

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 December 31, 1990

RJR Nabisco Holdings Corp.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

1-10215
(Commission file number)

13-3490602
(I.R.S. Employer Identification No.)

RJR Nabisco Holdings Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

1-10214
(Commission file number)

13-3504690
(I.R.S. Employer Identification No.)

RJR Nabisco Capital Corp.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

1-10248
(Commission file number)

13-3504693
(I.R.S. Employer Identification No.)

RJR Nabisco, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

1-6388
(Commission file number)

56-0950247
(I.R.S. Employer Identification No.)

1301 Avenue of the Americas
New York, New York 10019

(212) 258-5600

(Address, including zip code, and telephone number, including area code,
of the principal executive offices of RJR Nabisco Holdings Corp.,

RJR Nabisco Holdings Group, Inc., RJR Nabisco Capital Corp. and RJR Nabisco, Inc.)

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

Title of each class	Name of each exchange on which registered	Title of each class	Name of each exchange on which registered
RJR Nabisco Holdings Corp.		RJR Nabisco, Inc.	
Common Stock, par value \$.01 per share	New York	7¼% Sinking Fund Debentures, Due February 1, 2001	New York
Warrants to purchase Common Stock, par value \$.01 per share	New York	8% Sinking Fund Debentures, Due January 15, 2007	New York
Cumulative Convertible Preferred Stock, stated value \$25 and par value \$.01 per share, liquidation preference of \$25 per share plus accrued and unpaid dividends	New York	Subsidiaries of the Registrants R. J. REYNOLDS TOBACCO COMPANY	
Senior Converting Debentures Due 2009	New York	7¼% Sinking Fund Debentures, Due September 1, 1994	New York
RJR Nabisco Holdings Group, Inc.		NABISCO BRANDS, INC.	
Subordinated Exchange Debentures Due 2007	New York	Nabisco, Inc.	
RJR Nabisco Capital Corp.		7¼% Sinking Fund Debentures Due May 1, 2001	New York
Subordinated Discount Debentures due May 15, 2001	New York	7¼% Sinking Fund Debentures Due November 1, 2003	New York
15% Payment-in-Kind Subordinated Debentures due May 15, 2001	New York	Standard Brands Incorporated	
13¼% Subordinated Debentures due May 15, 2001	New York	6¼% Sinking Fund Debentures, due June 1, 1993	New York
Subordinated Floating Rate Notes due May 15, 1999	New York	7¼% Sinking Fund Debentures, due May 1, 2001	New York
Subordinated Extendible Reset Debentures due May 15, 1991	New York	9½% Sinking Fund Debentures, due December 15, 2004	New York

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

None

Indicate by check mark whether the Registrants (1) have 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 Registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. YES NO

The aggregate market value of voting stock held by non-affiliates of RJR Nabisco Holdings Corp. on March 1, 1991 and before the completion of the exchange offer then pending was approximately \$96.0 million. Certain affiliates of KKR Associates and directors and executive officers of RJR Nabisco Holdings Corp. are considered affiliates for purposes of this calculation but should not necessarily be deemed affiliates for any other purpose. None of the voting stock of RJR Nabisco Holdings Group, Inc., RJR Nabisco Capital Corp. or RJR Nabisco, Inc. is held by any non-affiliate.

Indicate the number of shares outstanding of each of the Registrants' classes of common stock, as of the latest practicable date: March 1, 1991 and before the completion of the exchange offer then pending:

RJR Nabisco Holdings Corp.: 580,676,863 shares of common stock, par value, \$.01 per share
RJR Nabisco Holdings Group, Inc.: 1,000 shares of common stock, par value \$.01 per share
RJR Nabisco Capital Corp.: 1,000 shares of common stock, par value \$.01 per share
RJR Nabisco, Inc.: 2,247,61275 shares of common stock, par value \$1,000 per share

Documents Incorporated by Reference

None

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PART I

Item 1. Business

(a) General Development of Business

RJR Nabisco Holdings Corp. ("Holdings"), through its wholly-owned, indirect subsidiary, RJR Nabisco, Inc. ("RJRN"), is among the largest tobacco and food companies in the world. In the United States, the tobacco business is conducted by R. J. Reynolds Tobacco Company ("RJRT"), the second largest producer of cigarettes, and the packaged food business is conducted by Nabisco Brands, Inc. ("Nabisco"), the largest manufacturer and marketer of cookies and crackers. RJRN's tobacco products are sold around the world under a variety of brand names and its food products are sold in the United States, Canada, Latin America and certain other international markets. Together with RJRT and Nabisco, RJRN's principal subsidiaries are R. J. Reynolds Tobacco International, Inc. ("Tobacco International") and Planters LifeSavers Company ("Planters Lifesavers"). For financial information with respect to RJRN's industry segments, lines of business and operations in various geographic locations, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 17 to the Consolidated Financial Statements.

RJRN was incorporated in 1970 and can trace its origins back to the formation of R. J. Reynolds Tobacco Company in 1875. Activities were confined to the tobacco industry until the 1960's, when diversification led to investments in transportation, energy and food. With the acquisition of Del Monte in 1979, RJRN began to concentrate its diversification efforts toward consumer products. RJRN's strategy led to the acquisition of Heublein, Inc. in 1982 and culminated in the acquisition, at a total cost of \$4.9 billion, of Nabisco, including Planters LifeSavers, in 1985. During the past several years RJRN has continued to refine its focus on tobacco and food products. In 1986, RJRN divested several operations not considered to be within its consumer products focus, including its quick service restaurant businesses, conducted principally by Kentucky Fried Chicken Corporation, for \$840 million in cash. During 1987, RJRN sold its spirits and wines businesses, conducted principally by Heublein, Inc., for \$1.2 billion in cash.

Holdings, RJR Nabisco Holdings Group, Inc. ("Group") and RJR Nabisco Capital Corp. ("Capital") were organized as Delaware corporations in 1988 at the direction of Kohlberg Kravis Roberts & Co., L.P. ("KKR"), a Delaware limited partnership, to effect the acquisition of RJRN, which was completed on April 28, 1989 (the "Acquisition"). As a result of the Acquisition, RJRN became, and presently is, a direct, wholly owned subsidiary of Capital, which in turn is a direct, wholly owned subsidiary of Group, which in turn is a direct, wholly owned subsidiary of Holdings. The business of Holdings, Group and Capital is conducted through RJRN. The business of RJRN continues to be conducted under the name "RJR Nabisco, Inc.". Holdings, Group, Capital and RJRN are referred to herein collectively as the "Registrants".

For additional information with respect to the Acquisition and the series of transactions contemplated by the recapitalization program announced by Holdings in July 1990 (the "Recapitalization Program"), see Note 1 to the Consolidated Financial Statements.

Recent Dispositions

Consistent with the Registrants' long-term strategic goals, as well as obligations under a Federal Trade Commission ("FTC") consent decree relating to the Acquisition (the "Consent Decree") to sell certain businesses of RJRN or of Beatrice Company and the Registrants' obligations to repay certain loans in the amount of \$5.0 billion prior to February 9, 1990 pursuant to the terms of the Credit Agreement, dated as of January 31, 1989 (as amended, the "1989 Credit Agreement"), entered into in connection with the financing of the Acquisition, during 1989 and 1990, the Registrants divested a number of businesses and operating units. In 1989, such dispositions included the sales of (i) Nabisco International's food businesses in the United Kingdom, France and Italy; (ii) Associated Biscuits International Limited and Stalwart Holdings Limited in the United Kingdom; (iii) Oxford Biscuit

Fabrik A/S and Nabisco Brands Norge A/S in Scandinavia; (iv) the assets of the Chun King business; (v) the food businesses of RJRN in Spain and Portugal; and (vi) the fresh fruit business of Del Monte Corporation ("Del Monte"). The aggregate cash purchase prices for these businesses totalled approximately \$3.57 billion. During 1990, a number of other businesses were sold as discussed below.

On January 9, 1990, RJRN completed the sale of the Del Monte processed foods business to DMPF Corp., for a purchase price of approximately \$1.475 billion in cash, subject to certain post-closing adjustments. DMPF Corp. is a corporation formed by Merrill Lynch & Co., Inc. and certain other investors.

On February 23, 1990, RJRN completed the sale of the assets of the Curtiss Confections business to Nestle Foods Corporation and Nestle S.A., for a purchase price of approximately \$370 million in cash.

On April 2, 1990, RJRN completed the sale of Nabisco's food businesses in New Zealand to Suffell Holdings Limited and Nabisco's food businesses in Singapore, Malaysia and Hong Kong to Britannia Brands Pte. Ltd. The aggregate purchase price for Nabisco's New Zealand and Far East food businesses was approximately \$180 million in cash, subject to certain post-closing adjustments. Britannia Brands Pte. Ltd. is a Singapore-based joint venture of Britannia Industries Pte. Ltd. and BSN Groupe.

On April 9, 1990, RJRN completed the sale of its Brazilian tobacco operations to Dibrell Brothers, Incorporated for a purchase price of approximately \$50 million in cash, subject to certain post-closing adjustments.

On November 8, 1990, RJRN completed the sale of its 20% interest in ESPN, Inc. to The Hearst Corporation for a purchase price of approximately \$168 million in cash.

RJRN will continue to assess its businesses to evaluate their consistency with strategic objectives. Although RJRN may divest additional businesses in the future, no decisions have been made with respect to any such divestitures. The Credit Agreement, dated as of July 9, 1990 (as amended, the "1990 Credit Agreement") entered into in connection with the implementation of the Recapitalization Program prohibits the sale prior to February 9, 1993 of all or substantially all, or any substantial portion, of RJRN's domestic tobacco operations or the operations of Nabisco relating to the manufacture and sale of cookies and crackers in the United States. The 1989 Credit Agreement and the 1990 Credit Agreement also prohibit the sale of any capital stock owned directly by RJRN and pledged to secure the obligations under the 1989 Credit Agreement and the 1990 Credit Agreement.

The FTC has found that certain of the divestitures described above, together with the divestiture of Fisher Nut Co. by Beatrice Company, satisfy all divestiture obligations under the Consent Decree. As required by the 1989 Credit Agreement, the asset sale bridge facility under the 1989 Credit Agreement (the "Asset Sale Bridge Facility") has been repaid and at least \$5.0 billion of such repayment consisted of the net cash proceeds from the above divestitures.

(b) Financial Information about Industry Segments

During 1990, the Registrants' industry segments were tobacco and food.

For information relating to industry segments for the years ended December 31, 1990, 1989 and 1988, see Note 17 to the Consolidated Financial Statements.

(c) Narrative Description of Business

Tobacco

RJRN's tobacco business includes the operations of RJRT and Tobacco International, which manufacture, distribute and sell cigarettes. Cigarettes are manufactured in the United States and in 30 foreign countries and territories by Tobacco International and subsidiaries or licensees of RJRT and are sold throughout the United States and in more than 160 markets around the world. In 1990,

approximately 72% of total tobacco segment net sales (after deducting excise taxes) and 85% of total tobacco segment operating income before amortization of trademarks and goodwill were attributable to domestic tobacco operations.

Domestic Tobacco Operations

The domestic tobacco business is conducted by RJRT, which is the second largest cigarette manufacturer in the United States. According to data prepared by an independent source that develops retail market share information for the U.S. tobacco industry, RJRT had an overall share of retail consumer cigarette sales during 1990 of 31.3%, a decrease of slightly more than one share point from 1989. RJRT believes that the sampling techniques customarily used in preparing this data may overstate RJRT's actual retail share by approximately one share point. RJRT's largest selling cigarette brands in the United States include WINSTON, SALEM, DORAL, CAMEL and VANTAGE. RJRT's other cigarette brands, including MORE, NOW, CENTURY, MAGNA and STERLING, are marketed to meet a variety of smoker preferences. Most RJRT brands are marketed in a variety of styles. On December 3, 1990, RJRT introduced nationally CAMEL ULTRA LIGHTS, a line extension of the popular CAMEL brand. During 1990, RJRT and the largest domestic cigarette manufacturer, Philip Morris U.S.A., together sold approximately 70% of all cigarettes sold in the United States.

RJRT has long been an innovator in the cigarette industry, introducing the first national branded cigarette, CAMEL, in 1913, the first filter cigarette, WINSTON, in 1954, the first filtered menthol cigarette, SALEM, in 1956, the first "low-tar" cigarette, VANTAGE, in 1970 and the first branded cigarette in the growing savings segment, DORAL, in 1984. HORIZON, a recent product innovation which is currently in test markets, uses new technology to give the lit-end smoke a pleasant aroma.

Substantially all of RJRT's domestic manufacturing facilities, consisting principally of factories and leaf storage facilities, are located in or near Winston-Salem, North Carolina. All such facilities are owned by RJRT. Included in such facilities are the Tobaccoville cigarette manufacturing plant of approximately two million square feet that became fully operational in 1987 and the Whitaker Park cigarette manufacturing complex, which underwent an extensive modernization that was completed early in 1989. Both the construction of the Tobaccoville plant and the modernization of the Whitaker Park facility were part of a ten-year \$2 billion facilities modernization program that was completed in 1989. RJRT believes that its manufacturing facilities are the most technologically advanced cigarette manufacturing facilities in the United States. RJRT also has significant research and development facilities in Winston-Salem, North Carolina.

RJRT's cigarettes are sold in the United States primarily to chain stores, other large retail outlets and through distributors to other retail and wholesale outlets. None of RJRT's customers accounted for more than 10% of sales during 1990. RJRT distributes its cigarettes from distribution centers in Winston-Salem, North Carolina primarily to public warehouses located throughout the United States, which serve as local distribution centers for RJRT's customers.

RJRT's products are marketed to adult smokers through distributors and retail outlets. RJRT utilizes print media, billboards, point-of-sale displays and other methods of advertising. Since 1971, television and radio advertising of cigarettes has been prohibited in the United States.

International Tobacco Operations

Tobacco International operates in over 160 markets around the world. Although overall foreign cigarette sales (excluding China) have increased at a rate of only 1% per annum in recent years, the American Blend segment, in which Tobacco International primarily competes, is believed by RJRN to be growing significantly faster. Tobacco International is the second largest of two international cigarette producers that have significant positions in the American Blend segment. The share of sales of Philip Morris International Inc., the largest American Blend producer, however, is approximately three times larger than that of Tobacco International.

Tobacco International has strong brand presence in Western Europe and is well established in its other key markets in the Middle East/Africa, Asia and Canada. Tobacco International has over 55 brands of which WINSTON, CAMEL and SALEM, all American Blend cigarettes, are its international leaders. WINSTON, Tobacco International's largest international brand, has a significant presence in Puerto Rico and has particular strength in the Western Europe and Middle East/Africa regions. CAMEL is sold in approximately 135 markets worldwide and is Tobacco International's second largest international brand. SALEM is the world's largest selling menthol cigarette and has particular strength in Far East markets. Tobacco International also manufactures and markets a number of local brands in various foreign markets. None of Tobacco International's customers accounted for more than 10% of sales during 1990.

Approximately 32% of Tobacco International's cigarette volume for 1990 was manufactured by RJRT in the United States for sale in foreign markets. The remainder was manufactured overseas, either in Tobacco International-owned manufacturing facilities or by licensees. Tobacco International-owned facilities are located in Canada, the Canary Islands, Hong Kong, Malaysia, Puerto Rico, Switzerland and Germany. In 1988, Tobacco International opened a factory in the People's Republic of China as a part of the first tobacco business joint venture in that country.

Certain of Tobacco International's foreign operations are subject to local regulations that set import quotas, restrict financing flexibility and affect repatriation of earnings or assets. In recent years, certain trade barriers for cigarettes, particularly in Asia and, to a lesser extent in Western Europe, have been liberalized. Such liberalization may provide opportunities for all international cigarette manufacturers, including Tobacco International, to expand operations in such markets; however, there can be no assurance that such liberalizing trends will be maintained or extended or that Tobacco International will be successful in pursuing such opportunities.

During the fall of 1990, Tobacco International reached an agreement to supply 14.1 billion cigarettes to the Soviet Union during the following twelve months and is currently in the process of finalizing negotiations to supply an additional 2 to 3 billion cigarettes to the Soviet Union during such period. These transactions are not expected to have a material effect on the results of operations of any of the Registrants.

Raw Materials

In its domestic production of cigarettes, RJRT primarily uses domestic burley and flue cured leaf tobaccos purchased at domestic auction. RJRT also purchases oriental tobaccos, grown primarily in Turkey and Greece, and certain other non-domestic tobaccos. Tobacco International uses a variety of tobacco leaf from both United States and international sources. Tobacco leaf is an agricultural commodity subject in the United States to government production controls and price supports that can affect market prices substantially. The tobacco leaf price support program was last substantially revised in 1986 and domestic tobacco production has increased over the last five years. The program is subject to Congressional review and may be changed at any time in the future. A bill was introduced in Congress in June 1990 that would have eliminated the federal price support program, but no action was taken with respect thereto. RJRT is unable to predict whether such a bill will be reintroduced or the effect of the enactment of that or any other bill related to the program or RJRT. RJRT and Tobacco International believe there is a sufficient supply of tobacco in the worldwide tobacco market to satisfy their current production requirements.

Legislation and Other Matters Affecting the Cigarette Industry

For over 25 years, the advertising, sale and use of cigarettes has been under attack by government and health officials in the United States and other countries, principally due to claims that cigarette smoking is harmful to health. This attack has resulted in a number of substantial restrictions on the marketing, advertising and use of cigarettes, diminishing social acceptability of smoking and activities by anti-smoking groups designed to inhibit cigarette sales and the testing and introduction of new cigarette products. Together with manufacturers' price increases and substantial increases in state and

federal excise taxes on cigarettes, this has had and will likely continue to have an adverse effect on cigarette sales.

In 1964, the Report of the Advisory Committee to the Surgeon General of the U.S. Public Health Service concluded that cigarette smoking was a health hazard of sufficient importance to warrant appropriate remedial action. Since 1966, federal law has required a warning statement on cigarette packaging. Federal law also requires annual reports to Congress from the FTC and the Secretary of Health and Human Services. The FTC has recommended in such reports to Congress that Congress enact legislation requiring stronger warnings and that funding be provided for anti-smoking messages in mass media. Since 1971, television and radio advertising of cigarettes has been prohibited in the United States. Cigarette advertising in other media in the United States is required to include information with respect to the "tar" and nicotine content of cigarettes, as well as a warning statement.

During the past two decades, various legislation affecting the cigarette industry has been enacted. In 1984, Congress enacted the Comprehensive Smoking Education Act (the "Smoking Education Act"). Among other things, the Smoking Education Act: (i) establishes an interagency committee on smoking and health that is charged with carrying out a program to inform the public of any dangers to human health presented by cigarette smoking; (ii) requires a series of four new health warnings to be printed on cigarette packages and advertising on a rotating basis; (iii) increases type size and area of the warning on cigarette advertisements; and (iv) requires that cigarette manufacturers provide annually, on a confidential basis, a list of ingredients used in the manufacture of cigarettes to the Secretary of Health and Human Services. The warnings currently required on cigarette packages and advertisements (other than billboards) are as follows: (i) "Surgeon General's Warning: Smoking Causes Lung Cancer, Heart Disease, Emphysema, And May Complicate Pregnancy"; (ii) "Surgeon General's Warning: Quitting Smoking Now Greatly Reduces Serious Risks To Your Health"; (iii) "Surgeon General's Warning: Smoking By Pregnant Women May Result in Fetal Injury, Premature Birth, and Low Birth Weight"; and (iv) "Surgeon General's Warning: Cigarette Smoke Contains Carbon Monoxide." Similar warnings are required on outdoor billboards. In October 1984, the Cigarette and Little Cigar Fire Safety Act of 1984 also was enacted which, among other things, created an interagency committee on cigarette fire safety. In December 1987, the interagency committee submitted a report to Congress that concluded, among other things, that a cigarette with reduced ignition propensity was technically feasible and may be commercially feasible, but recommended further study. In August 1990 the Fire Safe Cigarette Act of 1990 was enacted, which directs the Consumer Product Safety Commission to conduct and oversee further research and to assess the practicability of developing a performance standard to reduce cigarette ignition propensity. A final report is due to Congress in 36 months. A new federal law prohibits smoking on all domestic airline flights of six hour duration or less and the Interstate Commerce Commission has taken steps to ban smoking on buses transporting passengers inter-state.

Since the initial report in 1964, the Secretary of Health, Education and Welfare and the Surgeon General have issued a number of other reports which purport to link cigarette smoking with certain health hazards, including various types of cancer, coronary heart disease and chronic obstructive lung disease. These reports have recommended various governmental measures to reduce the incidence of smoking. The Surgeon General's 1988 and 1989 reports concluded, among other things, that cigarettes and other forms of tobacco are addictive and contain a series of recommendations for achieving a "smokeless" society by the year 2000. In February 1990, the Surgeon General released a report surveying smoking patterns of Americans based on various age, sex and race categories and compiling various governmental anti-smoking legislation and activities. On September 25, 1990, the Surgeon General released a report on the benefits of quitting smoking and recommending that insurers pay for smoking cessation programs.

Cigarettes are subject to substantial excise taxes in the United States and to similar taxes in many foreign markets. Recently enacted legislation increased the federal excise tax per pack of 20 cigarettes to 20 cents from 16 cents on January 1, 1991 and provides for an increase in the federal excise tax on

January 1, 1993 to 24 cents. In addition, states impose excise taxes of levels ranging from 2 cents to 41 cents per pack on cigarettes, and increases in these state excise taxes could also have an adverse effect on cigarette sales. In 1989, California raised its state excise taxes on cigarettes by 25 cents per pack and in 1990 eight states have enacted excise tax increases ranging from 3 cents to 15 cents per pack.

In addition to the foregoing, legislation and regulations potentially detrimental to the cigarette industry, generally relating to the taxation of cigarettes and regulation of advertising, labeling, promotion, sale and smoking of cigarettes, have been proposed from time to time at various levels of the federal government. Bills were introduced in the last Congress (i) that would subject cigarettes to regulation in various ways under the U.S. Department of Health and Human Services, including regulation by the U.S. Food and Drug Administration and by the Centers for Disease Control, (ii) that would subject cigarettes generally to regulation under the Consumer Products Safety Act, (iii) that could increase manufacturers' costs, (iv) that would mandate anti-smoking education campaigns, (v) that would provide additional funding for federal and state anti-smoking activities, potentially allowing state and local governments to restrict cigarette advertising and promotion and (vi) that would require a new list of nine health warnings on cigarette packages and advertising, expand the required size of the warnings, restrict the contents of cigarette advertising and promotional activities and repeal the preemptive effects of the Federal Cigarette Labeling and Advertising Act (the "Cigarette Act") in civil litigation. The U.S. Environmental Protection Agency has also released draft documents which conclude that environmental tobacco smoke is a known human carcinogen and call for a virtual ban on smoking in workplaces.

Legislation imposing restrictions on public smoking has also been enacted in a number of state and local jurisdictions, certain employers have initiated programs restricting or eliminating smoking in the workplace and one state has enacted legislation designating a portion of increased cigarette excise taxes to fund anti-smoking advertising. It is not possible to determine whether additional federal, state or local legislation or regulations relating to smoking or cigarettes will be enacted or to predict any resulting effect thereof on RJRT, Tobacco International or the cigarette industry.

A number of foreign countries have also taken steps to discourage cigarette smoking, to restrict or prohibit cigarette advertising and promotion and to increase taxes on cigarettes. Such restrictions are, in some cases, more onerous than restrictions imposed in the United States.

On December 11, 1990, RJRN and other U.S. cigarette manufacturers, through The Tobacco Institute, announced a tobacco industry initiative to assist retailers in enforcing minimum age laws on the sale of cigarettes, to seek the uniform establishment of 18 as the minimum age for the sale of cigarettes in all states, to distribute informational materials to assist parents in combatting peer pressure on their children to smoke and to limit voluntarily certain cigarette advertising and promotional practices.

Litigation Affecting the Cigarette Industry

Various legal actions, proceedings and claims are pending or may be instituted against RJRN or its subsidiaries, including those claiming that lung cancer and other diseases have resulted from the use of RJRT's tobacco products. During 1990, 7 new actions were filed against RJRT or its indemnitees and 11 actions were dismissed or otherwise resolved in favor of RJRT or its indemnitees without trial. A total of 28 such actions in the United States and one against RJRT's Canadian company were pending on December 31, 1990. As of February 20, 1991, 26 active cases were pending in the United States and one in Canada. The United States cases are in 10 states and are distributed as follows: 10 in Texas, 5 in New Jersey, 3 in Pennsylvania, 2 in Louisiana, and one each in Arizona, Indiana, Minnesota, Mississippi, New York and West Virginia. Of the 26 active cases in the United States, 19 are pending in state court and 7 in federal court.

The plaintiffs in these actions seek recovery on a variety of legal theories, including strict liability in tort, design defect, negligence, breach of warranty, failure to warn and conspiracy. Punitive damages, often in amounts totalling many millions of dollars, are specifically pleaded in 19 cases in addition to

compensatory and other damages. The defenses raised by RJRT, where applicable, include preemption by the Cigarette Act of some or all such claims arising after 1965; the lack of any defect in the product; assumption of the risk; lack of proximate cause; and statutes of limitations or repose. RJRT intends to defend vigorously all such actions that may be brought against it.

The issue of whether state law tort claims are preempted by federal law, and if so, the scope of that preemption has been considered by a number of federal courts of appeal and two state supreme courts. Five federal courts of appeal and the Minnesota Supreme Court have held that the Cigarette Act has preemptive effect. The New Jersey Supreme Court and an intermediate Texas Court of Appeal have held that it does not. The issue is currently the question presented in a petition for certiorari to the United States Supreme Court in a case in which RJRT is not a party. It is not yet known whether the petition will be granted.

In two recent smoking and health cases in which neither RJRN nor any subsidiary was a party, *Cipollone v. Liggett Group, et al.* and *Horton v. American Tobacco Company, et al.*, juries have found in favor of plaintiffs. In *Cipollone*, the jury awarded \$400,000 in damages and in *Horton*, no damages were awarded. The award of damages in *Cipollone* was reversed on appeal. Petitions seeking further review are pending in both cases.

Litigation is subject to many uncertainties, and it is possible that some of the legal actions, proceedings or claims could be decided against RJRN or its subsidiaries. Determinations of liability or adverse rulings against other cigarette manufacturers that are defendants in similar actions, even if such rulings are not final, could adversely affect the litigation against RJRN and its subsidiaries and increase the number of such claims.

RJRN previously had maintained product liability insurance covering certain of these tobacco-related legal actions, proceedings and claims. As of April 13, 1990, RJRN became wholly self-insured for existing tobacco-related litigation risks.

