniture	5 to 7 years	2,549,478	2,304,243
Equipment under capital leases	5 Years	-	516,362
Vehicles	3 years	178,837	42,684
Leasehold improvements	5 to 39 years	1,842,313	1,274,076
Total property and equipment		20,980,201	17,747,995
Less accumulated depreciation and amortization		(8,706,136)	(7,216,130)
Property and equipment, net		$12,274,065	$10,531,865

At June 30, 1998 accumulated depreciation and amortization includes $477,532 of amortization of equipment under capital leases.

E. INVESTMENTS

Investments consist of marketable securities. Securities held at June 30, 1999 and 1998 are considered "available for sale securities." Securities are valued at $383,515 and $61,971 as of June 30, 1999 and 1998. The security portfolio includes gross unrealized losses, net of tax, of $59,564 and $48,141 at June 30, 1999 and 1998.

F. LINE OF CREDIT AGREEMENTS

The Company has revolving lines of credit agreements permitting borrowings up to $3,000,000, which are secured by the Company’s receivables, inventories, equipment, and vehicles and bear interest at the bank's prime rate, which was 7.75% at June 30, 1999. Advances against the revolving lines of credit cannot exceed 70% of eligible receivables. These agreements contain financial covenants concerning limitations on maintenance of debt, certain financial ratios and other matters. The lines of credit expire on January 19, 2000; management expects such lines to be renewed in the normal course of business. There were no amounts outstanding under these credit agreements at June 30, 1999 and 1998, respectively. The Company received a waiver for certain debt covenants for which it was not compliant as of June 30, 1999.

G. LONG-TERM DEBT

Long-term debt consisted of the following as of June 30:

	1999	1998
Note payable to bank, secured by building, interest at 8.25% principal and interest payments of $10,769 monthly, due 2011	$977,350	$1,023,876
Less current installments	(50,486)	(46,501)
Long-term debt, less current installments	$926,864	$977,375

Aggregate amounts of long-term debt maturities as of June 30, 1999 are as follows:

2000	$ 50,486
2001	54,812
2002	59,509
2003	64,608
2004	60,145
Thereafter	687,790
	$ 977,350

H. CAPITAL LEASE OBLIGATION

The Company leased certain equipment under a capital lease, which expired in fiscal year 1999. The present value of the future minimum capital lease payments as of June 30 are as follows:

	1999	1998
Capital lease payable to AT&T Credit Corporation, secured by phone system, interest at 13%, principal and interest in monthly installments of $2,504. Lease expired May 1999.	$ -	$24,964
Less amount representing interest	-	(1,422)
Present value of net minimum lease payments	-	23,542
Less current installments	-	(23,542)
Capital lease obligations - less current installments	$ -	$ -

I. INCOME TAXES

Income taxes (benefit) for the year ended June 30 consist of the following:

	1999	1998	1997
Current:			
Federal	($857,000)	$3,104,000	$850,000
State	(10,000)	681,000	166,000
	(867,000)	3,785,000	1,016,000
Deferred:			
Federal	(689,000)	8,500	(215,000)
State	(343,000)	1,500	(81,000)
	(1,032,000)	10,000	(296,000)
Income taxes (benefit)	($1,899,000)	$3,795,000	$720,000

The provision (benefit) for deferred income taxes for the year ended June 30 consists of the following:

	1999	1998	1997
Accrual for loss on lease obligation	$ (971,000)	$ -	$ -
Accelerated depreciation and amortization for tax purposes	93,000	13,000	95,000
Increase in valuation allowance	-	-	2,000
Inventories	(106,000)	(24,000)	(131,000)
Bad debt expense	(245,000)	238,000	(309,000)
Accrued vacation expense	7,000	1,000	(15,000)
Customer deposits	-	-	(1,000)
State income taxes	232,000	(207,000)	63,000
Other, net	14,000	(11,000)	-
Net operating loss carryforward	(56,000)	-	-
	($1,032,000)	$10,000	($296,000)

(continued)

I. INCOME TAXES *(continued)*

Net deferred tax assets and deferred tax liabilities as of June 30 are as follows:

	1999	1998
Deferred tax assets:		
Accrual for loss on lease obligation	$ 971,000	$ -
Allowance for doubtful accounts	443,000	198,000
Accrued vacation expense	46,000	53,000
Investment loss carryforward	36,000	36,000
State income taxes	-	232,000
Allowance for inventories	463,000	357,000
Other, net	-	14,000
Net operating loss carryforward	56,000	-
Total gross deferred tax assets	2,015,000	890,000
Less valuation allowance	36,000	36,000
Net deferred tax assets	1,979,000	854,000
Deferred tax liabilities:		
Accumulated depreciation and amortization	593,000	500,000
Net deferred tax asset	$1,386,000	$354,000

The valuation allowance for deferred tax assets was $36,000 at June 30, 1999 and 1998. 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 not be realized. Management considers, among other things, the scheduled reversal of deferred tax liabilities, projected future taxable income, and other planning strategies. In making this assessment, management believes it is more likely than not that the Company will realize the benefit of the deferred tax asset, net of the existing valuation allowance, at June 30, 1999 and 1998.

(continued)

I. INCOME TAXES *(continued)*

A reconciliation of income taxes computed by applying the statutory federal income tax rate of 34% to earnings before income taxes for the year ended June 30 is as follows:

	1999	1998	1997
Income taxes (benefit) computed at statutory federal income tax rate	($1,640,000)	$3,286,700	$626,000
State income taxes (benefit), net of federal income tax benefit (expense)	(220,000)	451,000	56,000
Increase in valuation allowance	-	-	2,000
Expenses not deductible for tax purposes	32,000	35,000	31,000
Other	(71,000)	22,300	5,000
Income taxes (benefit) as reported	($1,899,000)	$3,795,000	$720,000
Effective tax rate	39.4%	39.3%	39.1%

J. EMPLOYEE BENEFIT PLANS

The Company has a profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code, whereby participants may contribute a percentage of compensation, but not in excess of the maximum allowed under the Code. All employees with twelve months and at least one thousand hours of service during the twelve-month period are eligible to participate in the plan. The Company may make contributions at the discretion of its Board of Directors. The Company contributed and expensed $167,218, $146,277, and $114,206 in 1999, 1998 and 1997, respectively.

The Company has a "Cafeteria Plan" pursuant to Section 125 of the Internal Revenue Code, whereby health care benefits are provided for active employees through insurance companies. Substantially all active full-time employees are eligible for these benefits. The Company recognizes the cost of providing these benefits by expensing the annual premiums, which are based on benefits paid during the year. The premiums expensed for these benefits totaled $365,613, $241,815, and $228,805 for 1999, 1998 and 1997, respectively.

The Company sponsors a defined benefit pension plan (the “Plan”), which provides retirement benefits to employees based generally on years of service and compensation during the last five years before retirement. Effective June 21, 1999, the Company adopted an amendment to freeze benefit accruals of the participants of the Plan, resulting in the recognition of $97,606 of net curtailment gains in 1999. The gain resulted from the net decrease of the Company’s benefit obligation. At June 30, 1999, the estimated amortized portion of the unfunded estimated accrued liability for prior service cost, using a 30-year funding period, amounted to $410,048. This amount has been accrued in the current period. The Company’s policy is to fund the net pension cost accrued. However, the Company would not contribute an amount less than the minimum funding requirements of the Employee Retirement Income Security Act of 1974 or more than the maximum tax-deductible amount.

(continued)

J. EMPLOYEE BENEFIT PLANS *(continued)*

Disclosure of Funded Status

The following table sets forth the Plan's funded status and amount recognized in the Company's consolidated balance sheets at June 30, after the effect of curtailment:

	1999	1998
Change in Benefit Obligation		
Benefit obligation at beginning of year	$ 2,084,109	$ 1,207,944
Service cost	527,319	268,815
Interest cost	124,216	84,171
Plan participant contributions	-	-
Actuarial (gain)/loss	165,610	530,572
Benefits paid	0	(7,393)
Effect of curtailment	(1,722,023)	-
Benefit obligation at end of year	$ 1,179,231	$ 2,084,109
Change in Plan Assets		
Fair value of plan assets at beginning of year	$ 313,750	$ -
Actual return on plan assets	18,812	5,368
Employer contributions	436,621	315,775
Plan participant contributions	-	-
Benefits paid	-	(7,393)
Fair value of plan assets at end of year	$ 769,183	$ 313,750
Reconciliation of Funded Status		
Funded status (under)/over funded	$ (410,048)	$ (1,770,359)
Unrecognized net actuarial (gain)/loss	-	529,132
Unrecognized transition (asset)/obligation	-	-
Unrecognized prior service cost	-	993,828
(Accrued)/Prepaid benefit cost	$ (410,048)	$ (247,399)
Additional Minimum Liability Disclosures		
Accrued benefit liability	$ -	$ (662,564)
Intangible asset	$ -	$ 415,165
Other comprehensive income, not adjusted for applicable income tax	$ -	$ -