Food

RJRN's food business is conducted by the RJR Nabisco Foods Group, which consists principally of Nabisco and Planters LifeSavers. Each of these subsidiaries is a leader in certain segments of the food industry. Food products are sold under trademarks owned or licensed by RJRN or its subsidiaries, and brand recognition is considered essential to their successful marketing.

Nabisco

Nabisco is one of the largest packaged food companies in the world. It manufactures or markets cookies, crackers, snack foods, hot and ready-to-eat cereals, margarine, pet foods, dry-mix dessert products and other grocery products under established and well-known trademarks, including OREO, RITZ, CHIPS AHOY!, PREMIUM, FLEISCHMANN'S, BLUE BONNET, A.1., GREY POUPON and MILK-BONE. None of Nabisco's customers accounted for more than 10% of sales during 1990.

Nabisco is comprised of four principal divisions: Nabisco Biscuit, Nabisco Foods, Nabisco Brands Ltd (Canada) and Nabisco International. See "Recent Dispositions" for a discussion of the divestiture of certain assets of Nabisco and the sale of certain other food businesses and Note 4 to the Consolidated Financial Statements for a discussion of the decision to retain the remaining businesses of Nabisco International previously held for sale.

Nabisco Biscuit. Nabisco Biscuit is the largest manufacturer and marketer in the United States cookie and cracker industry with the top eight selling brands, each of which had annual sales of over \$100 million in 1990. Overall, in 1990, Nabisco Biscuit had an estimated share of domestic cookie industry sales exceeding 35%, more than double the share of its closest competitor, and an estimated share of the domestic cracker industry sales exceeding 55%, more than three times the share of its

closest competitor. Leading Nabisco Biscuit cookie brands include OREO, CHIPS AHOY!, NEWTONS and TEDDY GRAHAMS. Leading Nabisco Biscuit cracker brands include RITZ, WHEAT THINS, PREMIUM, NABISCO GRAHAMS and TRISCUIT.

OREO and CHIPS AHOY! are the two largest selling cookies in the United States. OREO, the leading sandwich cookie, is Nabisco Biscuit's largest selling cookie brand. Line extensions such as OREO BIG STUF and FUDGE COVERED OREO continue to increase the brand's appeal to targeted consumer groups. CHIPS AHOY! is the leader in the chocolate chip cookie segment with recent line extensions such as SELECTIONS, SPRINKLES and MINI CHIPS AHOY! broadening its appeal and adding incremental sales.

NEWTONS, the oldest Nabisco cookie brand, has no significant national competitor in the fruit-filled segment. During the 1980's, additional fruit flavor fillings expanded the appeal of NEWTONS, helping it to become the third leading cookie brand in the United States. After its highly successful introduction in late 1988, TEDDY GRAHAMS was the fourth largest selling cookie brand in the United States in 1990.

Nabisco Biscuit's cracker division is led by RITZ, the largest selling cracker in the United States, and RITZ BITS, a successful product line extension, which together accounted for more than 14% of cracker sales in the United States in 1990. In addition, PREMIUM, the oldest Nabisco cracker brand and the leader in the saltine cracker segment, is joined by NABISCO GRAHAMS, WHEAT THINS, and TRISCUIT, to comprise, along with RITZ, the five largest selling cracker brands in the United States.

Nabisco Biscuit's other cookie and cracker brands, which include NILLA WAFERS, NUTTER BUTTER, BARNUM'S ANIMALS CRACKERS, BETTER CHEDDARS, HARVEST CRISPS and AMERICAN CLASSIC, compete in consumer niche segments. Many are the first or second largest selling brands in their respective segments.

Nabisco Biscuit's products are manufactured in nine RJRN-owned bakeries and in 11 facilities with which RJRN has production agreements. Nabisco Biscuit is in the process of implementing plans to modernize its facilities. Nabisco Biscuit also operates a flour mill in Toledo, Ohio, which supplies 85% of its flour needs, and a facility in Wrightstown, Wisconsin, which produces EASY CHEESE pasteurized process cheese spreads.

Nabisco Biscuit's products are sold to major grocery and other large retail chains through Nabisco Biscuit's direct sales/direct store door delivery system. The system is supported by a distribution network utilizing nine major distribution warehouses and 137 shipping branches where shipments are consolidated for delivery to approximately 106,000 separate delivery points.

Nabisco Foods. Nabisco Foods markets a broad range of food products, with cereals, margarine and pet foods representing the largest categories. Many of Nabisco Foods' products are first or second in their product categories. Well-known brand names include NABISCO SHREDDED WHEAT and CREAM OF WHEAT cereals, FLEISCHMANN'S and BLUE BONNET margarines, MILK-BONE pet snacks, A.I. steak sauce, GREY POUPON mustards, ORTEGA Mexican foods and EGG BEATERS egg substitutes.

Nabisco Foods' ready-to-eat cereals include NABISCO SHREDDED WHEAT, NABISCO 100% BRAN and TEAM FLAKES in the adult segment of the category and FRUIT WHEATS and FROSTED WHEAT SQUARES in the all family segment. NABISCO SHREDDED WHEAT is a leading brand in the adult segment. Nabisco Foods' FRUIT WHEATS and FROSTED WHEAT SQUARES have proved to be successful line extensions in the all family segment. Nabisco Foods' ready-to-eat cereals are manufactured in three facilities, which also manufacture TRISCUIT crackers.

Nabisco Foods is the second largest manufacturer in the hot cereal category, participating in the cook-on-stove and cook-in-bowl segments of the hot cereals category. CREAM OF WHEAT, the leading wheat-based hot cereal, and CREAM OF RICE participate in the cook-on-stove segment and

at least six varieties of MIX 'N EAT wheat-based cereal participate in the cook-in-bowl segment. Hot cereals are manufactured in one facility.

Kellogg Company has approximately 37% of the ready-to-eat cereals category volume sales and is the largest producer in the ready-to-eat category. The Quaker Oats Company, with over 60% of the hot cereals category volume sales, is the most significant participant in the hot cereals category. Although Nabisco Foods' cereals have sizeable niche positions in the wheat-based segment of both the ready-to-eat and hot cereals categories, recent entries by competitors in both the ready-to-eat wheat segment and the hot cereals oatmeal segment have required Nabisco Foods to respond by increasing its marketing expenditures.

Nabisco Foods' margarine business is the second largest margarine producer in the United States. Nabisco Foods currently participates in all three segments of the margarine category, with FLEISCHMANN'S in the premium health segment, BLUE BONNET in the selected intermediate segment and BETTER BLEND in the margarine and butter blends segment. Nabisco Foods' margarines are manufactured in four facilities. Nabisco Foods is the market leader in the egg substitute category with FLEISCHMANN'S EGG BEATERS, the first retail egg substitute.

Nabisco Foods is the leading manufacturer of dog snacks in the United States with MILK-BONE dog biscuits. Recent entries by competitors have increased the competitive environment, requiring additional product development and marketing support spending. Two new MILK-BONE products, MILK-BONE T.C. BISCUITS and MILK-BONE T.C. RAWHIDE STRIPS were introduced in early 1990. Other Nabisco Foods' pet snacks include FLAVOR SNACKS, DOG TREATS and BUTCHER BONES. Pet snacks are produced at a single manufacturing facility.

Nabisco Foods' primary entries in the sauce and condiment segments are A.1. steak sauce, the leading steak sauce, and GREY POUPON mustard, the leading Dijon mustard. Nabisco Foods also produces REGINA wine vinegar, the leader in its segment of the vinegar market. A.1., GREY POUPON and REGINA products are manufactured in one facility.

Nabisco Foods produces shelf-stable Mexican foods under its ORTEGA brand name. Nabisco Foods also participates in the dry mix dessert category with ROYAL gelatins and puddings and has lines of regional products including COLLEGE INN broths, VERMONT MAID syrup, MY-T-FINE puddings, DAVIS baking powder and BRER RABBIT molasses and syrup.

Nabisco Foods' products are sold to retail grocery chains, drug/mass merchandisers and other major retail outlets. All products are sold by independent brokers.

Nabisco Foods also sells a variety of specially packaged food products, including cookies, crackers, cereals and sauces for restaurant, institution and table top uses.

Nabisco Brands Ltd. Nabisco Brands Ltd conducts Nabisco's Canadian operations, which comprise two divisions, biscuit and grocery. In 1990, the biscuit division produced nine of the top ten cookies and the top ten crackers in Canada. Nabisco Brands Ltd's cookie and cracker brands in Canada include OREO, CHIPS AHOY!, FUDGE-O, PEEK FREANS, DAD'S, DAVID, PREMIUM PLUS, RITZ, TRISCUIT and STONED WHEAT THINS. The biscuit division's products are manufactured in five bakeries in Canada. One bakery is undergoing modernization which is expected to be completed in 1991. The biscuit division's products are sold through a direct store delivery system, utilizing 11 sales offices and distribution centers and a combination of public and private carriers.

Nabisco Brands Ltd's grocery division produces and markets ready-to-eat cereal, canned fruits and vegetables and pet snacks. The grocery division is the second largest ready-to-eat cereal manufacturer in Canada with core brands including SHREDDIES, SHREDDED WHEAT, FRUIT WHEATS and 100% BRAN. In 1990, SHREDDIES and SHREDDED WHEAT were the second and sixth largest selling brands of ready-to-eat cereal in Canada, respectively. The grocery division is the leading canned fruit producer in Canada and is the second largest canned vegetable producer in Canada. Canned fruit and vegetables and fruit drinks are marketed under the DEL MONTE trademark, pursuant to a license from Del Monte, and under the AYLMEER trademark. The grocery division also markets MILK-

BONE dog snacks, the leading brand in Canada, and MAGIC baking powder. The grocery division currently operates eight manufacturing facilities, five of which are devoted to canned products, principally fruits and vegetables, two of which manufacture cereals and one of which produces pet snacks. The grocery division's products are sold directly to retail chains and are distributed through six regional warehouses.

Nabisco International. Nabisco International is a leading producer of powdered dessert and drink mixes, biscuits, baking powder and other grocery items, industrial yeast and bakery ingredients in many of the 16 Latin American countries in which it has operations. Nabisco International also exports a variety of Nabisco products to markets in Europe and Asia from the United States.

Nabisco International manufactures and markets yeast, baking powder and bakery ingredients under the FLEISCHMANN and ROYAL brands, biscuits and crackers under the NABISCO brand, desserts and drink mixes under the ROYAL brand, processed milk products under the GLORIA brand, and canned fruits and vegetables under the DEL MONTE brand pursuant to a license from Del Monte. Nabisco International's largest market is Brazil, where it operates 11 plants. Nabisco International is the market leader in powdered desserts in most of Latin America, the yeast category in Brazil, biscuits in Venezuela and Uruguay, and canned vegetables in Venezuela. Nabisco International also maintains a strong position in the processed milk category in Brazil.

Nabisco International's grocery products are sold to retail outlets through its own sales forces and independent wholesalers and distributors. Industrial yeast and bakery products are sold to the bakery trade through Nabisco International's own sales forces and independent distributors.

Certain of Nabisco International's businesses have been sold. See "General Development of Business—Recent Dispositions".

Planters LifeSavers

Planters LifeSavers manufactures and markets nuts, hard roll candy, gum and snacks primarily for sale in the United States. Planters LifeSavers' well-known brands include PLANTERS nuts, LIFE SAVERS hard roll candy, BREATH SAVERS sugar free mints, BUBBLE YUM bubble gum and CARE*FREE sugarless gum. On the basis of the most recent data available, PLANTERS nuts are currently the clear leader in the packaged nut category, LIFE SAVERS is currently the largest selling hard roll candy in the United States, with an approximately 32% share of the hard roll candy category in 1990, BREATH SAVERS is currently the largest selling sugar free breath mints in the United States and BUBBLE YUM is currently the largest selling chunk bubble gum in the United States.

Planters LifeSavers also manufactures PLANTERS salty snacks and markets PLANTERS peanut and popcorn oils.

Planters LifeSavers' snack products, sold primarily under the PLANTERS name, are commodity oriented, are marketed to the trade customer and are seasonally strongest in the fourth quarter. Its confectionery products, including LIFE SAVERS and BUBBLE YUM, are marketed to the consumer and are seasonally strongest during the third and fourth quarters.

Planters LifeSavers sells its products in the United States primarily to large retail outlets, chain accounts and to other retail and wholesale outlets. These include grocery stores, drug/mass merchandisers, convenience stores, food service, military and vending machine suppliers. None of Planters LifeSavers' customers accounted for more than 10% of sales during 1990. The products are distributed from 13 distribution centers located throughout the United States. Planters LifeSavers currently owns and operates five manufacturing facilities, three for its PLANTERS label products and two for its confectionery products.

Based on favorable test market results, national distribution of LIFE SAVERS HOLES, a miniature hard candy, commenced in October 1990. In January 1991, in response to a few isolated incidents where misuse of the package caused the package's cap to detach, the product as so packaged was voluntarily withdrawn from the market as a precautionary safety measure. It is anticipated that the product will be back in distribution with a modified package in the second quarter of 1991.

Raw Materials

Various agricultural commodities constitute the principal raw materials used by RJRN in its food businesses. Other raw materials used by RJRN are purchased on the commodities market and through supplier contracts. Prices of agricultural commodities tend to fluctuate due to various seasonal, climatic and economic factors, which factors generally also affect RJRN's competitors. RJRN believes that the raw materials for its products are in plentiful supply and all are readily available from a variety of independent suppliers.

Other Matters

Competition

Generally, the markets in which RJRN's tobacco and food businesses are conducted are highly competitive, with a number of large participants. Competition is conducted on the basis of brand recognition and brand loyalty and substantial advertising and promotional expenditures are required to maintain or improve a brand's position or to introduce a new brand. In addition, anti-smoking groups have undertaken activities designed to inhibit cigarette sales and the testing and introduction of new cigarette products. Because television and radio advertising for cigarettes is prohibited in the United States, established cigarette brands in the United States have a competitive advantage. In addition, brand loyalty tends to be higher in the cigarette industry than in other consumer product industries. RJRT believes that of those individuals who start smoking cigarettes, substantially fewer start smoking RJRT brands than the brands of Philip Morris U.S.A., its major competitor. RJRT has repositioned or introduced brands designed to appeal to smokers of the largest selling cigarette brand in the United States, but there can be no assurance that such efforts will be successful.

In addition, increased selling prices and taxes on cigarettes have resulted in additional price sensitivity of cigarettes at the consumer level and in a proliferation of discounted brands in the growing savings segment of the market. Generally, sales of cigarettes in the savings segment are not as profitable as those in other segments.

Environmental Matters

The U.S. Government and various state and local governments have enacted or adopted laws and regulations concerning protection of the environment. The regulations promulgated by the Environmental Protection Agency and other governmental agencies under various statutes have resulted in, and will likely continue to result in, substantial expenditures for pollution control, waste treatment, plant modification and similar activities.

RJRN has been engaged in a continuing program to assure compliance with such laws and regulations. Although it is difficult to identify precisely the portion of capital expenditures or other costs attributable to compliance with environmental laws, the Registrants do not expect such expenditures or other costs to have a material effect on any of the Registrants' financial position.

Employees

At December 31, 1990, the Registrants had approximately 55,000 full time employees, including employees of the Nabisco International businesses. None of RJRT's operations is unionized. At various times in the past, attempts have been made to unionize certain of RJRT's operations. The last attempt in 1974 was unsuccessful. In 1989, the Bakery, Confection and Tobacco Workers Union (the "BCTU") announced its intention in the press to conduct a campaign to unionize RJRT's employees. No formal request for a vote has been filed with the National Labor Relations Board. It is the view of management that the unionization of any group of employees within RJRT would have no beneficial impact on RJRT. Most of the unionized workers at Nabisco's operations are represented under a national contract with the BCTU, which was ratified in September 1990 and which will expire in September 1993. Other unions represent the employees of a number of Nabisco's and Planters LifeSavers' operations. In addition, several of Tobacco International's operations are unionized. RJRN believes that its relations with its employees and with the unions in which its employees are members are good.

(d) Financial Information about Foreign and Domestic Operations and Export Sales

For information about foreign and domestic operations and export sales for the years 1988 through 1990, see "Geographic Data" in Note 17 to the Consolidated Financial Statements.

Item 2. Properties

For information pertaining to the Registrants' assets by continuing lines of business and geographic areas as of December 31, 1990 and 1989, see Note 17 to the Consolidated Financial Statements.

Substantially all of RJRT's domestic tobacco manufacturing facilities, consisting principally of factories and leaf storage facilities, are located in or near Winston-Salem, North Carolina. All such facilities are owned by RJRT. Included in such facilities is the Tobaccolville cigarette manufacturing plant of approximately two million square feet which commenced production in the first quarter of 1986 and became fully operational in 1987. In addition, RJRT completed the modernization of its Whitaker Park cigarette manufacturing complex in early 1989.

Tobacco International has two tobacco manufacturing facilities located in Germany and one each in Switzerland, Canada, Puerto Rico, the Canary Islands, Hong Kong, Malaysia and the People's Republic of China.

Nabisco's food operations have numerous operating properties and facilities, both owned and leased, including food processing plants and related facilities located throughout the United States, Canada and Latin America.

Planters LifeSavers has manufacturing plants at four locations in the United States and one in Puerto Rico.

Item 3. Legal Proceedings

Stockholder Litigation

Since the initial announcement on October 20, 1988 by the board of directors of RJRN that certain then current members of RJRN's management intended to develop a proposal to acquire RJRN in a leveraged buyout, at least nine complaints purporting to be class actions have been filed in the Court of Chancery of the State of Delaware. With the exception of one action, which is inactive by stipulation of the parties, these actions have been consolidated under the title *In re RJR Nabisco, Inc. Shareholders*

Litigation, Consolidated C.A. No. 10389 (Del. Ch. Ct., dated Dec. 2, 1988) (the "Consolidated Delaware Action"). The amended complaint in the Consolidated Delaware Action names as defendants RJRN and its then current directors and KKR, RJR Acquisition Corporation ("Merger Sub"), a direct, wholly-owned subsidiary of Capital which was merged (the "Merger") with and into RJRN in connection with the Acquisition on April 28, 1989 and Holdings (collectively, the "KKR Defendants"). The amended complaint in the Consolidated Delaware Action alleges that the board of directors of RJRN violated its fiduciary duty to stockholders by favoring KKR in the conduct of the auction through, among other things, accepting KKR's \$109 bid to acquire RJRN (which bid allegedly presented antitrust and financing concerns) without seeking to obtain a higher bid from the competing group comprised of F. Ross Johnson, certain other members of then current management of RJRN, Shearson Lehman Hutton Inc. ("Shearson") and Salomon Brothers Inc (collectively, the "Johnson Group"), whose bid allegedly was superior and did not pose similar concerns. The amended complaint in the Consolidated Delaware Action also alleges that the director defendants violated their fiduciary duty by agreeing in the Agreement and Plan of Merger, dated as of November 30, 1988 and amended as of April 3, 1989 (the "Merger Agreement"), among RJRN, Holdings, Group and Merger Sub that Holdings would receive a \$1.00 per share termination fee plus expenses in the event the directors decided to terminate the Merger Agreement to accept a better proposal from a third party. The KKR Defendants are not accused of any wrongdoing, but are named, according to the amended complaint, in order to effectuate complete relief. The amended complaint in the Consolidated Delaware Action sought to enjoin the KKR Defendants from consummating the tender offer to acquire shares of RJRN which was completed on February 9, 1989 (the "Tender Offer") and to invalidate the Merger Agreement's break-up fee provision. On January 31, 1989, the Chancery Court denied plaintiffs' motion for a preliminary injunction. On February 2, 1989, upon direct application to the Delaware Supreme Court, plaintiffs' requests for certification of the Chancery Court's ruling for an expedited appeal and for a stay pending such appeal were denied. On July 17, 1990, plaintiffs filed a motion for a preliminary injunction seeking to enjoin RJRN and the KKR Defendants from implementing the Recapitalization Program and on August 2, 1990, plaintiffs filed a motion for leave to file a second amended and supplemental complaint (the "Second Amended Complaint"). The proposed Second Amended Complaint reiterates plaintiffs' initial allegations and further alleges that the exchange offers which were commenced on October 3, 1990 and completed on November 1, 1990 (the "1990 Exchange Offers") are coercive and that the procedure whereby the fixed interest rates on the Senior Converting Debentures Due 2009 of Holdings (the "Converting Debentures") and the Subordinated Exchange Debentures Due 2007 of Group (the "Group Debentures", and collectively, with the Converting Debentures, the "Debentures") were established failed to cause the Debentures to trade at par, as allegedly represented and covenanted.

The parties to the Consolidated Delaware Action have recently reached an understanding to settle such action. Under the terms of the proposed settlement, certain classes of security holders will receive payments, without interest thereon, subject to the holders' submission of valid proofs of claim. The proposed settlement is subject to the parties' execution of a definitive agreement and the approval of the Court. It is anticipated that in light of these and other contingencies, including possible appeals, and the time needed to process valid proofs of claim, no payment to holders under any settlement would be made until at least 1992. A portion of any amounts payable in respect of the settlement is expected to be covered by insurance. The Registrants do not believe that the proposed settlement will have a material effect on the Registrants' financial condition.

In an order entered March 8, 1989, four previously filed actions, *Brown, et al. v. RJR Nabisco, Inc., et al.*, 88 Civ. 7905 (JMW) (S.D.N.Y., dated November 7, 1988) (the "Brown Action"), *Handel v. RJR Nabisco, Inc., et al.*, 88 Civ. 9252 (S.D.N.Y., dated December 29, 1988) (the "Handel Action"), *Friedman v. RJR Nabisco, Inc.*, 88 Civ. 8739 (S.D.N.Y., filed December 9, 1988) (the "Friedman Action") and *Foster v. RJR Nabisco, Inc., et al.*, 88 Civ. 9033 (S.D.N.Y., filed December 21, 1988) (the "Foster Action") were consolidated under the Brown Action case caption and civil

action number for all purposes in the United States District Court for the Southern District of New York. Pursuant to a stipulation and order dated January 30, 1991, plaintiffs in the Brown, Handel, Friedman and Foster Actions filed a consolidated amended class action complaint (the "Consolidated Complaint"). The Consolidated Complaint names as defendants RJRN and eight former officers and directors of RJRN. Also pursuant to the January 30, 1991 stipulation and order, Holdings, Group and Merger Sub, each of which had previously intervened as defendants in the consolidated actions, are dismissed from the consolidated actions without prejudice and without costs. The consolidated actions are brought as purported class actions on behalf of former stockholders of RJRN who sold shares of common stock between March 30, 1988 and October 20, 1988 (the "purported class period") (1) in the RJRN issuer-tender offer that expired on April 26, 1988, (2) in the exercise of certain employee stock option or stock appreciation rights pursuant to a Prospectus and Special Vesting Offer that was in effect for the month of August 1988 and (3) in open-market transactions. The Consolidated Complaint generally alleges that defendants failed to disclose during the purported class period the alleged respective interests of KKR, F. Ross Johnson, then RJRN's President and others, in acquiring RJRN in a leveraged buyout. The Consolidated Complaint alleges that the defendants' failure to disclose the alleged information constitutes a violation of the federal securities laws, as well as breach of fiduciary duty and negligent misrepresentation. The Consolidated Complaint also seeks damages. Discovery is proceeding in these consolidated actions.

On October 28, 1988, a complaint entitled *Bluegrass Partners, Ltd. v. RJR Nabisco, et al.*, No. 8817090-18 (Sup. Ct. Ga., Cobb County, filed October 28, 1988) (the "Bluegrass Action") was filed in the Superior Court for the County of Cobb, State of Georgia. Plaintiff brought the Bluegrass Action as a class action on behalf of all stockholders of RJRN against RJRN and its then current directors. On or about December 12, 1988, plaintiff filed an amended complaint which alleges that the directors breached their fiduciary duties by accepting KKR's \$109 offer to acquire RJRN, by conducting an auction which was procedurally unfair and by approving certain severance agreements with certain of RJRN's management. Defendants moved to stay the Bluegrass Action on the ground that it is substantially identical to the Consolidated Delaware Action. This motion was granted on July 8, 1989.

On or about February 28, 1989, an action entitled *Schneider, et al. v. Lazard Frères & Co. and Dillon, Read & Co., Inc.* (N.Y. Sup. Ct., dated February 28, 1989) was commenced in the Supreme Court of the State of New York, County of New York (the "Schneider Action"). The Schneider Action is brought on behalf of a purported class of stockholders of RJRN as of November 30, 1988. The complaint alleges that the defendants, Lazard Frères and Dillon Read, acted negligently in their capacity as financial advisors to the special committee of the Board of Directors of RJRN formed to consider proposals for the acquisition of RJRN during the auction for RJRN which culminated in the execution of the Merger Agreement and in valuing the bids made by the Johnson Group and KKR. Plaintiffs seek compensatory damages. The Schneider Action is now stayed pending resolution of the claims raised in the Consolidated Delaware Action. It is contemplated that if the proposed settlement of the Consolidated Delaware Action is approved by the Court, the Schneider Action will be dismissed.

At the present time, no class has been certified in any of the above stockholder actions.

On or about May 10, 1989, an action entitled *Cook, et al. v. Johnson, et al.*, 89-CVS-2272 (N.C. Gen. Ct. Justice, Sup. Ct. Div., Forsyth Co., filed May 10, 1989) was commenced in North Carolina state court (the "Cook Action"). The Cook Action is brought by nine former employees of RJRN, in their individual capacities and not as a class action, who exercised employee stock options and stock appreciation rights pursuant to the Prospectus and Special Vesting Offer in effect for the month of August 1988. The complaint names as defendants F. Ross Johnson, eight other officers and directors of RJRN, Holdings, Group, Merger Sub, Shearson and a corporation organized by certain members of RJRN management in connection with their bid to acquire RJRN. The complaint in the Cook Action, as amended, generally alleges that the defendants, other than Holdings, Group and Merger Sub, failed

to disclose, in the period prior to the Special Vesting Offer, KKR's and Johnson's alleged respective interests in acquiring RJRN in a leveraged buyout. The complaint alleges that the defendants' failure to disclose the alleged information constitutes breach of fiduciary duty, fraud, violations of federal and North Carolina securities law and negligence. Holdings, Group and Merger Sub are sued as alleged indemnitors of certain of the other defendants. Plaintiffs seek compensatory and punitive damages. On June 8, 1989, the Cook Action was removed by the defendants to North Carolina federal court and, on October 10, 1989 was transferred to the United States District Court for the Southern District of New York for consolidated pre-trial proceedings with the actions pending there.