(continued)

J. EMPLOYEE BENEFIT PLANS *(continued)*

Net Periodic Benefit Cost

The Net Periodic Benefit Cost for the fiscal years ending June 30 includes the following components:

	1999	1998
Components of Net Periodic Benefit Cost		
Service cost	$527,319	$268,815
Interest cost	124,216	84,171
Expected return on Plan Assets	(32,078)	(7,681)
Recognized net actuarial (gain)/loss	18,110	-
Amortization of transition (asset)/obligation	-	-
Amortization of prior service cost	59,309	59,309
Effect of special events (curtailment)	(97,606)	-
Net periodic benefit cost	$599,270	$404,614

Assumption and Method Disclosures

	1999	1998
Discount rate	6.00%	6.00%
Expected long term rate of return	7.50%	7.50%
Weighted average rate of compensation increase	N/A	N/A
Amortization method	Straight-line	Straight-line

K. STOCKHOLDERS' EQUITY

Treasury Stock

In February 1999, the Board of Directors approved a repurchase program of up to 500,000 shares of the Company's common stock. As of June 30, 1999, 199,500 shares had been repurchased under this repurchase approval. In addition, the Company repurchased 13,000 from an officer of the Company, bringing the aggregate amount of repurchases to 212,500 shares of common stock for a total, net of broker fees, of $1,116,250.

Employee Stock Option Plans

Effective June 5, 1992, the Company adopted the 1992 Incentive Stock Option Plan for which 500,000 common shares have been reserved for issuance to officers, directors, and key employees of the Company. The plan provides that no option may be granted at an exercise price less than the fair market value of the common stock of the Company on the date of grant. On September 9, 1993, 200,000 options were granted with an exercise price equal to the fair market value price of $4.875 per share. On January 21, 1998, 300,000 options were granted with an exercise price equal to the fair market value price of $10.50 per share. During 1999, 188,250 of these options were forfeited, and on May 10, 1999 an additional 70,000 options were granted with an exercise price equal to the fair market value price of $3.78 per share.

(continued)

K. STOCKHOLDERS' EQUITY *(continued)*

Also effective June 5, 1992, the Company adopted the 1992 Nonqualified Stock Option Plan and reserved a total of 250,000 common shares for issuance to officers, employees, and consultants of the Company. On September 9, 1993, 250,000 options were granted with an exercise price equal to the fair market value price of $4.875 per share. All remaining options under this plan were exercised as of June 30, 1999.

Effective December 9, 1994, the Board of Directors approved the 1994 Nonqualified Stock Option Plan for which 500,000 common shares were reserved for issuance to officers, employees, and consultants of the Company. On January 24, 1995, 500,000 options were granted with an exercise price equal to the fair market value price of $4.625 per share. During fiscal 1999, 125,000 of the unexercised options were forfeited.

All stock options under each of the plans have five-year terms and all options become fully vested within three years of their grant date.

Stock option activity during the periods indicated is summarized below:

	1992 Incentive Plan	1992 Nonqualified Plan	1994 Nonqualified Plan
Outstanding at June 30, 1996	124,002	233,498	489,000
Exercised	27,833	12,556	37,500
Outstanding at June 30, 1997	96,169	220,942	451,500
Exercised	57,778	159,333	121,334
Granted	300,000	-	-
Outstanding and exercisable at June 30, 1998	338,391	61,609	330,166
Exercised	38,391	61,609	34,166
Forfeited	188,250	-	125,000
Granted	70,000	-	-
Outstanding and exercisable at June 30, 1999	181,750	-	171,000
Weighted-average exercise price:			
June 30, 1999	$ 7.91	$ -	$ 4.63
June 30, 1998	$ 9.86	$ 4.88	$ 4.63
Weighted-average remaining contractual life in years	4.25	-	0.5
Available for grant at June 30, 1999	118,250	-	-

The fair value of the option grants was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions for fiscal 1999: risk-free interest rate equal to 5.90% at the grant date; dividend yield of zero; expected life of three years; and volatility of 62.1%. The weighted average fair value of options granted during fiscal year 1999 was $1.74. The assumptions used for fiscal 1998 are as follows: risk-free interest rate equal to 5.33% at the grant date; dividend yield of zero; expected life of three years; and volatility of 53.4%. The weighted average fair value of options granted during fiscal year 1998 was $4.27.