Bondholder Litigation

Two actions brought against RJRN and certain former officers of RJRN by holders of debt securities of RJRN are currently pending: *Metropolitan Life Insurance Co., et al. v. RJR Nabisco, Inc., et al.*, 88 Civ. 8266 (JMW) (S.D.N.Y.) (the "Metlife Action") and *Gekoski, et al. v. F. Ross Johnson, et al.*, 88 Civ. 8636 (JMW) (S.D.N.Y.) (the "Gekoski Action"). The plaintiffs in the Metlife Action held debt securities of RJRN aggregating approximately \$348.4 million at the time such action was filed and the named plaintiffs in the Gekoski Action held \$35,000 at the time such action was filed.

The Gekoski Action is a class action on behalf of purchasers of debt securities of RJRN. The class is defined as all persons and entities who purchased securities issued by RJRN from February 10, 1988 to October 19, 1988. The principal current claim in the Gekoski Action is alleged nondisclosure by RJRN of material information in violation of federal securities laws.

The principal remaining allegations in the Metlife Action are the alleged breach of covenants governing the relevant debt securities, alleged fraud and alleged fraudulent conveyances. In 1989, RJRN received notices from the two plaintiffs in the Metlife Action purporting to be notices of default (and one notice of acceleration) under debt issues and a debt guarantee agreement of RJRN and its subsidiaries with an aggregate outstanding principal amount of approximately \$1.45 billion. Such notices appear to allege that the arrangements pursuant to the 1989 Credit Agreement and certain existing indebtedness of RJRN and its subsidiaries are secured (including the indebtedness covered by the notices) create defaults under the "equal and ratable" covenants in the indentures governing such issues. Plaintiffs in the Metlife Action have repeated these allegations in a separate claim in the second amended complaint in the Metlife Action. In that complaint, plaintiffs sought redemption of their debt securities, among other remedies. In July 1990, plaintiffs amended their complaint to include a claim that the arrangements pursuant to which the 1989 Credit Agreement and certain existing indebtedness of RJRN and its subsidiaries are secured create defaults under certain additional covenants in the indentures governing the debt securities held by plaintiffs. Those covenants require the granting of a prior lien if, upon a merger, the assets of the issuer or certain subsidiaries would, by reason of an after-acquired property clause or similar provision, become subject to a mortgage, lien, pledge, charge or encumbrance. Such covenants, or others similar to them, as well as equal and ratable covenants, are commonly found in corporate debt of many issuers, including much of the other outstanding long-term debt issued by RJRN. The Registrants believe that the provisions of the pledges securing the obligations under the 1989 Credit Agreement comply fully with the requirements of the debt securities held by the plaintiffs in the Metlife Action and other similar debt, that the plaintiffs' interpretations of the covenants at issue are without precedent and that such purported notices of default and acceleration were issued improperly and without basis.

On May 25, 1989, RJRN sought an injunction in the Metlife Action staying the effect of the plaintiffs' notices, and requested permission to file counterclaims against the plaintiffs for lender liability and for declaratory judgment that there was no violation of the "equal and ratable" covenants. On May 26, 1989, the Court issued an injunctive order tolling the effect of the notices and granting RJRN permission to file its counterclaims, which were filed on May 30, 1989. On June 9, 1989, the

Court reaffirmed its injunctive order tolling the effect of the notices with the exception of the one notice of acceleration which pertains to \$5.0 million of notes held by the Metropolitan Life Insurance Company ("Metlife"). The \$5.0 million of notes were subsequently retired in connection with the sale of certain assets of Del Monte. On July 6, 1989, plaintiffs filed an appeal of the injunctive order. On June 25, 1990, the Court of Appeals issued an opinion vacating the preliminary injunction in the form issued by the District Court and remanding the matter to the District Court for further proceedings not inconsistent with that opinion. Prior to the decision by the Court of Appeals, the District Court established a schedule for the submission of briefs and other papers supporting motions for summary judgment with respect to the covenants at issue. In compliance with that schedule, as revised, the motions were fully briefed and taken under consideration by the District Court as of October 19, 1990.

The parties have agreed that the cure periods under the indentures containing the covenants at issue will extend until 18 days after the District Court renders its determination on the pending summary judgment motions as to whether there has been a covenant breach. In the event of an adverse decision by the District Court, RJRN would intend to seek leave to appeal and to obtain an expedited ruling from the Court of Appeals prior to expiration of the 18-day cure period or a stay further extending the cure period to the extent that an appeal could not be resolved within the 18-day period. There can be no assurance that such an expedited ruling or stay would be granted. The limited duration of the cure period could adversely affect RJRN's ability to effectuate any required cure or to obtain effective appellate relief.

On January 18, 1991, Holdings, RJRN and Metlife agreed in principle to reinstitute normal business relations and to settle and dismiss the Metlife Action. As part of such agreement, Metlife will become an equity investor in Holdings and one of the primary lenders with respect to the ESOP (as hereinafter defined) described in Item 11. "Executive Compensation—Employee Stock Ownership Plan" below. On January 21, 1991, Metlife, Jefferson-Pilot Life Insurance Company, the other plaintiff in the Metlife Action ("Jefferson Pilot"), Holdings and RJRN requested that the District Court defer decision in the current action pending finalization of a definitive settlement agreement.

The parties have undertaken to enter into a definitive settlement agreement containing customary terms and conditions which will provide for the exchange by Metlife with Holdings of an aggregate of \$125 million principal amount of 8.9% Debentures due 1996 (the "1996 Debentures") and 8% Debentures due 2007 (the "2007 Debentures") for a 100% participation (the "ESOP Participation") in the External ESOP Note (as hereinafter defined) issued to Holdings in connection with the sale of Holdings stock to the ESOP. The ESOP Participation will be guaranteed by Holdings which guarantee will be secured by a pledge of the unamortized portion of the 1996 Debentures and 2007 Debentures acquired by Holdings. It is expected that the closing of the ESOP Participation will occur by the end of the first quarter of 1991, and in any event not later than August 1, 1991.

The parties have further agreed in principle that, pursuant to the terms of the definitive settlement agreement, Metlife will become an equity investor in Holdings by exchanging up to an aggregate of \$32.5 million principal amount of 1996 Debentures and 2007 Debentures (the remainder of the 1996 Debentures and 2007 Debentures then owned by Metlife) with Holdings for Common Stock, par value \$.01 per share, of Holdings ("Holdings Common Stock") at a price equal to the average closing price for Holdings Common Stock over a specified period shortly before the date of issuance. It is expected that the closing of the equity investment will occur on August 1, 1991, and in any event not later than October 1, 1991. The Holdings Common Stock to be issued to Metlife will be subject to contractual transfer restrictions whereby Metlife may not dispose of any of the shares of such Holdings Common Stock prior to March 1, 1992; provided that up to 50% of such Holdings Common Stock may be transferred after December 2, 1991. In connection with its equity investment, Metlife will be granted demand registration rights providing for not more than two shelf registrations of such Holdings Common Stock for specified periods. In connection with the ESOP Participation and the equity investment, Metlife has undertaken to offer to acquire all of the 2007 Debentures not now owned by it.

Holdings has also undertaken to make exchange offers to be consummated by December 15, 2002 for the 9½% Sinking Fund Debentures, Due April 1, 2016, the 8½% Sinking Fund Debentures, Due February 1, 2017 and the 8½% Sinking Fund Debentures, Due March 15, 2017 of RJRN then outstanding. Such exchange offers will be made at par and the consideration to be offered will consist of 90% cash and 10% Holdings Common Stock or, at the option of Holdings, a greater percentage of cash up to 100% with any balance in Holdings Common Stock, any such Holdings Common Stock to be priced in relation to the then current market price. In connection with the final settlement of the litigation, Holdings will reimburse Metlife for Metlife's and Jefferson-Pilot's legal, executive and other costs and expenses related to the litigation.

Other Litigation

For information relating to other litigation relating to the tobacco business, see "Litigation Affecting the Cigarette Industry" contained in Item 1 hereof.

The Registrants believe that the ultimate outcome of all pending stockholder, bondholder and other litigation matters should not have a material adverse effect on the Registrants' financial condition. However, no assurance can be given as to the decisions which may be rendered by the courts in any of the litigation matters described above, certain of which involve material claims.

Item 4. Submission of Matters to a Vote of Security Holders

On November 7, 1990 and January 15, 1991, the board of directors of each of Holdings and Group was re-elected in its entirety. The election was approved by written consents dated as of November 7, 1990 and January 15, 1991 of the holders of an aggregate of 553,182,254 shares of Holdings Common Stock, in the case of Holdings, constituting a majority of the then issued and outstanding shares of Holdings Common Stock of Holdings, and of an aggregate of 1,000 shares of common stock, par value \$.01 per share, in the case of Group, constituting all of the issued and outstanding shares of common stock of Group.

On November 7, 1990 and January 15, 1991, the board of directors of Capital was re-elected in its entirety. The election was approved by written consent dated as of November 7, 1990 and January 15, 1991 of the holders of an aggregate of 1,000 shares of common stock, par value \$.01 per share, constituting all of the issued and outstanding common stock of Capital.

On November 7, 1990 and January 15, 1991, the board of directors of RJRN was re-elected in its entirety. The election was approved by written consent dated as of November 7, 1990 and January 15, 1991 of the holders of an aggregate of 2,247.61275 shares of common stock, par value \$1,000 per share, constituting all of the issued and outstanding common stock of RJRN.

On January 29, 1991, Holdings amended its certificate of incorporation to increase the authorized number of shares of capital stock from 1,200,000,000 shares of common stock, par value \$.01 per share, and 150,000,000 shares of preferred stock, par value \$.01 per share, to 1,500,000,000 shares of common stock and 150,000,000 shares of preferred stock. The amendment was approved by consent dated as of January 15, 1991 of the holders of an aggregate of 553,182,254 shares of Holdings Common Stock, constituting a majority of the then issued and outstanding shares of Holdings Common Stock.

PART II

Item 5. Market for Registrants' Common Equity and Related Stockholder Matters

In connection with the exchange offer commenced on February 1, 1991 and completed on March 2, 1991 (the "1991 Exchange Offer"), trading of Holdings Common Stock commenced on the New York Stock Exchange (the "NYSE") on a when-issued basis on February 1, 1991. During the period from February 1, 1991 to March 1, 1991, the high and low sales prices for Holdings Common Stock as reported in published financial sources were \$10.25 and \$5.50, respectively. There is no established trading market for the common stock of Group or Capital. Since completion of the Acquisition there has been no public trading market for the capital stock of RJRN.

As of March 1, 1991 and prior to the closing of the 1991 Exchange Offer, there were approximately 505 holders of Holdings Common Stock. All of the common stock of Group is owned by Holdings. All of the common stock of Capital is owned by Group. All of the common stock of RJRN is owned by Capital.

Holdings has never paid any cash dividends on shares of Holdings Common Stock. On January 15, 1991, Holdings paid a dividend on its Cumulative Convertible Preferred Stock, stated value \$25 per share and par value \$.01 per share ("Holdings Preferred Stock") in an amount of approximately \$50 million, which dividend was funded from the \$200 million dividend reserve (the "Dividend Reserve") set aside by Holdings during 1990 to create a reserve initially available to fund 1991 cash dividends on Holdings Preferred Stock. Substantially all of the remaining funds in the Dividend Reserve were subsequently released in connection with the completion of the 1991 Exchange Offer. The ability of Holdings to pay dividends is restricted by provisions of the 1989 Credit Agreement, the 1990 Credit Agreement and various debt instruments of Capital. The 1989 Credit Agreement and the 1990 Credit Agreement prohibit any payment of cash dividends on Holdings Common Stock.

In 1989, prior to the consummation of the Merger, RJRN paid no cash dividends on its common stock. In 1989, prior to the consummation of the Merger, RJRN paid two dividends of \$2.875 per share on the then outstanding shares of its Series B Cumulative Preferred Stock. In February 1989, RJRN redeemed all outstanding Preferred Stock Purchase Rights (each a "Right") associated with the RJRN common stock at a price of \$0.05 per Right.

The operations of the Registrants are conducted through RJRN's subsidiaries and, therefore, the Registrants are dependent on the earnings and cash flow of RJRN's subsidiaries to satisfy their respective debt obligations and other cash needs. Funds are provided to RJRN by its direct subsidiaries and to Capital by RJRN through dividends and payments on intercompany indebtedness as to which there are no restrictions under the 1989 Credit Agreement and the 1990 Credit Agreement or the indentures relating to Capital's and RJRN's debt securities. The ability of Capital to pay dividends to Group or to make loans to Holdings is, however, substantially restricted by the 1989 Credit Agreement and the 1990 Credit Agreement and the indentures relating to the debt securities of Capital.

Item 6. Selected Financial Data

The selected consolidated financial data presented below as of December 31, 1990 and 1989 and for the year ended December 31, 1990 and the period from February 9, 1989 through December 31, 1989 for Holdings and for the period from January 1, 1989 through February 8, 1989 for RJRN were derived from the 1990 Consolidated Financial Statements, which have been audited by Deloitte & Touche, independent auditors. The selected consolidated financial data for each of the years in the three-year period ended December 31, 1988 was derived from the Consolidated Financial Statements of RJRN, which have been audited by Ernst & Young, independent auditors. The data should be read in conjunction with the Consolidated Financial Statements, related notes and other financial information included herein.

(Dollars in Millions Except Per Share Amounts)	Holdings		RJRN			
	For the Years Ended December 31,					
	1990	1989	1988	1987	1986	
	2/9 to 12/31	1/1 to 2/8				
Results of Operations						
Net sales	\$13,879	\$12,114	\$ 650	\$12,635	\$11,765	\$11,517
Cost of products sold	5,652	5,241	332	5,661	5,458	5,402
Selling, advertising, administrative and general expenses	4,801	4,276	295	4,486	4,043	3,984
Amortization of trademarks and goodwill	608	557	10	121	117	122
Restructuring expense, net	—	—	—	—	232	—
Operating income(1)	2,818	2,040	13	2,367	1,915	2,009
Interest expense	(3,000)	(2,893)	(44)	(537)	(448)	(527)
Amortization of debt issuance costs	(176)	(447)	—	(12)	(6)	(4)
Change in control costs	—	—	(247)	—	—	—
Other income (expense), net	(44)	169	15	7	(6)	(29)
Income (loss) from continuing operations before income taxes	(402)	(1,131)	(263)	1,825	1,455	1,449
Provision (benefit) for income taxes	60	(156)	(66)	654	591	646
Income (loss) from continuing operations(2)	\$ (462)	\$ (975)	\$ (197)	\$ 1,171	\$ 864	\$ 803
Income (loss) from operations of discontinued businesses, net of income taxes(3)	\$ —	\$ (1)	\$ 24	\$ 222	\$ 210	\$ 300
Net income (loss)(4)	\$ (429)	\$ (976)	\$ (173)	\$ 1,393	\$ 1,209	\$ 1,064
Preferred stock dividends	50	—	4	15	30	102
Net income (loss) applicable to common stock	\$ (479)	\$ (976)	\$ (177)	\$ 1,378	\$ 1,179	\$ 962
Other Data						
Income (loss) from continuing operations per common share(2)	\$ (1.19)	\$ (3.21)	\$(0.89)	\$ 4.97	\$ 3.33	\$ 2.79
Dividends per common share	—	—	—	2.06	1.76	1.51
Balance Sheet Data (at end of periods)						
Working capital(5)	\$ (1,089)	\$ 106		\$ 1,436	\$ 1,010	\$ 631
Total assets	32,915	36,412		16,013	15,250	15,230
Total debt	18,675	24,761		5,518	4,279	5,591
Redeemable preferred stock	1,795	—		125	173	291
Common stockholders' equity(6)	2,494	1,237		5,694	6,038	5,312

(Footnotes on following page)

(Footnotes for previous page)

- (1) The 1989 amount for Holdings includes the effects of the implementation of a plan to eliminate excess domestic trade inventories of its tobacco products which reduced operating income by an estimated \$360 million. (See Note 2 to the Consolidated Financial Statements.)
- (2) The 1988 amount includes the effects of the additional tax provisions for the repatriation of certain foreign earnings and advisory fees and certain other expenses that were incurred in anticipation of the Merger. The combined effect was a reduction of income from continuing operations by \$70 million for the year ended December 31, 1988. The 1990 amount includes \$75 million of advisory fees incurred in connection with the Recapitalization Program and the establishment of fixed interest rates on the Converting Debentures and Group Debentures. (See Note 2 to the Consolidated Financial Statements.)
- (3) The 1989 amount for Holdings includes \$237 million of interest expense allocated to discontinued operations. (See Note 4 to the Consolidated Financial Statements.)
- (4) The 1987 amount includes net after-tax gains on the sale of RJRN's discontinued operations of \$215 million. In addition, the 1987 amount includes an extraordinary loss of \$80 million from the early extinguishment of debt. The 1990 amount includes an extraordinary gain of \$33 million which resulted from the early extinguishments of debt and consists of a pre-tax gain of \$220 million from the repurchase of Group Debentures on the open market, a write-off of debt issuance costs aggregating \$79 million and a provision for income taxes of \$108 million related to the Recapitalization Program. (See Note 5 to the Consolidated Financial Statements.)
- (5) The 1990 working capital amount for Holdings includes current maturities of long-term debt of \$1.425 billion which is expected to be repaid during 1991 primarily from cash flows from operating activities.
- (6) Holdings common stockholders' equity at December 31, 1990 and 1989 includes non-cash expenses related to accumulated trademark and goodwill amortization of \$1.165 billion and \$557 million, respectively. (See Note 15 to the Consolidated Financial Statements.)

See Notes to Consolidated Financial Statements.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of Holdings' financial condition and results of operations covers periods before and after the Acquisition. The consolidated financial statements of Holdings for the period after February 8, 1989, are not directly comparable to the consolidated financial statements of RJRN for prior periods, primarily due to the allocation of the purchase cost in connection with the Acquisition and related financings. The following discussion and analysis should be read in connection with the historical financial information included in the Consolidated Financial Statements. The following discussion and analysis does not address the results of operations for discontinued businesses. See Item 1. "Business—Recent Dispositions."

Results of Operations

Consolidated

1990 vs. 1989. Consolidated net sales for 1990 were \$13.9 billion, an increase of 9% from 1989, which includes results of RJRN before the Acquisition. Net sales for the tobacco line of business in 1990 were \$8.1 billion, up 15% compared with 1989. Net sales for the food line of business in 1990 were \$5.8 billion, a slight increase from 1989.

Consolidated operating income for 1990 was \$2.8 billion, a 37% increase compared with \$2.1 billion for 1989. Operating income before amortization of trademarks and goodwill ("Business Unit Contribution") was \$3.4 billion in 1990, an increase of 31% from \$2.6 billion in 1989.

Consolidated interest expense of \$3.0 billion in 1990 increased 2% from the 1989 level of \$2.9 billion due primarily to higher interest expense from the setting of fixed interest rates, effective July 16, 1990, on the Converting Debentures and the Group Debentures, partially offset by repayments of debt since the Acquisition and the initial effects of the Recapitalization Program.

Holdings' loss from continuing operations was reduced to \$462 million in 1990, a 61% decrease from \$1.2 billion in 1989. Included in the loss from continuing operations for 1990 was \$1.8 billion (\$1.7 billion in 1989) of non-cash interest and amortization of debt issuance costs as well as \$1.2 billion (\$1.1 billion in 1989) of other non-cash charges, primarily amortization of trademarks and goodwill and depreciation expense. In addition, \$75 million of advisory fees incurred in connection with the Recapitalization Program and the establishment of fixed interest rates on the Converting Debentures and Group Debentures were charged to "Other income (expense), net" during 1990.

Holdings' net loss of \$429 million in 1990 includes an extraordinary gain of \$33 million which resulted from the early extinguishments of debt and consists of a pre-tax gain of \$220 million from the repurchase of Group Debentures on the open market, a write-off of debt issuance costs aggregating \$79 million and a provision for income taxes of \$108 million related to the Recapitalization Program.

1989 vs. 1988. Consolidated net sales for 1989 were \$12.8 billion, an increase of 1% from 1988. Net sales for the tobacco line of business in 1989 of \$7.0 billion decreased \$87 million from 1988 due to lower domestic tobacco volume, reflecting the impact of a program to eliminate excess domestic trade inventories in the second half of 1989 and an industry-wide downward trend, partially offset by volume gains recorded in Tobacco International and price increases. Net sales for the food line of business in 1989 increased \$216 million from 1988 to \$5.8 billion, primarily due to higher pricing and new product introductions.

Consolidated operating income for 1989 was \$2.1 billion, a \$314 million decrease from 1988 due primarily to the significantly higher amortization of trademarks and goodwill resulting from the

allocation of the purchase cost associated with the Acquisition. Business Unit Contribution was \$2.6 billion in 1989, an increase of 5% over 1988. However, Business Unit Contribution increased 29% from 1988, after adjustments for the one-time impact of the program to eliminate excess domestic tobacco trade inventories in the second half of 1989, the allocation of the purchase cost associated with the Acquisition and a non-recurring gain on the sale of certain confectionery operations in 1988.

Consolidated interest expense increased substantially from the 1988 level of \$537 million to \$2.9 billion in 1989, due primarily to interest charges on the debt incurred in connection with the Acquisition. The 1989 amount includes \$1.2 billion in non-cash interest expense.

Holdings reported a loss of \$1.2 billion from continuing operations in 1989, compared to RJRN's income from continuing operations of \$1.2 billion in 1988. The loss in 1989 was due primarily to the significantly higher interest expense, amortization of debt issuance costs, adjustments including intangible amortization resulting from the allocation of the purchase cost associated with the Acquisition, one-time change in control costs and the impact of the decision to eliminate excess domestic tobacco trade inventories. Included in the loss from continuing operations in 1989 was \$2.8 billion of non-cash charges, primarily non-cash interest, amortization of debt issuance costs, amortization of trademarks and goodwill and depreciation expense.

Industry Segments

The percentage contributions of each of RJRN's industry segments to net sales and Business Unit Contribution during the last five years were as follows:

	<u>1990</u>	<u>1989(1)</u>	<u>1988</u>	<u>1987</u>	<u>1986</u>
Net sales					
Tobacco	58%	55%	56%	54%	51%
Food	<u>42</u>	<u>45</u>	<u>44</u>	<u>46</u>	<u>49</u>
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
Business Unit Contribution(2)					
Tobacco	77%	73%	73%	74%	73%
Food	<u>23</u>	<u>27</u>	<u>27</u>	<u>26</u>	<u>27</u>
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

(1) Includes Predecessor period January 1, 1989 through February 8, 1989.

(2) Contributions by industry segment computed without effects of Corporate expenses.

Summarized financial data for the tobacco and food industry segments were as follows (in millions):

	Holdings		RJRN	
	Year Ended December 31, 1990	February 9, 1989 through December 31, 1989	January 1, 1989 through February 8, 1989	Year Ended December 31, 1988
Tobacco:				
Net sales	<u>\$8,053</u>	<u>\$6,655</u>	<u>\$326</u>	<u>\$7,068</u>
Business Unit Contribution(1)(2) ..	<u>\$2,729</u>	<u>\$1,964</u>	<u>\$ 52</u>	<u>\$1,924</u>
Amortization of trademarks and goodwill	<u>(403)</u>	<u>(368)</u>	<u>—</u>	<u>(1)</u>
Operating income(1)(2)	<u>\$2,326</u>	<u>\$1,596</u>	<u>\$ 52</u>	<u>\$1,923</u>
Food:				
Net sales	<u>\$5,826</u>	<u>\$5,459</u>	<u>\$324</u>	<u>\$5,567</u>
Business Unit Contribution(1)(2) ..	<u>\$ 802</u>	<u>\$ 757</u>	<u>\$(15)</u>	<u>\$ 730</u>
Amortization of trademarks and goodwill	<u>(205)</u>	<u>(189)</u>	<u>(10)</u>	<u>(120)</u>
Operating income (loss)(1)(2)	<u>\$ 597</u>	<u>\$ 568</u>	<u>\$(25)</u>	<u>\$ 610</u>

(1) Excludes Corporate expenses.

(2) The 1990 and 1989 Holdings' periods include the impact of higher depreciation costs associated with the appraisal value of property, plant and equipment and other adjustments resulting from the allocation of the purchase cost associated with the Acquisition.

Tobacco

1990 vs. 1989. The worldwide tobacco business of Holdings reported net sales of \$8.1 billion in 1990, a 15% increase from 1989, reflecting sales gains by both RJRT and Tobacco International. Operating income increased to \$2.3 billion in 1990, up 41% from 1989. Business Unit Contribution was \$2.7 billion in 1990, a 35% increase from 1989.

RJRT recorded net sales of \$5.8 billion in 1990, an 18% increase from 1989, reflecting higher volume and selling prices. Business Unit Contribution in 1990 was \$2.3 billion, an increase of 37% from 1989, due to higher net sales combined with benefits from cost-reduction programs, partially offset by higher marketing expenses. RJRT's lower volumes in 1989 reflected the decision to eliminate excess domestic trade inventories, which reduced Business Unit Contribution by approximately \$360 million in 1989.

Tobacco International recorded net sales of \$2.3 billion in 1990, an increase of 9% from 1989, resulting principally from volume gains, primarily in the markets of Europe and Asia, higher selling prices and the favorable effects of the strengthening of foreign currencies against the U.S. dollar, primarily in Europe. Business Unit Contribution rose to \$413 million in 1990, an increase of 26% from 1989, due primarily to higher net sales. In 1990, Tobacco International improved or maintained market share in 19 of the 24 key markets principally due to volume increases in three primary international brands, WINSTON, CAMEL and SALEM.

1989 vs. 1988. The worldwide tobacco business of Holdings reported slightly lower net sales in 1989 of \$7.0 billion due primarily to the decision to eliminate excess domestic trade inventories. Operating income decreased 14% to \$1.6 billion when compared with 1988, due primarily to the significantly higher amortization of trademarks and goodwill resulting from the allocation of the

purchase cost associated with the Acquisition and the program to eliminate excess trade inventories. Business Unit Contribution was \$2.0 billion, a 5% increase from \$1.9 billion in 1988. Excluding the impact of purchase cost allocation adjustments and the trade inventory decision, tobacco Business Unit Contribution would have increased 27% from 1988.

RJRT recorded lower net sales of \$4.9 billion in 1989 compared with \$5.2 billion in 1988, due primarily to the impact of the decision to eliminate excess trade inventories and an industry-wide downward volume trend. This program substantially reduced net sales in the second half of 1989 and decreased Business Unit Contribution by approximately \$360 million for the full year of 1989 compared to 1988. Nevertheless, Business Unit Contribution of \$1.7 billion in 1989 increased over 1988 as the impact of lower volume was more than offset by higher prices and operational cost savings, including staff reductions. On August 10, 1989, RJRT announced a reduction in its work force by 1,640 employees, including 825 salaried, 700 hourly and 115 temporary employees. Most employees were given salary continuation for a minimum of eight months and others were eligible for retirement. This program was necessary in order to streamline tobacco operations. The cost of the program has been included in the allocation of the purchase cost associated with the Acquisition.