(continued)

K. STOCKHOLDERS' EQUITY *(continued)*

On May 10, 1999, the Board of Directors adopted the 1999 Omnibus Equity Incentive Plan ("1999Plan") and reserved for issuance thereunder 500,000 shares of common stock for officers, directors, employees and consultants of the Company. The 1999 Plan is subject to shareholder approval which is currently scheduled to be requested at the Annual Meeting of Shareholders on December 6, 1999. No options have been granted under the 1999 Plan.

	1999	1998
Net earnings (loss), as reported	($2,923,340)	$ 5,871,765
Pro forma net earnings (loss)	($3,311,091)	$ 5,700,965
Basic earnings (loss) per share, as reported	$ (0.50)	$ 1.06
Pro forma basic earnings (loss) per share	$ (0.56)	$ 1.03
Diluted earnings (loss) per share, as reported	$ (0.50)	$ 1.00
Pro forma diluted earnings (loss) per share	$ (0.56)	$ 0.97

The Company applies APB Opinion No. 25 in accounting for its Plans and, accordingly, no compensation cost has been recognized for its stock option grants to employees in the financial statements. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123, the Company's net earnings (loss) would have been the pro forma amounts indicated below:

Proforma net earnings (loss) reflect only options granted in fiscal years 1999 and 1998 as there were no options granted by the Company during fiscal year 1997 or 1996. The full impact of calculating compensation cost for stock options under Statement No. 123 is not reflected in the proforma net earnings (loss) amounts presented above because compensation cost is reflected over the options' vesting period and compensation cost for options granted prior to July 1, 1995 is not considered.

Other Stock Options

On January 24, 1995, the Board of Directors granted 100,000 options with an exercise price of $4.625 in exchange for consulting services and reserved 100,000 common shares. The options were exercised in January 1999.

On March 14, 1997, 45,000 options were granted pursuant to a consulting agreement at prices ranging from $9.00 to $15.00 per share. Consulting expense incurred as a result of these options was $84,000 for the year ended June 30, 1997. None of the options were exercised and all had expired as of June 30, 1999.

L. COMMITMENTS AND RELATED PARTY TRANSACTIONS

The Company leases part of its main facilities under leases that are classified as noncancelable operating leases. In August 1997, the Company entered into a 15-year lease agreement under which the lessor was to construct a build-to-suit office and manufacturing facility in Carlsbad, California. Monthly lease payments commenced in November, 1998, at $103,000 per month and are subject to annual inflation adjustments. In March 1999, the Company made the decision to sublease, and not occupy, the partially completed facility. In the third quarter of 1999, the Company recorded a $2.3 million charge for impairment of leasehold assets and an accrual of $2.7 million representing the present value of the excess of future lease payments over estimated sub-lease income. The Company has an option to acquire the facility during the sixth year of the lease.

(continued)

L. COMMITMENTS AND RELATED PARTY TRANSACTIONS *(continued)*

The Company entered into two lease agreements during fiscal year 1999 for adjacent buildings located in Vista, California. The facilities are leased from an unaffiliated third party and consist of a total of approximately 74,000 square feet. The lease for the first building commenced in August 1998 under a 5-year lease agreement and consists of approximately 54,000 square feet to be utilized as a warehousing and blending facility. The lease for the second building commenced in March 1999 under a 3.5-year lease agreement for the rental of approximately 20,000 square feet to be utilized as a packaging facility.

Minimum rental commitments (exclusive of property tax, insurance and maintenance) under all noncancelable operating leases, including the leases agreements referred to above, (with initial or remaining lease terms in excess of one year) are set forth below:

2000	$1,838,618
2001	1,832,931
2002	1,817,001
2003	1,850,836
2004	1,491,810
Thereafter	15,438,588
	$24,269,784

Rental expense totaled $419,254, $193,018, and $169,079 for the years ended June 30, 1999, 1998 and 1997, respectively.

During 1997, the Company had sales of $14,812 to a company in which a key employee and beneficial owner of 1% of the stock of the Company was formerly the president and part owner. At June 30, 1997, the amount receivable from this company was $775,302, which was fully reserved because the Company had determined the account to be doubtful of collection. The Company recovered $263,400 in the year ended June 30, 1998 and $511,902 was written off in the year ended June 30, 1999.

The Company entered into an agreement with the father-in-law and mother-in-law of the Chief Executive Officer of the Company in December 1991, which provides commissions on sales to a particular customer. The agreement will expire in December 2001. The commission equals 5% of sales, and is capped at $25,000 per calendar quarter, effective January 1, 1993. Amounts paid under this agreement were $100,000 for each of the years ended June 30, 1999, 1998 and 1997. There were no amounts owed under the agreement at June 30, 1999 or 1998.

During fiscal year 1993, the Company entered into an agreement with an unrelated party that required future minimum royalty payments over the term of the contract, which expired December 31, 1996. Amounts paid under this agreement were $154,728 for the year ended June 30, 1997.

Included in notes receivable are notes with the Chief Executive Officer, the Vice President of Science and Technology, the Vice President of Marketing, Business Development and Strategic Management, and the Vice President of Operations. During fiscal 1999, the Company made 6% interest-bearing loans, secured by Company stock, for $20,000 each to the Vice President of Science and Technology, the Vice President of Marketing, Business Development and Strategic Management, and the Vice President of Operations. The balances of these notes as of June 30, including accrued interest, are shown below:

	1999	1998
Chief Executive Officer	$63,208	$84,685
Vice President of Science and Technology	79,036	52,538
Vice President of Marketing, Business Development and Strategic Management	20,143	-
Vice President of Operations	20,143	-

(continued)

L. COMMITMENTS AND RELATED PARTY TRANSACTIONS *(continued)*

In addition, during the year ended June 30, 1999, the Company made a 5-1/2% interest-bearing loan to the Executive Vice President in the amount of $250,000. The loan, including accrued interest, was repaid in February 1999.

During the year ended June 30, 1999, the Company made noninterest-bearing loans to the Chairman of the Board and the former President in the amount of $50,000 and $6,901, respectively. Amounts owed on these loans, which are secured by proceeds from life insurance policies on their respective lives, were $250,000 and $200,000 for the Chairman of the Board and $0 and $82,815 for the former President at June 30, 1999 and 1998, respectively.

M. ECONOMIC DEPENDENCY

The Company had substantial sales to four separate customers during one or more of the periods shown in the following table. The loss of any of these customers could have an adverse impact on the Company's revenues and earnings in the short-term. Sales by customer, representing 10% or more of the respective year’s total sales, are shown below:

	1999		1998		1997	
Customer	Sales by Customer	%(a)	Sales by Customer	%(a)	Sales by Customer	%(a)
Customer 1	$18,389,660	32%	$24,914,144	37%	$17,934,985	36%
Customer 2	13,392,763	23%	11,659,906	17%	6,851,560	14%
Customer 3	(b)		(b)		5,936,477	12%
Customer 4	9,382,527	16%	(b)		(b)	
	41,164,950	71%	36,574,050	54%	30,723,022	62%

(a) Percent of total sales (b) Sales for the year were less than 10% of total sales.

Accounts receivable from these customers totaled $4,396,947 and $7,834,849 at June 30, 1999 and 1998, respectively.

N. CONTINGENCIES

The Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, based in part on the advice of counsel, the ultimate disposition of these matters will not have a material adverse effect on the Company’s consolidated financial position, results of operations or liquidity.

O. QUARTERLY DATA (unaudited)

The following is a summary of unaudited quarterly data:

	Year Ended June 30, 1999				
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Net sales	$16,985,802	$17,317,129	$13,122,768	$10,004,199	$57,429,898
Gross profit	4,654,109	3,265,419	1,890,817	2,609,252	$12,419,597
Net earnings (loss)	1,519,771	382,628	(4,320,762)	(504,977)	($2,923,340)
Net earnings (loss) per common share:					
Basic	0.26	0.06	(0.73)	(0.09)	(0.50)
Diluted	0.25	0.06	(0.73)	(0.09)	(0.50)