Tobacco International recorded sharply higher net sales in 1989 of \$2.1 billion, due primarily to strong volume growth of 6% over 1988 and favorable pricing. Business Unit Contribution of \$328 million in 1989 increased 26% over 1988 due to the volume gains, favorable pricing and productivity improvements, which were partially offset by increased marketing and selling expenses primarily in the development of Asian markets. In 1989, Tobacco International gained or maintained market share in 23 of 25 key markets principally due to volume increases in three primary international brands, CAMEL, WINSTON and SALEM.

Food

1990 vs. 1989. Net sales for the food businesses of Holdings were \$5.8 billion for 1990, a slight increase from 1989, despite the loss of sales from the Baby Ruth/Butterfinger business and Chun King, both of which have been sold. Excluding the results for those businesses sold, net sales would have risen 5% in 1990 when compared with 1989. Operating income of \$597 million in 1990 increased 10% when compared with 1989. Business Unit Contribution increased 8% to \$802 million in 1990 when compared with 1989. Excluding the results of the businesses sold, Business Unit Contribution would have risen 19% when compared with 1989.

Nabisco reported net sales of \$4.8 billion for 1990, a 4% increase from 1989 primarily due to higher selling prices in all businesses and volume gains in its U.S. biscuit business. Business Unit Contribution increased 18% to \$671 million in 1990 when compared with 1989. Volume gains and margin improvements in the U.S. biscuit business and productivity gains in all businesses contributed to the Business Unit Contribution improvement in 1990. The volume gains of the U.S. biscuit business were driven by the solid performance of new products and the strength of key core brands, partially offset by lower volume in the cereal and margarine businesses.

Planters LifeSavers reported net sales of \$1.1 billion for 1990, a decrease of 13% from 1989. The decrease is due primarily to the loss of sales from the Baby Ruth/Butterfinger candy business sold in the first quarter of 1990. Business Unit Contribution of \$131 million for 1990 decreased approximately \$40 million from 1989 due primarily to the absence of the candy business sold and one-time product recall costs. Excluding the results of the candy business sold from both periods and the one-time product recall costs, Business Unit Contribution would have increased by 26% for 1990 when compared with 1989, due primarily to higher selling prices and improved productivity.

1989 vs. 1988. Net sales for the food line of business were \$5.8 billion in 1989, a 4% improvement over the \$5.6 billion in 1988. Operating income decreased 11% to \$543 million in 1989 compared with

1988, due primarily to the significantly higher amortization of trademarks and goodwill associated with the Acquisition. Business Unit Contribution increased 2% to \$742 million in 1989 compared to 1988. Excluding the impact of purchase cost allocation adjustments and a non-recurring gain from the sale of certain confectionery operations in 1988, Business Unit Contribution would have increased 24%.

Nabisco reported higher net sales of \$4.6 billion and Business Unit Contribution of \$571 million in 1989 compared to \$4.3 billion and \$502 million, respectively, in 1988. The improvement in Business Unit Contribution resulted primarily from higher pricing, productivity cost reductions and volume gains. Volume gains in the U.S. biscuit business (led by successful new product introductions—primarily TEDDY GRAHAMS, RITZ BITS and TRISCUIT BITS) were partially offset by lower volume in grocery products, principally in ready-to-eat cereal markets.

Planters LifeSavers reported lower net sales of \$1.2 billion in 1989 compared to \$1.3 billion in 1988, primarily due to volume declines in hard roll candy and nut products. The decrease in Business Unit Contribution to \$171 million in 1989 compared to \$228 million in 1988 was due to a gain on the sale of certain confectionery operations in 1988 and the lower 1989 sales volume.

Postretirement Benefits Other Than Pensions

During December 1990, Statement of Financial Accounting Standards No. 106 ("SFAS No. 106"), "Employers' Accounting for Postretirement Benefits Other Than Pensions", was issued. SFAS No. 106 will be effective for years beginning after 1992 and will require the accrual of costs for retirees' health and other postretirement benefits other than pensions and the recognition of an unfunded and unrecognized accumulated benefit obligation for these benefits. Although RJRN has not yet adopted SFAS No. 106, management currently estimates that the accumulated benefit obligation for these benefits could range from approximately \$1.0 billion to \$1.5 billion when adopted. RJRN's retiree health care and other postretirement benefit plans other than pensions are currently under study, therefore, the exact amount of the accumulated benefit obligation at adoption cannot be determined. Neither has RJRN determined whether it will adopt SFAS No. 106 prospectively or by recording the cumulative effect as a one-time adjustment to income. However, in connection with the purchase cost allocation as of February 9, 1989, RJRN recorded an estimated present-valued obligation for these benefits, and accordingly, an accrual of approximately \$1.1 billion is reflected in RJRN's Balance Sheet at December 31, 1990.

Liquidity and Financial Condition

December 31, 1990

Despite Holdings' losses from continuing operations of \$462 million and \$1.2 billion for 1990 and 1989, respectively, earnings before interest, taxes, depreciation and amortization ("EBITDA"), amounted to \$4.0 billion and \$3.4 billion for the respective periods. Cash flow available for repayment of debt, after working capital and other operating and investing requirements, but excluding net divestiture proceeds and financing activities, amounted to \$2.7 billion and \$647 million, for 1990 and 1989, respectively, as follows:

(In Millions)	Years Ended December 31,	
	1990	1989
Income (loss) from continuing operations	\$ (462)	\$(1,172)
Interest expense	3,000	2,937
Amortization of debt issuance costs	176	447
Income tax provision (benefit)	60	(222)
Depreciation of property, plant and equipment	450	449
Amortization (principally intangibles)	680	639
Change in control costs	—	247
Accretion of other noncurrent liabilities	86	75
EBITDA	3,990	3,400
Interest paid	(1,424)	(1,909)*
Taxes refunded (paid), excluding divestiture related taxes	32	(229)
Decrease in working capital, excluding income taxes and interest	379**	93
Capital expenditures	(426)	(522)
Other, net	151	(186)
Cash flow available for repayment of debt	\$ 2,702	\$ 647

* Includes \$339 million in 1989 of interest allocated to discontinued operations.

** Includes \$321 million of certain domestic trade accounts receivable sold at December 31, 1990.

At December 31, 1990, Holdings had outstanding debt of approximately \$18.7 billion, compared to approximately \$24.8 billion at December 31, 1989. This decrease is primarily due to the repayment of \$2.3 billion of the Asset Sale Bridge Facility, the retirement and exchange of approximately \$2.2 billion principal amount of Group Debentures and approximately \$1.5 billion principal amount of Converting Debentures pursuant to the Recapitalization Program.

At December 31, 1990, Holdings' working capital amount included current maturities of long-term debt of \$1.4 billion, which is expected to be repaid during 1991 primarily from cash flows from operating activities. RJRN maintains a working capital facility of \$750 million of which approximately \$614 million was unborrowed and available as of December 31, 1990. At December 31, 1990, Capital had a revolving credit facility that provided for the extension of credit in the aggregate amount of \$1.750 billion. In addition, Capital has arranged for the extension of irrevocable letters of credit of approximately \$550 million, which support the principal and interest on certain existing foreign debt of

RJRN and its subsidiaries, which reduced the amount available under the revolving credit facility to \$1.2 billion. At December 31, 1990, \$1.1 billion of this facility was unborrowed and available.

On February 7, 1990, RJRN entered into a five-year arrangement to sell up to \$500 million of certain of its domestic trade accounts receivable. In connection with this arrangement, \$321 million of certain domestic trade accounts receivable were sold at December 31, 1990.

Under the terms of Capital's subordinated debt indentures, Capital's ability to make certain payments to Group or Holdings for, among other things, dividends, retirement of certain securities and permitted investment in certain subsidiaries was significantly restricted until the consolidated fixed charge ratio, as defined under such subordinated debt indentures, reached 2.0-to-1. Thereafter, an adjusted percentage of consolidated net operating income, as defined under such subordinated debt indentures, is available, inter alia, for such purposes. At December 31, 1990, Capital attained the 2.0-to-1 consolidated fixed charge ratio.

The terms of the Converting Debentures and the Group Debentures required that the interest rates on these securities be set permanently at fixed rates designed to result in the respective debentures trading at par on a fully distributed basis, without taking into account any accrued and unpaid interest thereon and, in the case of the Converting Debentures, without giving effect to the conversion feature of such securities, by no later than April 28, 1991 (or if substantially all of the First Subordinated Increasing Rate Notes due 1997 and the Second Subordinated Increasing Rate Notes due 1997 (collectively, the "Increasing Rate Notes") of Capital had been refinanced prior to April 28, 1990, one year from the date of such refinancing). Effective July 16, 1990, Holdings established a permanent annual fixed interest rate of 17 $\frac{1}{2}$ % on the Converting Debentures and Group established a permanent annual fixed interest rate of 17% on the Group Debentures. The Group Debentures are subject to optional redemption by Group at any time at 100% of the principal amount thereof plus accrued and unpaid interest thereon. Group is currently prohibited from redeeming any Group Debentures under the 1989 Credit Agreement and the 1990 Credit Agreement without obtaining prior consent of the banks party thereto.

At December 31, 1990, Holdings' total capital was approximately \$23.0 billion, compared with total capital of approximately \$26.0 billion at December 31, 1989. This decrease was primarily due to the repayment of approximately \$2.3 billion of the Asset Sale Bridge Facility, the retirement and exchange of approximately \$2.2 billion principal amount of Group Debentures and \$1.5 billion principal amount of Converting Debentures pursuant to the Recapitalization Program, all of which were partially offset by \$1.7 billion in proceeds from a new common equity investment by a partnership affiliated with KKR and the issuance of \$1.8 billion stated value of Holdings Preferred Stock, also pursuant to the Recapitalization Program. At December 31, 1990, Holdings had ratios of consolidated debt to total equity and consolidated debt and redeemable preferred stock to common stockholders' equity of 4.4-to-1 and 8.2-to-1, respectively. The weighted average interest rate approximated 12.9% for Holdings' long-term debt outstanding as of December 31, 1990, compared to the weighted average interest rate of approximately 12.3% as of December 31, 1989, principally due to repayment of debt with a 12% interest rate under the Asset Sale Bridge Facility and the higher rates from the setting of fixed interest rates on the Converting Debentures and the Group Debentures.

As of December 31, 1990, approximately \$6.4 billion (a decrease from approximately \$16.0 billion at December 31, 1989) of consolidated indebtedness was subject to interest at fluctuating or increasing rates, before consideration of any interest rate protection taken. This decrease was primarily due to the setting of fixed interest rates effective July 16, 1990, on the Converting Debentures and Group Debentures, representing an aggregate of approximately \$6.3 billion principal amount at December 31, 1989, and the repayment of approximately \$2.3 billion of the Asset Sale Bridge Facility. The exposure to changes in interest rates has been reduced through interest rate swap agreements and futures

contracts covering approximately \$4.1 billion of such debt at December 31, 1990. Nevertheless, Holdings will remain sensitive to prevailing interest rates.

On November 1, 1990, Holdings completed the exchange of \$1.859 billion of the sum of principal of and accrued and unpaid interest on Converting Debentures and \$541 million of the sum of principal of and accrued and unpaid interest on Group Debentures for an aggregate of approximately \$800 million in cash and approximately \$1.6 billion stated value of Holdings Preferred Stock (64,032,000 shares) pursuant to the 1990 Exchange Offers. On March 2, 1991, Holdings completed the exchange of \$1.176 billion of principal amount of Group Debentures for an aggregate of approximately \$547 million in cash and approximately 129.4 million shares of Holdings Common Stock pursuant to the 1991 Exchange Offer. In connection with the 1990 Exchange Offers and the 1991 Exchange Offer, the board of directors of Holdings determined that no antidilution adjustments were required under the terms of Holdings' public warrants, Holdings' private warrants or the Converting Debentures and, in addition, in the case of the 1991 Exchange Offer, the Holdings Preferred Stock.

With the closing of the 1991 Exchange Offer, the Recapitalization Program is now complete and is expected to further reduce the overall level of interest expense of Holdings in subsequent periods through a reduction in non-cash interest expense, partially offset by higher cash interest expense. The lower non-cash interest expense results principally from the reduction of outstanding amounts of Converting Debentures and Group Debentures reacquired as a result of the Recapitalization Program, partially offset by the setting of fixed interest rates of 17¼% and 17% per annum, respectively, effective July 16, 1990, on such Debentures remaining outstanding. The increase in cash interest expense results from additional borrowings at fluctuating rates to partially finance the Recapitalization Program. Cash flow of Holdings will be further reduced due to cash dividend requirements of 11.5% per annum of the stated value of the Preferred Stock, and cash interest requirements on such additional borrowings. Furthermore, Holdings' ratios of consolidated debt to total equity and consolidated debt and redeemable preferred stock to common stockholders' equity has been reduced to approximately 3.7-to-1 and 6.3-to-1, respectively.

With the Recapitalization Program completed, Holdings expects to continue to reevaluate its capital structure and the opportunities afforded by the financial markets. Holdings believes that the improvement to its capital structure by reason of the Recapitalization Program, together with recent improvements to the ratings of Holdings' and its subsidiaries' debt securities by a nationally recognized rating agency, should improve its ability to take advantage of these opportunities. Nonetheless, Holdings' and its subsidiaries' ability to take advantage of such opportunities is subject to many restrictions in its bank credit agreements and debt indentures. Holdings and its subsidiaries expect that they will continue to consider opportunities as they present themselves, and such alternatives, if pursued, could involve further acquisitions from time to time of securities of Holdings or its subsidiaries through open market purchases, tender or exchange offers or otherwise and/or the issuance from time to time of additional debt and/or equity securities by Holdings or its subsidiaries.

Capital expenditures for 1990 were \$426 million, compared to \$522 million for 1989. The current level of expenditures planned for 1991 is expected to be in the range of approximately \$500 to \$550 million (approximately 60% Food and 40% Tobacco), which will be funded primarily by cash flow from operating activities. Management expects that its capital expenditure program will continue at a level sufficient to support the strategic and operating needs of the Registrants' continuing businesses.

RJRN has operations in many countries, utilizing 23 functional currencies in its foreign subsidiaries and branches. The major functional currency is the U.S. dollar. Significant foreign currency net investments are located in Germany, Canada, Hong Kong and Spain. Changes in the strength of these countries' currencies relative to the U.S. dollar result in direct charges or credits to equity. RJRN also has significant exposure to foreign exchange sale and purchase transactions in currencies other than a functional currency. The exposures include the U.S. dollar, Japanese yen, German mark, British

pound, Swiss franc, and cross rate exposure between the French franc, the Belgian franc, Italian lira and the German mark. RJRN manages these exposures to minimize the effects of foreign currency transactions on its cash flows.

Fluctuations in the value of foreign currencies cause U.S. dollar translated amounts to change in comparison with previous periods and, accordingly, RJRN cannot quantify in any meaningful way the effect of such fluctuations upon future income. This is due to the large number of currencies involved, the constantly changing exposure in these currencies, the complexity of intercompany relationships, the hedging activity entered into to minimize the effect of exchange rate changes and the fact that all foreign currencies do not react in the same manner against the U.S. dollar.

The Registrants believe that they are currently in compliance with all covenants and restrictions of the 1989 Credit Agreement, the 1990 Credit Agreement and their other indebtedness although plaintiffs in certain pending actions have alleged that certain covenants in certain indentures have been breached. See Item 3. "Legal Proceedings."

Item 8. Financial Statements and Supplementary Data

Refer to the Index to Financial Statements and Financial Statement Schedules on page 46, for the required information.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

PART III

Item 10. Directors and Executive Officers of the Registrants

Directors and Executive Officers of Holdings, Group and Capital

The directors of each of Holdings, Group and Capital are Louis V. Gerstner, Jr., R. Theodore Ammon, Vernon E. Jordan, Jr., Henry R. Kravis, John G. Medlin, Jr., Paul E. Raether, Rozanne L. Ridgway, Clifton S. Robbins and Scott M. Stuart. In addition, James H. Greene, Jr. and George R. Roberts are directors of Holdings and Group.

The executive officers of each of Holdings, Group and Capital are Mr. Gerstner (Chairman of the Board, President and Chief Executive Officer), Eugene R. Croisant (Executive Vice President), Lawrence R. Ricciardi (Executive Vice President and General Counsel), Karl M. von der Heyden (Executive Vice President and Chief Financial Officer), Jon F. Danski (Vice President and General Auditor), Robert S. Roath (Senior Vice President and Controller), Robert F. Sharpe, Jr. (Vice President, Assistant General Counsel and Secretary) and Frederick W. Zuckerman (Senior Vice President and Treasurer).

The following table sets forth certain information regarding Messrs. Gerstner, Croisant, Ricciardi, von der Heyden, Danski, Raether, Roath, Robbins, Stuart, Sharpe, Zuckerman, Ammon, Greene, Jordan, Kravis and Medlin, Ms. Ridgway and Mr. Roberts. The business address of Messrs. Gerstner, Croisant, Ricciardi, von der Heyden, Danski, Roath, Sharpe and Zuckerman is c/o RJR Nabisco, Inc., 1301 Avenue of the Americas, New York, New York 10019. The business address of Messrs. Ammon, Kravis, Raether, Robbins and Stuart is c/o Kohlberg Kravis Roberts & Co., 9 West 57th Street, New York, New York 10019. The business address of Messrs. Greene and Roberts is c/o Kohlberg Kravis Roberts & Co., 101 California Street, San Francisco, California 94111. The business address of Mr. Jordan is Akin, Gump, Strauss, Hauer & Feld, 1333 New Hampshire Avenue, N.W., Suite 400, Washington, D.C. 20036. The business address of Mr. Medlin is First Wachovia Corporation, P.O. Box 3099, Winston-Salem, North Carolina 27150. The business address of Ms. Ridgway is 1616 H Street, N.W., Washington, D.C. 20006. Each person has had the principal occupation or employment listed in the table below for more than the past five years except as otherwise noted.

<u>Name</u>	<u>Age</u>	<u>Present Principal Occupation or Employment and Five-Year Employment History</u>
Louis V. Gerstner, Jr.	49	1989-Present, Chairman of the Board, President and Chief Executive Officer, RJRN; 1985-1989, President, American Express Company; 1982-1989, Chairman and Chief Executive Officer, American Express Travel Related Services Co., Inc. Director since 1989.
Eugene R. Croisant	53	1989-Present, Executive Vice President of Human Resources and Administration, RJRN; 1988-1989, Chief Operations Officer, Continental Bank Corporation, previously Sector Executive (1985-1988).
Lawrence R. Ricciardi	50	1989-Present, Executive Vice President and General Counsel, RJRN; 1985-1989, Executive Vice President and General Counsel, American Express Travel Related Services Co., Inc.
Karl M. von der Heyden	54	1989-Present, Executive Vice President and Chief Financial Officer, RJRN; 1983-1989, Senior Vice President-Finance and Chief Financial Officer, H.J. Heinz Company.
Jon F. Danski	38	1989-Present, Vice President and General Auditor, RJRN, previously Senior Director-Internal Audit (1987-1989); 1984-1987, Group Controller, Electronic Data Systems Corp.
Paul E. Raether	44	1986-Present, General Partner, KKR; 1980-1986, Associate, KKR. Director since 1989.

<u>Name</u>	<u>Age</u>	<u>Present Principal Occupation or Employment and Five-Year Employment History</u>
Robert S. Roath	48	1991-Present, Senior Vice President and Controller, RJRN; 1990-1991, Vice President and Controller, RJRN; 1988-1990, Vice President and Corporate Controller, Colgate-Palmolive Company; 1984-1988, Vice President, Finance and Business Development, General Foods Canada.
Clifton S. Robbins	33	1987-Present, Associate, KKR; prior thereto Investment Banker, Morgan Stanley & Co. Incorporated. Director since 1988.*
Scott M. Stuart	31	1986-Present, Associate, KKR; 1984-1986, Stanford Graduate School of Business. Director since 1988.*
Robert F. Sharpe, Jr.	38	1989-Present, Vice President, Assistant General Counsel and Secretary, RJRN, previously Assistant General Counsel (1988-1989), Senior Counsel (1987-1988), Counsel (1985-1986)
Frederick W. Zuckerman	56	1991 (February)-Present, Senior Vice President and Treasurer, RJRN; 1981-1990, Vice President and Treasurer, Chrysler Corporation.
R. Theodore Ammon	41	1991-Present, General Partner, KKR; 1984-1990, Associate, KKR. Director since 1988.*
James H. Greene, Jr.	40	1986-Present, Associate, KKR; prior thereto, Vice President, Bankers Trust Company. Director since 1988.*
Vernon E. Jordan, Jr.	55	Partner, Akin, Gump, Strauss, Hauer & Feld. Director since 1989.
Henry R. Kravis	47	General Partner, KKR. Director since 1989.
John G. Medlin, Jr.	57	1985-Present, President and Chief Executive Officer, and 1987-Present, Chairman, First Wachovia Corporation; 1977-1985, President and Chief Executive Officer, The Wachovia Corporation. Director since 1989.
Rozanne L. Ridgway	55	1989-Present, President of the Atlantic Council of the United States; 1985-1989, Assistant Secretary of State for European and Canadian Affairs; 1982-1985, Ambassador to the German Democratic Republic. Director since 1989.
George R. Roberts	47	General Partner, KKR. Director since 1989.

* Messrs. Robbins, Stuart, Ammon and Greene became directors of RJRN in 1989.

Mr. Gerstner is a director of American Telephone & Telegraph Company, Bristol-Myers Squibb Company, Caterpillar, Inc. and The New York Times Company. Messrs. Kravis and Roberts are each directors of Duracell Holdings Corporation, Hillsborough Holdings Corporation, IDEX Corporation, Owens-Illinois, Inc., Owens-Illinois Group, Inc., Safeway Inc., The Stop & Shop Companies, Inc., Stop & Shop Holdings, Inc., Union Texas Petroleum Holdings, Inc. and Walter Industries, Inc. Mr. Roberts is also a director of Red Lion Properties, Inc. Mr. Raether is a director of Fred Meyer, Inc., Hillsborough Holdings Corporation, IDEX Corporation, The Stop & Shop Companies, Inc., Stop & Shop Holdings, Inc. and Walter Industries, Inc. Mr. Greene is a director of Owens-Illinois, Inc., Owens-Illinois Group, Inc., Safeway Inc., The Stop & Shop Companies, Inc. and Stop & Shop Holdings, Inc. Mr. Robbins is a director of IDEX Corporation, The Stop & Shop Companies, Inc. and Stop & Shop Holdings, Inc. Mr. Jordan is a director of the American Express Company, Bankers Trust Company, Bankers Trust New York Corporation, Corning Incorporated, Dow Jones & Co., Inc., J. C. Penney Company, Inc., Revlon Group, Ryder System, Inc., Sara Lee Corporation, Union Carbide Corp. and Xerox Corporation. Mr. Medlin is a director of First Wachovia Corporation and its principal subsidiaries: First Atlanta Corporation, First National Bank of Atlanta, The Wachovia Corporation and Wachovia Bank and Trust Co., N.A.; Mr. Medlin is also a director of Bell South Corporation, National Services Industries, Inc. and USAir Group, Inc. Ms. Ridgway is a director of Bell Atlantic

Corporation, Berlitz International, Inc., Citicorp, Minnesota Mining and Manufacturing Company and Union Carbide Corp.

Messrs. Kravis and Roberts are first cousins.

Directors and Executive Officers of RJRN

The directors of RJRN are Messrs. Gerstner and von der Heyden, H. John Greeniaus, James W. Johnston, Messrs. Ammon, Jordan, Kravis, Medlin, Raether, Robbins and Stuart and Ms. Ridgway. Messrs. Greeniaus and Johnston were first elected in June 1989. Mr. Jordan is a former director of RJRN who resigned in February 1989 upon consummation of the Tender Offer. Mr. Medlin is a former director of RJRN who resigned in April 1989 upon the completion of the Acquisition. Mr. Jordan and Mr. Medlin were reelected in June 1989. Set forth below are the names, ages, positions and offices held and a brief account of the business experience during the past five years of each director and/or executive officer of RJRN, other than those listed above.

Directors and/or Executive Officers of RJRN Not Listed Above

<u>Name</u>	<u>Age</u>	<u>Present Principal Occupation or Employment and Five-Year Employment History</u>
H. John Greeniaus	46	Director of RJRN since 1989 and Group Executive RJRN Food Group since February 1991; President and Chief Executive Officer of Nabisco Brands, Inc. since 1987; previously Executive Vice President of Nabisco Brands, Inc., 1987; President, Biscuit Division of Nabisco Brands, U.S.A., 1985-1987.
James W. Johnston	44	Director of RJRN and Chairman and Chief Executive Officer of R.J. Reynolds Tobacco Company since 1989; previously Division Executive, Citibank, N.A., 1984-1989.
Kenneth E. Glover	39	Senior Vice President, Corporate and Government Relations since 1990; previously Vice President and Manager, First Chicago Capital Markets, Inc., March-June 1990; Managing Director, Drexel Burnham Lambert Incorporated, 1983-1990.
David B. Kalis	43	Senior Vice President, Worldwide Communications since 1989; previously Senior Vice President, Worldwide Communications, American Express Travel Related Services Co., Inc., 1987-1989; Senior Vice President, Communications, Fireman's Fund Insurance Company, 1983-1987.
M.B. Oglesby, Jr.	48	Senior Vice President, Government Affairs since 1989; previously Deputy Chief of Staff to President Ronald Reagan, June 1988-January 1989; Partner, Hecht, Spencer and Oglesby, March 1986-June 1988; Assistant for Legislative Affairs to President Ronald Reagan, November 1983-March 1986.
J. Thomas Pearson	49	Senior Vice President, Taxation since 1988; previously Vice President, Taxation, 1987-1988; Vice President, Taxation, Nabisco Brands, Inc., 1982-1987.
Roger D. Semerad	50	Senior Vice President since 1989; previously Senior Vice President, Policy Development, American Express Company, 1988-1989; Assistant Secretary of Labor for Employment and Training, 1985-1988.
Dale F. Sisel	53	President and Chief Executive Officer of R.J. Reynolds Tobacco International, Inc. since 1989; President and Chief Operating Officer of R.J. Reynolds Tobacco International, Inc., 1986-1989; Executive Vice President of R.J. Reynolds Tobacco International, Inc., 1981-1986.

<u>Name</u>	<u>Age</u>	<u>Present Principal Occupation or Employment and Five-Year Employment History</u>
Stephen R. Wilson	44	Senior Vice President, Corporate Development since 1990; previously General Manager, North American Operations, Franklin Mint, 1989-1990; President, Cadbury Beverages North America, 1987-1989; Senior Vice President, Finance, Cadbury Beverages North America, 1985-1987.

Item 11. Executive Compensation

The following table sets forth information concerning the compensation of the five most highly salaried executive officers of RJRN and all executive officers of RJRN during 1990 as a group (including one who ceased to be an executive officer during 1990). Compensation shown represents cash compensation paid for 1990 services, including amounts paid to such individuals under RJRN's Annual Incentive Award Plan for 1990 performance.

<u>Name of Individual</u>	<u>Principal Capacities</u>	<u>Cash Compensation</u>
Louis V. Gerstner, Jr.	Chairman, President and Chief Executive Officer	\$ 3,020,229
H. John Greeniaus	President and Chief Executive Officer, Nabisco Brands, Inc.	\$ 1,013,000
James W. Johnston	Chairman and Chief Executive Officer, R.J. Reynolds Tobacco Company	\$ 994,774
Lawrence R. Ricciardi	Executive Vice President and General Counsel	\$ 688,524
Karl M. von der Heyden	Executive Vice President and Chief Financial Officer	\$ 801,793
All executive officers as a group (19 persons)		\$11,226,227

Agreements with Certain Officers

In 1989, Holdings and RJRN entered into an employment agreement (the "Employment Agreement"), with Mr. Gerstner that continues through March 9, 1994. RJRN will pay Mr. Gerstner a base salary of \$975,000 per annum, increasing each January 1 by at least 6%. Pursuant to the Employment Agreement, Mr. Gerstner is entitled to receive a minimum bonus so that his salary plus bonuses for each of the years 1991 and 1992 will be no less than \$2.7 million and \$3.0 million, respectively.

In order to compensate Mr. Gerstner for certain other benefits offered by his previous employer, RJRN has provided Mr. Gerstner with a supplemental compensation arrangement consisting of ten annual payments of \$446,374 commencing upon his attainment of age 60 and, in addition, on his death, his beneficiary or estate will receive a death benefit equal to \$5,000,000. RJRN has also agreed to provide Mr. Gerstner with a vested supplemental pension substantially similar to RJRN's Supplemental Executive Retirement Plan, except that Mr. Gerstner will be credited for his 11½ years of service with his previous employer in addition to his actual service with RJRN.

The Employment Agreement provides for the continuation of the payment to Mr. Gerstner of compensation, for three years if RJRN terminates Mr. Gerstner's employment prior to March 9, 1994 other than for cause or if Mr. Gerstner terminates his employment during such period for certain reasons, including a change of control of Holdings. Such continued compensation will be based on Mr. Gerstner's then current base salary and the highest annual bonus paid to or accrued for him. Mr. Gerstner would also be reimbursed for the amount of the excise tax, if any, on his termination payments, as well as any incremental income taxes payable on the reimbursed amount.

Mr. von der Heyden, Mr. Johnston, Mr. Greeniaus and Mr. Ricciardi also have employment agreements with RJRN.

Mr. von der Heyden's employment agreement provides for an initial salary of \$450,000 per annum. If he is terminated within five years of employment, a special pension amount will be paid to him in a lump sum equalling 20% of his base pay times the number of fiscal years worked within the aforesaid five-year period. If Mr. von der Heyden is terminated without cause or voluntarily terminates under certain conditions designated in his agreement, he will receive a severance payment equal to two years' base pay plus bonus.

Mr. Johnston's employment agreement provides for an initial salary of \$500,000 per annum. A special pension provision deems Mr. Johnston to have no less than 10 years of benefit calculation service under the Supplemental Executive Retirement Plan. If Mr. Johnston is terminated within five years of employment without cause or voluntarily terminates within such five years under certain conditions designated in his agreement, he will receive a severance payment equal to three years base pay plus bonus. If Mr. Johnston is terminated without cause after the initial five years employment, his severance will be two years' base pay plus bonus.

Mr. Greeniaus', Mr. Ricciardi's and one other executive officer's employment agreements provide that if such executive officer is involuntarily terminated other than for cause, he will receive three years compensation in Mr. Greeniaus' case and two years compensation in Mr. Ricciardi's and such other executive officer's case. Payments would be made over three years, except that such continuance would not extend beyond normal retirement age established under RJRN's Supplemental Executive Retirement Plan. Compensation continuance is based upon the annual rate of salary in effect immediately prior to termination and the most recent annual incentive award or current target level, if higher.

On February 20, 1991, RJRN implemented its preexisting severance agreement with one of its executive officers. This Agreement was a standard format severance agreement entered into with executives in 1988 and provides, in the event of separation of employment, for two years compensation and benefits to be paid over three years. In addition, in connection with his separation for purposes of the management equity plan implemented by the Management Offering (as hereinafter defined), such executive officer's last day of active employment was February 28, 1991; his options were 20% vested and the book value on his Purchase Stock (as hereinafter defined) was deemed to be \$6.05. Also, such executive officer, upon completion of his severance period, will be eligible to receive an unreduced retirement benefit based on a deemed 20 years service with the Company and an attained age of 51 years and 5 months.

Executive Compensation Pursuant to Plans

RJRN maintains certain compensation plans, programs and arrangements for its executive officers and key employees of RJRN and its subsidiaries, which are administered by the Compensation Committee of the board of directors (including predecessor committees, the "Compensation Committee"). Set forth below is a brief description of each such plan under which compensation or other benefits were paid during 1990 or are proposed to be paid in the future.

Subscription Agreements

During 1989, Holdings sold shares of Common Stock at a price of \$5.00 per share to certain officers and key employees of Holdings and its subsidiaries, in addition to separate offerings to Messrs. Gerstner and von der Heyden (the "Management Offering"). Each purchaser (the "Purchaser") entered into a Common Stock Subscription Agreement (each, a "Subscription Agreement") with Holdings.

Generally, each Purchaser was also granted options (the "Management Options") covering four shares of Common Stock for each share purchased pursuant to the Purchaser's Subscription Agreement (the "Purchase Stock"). The Management Options were issued pursuant to the Stock Option Plan for Directors and Key Employees of RJR Nabisco Holdings Corp. and Subsidiaries (the "Stock Option Plan") and Non-Qualified Stock Option Agreements executed in connection with such grant. The Management Options vest according to a vesting schedule and are subject to cancellation upon or

following termination of the optionee's employment, in certain circumstances in which such optionees are entitled or required to sell to Holdings all shares of Holdings Common Stock owned by them, and (if the committee administering the Stock Option Plan so determines) upon merger, consolidation or the sale of all or substantially all of Holdings' assets or voting stock, or upon liquidation or dissolution of Holdings.

The Subscription Agreements restrict the transfer of any shares of Holdings Common Stock until the earlier of May 1, 1994 or a public offering of Holdings Common Stock resulting from the conversion of Converting Debentures into shares of Holdings Common Stock (a "Conversion Public Offering") or, subject to certain limitations, other qualifying public offerings of Holdings Common Stock. Neither the 1990 Exchange Offers or the 1991 Exchange Offer, nor the offering of Holdings Common Stock issuable upon exercise of the warrants to purchase one share of Holdings Common Stock each with an exercise price of \$.07 per share (the "Warrants") is such a Conversion Public Offering or qualifying public offering. Holders of Purchase Stock and Management Options have limited "piggyback" registration rights with respect to shares of Holdings Common Stock purchased upon the exercise of Management Options and shares of Purchase Stock.

The Subscription Agreements provide that the Purchaser, his or her estate or beneficiary may require Holdings to repurchase all Purchase Stock and Holdings Common Stock purchased by the Purchaser on the exercise of Management Options and to redeem such Purchaser's Management Options upon the Purchaser's death or disability on or prior to the earlier of May 1, 1994 or the closing of a Conversion Public Offering. If, on or before the earlier of May 1, 1994 or the closing of a Conversion Public Offering, a Purchaser's employment by Holdings and its subsidiaries terminates for any reason (other than the death or permanent disability of the Purchaser), or such Purchaser effects a prohibited transfer of his or her shares of Holdings Common Stock, Holdings will have the right to purchase the above-described stock and exercisable Management Options at a price which varies according to the circumstances surrounding the termination of employment.

The rights and obligations of a Purchaser with respect to shares of Holdings Common Stock purchased upon the exercise of a Management Option will be identical to the rights and obligations applicable to shares of Purchase Stock, except that in certain circumstances, the price payable on repurchase of Holdings Common Stock by Holdings may not be the same for shares acquired upon exercise of Management Options as it is for shares of Purchase Stock.

During 1991, Holdings sold through a private placement subject to transfer restrictions and other terms similar to those contained in the Subscription Agreements additional shares of Holdings Common Stock at a purchase price of \$5.75 per share and additional Management Options with an exercise price of \$5.75 per share to certain officers and employees of Holdings and its subsidiaries who did not have the opportunity to participate in the initial Management Offering.

Mr. Gerstner's subscription agreement is similar to those discussed above except that the May 1, 1994 date referred to above is March 10, 1993 with respect to Mr. Gerstner's agreement. In addition, under his subscription agreement, Mr. Gerstner purchased 1,321,383 restricted shares of Common Stock (the "Restricted Stock"), at a price of \$.01 per share. 25% of the shares of Restricted Stock became vested immediately and the remaining shares will vest in equal installments on the second, third and fourth anniversaries of March 10, 1989. Restricted Stock will cease to vest and unvested shares of Restricted Stock will be cancelled upon termination of Mr. Gerstner's employment.

Both Mr. Gerstner's and Mr. von der Heyden's subscription agreements provide them with limited "piggyback" registration rights with respect to shares of Holdings Common Stock purchased upon the exercise of Management Options, shares of Purchase Stock and, in the case of Mr. Gerstner, vested shares of Restricted Stock similar to those discussed above except that Mr. Gerstner's registration rights are applicable for a shorter period of time.

Holdings Stock Option Plan

To provide an incentive to attract and retain key employees responsible for the management and administration of the business affairs of Holdings and its subsidiaries, on June 15, 1989 the board of directors of Holdings adopted the Stock Option Plan pursuant to which options to purchase Common Stock ("Options") may be granted. On June 16, 1989 the Stock Option Plan was approved by the written consent of the holders of a majority of Holdings Common Stock. Any director or key employee of Holdings or any subsidiary of Holdings is eligible to be granted Options under the Stock Option Plan. A maximum of 30,000,000 shares of Holdings Common Stock (which may be adjusted in the event of certain capital changes) may be issued under the Stock Option Plan.

The Stock Option Plan is administered by the Compensation Committee of the Board of Directors of Holdings (the "Compensation Committee"). The Compensation Committee has absolute discretion, subject to the terms of the Stock Option Plan, to determine who is eligible to receive Options, to select those who will actually receive Options and to determine the number of shares to be subject to such Options and the terms and conditions of such Options.

Options under the Stock Option Plan are not intended to be "incentive stock options" under Section 422A of the Internal Revenue Code of 1986, as amended (the "Code"). Under the Stock Option Plan, each Option shall be evidenced by a written stock option agreement that will be executed by the grantee of the Option and by Holdings. The price per share of the Common Stock subject to each Option shall be set by the Compensation Committee and may be less than the fair market value of such shares on the date such Option is granted but may in no event be less than 50% of the fair market value on such date. The Compensation Committee also determines when and in what installments Options shall become exercisable and when each Option expires, provided that no Option may be exercised after the expiration of ten years and one day from the date the Option is granted. The Compensation Committee may also accelerate the time at which an Option is exercisable.

Long Term Incentive Plan

On August 1, 1990, the board of directors of Holdings adopted the 1990 Long Term Incentive Plan (the "1990 LTIP") which was approved on such date by the written consent of the holders of a majority of the Common Stock. The 1990 LTIP authorizes grants of incentive awards ("Grants") in the form of "incentive stock options" under Section 422A of the Code, other stock options, stock appreciation rights, restricted stock, purchase stock, dividend equivalent rights, performance units, performance shares or other stock-based grants. Awards under the 1990 LTIP may be granted to key employees of, or other persons having a unique relationship to, Holdings and its subsidiaries. Directors who are not also employees are ineligible for Grants. A maximum of 25.6 million shares of Common Stock (which may be adjusted in the event of certain capital changes) may be issued under the 1990 LTIP pursuant to Grants. The 1990 LTIP also limits the amount of shares which may be issued pursuant to "incentive stock options" and the amount of shares subject to Grants which may be issued to any one participant. As of March 1, 1991, no incentive awards have been granted under the 1990 LTIP.

The 1990 LTIP is administered by the Compensation Committee. The Compensation Committee has absolute discretion, subject to the terms of the 1990 LTIP, to select who will receive incentive awards and to determine the forms of the awards and the terms, conditions and limitations of the awards.

Under the 1990 LTIP, each Grant will be evidenced by a written agreement that will be executed by the participant and by Holdings. The 1990 LTIP provides specific limitations on the option price and exercise period (where applicable) and certain other terms with respect to each form of Grant.

Other Compensation Plans

RJRN maintains its Annual Incentive Award Plan under which participants are awarded annual cash bonuses based upon attainment of individual and corporate goals. Bonuses awarded to executive officers of RJRN for 1990 are included in the table above.

Under RJRN's Capital Accumulation Plan, RJRN made matching contributions of up to 3% of a participant's salaried compensation. RJRN contributions that exceed statutory limitations are allocated on behalf of affected employees as an unfunded general and administrative expense to a statutorily recognized excess benefit plan. During 1990, amounts allocated by RJRN to such plan for the accounts of each of the individuals listed in the table above and to all executive officers as a group were as follows: L.V. Gerstner, Jr. \$24,729, H.J. Greeniaus \$10,500, J.W. Johnston \$9,774, L.R. Ricciardi \$5,224, and K.M. von der Heyden \$7,793; all executive officers as a group, \$104,127.

Retirement Plans

RJRN maintains a noncontributory defined benefit retirement plan covering all salaried employees of RJRN and certain of its subsidiaries. Credits are made monthly to each participant's personal retirement account ("PRA") consisting of a percentage of that month's eligible compensation, plus interest on his PRA balance, with vesting occurring after 5 years of service. The compensation credit percentage varies according to age bracket, ranging from 4% to 7%, with an additional 3% credit for any compensation in excess of the applicable Social Security wage base, prorated over the year. A participant's annual retirement benefit will be determined by dividing his PRA balance at retirement by an annuity conversion factor of 8.2 if retirement occurs at age 55 or older, with somewhat higher factors applicable to retirement at ages 50-54. Alternatively, a participant at retirement may elect a lump sum distribution of the PRA balance. The PRA benefit method became effective October 1, 1987 and a participant's PRA includes an opening balance equal to the present value of pension benefits accrued under the prior retirement plan applicable to his prior RJRN service, plus certain enhancements. Pursuant to the Merger Agreement, any participant whose employment was terminated after the acquisition of shares under the Tender Offer but prior to January 1, 1990 and who was eligible for salary continuation under RJRN's severance programs or individual contracts is vested in that person's PRA balance.

Any participant who as of January 1, 1988 was at least age 40 with 10 or more years service, or at least age 55 with 5 or more years service, is eligible to receive an alternative retirement benefit that is based on the terms of such participant's prior retirement plan. Such participants may receive an annual benefit based on a percentage of average final compensation, multiplied by years of credited service. Generally, average final compensation is the participant's average annual compensation during his last five years of credited service; compensation generally includes base salary and awards under RJRN's Annual Incentive Award Plan but not other forms of incentive compensation. The amount determined by this alternative benefit formula is reduced by a percentage of the participant's Social Security benefit multiplied by years of credited service. At retirement, an eligible participant will be provided with either the retirement benefit determined by his PRA, or, if greater, the alternative retirement benefit. Employees of certain subsidiaries such as RJRT are not covered by the PRA benefit method and continue to be covered by different retirement plans.

Certain executive officers of RJRN, including those listed in the table above, are covered by an unfunded Supplemental Executive Retirement Plan. The plan provides an annual pension commencing at a normal retirement age which, inclusive of benefits payable under RJRN's retirement plan and a portion of Social Security, will equal not less than 50% of average final compensation if the participant has completed 20 or more years of credited service. The 50% amount is reduced proportionately for less than 20 years of credited service, subject to a 33.3% minimum benefit. Benefits under the Supplemental Executive Retirement Plan are payable only if the participant agrees to retire by a specified retirement age.

The following table shows the estimated annual benefits payable upon retirement under the alternative average final compensation formula of the Supplemental Executive Retirement Plan described above to persons in specified remuneration and years-of-service classifications. The retirement benefits shown are computed without regard to the Social Security offset and are based upon retirement at age 65 and the payment of a single-life annuity to the employee. The amounts shown for fewer than 30 years of service are adjusted to reflect the aggregate benefits payable to participants in the Supplemental Executive Retirement Plan who have attained the retirement age specified for them pursuant to such plan.

Five Year Average Compensation	Estimated Annual Retirement Benefits			
	Years of Service			
	10	20	30	40
\$ 300,000	\$100,000	\$ 150,000	\$ 157,500	\$ 210,000
\$ 400,000	133,333	200,000	210,000	260,000
\$ 500,000	166,666	250,000	262,500	350,000
\$ 600,000	200,000	300,000	315,000	420,000
\$ 700,000	233,333	350,000	367,500	490,000
\$ 800,000	266,666	400,000	420,000	560,000
\$ 900,000	300,000	450,000	472,500	630,000
\$1,000,000	333,333	500,000	525,000	700,000
\$1,200,000	400,000	600,000	630,000	840,000
\$1,400,000	466,666	700,000	735,000	980,000
\$1,600,000	533,333	800,000	840,000	1,120,000
\$1,800,000	600,000	900,000	945,000	1,260,000
\$2,000,000	666,666	1,000,000	1,050,000	1,400,000
\$2,200,000	733,333	1,100,000	1,155,000	1,540,000

The following are estimated years of credited service at age 65 (rounded to the nearest year) under RJRN's retirement plan for the persons listed in the table above: L.V. Gerstner, Jr.: 29 years; H.J. Greeniaus: 33 years; J.W. Johnston: 32 years; L.R. Ricciardi: 32 years; and K.M. von der Heyden: 12 years. Section 415 of the Code places certain limitations on pensions that may be paid under plans qualified under the Code. Portions of the retirement benefits shown in the table above that exceed such limitations, as well as any benefits attributable to deferred compensation, will be paid outside the qualified plan as an unfunded general and administrative expense by a statutorily recognized excess benefit plan, and, to the extent applicable, by the Supplemental Executive Retirement Plan.

Other Executive Compensation

During 1990, RJRN provided executive officers and other key employees of RJRN and its subsidiaries with other compensation in the form of benefits, including financial counseling, supplemental insurance, club memberships, leased automobiles and use of RJRN-owned or leased aircraft and meeting facilities. RJRN's aggregate incremental cost of providing such benefits were as follows: L.V. Gerstner, Jr., \$64,347; H.J. Greeniaus, \$33,880; J.W. Johnston, \$57,297; L.R. Ricciardi, \$32,027; and K.M. von der Heyden, \$39,095.

Directors' Compensation

Any director of Holdings, Group, Capital and/or RJRN who is not an employee of RJRN or its subsidiaries is compensated at the rate of \$50,000 per year. In addition, each of the current directors

who is neither a partner or associate of KKR nor an employee and who had not previously been granted an option or entered into an agreement providing for the grant of an option has been granted an option pursuant to the Stock Option Plan to purchase 30,000 shares of Common Stock. No additional compensation is paid to directors who are employees of RJRN or its subsidiaries in their capacity as directors.

RJRN maintains the Directors Retirement Plan for directors who have never been employees of RJRN or an affiliated company. The Directors Retirement Plan provides each eligible director with a monthly allowance equal to the monthly directors' fee payable on the date the director's service terminates. The maximum benefits payable under the Directors Retirement Plan are (a) for those directors with ten or more years of service, 180 monthly payments; (b) for those directors with less than ten but more than five years of service, monthly payments equal to 180 multiplied by a fraction, the numerator of which is equal to the years of service of such director and the denominator of which is 10; or (c) for directors with less than five years of service, 48 monthly payments. For the purposes of computing years of service, partial years of service count as a full year. The Directors Retirement Plan also provides that upon a "change of control," the Directors Retirement Plan cannot be amended or terminated.

Employee Stock Ownership Plan

Beginning in June 1990, Holdings undertook a review of certain alternative vehicles for increasing employee ownership of Holdings stock. As a result of such study and in furtherance of Holdings' long-term compensation and benefits strategy, Holdings is forming an employee stock ownership plan (the "ESOP") which will permit Holdings to meet certain benefits obligations in a tax-efficient manner. The ESOP is currently expected to be in the range of approximately \$200 million to \$250 million in size. The ultimate size of the ESOP will be determined following the completion of Holdings' analysis of the optimum ESOP size for Holdings.

It is contemplated that the ESOP will purchase shares of Holdings Common Stock or convertible preferred stock from Holdings in exchange for an ESOP loan (the "ESOP Loan"). The ESOP Loan is expected to be in two tranches, the first tranche intended to be participated to an external lender (the "External ESOP Note") and the second tranche to be held by Holdings as an internal loan. The External ESOP Note will be in the principal amount of \$125 million, will have a final maturity in 1999 and will accrue interest at a fixed market rate equal to a spread over corresponding U.S. Treasury notes. For information regarding the purchase by Metlife of a 100% participation in the External ESOP Note, see Item 3 "Legal Proceedings".

Other Benefit Plans

On October 12, 1988, RJRN's Supplemental Benefits Plan was divided, with a portion of such plan being named RJRN's Additional Benefits Plan. Both of these plans are excess benefits plans, designed to provide benefits in excess of those otherwise permitted by the Code to be funded in RJRN's qualified retirement plans and for certain deferred compensation. Neither plan may be amended or terminated upon a "Change of Control". On July 21, 1988, the board of directors of RJRN amended the Supplemental Executive Retirement Plan, which provides additional retirement benefits to certain executive officers of RJRN, to provide that upon a "Change of Control" all benefits become immediately vested and the plan may not be terminated. For purposes of all of these plans, Merger Sub's purchase of shares pursuant to the Tender Offer constituted a "Change of Control" and none of these plans may now be amended or terminated. In addition, benefits under the Supplemental Executive Retirement Plan have become vested.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Holdings owns 100% of the outstanding voting stock of Group. Group owns 100% of the outstanding voting stock of Capital and Capital owns 100% of the outstanding voting stock of RJRN. As of March 1, 1991 and before the completion of the 1991 Exchange Offer, there were approximately 505 record holders of Common Stock. The following table sets forth certain information known to Holdings, as of March 1, 1991 and before the completion of the 1991 Exchange Offer regarding the beneficial ownership of Holdings Common Stock by the stockholders who own more than 5% of the outstanding shares, by each director of Holdings and by all directors of Holdings and executive officers of the Registrants as a group. Beneficial ownership under the Securities and Exchange Commission's definition includes shares that can be acquired within 60 days upon the exercise of warrants or options. Except as otherwise noted, the persons named in the table below have sole voting and investment power with respect to all shares shown as beneficially owned by them.

<u>Name and Address(1)</u>	<u>Number of Shares of Common Stock Beneficially Owned</u>	<u>Percent of Common Stock(6)</u>
KKR Associates 9 West 57th Street New York, NY 10019(2)	577,084,746	97.7%
R. Theodore Ammon(2)	—	—
Louis V. Gerstner, Jr.(3).....	3,699,873	*
James H. Greene, Jr.	—	—
Vernon E. Jordan, Jr.(4)	30,000	*
Henry R. Kravis(2)	—	—
John G. Medlin, Jr.(4)	30,000	*
Paul E. Raether(2)	—	—
Rozanne L. Ridgway(4)	30,000	*
Clifton S. Robbins	—	—
George R. Roberts(2)	—	—
Scott M. Stuart	—	—
All directors and executive officers as a group (other than as set forth in relation to KKR Associates)(5) ..	7,066,960	1.2%

* Less than 1%.

- (1) Messrs. Ammon, Gerstner, Greene, Jordan, Kravis, Medlin, Raether, Robbins, Roberts and Stuart and Ms. Ridgway are directors of Holdings.
- (2) Shares of Holdings Common Stock shown as owned by KKR Associates are owned of record by two limited partnerships (the "Common Stock Partnerships") of which KKR Associates, a New York limited partnership and an affiliate of KKR, is the sole general partner and as to which it possesses sole voting and investment power. The outstanding shares of Holdings Common Stock shown include 10,169,492 shares of Holdings Common Stock issuable upon the exercise of currently exercisable warrants. One of the Common Stock Partnerships also owns of record 8,000,000 shares of Holdings Preferred Stock. On a fully diluted basis, including the issuance of 129,412,360 shares of Holdings Common Stock in the 1991 Exchange Offer and assuming the conversion of all shares of Holdings Preferred Stock into Holdings Common Stock, the conversion of all Converting Debentures and the exercise of all warrants and options, including the Management Options, KKR Associates would hold approximately 58.5% of the Holdings Common Stock. Messrs. Kravis, Roberts, Raether and Ammon as general partners of KKR Associates, may be deemed to share beneficial ownership of the shares shown as beneficially owned by KKR Associates. Messrs. Kravis, Roberts, Raether and Ammon have disclaimed beneficial ownership of such shares.
- (3) Shares of Holdings Common Stock shown as owned by Mr. Gerstner include 1,321,383 restricted shares owned by Mr. Gerstner, of which 330,346 restricted shares have vested, with an additional 330,346 restricted shares vesting on March 13, 1991 and with the remainder not vesting until more than one year from the date hereof. The number shown includes 1,600 shares held in trust for the benefit of Mr. Gerstner's children, as to which Mr. Gerstner disclaims beneficial ownership

(Footnotes continued on following page)

(Footnotes continued from preceding page)

and 1,585,660 shares of Holdings Common Stock issuable upon the exercise of currently exercisable Management Options. Mr. Gerstner has additional Management Options that are not currently exercisable to purchase 1,585,660 shares of Holdings Common Stock. 50% of such non-exercisable Management Options will become exercisable on each of the third and fourth anniversaries of the date of grant.

- (4) Holdings has granted immediately exercisable options to purchase 30,000 shares of Holdings Common Stock to each of Mr. Jordan, Mr. Medlin and Ms. Ridgway. Mr. Jordan also owns 831 shares of Holdings Preferred Stock and \$1,250 principal amount of Converting Debentures and Mr. Medlin also owns \$31,250 principal amount of Converting Debentures.
- (5) Shares of Holdings Common Stock shown as owned by all directors and executive officers as a group include 3,031,660 shares issuable upon the exercise of currently exercisable Management Options out of the 10,945,668 Management Options granted to directors and executive officers to date, but does not include any shares of Holdings Common Stock issuable upon the conversion of approximately 19,836 shares of Holdings Preferred Stock held by such persons which are not convertible until May 1, 1991, or any shares issuable upon the conversion of approximately \$88,460 principal amount of Converting Debentures held by such persons, which may be converted on the first business day prior to May 1, 1993. The number of shares shown includes 121,600 shares held in trust for the benefit of family members of certain directors and executive officers. Certain of such directors and executive officers disclaim beneficial ownership as to 61,600 of such shares held in trust.
- (6) For each person, the percentage of Holdings Common Stock beneficially owned is computed on the assumption that all shares which could be acquired by such person within 60 days upon the exercise of warrants and options are outstanding.