	Year Ended June 30, 1998				
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Net sales	$12,032,576	$16,297,341	$18,960,255	$20,604,133	$67,894,305
Gross profit	3,161,354	4,442,561	5,223,250	5,909,423	18,736,588
Net earnings	598,420	1,363,023	1,823,729	2,086,593	5,871,765
Net earnings per common share:					
Basic	$ 0.11	$ 0.25	$ 0.33	$ 0.36	$ 1.06
Diluted	$ 0.11	$ 0.24	$ 0.31	$ 0.34	$ 1.00

SCHEDULE II

NATURAL ALTERNATIVES INTERNATIONAL, INC.
VALUATION AND QUALIFYING ACCOUNTS
FOR THE YEARS ENDED JUNE 30, 1999, 1998 AND 1997

Allowance for doubtful accounts	Balance at beginning of period	Provision	Deductions*	Balance at end of period
Year ended June 30, 1999	$1,073,000	$567,000	$1,168,000	$472,000
Year ended June 30, 1998	$1,006,000	$360,000	$293,000	$1,073,000
Year ended June 30, 1997	$319,000	$725,000	$38,000	$1,006,000

* Accounts written off

See accompanying independent auditors report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NATURAL ALTERNATIVES INTERNATIONAL, INC.
(Registrant)

Date: September 27, 1999 By: /Mark A. Ledoux/ .
(Mark A. LeDoux, Chief Executive Officer, President and Assistant Treasurer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/Marie A. LeDoux/ (Marie A. LeDoux)	Chairperson of the Board, Secretary, and Director	September 27, 1999
/Mark A. LeDoux/ (Mark A. LeDoux)	Chief Executive Officer, President, Assistant Treasurer, and Director	September 27, 1999
/David Lough/ (David Lough)	Executive Vice President	September 27, 1999
/William R. Kellas/ (William R. Kellas)	Director	September 27, 1999
/Lee G. Weldon/ (Lee G. Weldon)	Director	September 27, 1999
/J. Scott Schmidt/ (J. Scott Schmidt)	Director	September 27, 1999

Exhibit 23

Independent Accountants' Consent

The Board of Directors
Natural Alternatives International, Inc.:

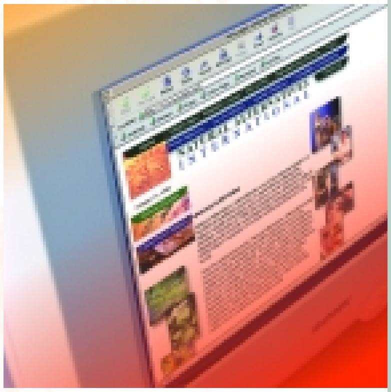
We consent to incorporation by reference in the registration statement (No. 33-00947) on Form S-8 of Natural Alternatives International, Inc. of our report dated September 10, 1999, relating to the consolidated balance sheets of Natural Alternatives International, Inc. and subsidiaries as of June 30, 1999 and 1998, and the related consolidated statements of operations and comprehensive income (loss), stockholders' equity, and cash flows for each of the years in the three-year period ended June 30, 1999, and the related financial statement schedule, which report appears in the June 30, 1999, annual report on Form 10-K of Natural Alternatives International, Inc.

KPMG LLP

San Diego, California
September 27, 1999

Board of Directors

Mark Le Doux, Lee Weldon,
Dr. William R. Kellas, Ph.D,
J. Scott Schmidt, Marie Le Doux



www.nai-online.com

NAI's updated website,
re-launched in September, 1999.

Board of Directors

Marie A.Le Doux
Chairman of the Board

Mark A. Le Doux
Director
and President and
Chief Executive Officer
Natural Alternatives
International

William R. Kellas, Ph.D
Director
and President
Center for Advanced
Medicine

Lee G. Weldon
Director
and President
Nature's Apothecary, Inc.

J. Scott Schmidt
Director
and Management
Consultant

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Certified Public Accountants
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San Diego, CA 92101

Legal Counsel

Fisher Thurber LLP
4225 Executive Square
La Jolla, CA 92037

Stockholder Inquiries

Please direct inquiries
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E-mail: info@nai-online.com
http://www.nai-online.com

Stock Listing

NASDAQ: NAII

Annual Meeting

The Annual Meeting of
Shareholders will be held
at the Quail's Inn Hotel
Conference Center, 1025
La Bonita Drive, San
Marcos, California, on
Monday, December 6,
1999, at 1:00 p.m.

NATURAL ALTERNATIVES
INTERNATIONAL

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