Item 13. Certain Relationships and Related Transactions

KKR renders management, consulting and financial services to Holdings and its subsidiaries for an annual fee. A fee of \$10,000,000 has been paid for such services performed in 1990. From time to time, KKR may receive customary investment banking fees for services rendered to Holdings and its subsidiaries in connection with divestitures, acquisitions, financing and certain other transactions. Partners and employees of KKR who also serve as directors and officers of Holdings, Group and/or Capital will not receive additional compensation for service in such capacity, other than customary directors' fees. KKR did not receive any investment fee for its services in connection with the 1991 Exchange Offer or the Recapitalization Program.

On February 9, 1989, the Common Stock Partnerships purchased an aggregate of 284,745,762 shares of Holdings Common Stock for \$5.00 per share from Holdings. The Common Stock Partnerships are two Delaware limited partnerships of which KKR Associates is the sole general partner and a number of institutional and other investors associated with KKR are the limited partners. KKR Associates is a New York limited partnership of which Messrs. Kravis, Raether, Roberts and Ammon, together with Robert I. MacDonnell, Michael W. Michelson and Saul A. Fox, are the general partners. The Common Stock Partnerships have sole voting and investment power with respect to such shares. In addition, one of the Common Stock Partnerships purchased \$500 million of debt securities (the "Partnership Debt Securities") and received a commitment fee from RJRN in the amount of \$10 million in connection with such purchase. On February 23, 1990, one of the Common Stock Partnerships purchased the 10,169,492 shares of Holdings Common Stock and warrants to purchase an additional 10,169,492 shares of Holdings Common Stock at a price of \$5.00 per share formerly owned by Drexel Burnham Lambert Incorporated. The funds for these purchases were contributed by the limited partners of the Common Stock Partnerships and KKR Associates from their respective assets. In connection with the Recapitalization Program, one of the Common Stock Partnerships has (i) purchased an additional 272 million shares of Holdings Common Stock for an aggregate purchase price of \$1.7 billion and (ii) exchanged \$200 million of the sum of principal of plus accrued and unpaid interest on the Partnership Debt Securities for 8 million unregistered shares of Preferred Stock which were later exchanged in a share for share exchange for 8 million shares of Preferred Stock covered by a registration statement relating to the 1990 Exchange Offers. Additional amounts of Partnership Debt Securities may also be refinanced.

The law firm of Akin, Gump, Strauss, Hauer & Feld of Washington, D.C. and Dallas, Texas of which Mr. Jordan is a partner provided legal services to RJRN in 1990.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

- (a)
 1. The financial statements listed in the accompanying Index to Financial Statements and Financial Statement Schedules are filed as part of this report.
 2. The financial statement schedules listed in the accompanying Index to Financial Statements and Financial Statement Schedules are filed as part of this report.
 3. The exhibits listed in the accompanying Index to Exhibits are filed as part of this report.
- (b) *Reports on Form 8-K filed in Fourth Quarter 1990*
None
- (c) *Exhibits*
See Exhibit Index.
- (d) *Financial Statement Schedules.*
See Index to Financial Statements and Financial Statement Schedules.

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, in the City of New York, State of New York on March 8, 1991.

RJR NABISCO CAPITAL CORP.

By: /s/ LOUIS V. GERSTNER, JR.
 (Louis V. Gerstner, Jr.)
 Chairman of the Board, President
 and Chief Executive Officer

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 indicated on March 8, 1991.

<u>Signature</u>	<u>Title</u>
... /s/ LOUIS V. GERSTNER, JR. (Louis V. Gerstner, Jr.)	Chairman of the Board, President and Chief Executive Officer (principal executive officer) and Director
... /s/ KARL M. VON DER HEYDEN (Karl M. von der Heyden)	Executive Vice President and Chief Financial Officer (principal financial officer)
..... /s/ ROBERT S. ROATH (Robert S. Roath)	Senior Vice President and Controller (principal accounting officer)
..... * (R. Theodore Ammon)	Director
..... * (Vernon E. Jordan, Jr.)	Director
..... * (Henry R. Kravis)	Director
..... * (John G. Medlin, Jr.)	Director
..... * (Paul E. Raether)	Director
..... * (Rozanne L. Ridgway)	Director
..... * (Clifton S. Robbins)	Director
..... * (Scott M. Stuart)	Director

*By: /s/ ROBERT F. SHARPE, JR.
 (Robert F. Sharpe, Jr.)
 Attorney-in-Fact

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, in the City of New York, State of New York on March 8, 1991.

RJR NABISCO, INC.

By: /s/ LOUIS V. GERSTNER, JR.
 (Louis V. Gerstner, Jr.)
 Chairman of the Board, President
 and Chief Executive Officer

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 indicated on March 8, 1991.

<u>Signature</u>	<u>Title</u>
... /s/ LOUIS V. GERSTNER, JR. (Louis V. Gerstner, Jr.)	Chairman of the Board, President and Chief Executive Officer (principal executive officer) and Director
.. /s/ KARL M. VON DER HEYDEN (Karl M. von der Heyden)	Executive Vice President and Chief Financial Officer (principal financial officer) and Director
..... /s/ ROBERT S. ROATH (Robert S. Roath)	Senior Vice President and Controller (principal accounting officer)
..... * (R. Theodore Ammon)	Director
..... * (H. John Greeniaus)	Director
..... * (James W. Johnston)	Director
..... * (Vernon E. Jordan, Jr.)	Director
..... * (Henry R. Kravis)	Director
..... * (John G. Medlin, Jr.)	Director
..... * (Paul E. Raether)	Director
..... * (Rozanne L. Ridgway)	Director
..... * (Clifton S. Robbins)	Director
..... * (Scott M. Stuart)	Director

*By: /s/ ROBERT F. SHARPE, JR.
 (Robert F. Sharpe, Jr.)
 Attorney-in-Fact

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Financial Statement Schedules

For the year ended December 31, 1990 and the period February 9, 1989 through December 31, 1989:

Schedule III —Condensed Financial Information of Registrants	S-1—S-8
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For the year ended December 31, 1988:

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All other schedules for which provision is made in the applicable regulations of the Securities and Exchange Commission are omitted because they are not required under the related instructions or are not applicable or the required information is shown in the financial statements or notes thereto.

REPORT OF DELOITTE & TOUCHE, INDEPENDENT AUDITORS

RJR Nabisco Holdings Corp.:
RJR Nabisco Holdings Group, Inc.:
RJR Nabisco Capital Corp.:
RJR Nabsico, Inc.:

We have audited the accompanying consolidated balance sheets of RJR Nabisco Holdings Corp. ("Holdings"), RJR Nabisco Holdings Group, Inc. ("Group"), RJR Nabisco Capital Corp. ("Capital") and RJR Nabisco, Inc. and subsidiaries ("RJRN") as of December 31, 1990 and 1989, the related consolidated statements of income and retained earnings and of cash flows for the year ended December 31, 1990 and for the period February 9, 1989 through December 31, 1989 of Holdings, Group, Capital and RJRN (collectively, "Successor Period"), and the related consolidated statements of income and retained earnings and of cash flows for the period January 1, 1989 through February 8, 1989 of RJRN ("Predecessor Period"). Our audits also included the financial statement schedules of Holdings, Group, Capital and RJRN as of December 31, 1990 and 1989, for the year ended December 31, 1990 and for the period February 9, 1989 through December 31, 1989 and of RJRN for the period January 1, 1989 through February 8, 1989 as listed in the accompanying Index to Financial Statements and Financial Statement Schedules. These financial statements and financial statement schedules are the responsibility of the companies' management. Our responsibility is to express an opinion on these financial statements and financial statement schedules 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 misstatements. 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, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of Holdings, Group, Capital and RJRN at December 31, 1990 and 1989, the consolidated results of their operations and their cash flows for the year ended December 31, 1990 and for the period February 9, 1989 through December 31, 1989 and the consolidated results of RJRN's operations and its cash flows for the period January 1, 1989 through February 8, 1989 in conformity with generally accepted accounting principles. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As more fully described in Note 1 to the consolidated financial statements, Holdings, Group and Capital directly and indirectly acquired RJRN as of February 9, 1989 in a business combination accounted for as a purchase. As a result of the acquisition, the consolidated financial statements for the Successor Period are presented on a different basis of accounting than that of the Predecessor Period and prior periods, and therefore are not directly comparable.

DELOITTE & TOUCHE

New York, New York
February 5, 1991 (except with respect
to the subsequent event discussed in Note 19,
as to which the date is March 2, 1991)

REPORT OF ERNST & YOUNG, INDEPENDENT AUDITORS

RJR Nabisco, Inc.

We have audited the accompanying consolidated financial statements for the year ended December 31, 1988 of RJR Nabisco, Inc. and subsidiaries (Predecessor) listed in the accompanying Index to Financial Statements and Financial Statement Schedules (Item 14(a)). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements listed in the accompanying Index to Financial Statements and Financial Statement Schedules (Item 14(a)) present fairly, in all material respects, the consolidated results of operations and cash flows of RJR Nabisco, Inc. and subsidiaries (Predecessor) for the year ended December 31, 1988 in conformity with generally accepted accounting principles.

ERNST & YOUNG

Atlanta, Georgia
January 30, 1989 (except with respect to the discontinued operations discussed in Note 4, as to which the date is September 24, 1989)

**RJR NABISCO HOLDINGS CORP.
RJR NABISCO HOLDINGS GROUP, INC.
RJR NABISCO CAPITAL CORP.
RJR NABISCO, INC.**

CONSOLIDATED FINANCIAL STATEMENTS

The Summary of Significant Accounting Policies below and the Notes to Consolidated Financial Statements on pages F-7 through F-32 are integral parts of the accompanying Consolidated Financial Statements.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This Summary of Significant Accounting Policies is presented to assist in understanding the Consolidated Financial Statements included in this report. These policies conform to generally accepted accounting principles.

Consolidation

Consolidated Financial Statements include the accounts of each Registrant and its subsidiaries.

Cash Equivalents

Cash equivalents include all short-term, highly liquid investments that are readily convertible to known amounts of cash and so near maturity that they present an insignificant risk of changes in value because of changes in interest rates.

Inventories

Inventories are stated at the lower of cost or market. Various methods are used for determining cost. The cost of U.S. tobacco inventories is determined principally under the LIFO method. The cost of remaining inventories is determined under the FIFO, specific lot and weighted average methods. In accordance with recognized trade practice, stocks of tobacco, which must be cured for more than one year, are classified as current assets.

Depreciation

Property, plant and equipment are depreciated principally by the straight-line method.

Trademarks and Goodwill

Values assigned to trademarks are based on appraisal reports and are amortized on the straight-line method over a 40 year period. Goodwill is also amortized on the straight-line method over a 40 year period.

Other Income (Expense), Net

Interest income, gains and losses on foreign currency transactions and other financial items are included in "Other income (expense), net".

Income Taxes

Income taxes are accounted for under the provisions of Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes" ("SFAS 96"), and are calculated for each Registrant on a separate return basis. Predecessor had not adopted SFAS 96.

Excise Taxes

Excise taxes are excluded from "Net sales" and "Cost of products sold".

Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the 1990 presentation.

**RJR NABISCO HOLDINGS CORP.
RJR NABISCO HOLDINGS GROUP, INC.
RJR NABISCO CAPITAL CORP.
RJR NABISCO, INC.**

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS
(Dollars in Millions Except Per Share Amounts)

	Successor								Predecessor	
	Year Ended December 31, 1990				February 9, 1989 through December 31, 1989				January 1, 1989 through February 6, 1989	Year Ended December 31, 1988
	Holdings	Group	Capital	RJRN	Holdings	Group	Capital	RJRN	RJRN	RJRN
Net sales (Note 2)	\$13,879	\$13,879	\$13,879	\$13,879	\$12,114	\$12,114	\$12,114	\$12,114	\$ 650	\$12,635
Costs and expenses (Notes 1 and 2):										
Cost of products sold	5,652	5,652	5,652	5,652	5,241	5,241	5,241	5,241	332	5,661
Selling, advertising, administrative and general expenses	4,801	4,790	4,790	4,790	4,276	4,276	4,276	4,276	295	4,486
Amortization of trademarks and goodwill	608	608	608	608	557	557	557	557	10	121
Operating income	2,818	2,829	2,829	2,829	2,040	2,040	2,040	2,040	13	2,367
Interest expense (Notes 9 and 11)	(3,000)	(2,724)	(2,117)	(2,117)	(2,893)	(2,655)	(2,117)	(1,564)	(44)	(537)
Amortization of debt issuance costs	(176)	(175)	(175)	(175)	(447)	(444)	(443)	(266)	—	(12)
Change in control costs (Note 2)	—	—	—	—	—	—	—	—	(247)	—
Other income (expense), net	(44)	(61)	(60)	(60)	169	169	169	169	15	7
Income (loss) from continuing operations before income taxes	(402)	(131)	477	477	(1,131)	(890)	(351)	379	(263)	1,825
Provision (benefit) for income taxes (Note 3)	60	152	359	359	(156)	(74)	20	268	(66)	654
Income (loss) from continuing operations	(462)	(283)	118	118	(975)	(816)	(371)	111	(197)	1,171
Income (loss) from operations of discontinued businesses, net of income taxes (Note 4)	—	—	—	—	(1)	(1)	(1)	(1)	24	222
Income (loss) before extraordinary item	(462)	(283)	118	118	(976)	(817)	(372)	110	(173)	1,393
Extraordinary item—gain (loss) on early extinguishments of debt, net of income taxes (Holdings' amount includes a pre-tax gain on the repurchase of certain debt of \$220, a write-off of debt issuance costs and a provision for income taxes) (Note 5)	33	112	(28)	(28)	—	—	—	—	—	—
Net income (loss)	(429)	(171)	90	90	(976)	(817)	(372)	110	(173)	1,393
Less preferred stock dividends	50	—	—	—	—	—	—	—	4	15
Net income (loss) applicable to common stock	(479)	(171)	90	90	(976)	(817)	(372)	110	(177)	1,378
Retained earnings (accumulated deficit) at beginning of period	(976)	(817)	(372)	110	—	—	—	—	5,349	5,548
Add preferred stock dividends charged to paid- in capital	50	—	—	—	—	—	—	—	—	—
Less:										
Cash dividends on common stock	—	—	—	—	—	—	—	—	—	475
Retirement of RJRN stock and other redemptions	—	—	—	—	—	—	—	—	11	1,102
Retained earnings (accumulated deficit) at end of period (Note 15)	\$ (1,405)	\$ (988)	\$ (282)	\$ 200	\$ (976)	\$ (817)	\$ (372)	\$ 110	\$ 5,161	\$ 5,349
Net income (loss) per common share:										
Continuing operations	\$ (1.19)	—	—	—	\$ (3.21)	—	—	—	\$ (0.89)	\$ 4.97
Discontinued operations	—	—	—	—	—	—	—	—	0.11	0.95
Extraordinary item	0.08	—	—	—	—	—	—	—	—	—
Net income (loss)	\$ (1.11)	—	—	—	\$ (3.21)	—	—	—	\$ (0.78)	\$ 5.92
Dividends per common share	—	—	—	—	—	—	—	—	—	\$ 2.06
Average number of common shares outstanding (in thousands)	431,818	—	—	—	303,700	—	—	—	225,545	232,587

See Notes to Consolidated Financial Statements.

**RJR NABISCO HOLDINGS CORP.
RJR NABISCO HOLDINGS GROUP, INC.
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RJR NABISCO, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Millions)**

	Successor								Predecessor	
	Year Ended December 31, 1990				February 9, 1989 through December 31, 1989				January 1, 1989 through February 8, 1989	Year Ended December 31, 1988
	Holdings	Group	Capital	RJRN	Holdings	Group	Capital	RJRN	RJRN	RJRN
Net cash flows from (used in) operating activities (Note 6)	\$ 2,716	\$ 2,704	\$ 2,704	\$ 2,704	\$ 965	\$ 964	\$ 964	\$ 1,553	\$ (84)	\$ 1,909
Cash flows from (used in) investing activities:										
Capital expenditures	(426)	(426)	(426)	(426)	(488)	(488)	(488)	(488)	(34)	(837)
Acquisition of RJRN, less cash and cash equivalents of \$929	—	—	—	—	(17,346)	(17,346)	(17,346)	(17,346)	—	—
Proceeds from dispositions of businesses	2,129	2,129	2,129	2,129	3,545	3,545	3,545	3,545	—	115
Acquisitions of businesses and minority interests	—	—	—	—	—	—	—	—	—	(176)
Other, net	45	45	45	45	77	77	77	77	20	29
Net cash flows from (used in) investing activities	1,748	1,748	1,748	1,748	(14,212)	(14,212)	(14,212)	(14,212)	(14)	(869)
Cash flows from (used in) financing activities:										
Proceeds from issuance of long-term debt	3,115	3,115	3,115	3,115	22,256	22,256	22,256	17,833	—	1,423
Repayments of long-term debt (including early extinguishments of debt in 1990)	(8,655)	(7,856)	(6,352)	(6,352)	(9,535)	(9,535)	(9,535)	(5,304)	(8)	(204)
Increase (decrease) in notes payable and other short-term borrowings	(203)	(203)	(203)	(203)	(198)	(198)	(198)	(198)	81	(41)
Proceeds from issuance of common stock and warrants	1,701	—	—	—	1,757	—	—	—	—	22
Financing and advisory fees paid	(255)	(227)	(205)	(205)	(888)	(877)	(852)	(675)	—	—
Capital contributions from parent	—	1,504	—	—	—	1,500	1,500	1,500	—	—
Dividends paid to parent	—	(800)	(800)	(800)	—	—	—	—	—	—
Dividends paid	—	—	—	—	—	—	—	—	(4)	(494)
Repurchase of and cancellations of stock and stock options	(1)	—	—	—	—	—	—	—	(275)	(1,380)
Other, net—including intercompany transfers	—	(36)	(58)	(58)	—	247	222	(352)	—	—
Net cash flows from (used in) financing activities	(4,298)	(4,503)	(4,503)	(4,503)	13,392	13,393	13,393	12,804	(206)	(674)
Effect of exchange rate changes on cash and cash equivalents	15	15	15	15	(3)	(3)	(3)	(3)	—	41
Net change in cash and cash equivalents	181	(36)	(36)	(36)	142	142	142	142	(304)	407
Cash and cash equivalents at beginning of period	142	142	142	142	—	—	—	—	1,233	826
Cash and cash equivalents at end of period	\$ 323	\$ 106	\$ 106	\$ 106	\$ 142	\$ 142	\$ 142	\$ 142	\$ 929	\$ 1,233

See Notes to Consolidated Financial Statements.

**RJR NABISCO HOLDINGS CORP.
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**CONSOLIDATED BALANCE SHEETS
(Dollars in Millions)**

	December 31, 1990				December 31, 1989			
	Holdings	Group	Capital	RJRN	Holdings	Group	Capital	RJRN
ASSETS								
Current assets:								
Cash and cash equivalents (Holdings' amount includes \$200 held as dividend reserve at December 31, 1990) (Note 6)	\$ 323	\$ 106	\$ 106	\$ 106	\$ 142	\$ 142	\$ 142	\$ 142
Accounts and notes receivable, net (less receivables sold) (Note 9)	703	702	702	702	998	995	995	995
Inventories (Note 7)	2,646	2,646	2,646	2,646	2,876	2,876	2,876	2,876
Prepaid expenses and excise taxes	444	444	444	444	358	358	358	358
Net assets available for sale (Note 4)	—	—	—	—	2,300	2,300	2,300	2,300
Total current assets	4,116	3,898	3,898	3,898	6,674	6,671	6,671	6,671
Property, plant and equipment—at cost	5,781	5,781	5,781	5,781	5,436	5,436	5,436	5,436
Less accumulated depreciation	(915)	(915)	(915)	(915)	(417)	(417)	(417)	(417)
Net property, plant and equipment (Note 8)	4,866	4,866	4,866	4,866	5,019	5,019	5,019	5,019
Trademarks, net	9,531	9,531	9,531	9,531	9,771	9,771	9,771	9,771
Goodwill, net	13,607	13,607	13,607	13,607	13,965	13,965	13,965	13,965
Other assets and deferred charges	795	791	773	773	983	973	950	950
	<u>\$32,915</u>	<u>\$32,693</u>	<u>\$32,675</u>	<u>\$32,675</u>	<u>\$36,412</u>	<u>\$36,399</u>	<u>\$36,376</u>	<u>\$36,376</u>
LIABILITIES AND STOCKHOLDERS' EQUITY								
Current liabilities:								
Notes payable (Note 9)	\$ 295	\$ 295	\$ 295	\$ 295	\$ 181	\$ 181	\$ 181	\$ 181
Accounts payable and accrued accounts (Note 10)	3,014	2,960	2,960	2,960	3,265	3,261	3,261	3,261
Current maturities of long-term debt (Note 11)	1,425	1,425	1,425	1,425	2,632	2,632	2,632	2,632
Income taxes accrued (Note 3)	471	471	471	471	490	572	666	713
Total current liabilities	5,205	5,151	5,151	5,151	6,568	6,646	6,740	6,787
Long-term debt (less current maturities) (Note 11)	16,955	16,604	13,740	13,740	21,948	20,142	15,642	15,642
Other noncurrent liabilities (Note 11)	2,653	2,537	2,582	2,018	2,873	2,659	2,531	1,801
Deferred income taxes (Note 3)	3,813	3,819	3,845	3,927	3,786	3,786	3,786	3,987
Commitments and contingencies (Note 12)	—	—	—	—	—	—	—	—
Redeemable convertible preferred stock—72,032,000 shares issued and outstanding (Note 13)	1,795	—	—	—	—	—	—	—
Common stockholders' equity (Notes 14 and 15):								
Common stock—580,023,513 and 308,090,813 shares issued and outstanding at December 31, 1990 and 1989, respectively	6	—	—	—	3	—	—	—
Paid-in capital	3,860	5,535	7,604	7,604	2,213	3,982	8,048	8,048
Cumulative translation adjustments	35	35	35	35	1	1	1	1
Retained earnings (accumulated deficit)	(1,405)	(988)	(282)	200	(976)	(817)	(372)	110
Unamortized value of restricted stock	(2)	—	—	—	(4)	—	—	—
Total common stockholders' equity	2,494	4,582	7,357	7,839	1,237	3,166	7,677	8,159
	<u>\$32,915</u>	<u>\$32,693</u>	<u>\$32,675</u>	<u>\$32,675</u>	<u>\$36,412</u>	<u>\$36,399</u>	<u>\$36,376</u>	<u>\$36,376</u>

See Notes to Consolidated Financial Statements.

**RJR NABISCO HOLDINGS CORP.
RJR NABISCO HOLDINGS GROUP, INC.
RJR NABISCO CAPITAL CORP.
RJR NABISCO, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Introduction

Recapitalization

During 1990, RJR Nabisco Holdings Corp. ("Holdings") announced a comprehensive recapitalization program (the "Recapitalization Program"). The Recapitalization Program has included, among other things, (i) the purchase on July 16, 1990 of 272,000,000 newly issued shares of common stock (the "Common Stock") of Holdings at \$6.25 per share by a partnership affiliated with Kohlberg Kravis Roberts & Co., L.P. ("KKR"), (ii) the exchange by KKR on July 16, 1990 of \$200 million of the sum of principal of plus accrued and unpaid interest on a subordinated promissory note (the "Partnership Debt Securities") of RJR Nabisco Capital Corp. ("Capital") for 8,000,000 shares of Cumulative Convertible Preferred Stock (the "Preferred Stock") of Holdings, (iii) the exchange of \$1.859 billion of the sum of principal of plus accrued and unpaid interest on Senior Converting Debentures Due 2009 (the "Converting Debentures") issued by Holdings and \$541 million of the sum of principal of plus accrued and unpaid interest on Subordinated Exchange Debentures Due 2007 (the "Group Debentures") issued by RJR Nabisco Holdings Group, Inc. ("Group") for approximately \$800 million in cash and approximately \$1.6 billion stated value of Preferred Stock pursuant to exchange offers (the "1990 Exchange Offers") which were commenced on October 3, 1990 and completed on November 1, 1990, (iv) the commencement of a program providing for the acquisition of Group Debentures and Converting Debentures (the "Purchase Program"), including (a) the purchase of approximately \$1.7 billion principal amount of Group Debentures and (b) the exchange of approximately \$547 million in cash and 129.4 million shares of Common Stock for approximately \$1.176 billion principal amount of Group Debentures (the "1991 Exchange Offer"), which was commenced on February 1, 1991 and completed on March 2, 1991, and (v) the repayment on July 18, 1990 of the refinancing bridge facility of Capital and the redemption on August 15, 1990 of the remaining \$1 billion principal amount then outstanding of First Subordinated Increasing Rate Notes due 1997 of Capital (the "Increasing Rate Notes") with proceeds from a \$2.25 billion new bank credit facility (as amended, the "1990 Credit Agreement").

During 1990, Holdings also announced the establishment, effective July 16, 1990, of permanent fixed interest rates of 17½ percent on the Converting Debentures and 17 percent on the Group Debentures.

Acquisition of RJR Nabisco, Inc.

On April 27, 1989, the stockholders of RJRN approved and adopted the Agreement and Plan of Merger, dated as of November 30, 1988 and amended as of April 3, 1989 (the "Merger Agreement"), among RJRN, Holdings, Group, a wholly owned subsidiary of Holdings, and RJR Acquisition Corporation, an indirect wholly owned subsidiary of Holdings ("Merger Sub"), providing for the merger of Merger Sub with and into RJRN, with RJRN as the surviving corporation (the "Merger"). Substantial financing for the transaction was obtained by Capital, a wholly owned subsidiary of Group.

The Merger, which was consummated on April 28, 1989, was the second and final step in the acquisition by Holdings and its affiliates of all of the capital stock of RJRN (the "Acquisition"). The first step was a cash tender offer (the "Offer") consummated on February 9, 1989, pursuant to which Merger Sub acquired approximately 74% of the shares of the unrestricted common stock of RJRN outstanding prior to the Offer for \$109 per share in cash and approximately 96% of the preferred stock of RJRN outstanding prior to the Offer for \$108 per share in cash.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 1—Introduction—(Continued)

The accompanying Consolidated Financial Statements present the twelve-month period ended December 31, 1989 in two components. The period January 1, 1989 through February 8, 1989 includes the historical results of RJRN and the period after February 8, 1989 includes the results of RJRN after the Acquisition. In these financial statements, RJRN is referred to as "Predecessor" prior to February 9, 1989, and, collectively with Holdings, Group and Capital, as "Successor" on and after this date.

The Merger has been accounted for under the purchase method of accounting as of February 9, 1989. Accordingly, Holdings has allocated its total purchase cost of approximately \$26 billion to the assets and liabilities of RJRN, Capital and Group based upon their respective fair values determined by valuations and other studies, which included appraisals of trademarks and property, plant and equipment. The remaining excess of purchase cost over net assets acquired has been allocated to goodwill. Based upon such allocation, the Consolidated Statements of Income and Retained Earnings of Successor reflect amortization of trademarks and goodwill over a life of 40 years, resulting in an annual amortization of \$608 million for trademarks and goodwill. Because of this purchase price allocation, the accompanying Consolidated Financial Statements of Successor are not directly comparable to those of Predecessor.

Note 2—Operations

Net sales and cost of products sold exclude excise taxes of \$3.398 billion and \$3.177 billion for the 1990 and 1989 Successor periods, respectively, and \$162 million and \$3.448 billion for the 1989 and 1988 Predecessor periods, respectively.

During 1990, \$75 million of advisory fees incurred in connection with the Recapitalization Program and the establishment of fixed interest rates on the Converting Debentures and Group Debentures were charged to "Other income (expense), net".

On September 21, 1989, R. J. Reynolds Tobacco Company ("RJRT") announced a plan to eliminate excess trade inventories of its tobacco products by the end of 1989 through reduction of domestic cigarette shipments during the remainder of the year and a refocusing of its distribution trade incentives. Management estimates the effect on operating income of this plan was a \$360 million reduction in the second half of 1989.

The Predecessor results for the 1989 period ended February 8, 1989 reflect a nonrecurring charge of \$247 million attributable to change in control costs in connection with the closing of the Offer on February 9, 1989.

In the year ended December 31, 1988, Predecessor recorded a pre-tax gain of \$61 million on the sale of certain confectionery operations. The Predecessor results for 1988 also include advisory fees and certain other expenses that were incurred in anticipation of the Merger that reduced net income by \$41 million.

During 1988, \$681 million of accumulated income of foreign subsidiaries was repatriated, including \$444 million in December in anticipation of the Merger, for which \$29 million in taxes was provided in the fourth quarter.

No gain or loss has been recognized for financial statement purposes on the businesses sold post-Merger since the estimated net proceeds of such transactions were reflected in the fair value of such businesses as of the date of the acquisition of RJRN.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 3—Income Taxes

The provision (benefit) for income taxes consisted of the following:

	Successor								Predecessor	
	Year Ended December 31, 1990				February 9, 1989 through December 31, 1989				Jan. 1, 1989 through Feb. 8, 1989	Year Ended Dec. 31, 1988
	Holdings	Group	Capital	RJRN	Holdings	Group	Capital	RJRN	RJRN	RJRN
Current:										
Federal	\$(413)	\$(282)	\$ 7	\$ 7	\$(412)	\$(330)	\$(199)	\$(126)	\$(54)	\$250
Foreign and other	177	177	177	177	211	211	211	211	(13)	208
	<u>(236)</u>	<u>(105)</u>	<u>184</u>	<u>184</u>	<u>(201)</u>	<u>(119)</u>	<u>12</u>	<u>85</u>	<u>(67)</u>	<u>458</u>
Deferred:										
Federal	282	243	161	161	41	41	4	179	1	241
Foreign and other	14	14	14	14	4	4	4	4	—	(45)
	<u>296</u>	<u>257</u>	<u>175</u>	<u>175</u>	<u>45</u>	<u>45</u>	<u>8</u>	<u>183</u>	<u>1</u>	<u>196</u>
Provision (benefit) for income taxes ..	<u>\$ 60</u>	<u>\$ 152</u>	<u>\$359</u>	<u>\$359</u>	<u>\$(156)</u>	<u>\$ (74)</u>	<u>\$ 20</u>	<u>\$ 268</u>	<u>\$(66)</u>	<u>\$654</u>

The sources of the deferred income tax provision (benefit) and the tax effect of each were as follows:

	Successor								Predecessor	
	Year Ended December 31, 1990				February 9, 1989 through December 31, 1989				Jan. 1, 1989 through Feb. 8, 1989	Year Ended Dec. 31, 1988
	Holdings	Group	Capital	RJRN	Holdings	Group	Capital	RJRN	RJRN	RJRN
Excess of tax over book										
depreciation	\$ 71	\$ 71	\$ 71	\$ 71	\$ 152	\$ 152	\$ 152	\$ 152	\$ 1	\$213
Restructuring items	90	90	90	90	147	147	147	147	—	15
Trademark amortization	(74)	(74)	(74)	(74)	(68)	(68)	(68)	(68)	—	—
Original issue discount	131	90	2	2	62	62	25	—	—	—
Net operating loss	119	119	119	119	(195)	(195)	(195)	—	—	—
Other items	(41)	(39)	(33)	(33)	(53)	(53)	(53)	(48)	—	(32)
Deferred income tax provision	<u>\$ 296</u>	<u>\$ 257</u>	<u>\$175</u>	<u>\$175</u>	<u>\$ 45</u>	<u>\$ 45</u>	<u>\$ 8</u>	<u>\$ 183</u>	<u>\$ 1</u>	<u>\$196</u>

The major types of temporary differences that give rise to deferred income taxes on the Consolidated Balance Sheets are differences between the book and tax bases of trademarks, property, plant and equipment and accrued liabilities.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 3—Income Taxes—(Continued)

Pre-tax income (loss) from continuing operations for domestic and foreign operations is shown in the following table:

	Successor								Predecessor	
	Year Ended December 31, 1990				February 9, 1989 through December 31, 1989				Jan. 1, 1989 through Feb. 8, 1989	Year Ended Dec. 31, 1988
	Holdings	Group	Capital	RJRN	Holdings	Group	Capital	RJRN	RJRN	RJRN
Domestic (includes U.S. exports)	\$(626)	\$(355)	\$253	\$253	\$(1,417)	\$(1,176)	\$(637)	\$ 93	\$(299)	\$1,606
Foreign	224	224	224	224	286	286	286	286	36	219
Pre-tax income (loss)	<u>\$(402)</u>	<u>\$(131)</u>	<u>\$477</u>	<u>\$477</u>	<u>\$(1,131)</u>	<u>\$(890)</u>	<u>\$(351)</u>	<u>\$379</u>	<u>\$(263)</u>	<u>\$1,825</u>

The differences between the provision (benefit) for income taxes and income taxes computed at statutory U.S. federal income tax rates are explained as follows:

	Successor								Predecessor	
	Year Ended December 31, 1990				February 9, 1989 through December 31, 1989				Jan. 1, 1989 through Feb. 8, 1989	Year Ended Dec. 31, 1988
	Holdings	Group	Capital	RJRN	Holdings	Group	Capital	RJRN	RJRN	RJRN
Income taxes computed at statutory U.S. federal income tax rates	\$ (137)	\$ (45)	\$ 162	\$ 162	\$ (385)	\$(303)	\$(120)	\$128	\$ (90)	\$ 620
State taxes, net of federal benefit	76	76	76	76	59	59	59	59	(2)	66
Goodwill amortization	122	122	122	122	115	115	115	115	3	39
Preferred stock dividend	—	—	—	—	89	89	—	—	—	—
Repatriation of foreign earnings	—	—	—	—	—	—	—	—	—	29
Miscellaneous items	(1)	(1)	(1)	(1)	(34)	(34)	(34)	(34)	23	(100)
Provision (benefit) for income taxes	<u>\$ 60</u>	<u>\$ 152</u>	<u>\$ 359</u>	<u>\$ 359</u>	<u>\$(156)</u>	<u>\$(74)</u>	<u>\$ 20</u>	<u>\$268</u>	<u>\$(66)</u>	<u>\$ 654</u>
Effective tax rate	<u>(14.8)%</u>	<u>(116.4)%</u>	<u>75.2%</u>	<u>75.2%</u>	<u>(13.8)%</u>	<u>(8.3)%</u>	<u>5.7%</u>	<u>70.7%</u>	<u>(25.1)%</u>	<u>35.8%</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 3—Income Taxes—(Continued)

At December 31, 1990, Holdings had a remaining consolidated net operating loss carryforward for U.S. tax purposes resulting from 1989 operations of \$222 million. The related book tax benefits were recorded in the Consolidated Balance Sheets as of December 31, 1989.

Income taxes accrued at December 31, 1990 relate primarily to the sales of discontinued operations and income taxes related to the Recapitalization Program.

At December 31, 1990, there was \$520 million of accumulated and undistributed income of foreign subsidiaries. These earnings are intended to be reinvested abroad indefinitely. If these earnings were to be repatriated, withholding taxes of approximately \$50 million would be required.

There are a number of issues pending as a result of Internal Revenue Service audits. The resolution of these issues is not expected to have a material effect on RJRN's financial condition.

Note 4—Discontinued Operations

On April 2, 1990, the New Zealand and Far East food businesses of Nabisco International were sold for approximately \$180 million in cash, subject to certain post-closing adjustments. Furthermore, on June 6, 1989 five European food businesses of Nabisco International were sold for \$2.5 billion in cash, subject to certain adjustments. The divestiture of Nabisco International's New Zealand, Far East and European food businesses and certain related completed transactions comprise substantially all of the Nabisco International sector. The net cash proceeds from these divestitures were used to reduce amounts outstanding under the Asset Sale Bridge Facility (the "Asset Sale Bridge Facility").

On January 9, 1990 the processed foods business of Del Monte was sold for approximately \$1.475 billion in cash, subject to certain post-closing adjustments. Furthermore, on December 5, 1989 the fresh fruit business of Del Monte was sold for \$875 million in cash, subject to certain post-closing adjustments. The net cash proceeds from these divestitures were also used to reduce amounts outstanding under the Asset Sale Bridge Facility.

The Nabisco International and Del Monte operations, including the operations of the remaining unsold Nabisco International businesses, have been presented as discontinued operations through the respective divestiture measurement dates as initially reported during the third quarter of 1989. No gain or loss has been recognized for financial statement purposes on the discontinued businesses sold since the net proceeds from such transactions reflect the fair value of such businesses as of the date of Holdings' acquisition of RJRN.

Management has decided for strategic business reasons not to sell the remaining unsold Nabisco International businesses, consisting principally of the Latin America operations. Accordingly, the identifiable assets and liabilities for these businesses as of December 31, 1990 have been consolidated based upon their respective fair market values which, in the aggregate, approximate the net carrying amount of these businesses previously included under the caption "Net assets available for sale". Beginning in 1991, the results of operations and cash flows of the remaining unsold Nabisco International businesses will be consolidated and included in continuing operations as a result of the decision to retain such businesses.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 4—Discontinued Operations—(Continued)

Summarized information for discontinued operations is shown in the following table:

	<u>1989*</u>	<u>1988</u>
Net sales	\$2,460	\$4,321
Operating income	276	481
Interest allocation**	(237)	—
Income before income taxes	\$ 34	\$ 461
Provision for income taxes	<u>11</u>	<u>239</u>
Income from operations of discontinued businesses, net of income taxes	<u>\$ 23</u>	<u>\$ 222</u>

* Includes Predecessor period of January 1, 1989 through February 8, 1989.

** In addition, \$102 million of interest was allocated to the Consolidated Balance Sheets through December 31, 1989, representing interest on outstanding debt for the period subsequent to the divestiture measurement dates.

Note 5—Extraordinary Item

During 1990, in connection with the Recapitalization Program, the early extinguishments of debt of Holdings, Group and Capital resulted in the following extraordinary gains and losses:

	<u>Holdings</u>	<u>Group</u>	<u>Capital</u>	<u>RJRN</u>
Pre-tax gain on the repurchase of Group Debentures*	\$220	\$220		
Write-off of debt issuance costs	(79)	(57)	\$(41)	\$(41)
Extraordinary item—gain (loss) on early extinguishments of debt before income taxes	141	163	(41)	(41)
Provision (benefit) for income taxes	<u>108</u>	<u>51</u>	<u>(13)</u>	<u>(13)</u>
Extraordinary item—gain (loss) on early extinguishments of debt, net of income taxes	<u>\$ 33</u>	<u>\$112</u>	<u>\$(28)</u>	<u>\$(28)</u>

* Pre-tax gain of \$220 million resulted from open market purchases of a portion of the Group Debentures at prevailing market prices at an aggregate cost of \$1.504 billion.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 6—Supplemental Cash Flows Information

A reconciliation of net income (loss) to net cash flows from (used in) operating activities follows:

	Successor								Predecessor	
	Year Ended December 31, 1990				February 9, 1989 through December 31, 1989				January 1, 1989 through February 8, 1989	Year Ended Dec. 31, 1988
	Holdings	Group	Capital	RJRN	Holdings	Group	Capital	RJRN	RJRN	RJRN
Cash flows from (used in) operating activities:										
Net income (loss)	\$ (429)	\$ (171)	\$ 90	\$ 90	\$ (976)	\$ (817)	\$ (372)	\$ 110	\$ (173)	\$ 1,393
Adjustments to reconcile net income (loss) to net cash flows from (used in) operating activities:										
Depreciation of property, plant and equipment	450	450	450	450	417	417	417	417	32	380
Amortization (principally intangibles)	680	680	680	680	625	625	625	625	14	251
Deferred income tax provision	296	257	175	175	45	45	8	183	1	196
Non-cash interest expense	1,599	1,323	716	716	1,204	966	428	412	2	31
Amortization of debt issuance costs ..	176	175	175	175	447	444	443	266	—	12
(Gain) on disposition of businesses ..	—	—	—	—	—	—	—	—	—	(61)
Extraordinary item—(gain) loss on early extinguishments of debt	(141)	(163)	41	41	—	—	—	—	—	—
Change in control costs	—	—	—	—	—	—	—	—	247	—
(Increase) decrease in accounts and notes receivable	367	364	364	364	(151)	(148)	(148)	(148)	439	(115)
(Increase) decrease in inventories ..	188	188	188	188	265	265	265	265	(157)	11
(Increase) decrease in prepaid expenses and excise taxes	(23)	(23)	(23)	(23)	(156)	(156)	(156)	(156)	19	77
(Increase) decrease in other assets and deferred charges	56	56	56	56	(314)	(313)	(313)	(268)	(4)	(163)
Increase (decrease) in accounts payable and accrued accounts	(176)	(176)	(176)	(176)	(30)	(34)	(34)	(35)	(336)	84
(Decrease) in income taxes accrued ..	(503)	(429)	(204)	(204)	(599)	(517)	(387)	(313)	(97)	(158)
Increase (decrease) in other noncurrent liabilities	(35)	(35)	(35)	(35)	148	148	148	148	(8)	(116)
Change in net assets of discontinued businesses	99	99	99	99	27	27	27	27	(52)	63
Other, net	112	109	108	108	13	12	13	20	(11)	24
Total adjustments	3,145	2,875	2,614	2,614	1,941	1,781	1,336	1,443	89	516
Net cash flows from (used in) operating activities	\$ 2,716	\$ 2,704	\$ 2,704	\$ 2,704	\$ 965	\$ 964	\$ 964	\$ 1,553	\$ (84)	\$ 1,909

Cash payments for income taxes and interest were as follows:

	Successor								Predecessor	
	Year Ended December 31, 1990				February 9, 1989 through December 31, 1989				January 1, 1989 through February 8, 1989	Year Ended Dec. 31, 1988
	Holdings	Group	Capital	RJRN	Holdings	Group	Capital	RJRN	RJRN	RJRN
Income taxes paid (net of refunds)	\$ 335	\$ 335	\$ 335	\$ 335	\$ 242	\$ 242	\$ 242	\$ 242	\$ 38	\$ 596
Interest paid*	\$ 1,424	\$ 1,424	\$ 1,424	\$ 1,424	\$ 1,889	\$ 1,889	\$ 1,889	\$ 1,352	\$ 20	\$ 448

* The 1989 Successor amount includes \$339 million of interest allocated to discontinued operations (See Note 4 to the Consolidated Financial Statements).

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 6—Supplemental Cash Flows Information—(Continued)

Cash equivalents at December 31, 1990 and 1989, valued at cost (approximates market), totaled \$323 million and \$76 million, respectively, and consisted principally of Eurodollar time deposits, commercial paper and certificates of deposit.

During 1990, Holdings set aside \$200 million of the \$1.7 billion cash proceeds received in connection with the purchase by a partnership affiliated with KKR of 272,000,000 shares of Common Stock to create a dividend reserve initially available to fund the 1991 cash dividend payments on the Preferred Stock (the "Dividend Reserve"). On January 15, 1991, Holdings paid the initial dividend on the Preferred Stock of approximately \$50 million with funds from the Dividend Reserve. Substantially all of the remaining funds in the Dividend Reserve were subsequently released in connection with the completion of the 1991 Exchange Offer.

On July 16, 1990, Holdings issued 8,000,000 unregistered shares of Preferred Stock (\$25 stated value per share) in exchange for \$200 million of the sum of principal of and accrued and unpaid interest on Capital's Partnership Debt Securities held by a partnership affiliated with KKR. On November 1, 1990, Holdings exchanged such shares in a share for share exchange for 8,000,000 registered shares of Preferred Stock. Also on November 1, 1990, \$1.859 billion of the sum of principal of plus accrued and unpaid interest on the Converting Debentures and \$541 million of the sum of principal of plus accrued and unpaid interest on the Group Debentures were exchanged for an aggregate of approximately \$800 million in cash and approximately \$1.6 billion stated value of Preferred Stock (64,032,000 shares) pursuant to the 1990 Exchange Offers.

During 1990 and 1989, Group issued \$557 million and \$435 million, respectively, of additional Group Debentures in lieu of cash interest to the holders of such debentures. In addition, Capital issued approximately \$167 million and \$71 million of additional subordinated debentures in lieu of cash interest on its payment-in-kind debentures during 1990 and 1989, respectively.

A reconciliation for Holdings of the cash acquisition cost of RJRN to the purchase price follows:

Total purchase price plus financing costs	\$25,597
Less: Non-cash issuance of securities for RJRN common stock:	
Group Debentures	\$4,065
Converting Debentures	2,257
Financing fees paid during 1989	888
Unpaid financing/acquisition fees and expenses at December 31, 1989	112
Cash and cash equivalents at acquisition	<u>929</u>
Acquisition of RJRN, less cash and cash equivalents acquired	<u>8,251</u>
	<u>\$17,346</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 7—Inventories

The major classes of inventory are shown in the table below:

	December 31, 1990	December 31, 1989
Finished products	\$ 617	\$ 624
Leaf tobacco	1,565	1,796
Raw materials	198	224
Other	266	232
	<u>\$2,646</u>	<u>\$2,876</u>

At December 31, 1990 and 1989, approximately \$1.6 billion and \$1.8 billion, respectively, of the inventory was valued under the LIFO method. The current cost of LIFO inventories at December 31, 1990 and 1989, was greater than the amount at which these inventories were carried on the Consolidated Balance Sheets by \$216 million and \$95 million, respectively.

For the year ended December 31, 1990 and for the periods February 9, 1989 through December 31, 1989 and January 1, 1989 through February 8, 1989, net income was increased by \$17 million, \$8 million, and \$0, respectively, as a result of LIFO inventory liquidations. The LIFO liquidations resulted from programs to reduce leaf durations consistent with forecasts of future operating requirements. The overall cost of recent leaf purchases at auction has been increasing which results in higher cost of sales.

Note 8—Property, Plant and Equipment

Components of property, plant and equipment were as follows:

	December 31, 1990	December 31, 1989
Land and land improvements	\$ 264	\$ 266
Buildings and leasehold improvements	1,604	1,550
Machinery and equipment	3,510	3,162
Construction-in-process	403	458
	<u>5,781</u>	<u>5,436</u>
Less accumulated depreciation	(915)	(417)
Net property, plant and equipment	<u>\$4,866</u>	<u>\$5,019</u>

Note 9—Notes Payable and Related Information

Notes payable consisted of the following:

	December 31, 1990	December 31, 1989
Working capital facility	\$ 65	\$ 90
Notes payable to foreign banks	222	52
Commercial paper	8	39
	<u>\$295</u>	<u>\$181</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 9—Notes Payable and Related Information—(Continued)

RJRN maintains a working capital facility which provides for extension of credit in an aggregate amount of \$750 million. At December 31, 1990, approximately \$614 million of this facility was available. A commitment fee of 1/2% per annum is payable on the unused portion of the facility.

On February 7, 1990, RJRN entered into an arrangement in which it will sell for cash substantially all of its domestic trade accounts receivable generated during a five-year period to a financial institution. The accounts receivable will be sold with limited recourse at a purchase price reflecting the rate applicable to the cost to the financial institution of funding its purchases of accounts receivable and certain administrative costs. During 1990, total proceeds of approximately \$8.2 billion were received by RJRN throughout the year in connection with this arrangement. Accordingly, the accounts receivable amount at December 31, 1990 has been reduced by approximately \$321 million with respect to the receivables sold.

Note 10—Accounts Payable and Accrued Accounts

Accounts payable and accrued accounts consisted of the following:

	December 31, 1990	December 31, 1989
Trade accounts	\$ 387	\$ 311
Marketing and advertising	693	530
Payroll and employee benefits	311	440
Restructuring and relocation	110	235
Excise taxes	326	370
Accrued interest	267	284
Other	920	1,095
	<u>\$3,014</u>	<u>\$3,265</u>

Note 11—Long-term Debt and Interest Expense

Interest expense for Holdings (Successor) and RJRN (Predecessor) consisted of the following:

	Successor		Predecessor	
	Year Ended December 31, 1990	February 9, 1989 through December 31, 1989	January 1, 1989 through February 8, 1989	Year Ended December 31, 1988
Cash interest	\$1,401	\$1,689	\$42	\$506
Non-cash interest	1,599	1,204	2	31
	<u>\$3,000</u>	<u>\$2,893</u>	<u>\$44</u>	<u>\$537</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 11—Long-term Debt and Interest Expense—(Continued)

Long-term debt consisted of the following:

	<u>December 31, 1990</u>		<u>December 31, 1989</u>	
	<u>Due Within One Year</u>	<u>Due After One Year(1)</u>	<u>Due Within One Year</u>	<u>Due After One Year</u>
RJRN Debt:				
7½-9½% Debentures with semi-annual and annual sinking fund payments through 2017 (net of \$45 million and \$62 million of such debentures held by RJRN on December 31, 1990 and December 31, 1989, respectively, for future sinking fund requirements)	\$ 308	\$ 2,403	\$ 105	\$ 2,736
10-10¼% Notes, due 1991 to 1993	150	350	100	500
7.61-10.88% effective interest rates, Foreign Currency Debt, due 1991 to 2001(2)	183	448	115	619
Zero Coupon Guaranteed Notes, due 1992, net of discount of \$53 million and \$93 million at December 31, 1990 and December 31, 1989, respectively, effective interest rate of 14.64%		312		272
Other indebtedness	145	444	50	615
Bank Debt(3):				
Term Loan, variable interest (varies with prime rate and LIBOR)—10.82% at December 31, 1990, due in installments beginning 1991 through 1995	514	2,575		3,500
Revolving Credit Facility, variable interest (varies with prime rate and LIBOR)—11½% at December 31, 1990, due in quarterly installments beginning 1991 through 1995(4)	125			329
1990 Bank Credit Facility, variable interest (varies with prime rate and 3-month LIBOR)—12.06% at December 31, 1990, due in quarterly installments beginning 1995 through 1996		2,250		
Asset Sale Bridge Facility, repaid on July 27, 1990			2,262	
Refinancing Bridge Facility, repaid on July 18, 1990				1,500
Payment-In-Kind Debentures:				
Subordinated Debentures, net of discount of \$78 million and \$76 million at December 31, 1990 and December 31, 1989, respectively, effective interest rate of 15.88%, interest payable-in-kind until May 15, 1994, sinking fund requirements beginning 1999, due 2001		1,160		996
Subordinated Discount Debentures, net of discount of \$1,740 million and \$2,074 million at December 31, 1990 and December 31, 1989, respectively, effective interest rate of 15.88%, interest payable-in-kind until May 15, 1994, sinking fund requirements beginning 1999, due 2001		2,371		2,037

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 11—Long-term Debt and Interest Expense—(Continued)

	<u>December 31, 1990</u>		<u>December 31, 1989</u>	
	<u>Due Within One Year</u>	<u>Due After One Year(1)</u>	<u>Due Within One Year</u>	<u>Due After One Year</u>
Other Debentures and Notes:				
Subordinated Debentures and Notes, fixed rates of 13¼% and 13½%, and variable interest (varies with 3-month LIBOR)—11.91% at December 31, 1990, due through 2001		1,000		2,000
Partnership Debt:				
Subordinated Debentures, variable interest (varies with 7-year U.S. Treasury Note)—16% at December 31, 1990, interest payable-in-kind until February 8, 1994, due 1997		427		538
RJRN and Capital	1,425	13,740	2,632	15,642
Group Debentures:				
Group Debentures, 17% at December 31, 1990, interest payable-in-kind until May 1, 1995, due 2007(5)		2,864		4,500
Group	1,425	16,604	2,632	20,142
Converting Debentures:				
Converting Debentures, 17¼% at December 31, 1990, interest payable-in-kind until May 1, 1999, convertible into Holdings Common Stock on April 30, 1993, otherwise due 2009		351		1,806
Holdings	<u>\$1,425</u>	<u>\$16,955</u>	<u>\$2,632</u>	<u>\$21,948</u>

- (1) The payment of debt through December 31, 1995 is due as follows (in millions): 1992—\$1,751; 1993—\$1,733; 1994—\$532 and 1995—\$1,177.
- (2) RJRN has entered into hedging arrangements designed to offset the effects of future foreign currency exchange rate movements on these debt issues.
- (3) Capital has entered into hedging arrangements designed to offset the effects of future interest rate movements on approximately \$4.1 billion of bank debt at December 31, 1990.
- (4) Capital maintains a revolving credit facility of \$1.750 billion of which \$1.625 billion was unused at December 31, 1990. Availability of the unused portion of this facility is reduced by \$550 million for a separate letter of credit facility. A commitment fee of ½% per annum is payable on the unused portion of the facility.
- (5) The Group Debentures are subject to optional redemption by Group at any time at 100% of the principal amount thereof plus accrued and unpaid interest thereon. Group is currently prohibited from redeeming any Group Debentures under the 1989 Credit Agreement and the 1990 Credit Agreement without obtaining prior consent of the banks party thereto.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 11—Long-term Debt and Interest Expense—(Continued)

On November 1, 1990, Holdings completed the exchange of \$1.859 billion of the sum of principal of and accrued and unpaid interest on Converting Debentures and \$541 million of the sum of principal of and accrued and unpaid interest on Group Debentures for an aggregate of approximately \$800 million in cash and approximately \$1.6 billion stated value of Holdings Preferred Stock (64,032,000 shares) pursuant to the 1990 Exchange Offers.

During 1990, Group purchased Group Debentures at prevailing market prices at an aggregate cost of \$1.504 billion pursuant to the Purchase Program resulting in an extraordinary gain (See Note 5 to the Consolidated Financial Statements).

The bank credit agreement, dated as of January 31, 1989, as amended (the "1989 Credit Agreement") required that the full amount (\$6.0 billion) of the Asset Sale Bridge Facility be repaid by not later than August 9, 1990 and at least \$5.0 billion of the funds used to repay the principal amount of the Asset Sale Bridge Facility be obtained from the net cash proceeds from the sale of certain assets of RJRN and its subsidiaries. On July 27, 1990, the outstanding balance remaining under the Asset Sale Bridge Facility was fully repaid.

On July 16, 1990, a partnership affiliated with KKR exchanged \$200 million of the sum of principal of and accrued and unpaid interest on the Partnership Debt Securities of Capital for \$200 million stated value of unregistered shares of Preferred Stock of Holdings. On November 1, 1990, Holdings exchanged such shares in a share for share exchange for 8,000,000 registered shares of Preferred Stock.

On July 9, 1990, Holdings, Group, Capital and RJRN entered into the 1990 Credit Agreement under which Capital borrowed \$2.25 billion in connection with the Recapitalization Program. On July 18, 1990, Capital repaid the outstanding balance of \$1.15 billion remaining under the refinancing bridge facility due February 9, 1991, with a portion of the proceeds from borrowings under the 1990 Credit Agreement. In addition, Capital redeemed the remaining \$1.0 billion principal amount of Increasing Rate Notes on August 15, 1990 using a portion of the proceeds from borrowings under the 1990 Credit Agreement.

On July 17, 1989, Group exchanged, pursuant to the terms of its cumulative exchangeable preferred stock (the "Group Preferred Stock"), all of the Group Preferred Stock (\$4.065 billion stated value) for Group Debentures at the rate of \$1 principal amount of Group Debentures for each \$1 stated value of Group Preferred Stock. The Group Debentures were classified as long-term debt as of December 31, 1989. Interest accrued on these Group Debentures from the Offer date and, accordingly, previously recorded dividend accruals have been reclassified as interest.

The terms of the Converting Debentures and the Group Debentures required that the interest rates on such securities be set permanently at fixed interest rates designed to result in the respective debentures trading at par on a fully distributed basis, without taking into account any accrued and unpaid interest thereon and, in the case of the Converting Debentures, without giving effect to the conversion feature of such securities, by no later than April 28, 1991 (or if substantially all of Capital's Increasing Rate Notes had been refinanced prior to April 28, 1990, one year from the date of such

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Note 11—Long-term Debt and Interest Expense—(Continued)

refinancing). Effective July 16, 1990, the interest rates on the Converting Debentures and Group Debentures were set permanently at fixed rates of 17 $\frac{3}{4}$ % per annum and 17% per annum, respectively.

At December 31, 1990, approximately \$243 million of accrued payment-in-kind interest was included in "Other noncurrent liabilities". Such interest will be reported as additional "Long-term debt" when distributed as debt on the applicable interest due dates.

The 1989 Credit Agreement, the 1990 Credit Agreement and indentures under which the debt securities have been issued contain certain restrictive covenants that, among other things, limit the ability of Holdings and its subsidiaries to incur indebtedness, pay dividends, transfer assets among subsidiaries, engage in transactions with stockholders and affiliates, create liens, engage in mergers and consolidations, engage in sales of assets and subsidiary stock and make investments in unrestricted subsidiaries.

In connection with the Merger, RJRN guaranteed the debt of Capital. Accordingly, the financial statements of RJRN reflect all of Capital's debt and all debt-related costs since the Merger date. In accordance with certain of these guarantees, RJRN pledged the capital stock of certain of its principal subsidiaries.

Note 12—Commitments and Contingencies

Tobacco-Related Litigation

Various legal actions, proceedings and claims are pending or may be instituted against RJRN or its subsidiaries, including those claiming that lung cancer and other diseases have resulted from the use of RJRT's tobacco products. During 1990, 7 new actions were filed against RJRT or its indemnitees and 11 such actions were dismissed or otherwise resolved in favor of RJRT or its indemnitees without trial. A total of 28 such actions in the United States and one against RJRT's Canadian company were pending on December 31, 1990.

The plaintiffs in these actions seek recovery on a variety of legal theories, including strict liability in tort, design defect, negligence, breach of warranty, failure to warn and conspiracy. Punitive damages, often in amounts totalling many millions of dollars, are specifically pleaded in 19 cases in addition to compensatory and other damages. The defenses raised by RJRT, where applicable, include preemption by the Federal Cigarette Labeling and Advertising Act (the "Cigarette Act") of some or all such claims arising after 1965; the lack of any defect in the product; assumption of the risk; lack of proximate cause; and statutes of limitations or repose. RJRT intends to defend vigorously all such actions that may be brought against it.

The issue of whether state law tort claims are preempted by federal law, and if so, the scope of that preemption has been considered by a number of federal courts of appeal and two state supreme courts. Five federal courts of appeal and the Minnesota Supreme Court have held that the Cigarette Act has preemptive effect. The New Jersey Supreme Court and an intermediate Texas Court of Appeal have held that it does not. The issue is currently the question presented in a petition for certiorari to the United States Supreme Court in a case in which RJRT is not a party. It is not yet known whether the petition will be granted.

In two recent smoking and health cases in which neither RJRN nor any subsidiary was a party, *Cipollone v. Liggett Group, et al.* and *Horton v. American Tobacco Company, et al.*, juries have found

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 12—Commitments and Contingencies—(Continued)

in favor of plaintiffs. In *Cipollone*, the jury awarded \$400,000 in damages and in *Horton*, no damages were awarded. The award of damages in *Cipollone* was reversed on appeal. Petitions seeking further review are pending in both cases.

Litigation is subject to many uncertainties, and it is possible that some of the legal actions, proceedings or claims could be decided against RJRN or its subsidiaries. Determinations of liability or adverse rulings against other cigarette manufacturers that are defendants in similar actions, even if such rulings are not final, could adversely affect the litigation against RJRN and its subsidiaries and increase the number of such claims.

RJRN previously had maintained product liability insurance covering certain of these tobacco-related legal actions, proceedings and claims. As of April 13, 1990, RJRN became wholly self-insured for existing tobacco-related risks.

Litigation Related to the Merger

Numerous complaints, many purporting to be class actions, have been filed against RJRN by stockholders, holders of Registrants' debt securities and employees in connection with the Merger or events related thereto. In some of these actions, certain current and former members of RJRN's Board of Directors and certain former members of management are also named as defendants.

Eight of the cases brought in Delaware by former stockholders have been consolidated into one action. This consolidated action generally alleges that the defendants breached fiduciary duties by entering into the agreement providing for the Merger, and through related activities, including the failure to accept a competing and allegedly higher bid from a group led by former members of management. In addition, plaintiffs in the consolidated action have filed a motion to enjoin the Recapitalization Program and a motion to amend their complaint to incorporate allegations that the Exchange Offers are coercive and that covenants in certain indentures have been violated. The parties have reached an understanding to settle this action. The Registrants do not believe that the proposed settlement will have a material effect on the Registrants' financial condition. One case brought in Georgia by a former stockholder contains essentially the same claims relating to the Merger and related activities as the Delaware consolidated stockholder action. Such action has been stayed pending the outcome of the Delaware consolidated stockholder action. Another stockholder action has been filed in New York State court against RJRN's financial advisors, Dillon, Read & Co. Inc. and Lazard Frères & Co. Plaintiffs claim that defendants acted negligently in providing financial advice in connection with the signing of the Merger Agreement and related activities. Defendants moved to dismiss or to stay this action. That motion was denied by the trial court and the trial court's decision was appealed. The appellate court affirmed the denial of the motion to dismiss but reversed the denial of the motion to stay. It is anticipated that if the Delaware action is settled, the New York action will be dismissed.

Three of the actions brought by stockholders allege that RJRN violated federal securities laws or other laws or duties by failing to disclose information concerning discussions with third parties and alleged internal plans relating to transactions similar to the Merger, principally relating to the offer by RJRN for shares of its common stock pursuant to which RJRN purchased on April 27, 1988 approximately 21,000,000 shares of such stock at a price of \$53.50 per share, but also include claims in respect of all trading in RJRN's common stock after March 30, 1988 and until October 20, 1988. The parties to one such stockholder action in Delaware have filed a stipulation of dismissal for signature by the court. Three actions brought by former employees of RJRN contain similar allegations with respect

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Note 12—Commitments and Contingencies—(Continued)

to the exercise or cancellation of certain employee stock options. These actions have either been consolidated for all purposes or consolidated for discovery purposes.

Two cases brought by holders of debt securities of RJRN based upon a number of allegations, including violations similar to those described above of federal securities laws, fraud and breach of alleged fiduciary duties are currently pending. In addition, one of these actions alleges that the Merger would be a fraudulent conveyance. The plaintiffs generally seek damages or equitable relief, including rescission, along with attorney's fees. In one of the cases, a class of plaintiffs has been conditionally certified.

On May 9, 1989, one of the foregoing holders of debt securities gave RJRN and an affiliate notices purporting to be "Notices of Default" under certain debt issues of RJRN and its subsidiaries with an aggregate outstanding principal amount of approximately \$1 billion, of which such holder holds approximately \$230 million principal amount. On May 11, 1989, RJRN and an affiliate received notices from another of the foregoing holders of debt securities purporting to be "Notices of Default" under certain additional debt issues of RJRN. Such notices allege that the provisions of certain Merger-related credit arrangements create defaults under the provisions of the governing instruments covering the issues. RJRN believes that there is no basis for such default assertions and that such notices were issued improperly. A federal district court issued a preliminary injunction which stayed the effect of these notices pending a judicial determination of the issue. On June 25, 1990, the court of appeals vacated the preliminary injunction issued by the district court and remanded the case to the district court for further proceedings. Subsequently, the parties agreed that the cure periods under the indentures containing the covenants at issue will extend until 18 days after the district court renders its determination whether there has been a covenant breach. On July 13, 1990, the two holders of debt securities amended their complaint in the district court action to assert additional alleged defaults under the indentures at issue. RJRN believes that there is no basis for these additional default assertions.

On July 27, 1990, RJRN filed its motion for summary judgment on the covenant default claims in this action. On August 24, 1990, plaintiffs served a cross-motion seeking summary judgment with respect to the alleged covenant defaults at issue. These plaintiffs also asserted in their cross-motion and supporting papers that their purported notices of default were effective not only with respect to the two indentures governing a total of approximately \$165.6 million of debt securities for which one of the plaintiffs held the requisite percentage of the outstanding debt securities to send such notices, but also with respect to two other indentures, each governing \$1.0 billion of outstanding debt, for which plaintiffs did not hold the requisite debt percentages. In compliance with the schedule established by the District Court, as revised, the motions were fully briefed and taken under consideration by the District Court as of October 19, 1990.

On January 18, 1991, Holdings, RJRN and Metlife agreed in principle to reinstitute normal business relations and to settle and dismiss the Metlife action. As part of such agreement, Metlife will become an equity investor in Holdings and one of the primary lenders with respect to an employee stock ownership plan (the "ESOP") to be formed by Holdings. On January 21, 1991, Jefferson-Pilot Life Insurance Company, Metlife, Holdings and RJRN requested that the District Court defer decision in the current action pending finalization of a definitive settlement agreement.

The parties have undertaken to enter into a definitive settlement agreement containing customary terms and conditions which will provide for the exchange by Metlife with Holdings of an aggregate of

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Note 12—Commitments and Contingencies—(Continued)

\$125 million principal amount of 8.9% Debentures due 1996 (the "1996 Debentures") and 8% Debentures due 2007 (the "2007 Debentures") for a 100% participation (the "ESOP Participation") in a note representing one tranche of an ESOP loan issued to Holdings in connection with the sale of Holdings stock to the ESOP. The ESOP Participation will be guaranteed by Holdings which guarantee will be secured by a pledge of the unamortized portion of the 1996 Debentures and 2007 Debentures acquired by Holdings. It is expected that the closing of the ESOP Participation will occur by the end of the first quarter of 1991, and in any event not later than August 1, 1991.

The parties have further agreed in principle that, pursuant to the terms of the definitive settlement agreement, Metlife will become an equity investor in Holdings by exchanging up to an aggregate of \$32.5 million principal amount of 1996 Debentures and 2007 Debentures (the remainder of the 1996 Debentures and 2007 Debentures then owned by Metlife) with Holdings for Common Stock, par value \$.01 per share, of Holdings at a price equal to the average closing price for Holdings Common Stock over a specified period shortly before the date of issuance. It is expected that the closing of the equity investment will occur on August 1, 1991, and in any event not later than October 1, 1991. The Holdings Common Stock to be issued to Metlife will be subject to contractual transfer restrictions whereby Metlife may not dispose of any of the shares of such Common Stock prior to March 1, 1992; provided that up to 50% of such Common Stock may be transferred after December 2, 1991. In connection with its equity investment, Metlife will be granted demand registration rights providing for not more than two shelf registrations of such Common Stock for specified periods. In connection with the ESOP Participation and the equity investment, Metlife has undertaken to offer to acquire all of the 2007 Debentures not now owned by it. Holdings has also undertaken to make exchange offers to be consummated by December 15, 2002 for the 9½% Sinking Fund Debentures, Due April 1, 2016, the 8½% Sinking Fund Debentures, Due February 1, 2017 and the 8½% Sinking Fund Debentures, Due March 15, 2017 of RJRN then outstanding. Such exchange offers will be made at par and the consideration to be offered will consist of 90% cash and 10% Holdings Common Stock or, at the option of Holdings, a greater percentage of cash up to 100% with any balance in Holdings Common Stock, any such Common Stock to be priced in relation to the then current market price. In connection with the final settlement of the litigation, Holdings will reimburse Metlife for Metlife's and Jefferson-Pilot's legal, executive and other costs and expenses related to the litigation.

The Registrants believe that the ultimate outcome of all pending tobacco, stockholder, bondholder and other litigation matters should not have a material adverse effect on the Registrants' financial condition.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 12—Commitments and Contingencies—(Continued)

Commitments

In agreements reached between the tobacco industry and the Flue Cured Stabilization Board and the Burley Pool during 1986, RJRN committed to buy certain quantities of leaf tobacco. The remaining commitments to be drawn down through 1996 total approximately \$463 million subject to the timing of the purchases.

At December 31, 1990, commitments totalled approximately \$142 million, principally for the purchase of machinery and equipment.

Financial Instruments with Off-Balance Sheet Risk and Significant Concentrations of Credit Risk

Certain financial instruments with off-balance sheet risk have been entered into by Capital and RJRN to manage interest rate and foreign currency exposures. At December 31, 1990, Capital had outstanding interest rate swap agreements with commercial banks having a total notional principal amount of \$3.7 billion. Also at December 31, 1990, RJRN had outstanding forward foreign exchange contracts with commercial banks to purchase approximately \$600 million in foreign currency. In addition, RJRN had entered into the hedging arrangements related to its foreign currency debt at December 31, 1990 (See Note 11 to the Consolidated Financial Statements).

Approximately \$1.0 billion and \$2.7 billion of the interest rate swap agreements entered into by Capital mature during February, 1991 and August, 1992, respectively. The differential to be paid or received on the interest rate swap agreements entered into is accrued as interest rates change and is being recognized over the life of the agreements. In addition, \$400 million of Eurodollar futures contracts matured during December, 1990 which will be amortized by Capital during the first quarter of 1991. The forward foreign exchange contracts and other hedging arrangements entered into by RJRN generally mature at the time the hedged foreign currency transactions mature. Unrealized gains and losses on forward foreign exchange contracts is determined based on changes in market rates.

The above financial instruments entered into by Capital and RJRN involve, to varying degrees, elements of market risk as a result of potential changes in future interest and foreign currency exchange rates. However, because the impact of such potential changes in future interest and foreign currency exchange rates would offset the related impact on the underlying items being hedged, these instruments do not subject Capital or RJRN to market risk that would have otherwise resulted from changes in future interest and foreign currency exchange rates. Also, both Capital and RJRN may be exposed to credit losses in the event of non-performance by the counterparties to these financial instruments. However, Capital and RJRN continually monitor their respective positions and the credit ratings of their respective counterparties and therefore, Capital and RJRN do not anticipate any non-performance.

There are no significant concentrations of credit risk with any individual counterparties or groups of counterparties as a result of any financial instruments entered into including those financial instruments discussed above.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 13—Redeemable Convertible Preferred Stock

The Preferred Stock, 75,000,000 shares authorized, stated value \$25 per share and par value \$.01 per share, bears a cumulative cash dividend rate of 11.5% of stated value per annum and is payable quarterly in arrears commencing January 15, 1991, when, as and if declared by the board of directors of Holdings. Furthermore, the 1989 Credit Agreement, the 1990 Credit Agreement and various debt instruments of Capital contain certain restrictive covenants that, among other things, may limit the ability of Holdings to pay cash dividends on the Preferred Stock. The Preferred Stock may be converted after May 1, 1991 into shares of Common Stock at a conversion price of \$9 of stated value per share of Common Stock, subject to adjustment in certain events.

The Preferred Stock, which was the only class of preferred stock of Holdings outstanding at December 31, 1990, is senior to the Common Stock as to dividends and preferences in liquidation, and is subject to mandatory redemption on November 1, 2015 at \$25 per share, plus accrued and unpaid dividends. In addition to the mandatory redemption requirement, the Preferred Stock is redeemable at the option of Holdings, in whole or in part, at any time on or after November 1, 1993, at an initial optional redemption price of \$27.0125 per share, plus accrued and unpaid dividends. The initial optional redemption price declines thereafter on an annual basis in the amount of \$.2875 a year to \$25 per share on November 1, 2000, plus accrued and unpaid dividends.

Holders of Preferred Stock have certain voting rights with respect to the election of directors in the event that dividends on the Preferred Stock are in arrears and unpaid for six quarterly periods. Such voting rights will continue until such time as all the dividends in arrears have been paid or declared and set aside for payment.

On July 16, 1990, Holdings issued 8,000,000 unregistered shares of Preferred Stock, in exchange for \$200 million of the sum of principal of and accrued and unpaid interest on Capital's Partnership Debt Securities held by a partnership affiliated with KKR. On November 1, 1990, Holdings exchanged such shares in a share for share exchange for 8,000,000 registered shares of Preferred Stock.

On November 1, 1990, Holdings completed its 1990 Exchange Offers and issued, in partial consideration for the debentures accepted for exchange and payment, 64,032,000 shares of Preferred Stock.

On December 21, 1990, the board of directors of Holdings declared the initial Preferred Stock dividend which was distributed on January 15, 1991 to shareholders of record as of December 31, 1990. Holdings paid the initial dividend on the Preferred Stock of approximately \$50 million on January 15, 1991 with funds from the Dividend Reserve (See Note 6 to the Consolidated Financial Statements).

The remaining shares of preferred stock of RJRN (Predecessor) were repurchased during 1989 in connection with the Acquisition and were retired (See Note 1 to the Consolidated Financial Statements).

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 14—Common Stock and Paid-in Capital

The changes in Common Stock and paid-in capital are shown as follows:

	<u>1990</u>		<u>1989</u>	
	<u>Shares</u>	<u>Amount</u> (Dollars in millions)	<u>Shares</u>	<u>Amount</u>
Common Stock—\$0.01 par value—authorized 1,200,000,000 shares at December 31, 1990:				
Balance at beginning of year	308,090,813	\$ 3		
Shares issued to original investors	272,000,000	3	300,000,000	\$ 3
Shares issued to management investors	232,100	—	6,769,430	—
Restricted shares issued	—	—	1,321,383	—
Management shares repurchased and cancelled ..	(299,400)	—	—	—
Balance at end of year	<u>580,023,513</u>	<u>\$ 6</u>	<u>308,090,813</u>	<u>\$ 3</u>
Paid-in capital:				
Balance at beginning of year		\$2,213		
Shares issued during the period		1,698		\$1,537
Equity value of Converting Debentures		—		452
Equity value of warrants		—		224
Management shares repurchased and cancelled ..		(1)		—
Preferred Stock dividends declared		(50)		—
Balance at end of year		<u>\$3,860</u>		<u>\$2,213</u>

The changes in stock options are shown as follows:

	<u>1990</u>	<u>1989</u>
Balance at beginning of year	25,907,720	
Options granted to management investors and directors	933,200	25,907,720
Management options repurchased and cancelled ..	(1,202,400)	—
Balance at end of year	<u>25,638,520</u>	<u>25,907,720</u>

On July 16, 1990, a partnership affiliated with KKR purchased 272,000,000 additional shares of Common Stock of Holdings at \$6.25 per share (\$1.7 billion total purchase price) in connection with the Recapitalization Program.

The shares of Holdings Common Stock issued to management investors are generally subject to significant restrictions on transferability and Holdings generally has the right to repurchase such shares under certain circumstances.

On February 9, 1989, warrants were issued to purchase 15,254,238 shares of Holdings Common Stock. Such warrants are exercisable at an exercise price of \$5.00 per share, subject to adjustment in certain events, at any time prior to the tenth anniversary of the Offer date.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 14—Common Stock and Paid-in Capital—(Continued)

Warrants to purchase 45,529,024 shares of Holdings Common Stock were issued in connection with the sale of the payment-in-kind subordinated debentures and the subordinated discount debentures of Capital. Such warrants are exercisable at an exercise price of \$0.07 per share, subject to adjustment in certain events, and expire February 1, 1992.

Converting Debentures are convertible into 25,392,410 shares of Holdings Common Stock on the business day immediately preceding May 1, 1993, or earlier in the event of certain mergers or consolidations of Holdings, at a conversion price of \$13.8301, subject to adjustment in certain events.

Stock options have been issued to management investors and certain directors. These options generally vest equally over a five year period. The exercise price of such options is \$5.00 per share.

Paid-in capital of Group reflects the cash contributed from Holdings and used by Group in the Purchase Program, and also reflects the value of Group Debentures acquired by Holdings' in the 1990 Exchange Offers and contributed to Group. Additionally, paid-in capital of Group reflects the 1989 issuance of the Converting Debentures of Holdings, and paid-in capital of Capital and RJRN further reflects the 1989 issuance of the Group Debentures.

The shares of common stock of RJRN (Predecessor) were repurchased or exchanged for other securities in connection with the Acquisition (See Note 1 to the Consolidated Financial Statements).

Note 15—Retained Earnings and Cumulative Translation Adjustments

Retained earnings (accumulated deficit) at December 31, 1990 and 1989 includes non-cash expenses related to accumulated trademark and goodwill amortization of \$1.165 billion and \$557 million, respectively.

The changes in cumulative translation adjustments are shown as follows:

	<u>Successor</u>	<u>Predecessor</u>
	Year Ended December 31, 1990	February 9, 1989 through December 31, 1989
Balance at beginning of period	\$ 1	\$101
Translation and other adjustments	<u>34</u>	<u>(34)</u>
Balance at end of period	<u>\$ 35</u>	<u>\$ 67</u>

Note 16—Retirement Benefits

RJRN sponsors a number of non-contributory defined benefit pension plans covering most U.S. employees. Plans covering regular full-time employees in the tobacco operations (as well as hourly and certain salaried employees in the food operations) provide pension benefits that are based on the employee's length of service and final average compensation before retirement. Plans covering the

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Note 16—Retirement Benefits—(Continued)

majority of salaried employees in the corporate group and food operations provide for individual accounts which offer lump sum or annuity payment options, with benefits based on accumulated compensation and interest credits made monthly throughout the career of each participant, with an initial opening credit based on the value of retirement benefits accrued prior to the date of such amendment. RJRN's policy is to fund the cost of current service benefits and past service cost over periods not exceeding 30 years to the extent that such costs are currently tax deductible. Additionally, RJRN participates in several multi-employer plans, which provide defined benefits to certain of RJRN's union employees. Employees in foreign countries who are not U.S. citizens are covered by various post-employment benefit arrangements, some of which are considered to be defined benefit plans for accounting purposes.

A summary of the components of pension expense for RJRN-sponsored plans follows:

	Successor		Predecessor	
	Year Ended December 31, 1990	February 9, 1989 through December 31, 1989	January 1, 1989 through February 8, 1989	Year Ended December 31, 1988
Defined benefit pension plans:				
Service cost—benefits earned during the period	\$ 88	\$ 88	\$ 4	\$ 76
Interest cost on projected benefit obligation	220	207	12	197
Actual return on plan assets	(195)	(366)	(20)	(272)
Net amortization and deferral	<u>(43)</u>	<u>168</u>	<u>9</u>	<u>78</u>
Total	70	97	5	79
Multi-employer plans	<u>30</u>	<u>27</u>	<u>1</u>	<u>31</u>
Total pension expense	<u>\$ 100</u>	<u>\$ 124</u>	<u>\$ 6</u>	<u>\$ 110</u>

The principal plans used the following actuarial assumptions for accounting purposes:

	December 31, 1990	December 31, 1989
Weighted average discount rate	9.0%	8.0%
Rate of increase in compensation levels	6.5%	6.5%
Expected long-term rate of return on assets	9.5%	9.0%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 16—Retirement Benefits—(Continued)

The following table sets forth the funded status and amounts recognized in the Consolidated Balance Sheets at December 31, 1990 and 1989 for RJRN's defined benefit pension plans. The excess of the projected benefit obligation over plan assets at fair market value, determined as of February 9, 1989, was recorded as a liability in connection with the purchase cost allocation.

	December 31, 1990		December 31, 1989	
	Plans Whose Assets Exceeded Accumulated Benefits	Plans Whose Accumulated Benefits Exceeded Assets	Plans Whose Assets Exceeded Accumulated Benefits	Plans Whose Accumulated Benefits Exceeded Assets
Actuarial present value of:				
Vested benefits	\$1,947	\$ 239	\$2,039	\$ 263
Non-vested benefits	31	17	33	21
Accumulated benefit obligation	1,978	256	2,072	284
Effect of future salary increases	402	52	432	60
Projected benefit obligation	2,380	308	2,504	344
Plan assets at fair market value	2,371	118	2,539	181
Plan assets in excess of (less than) projected benefit obligation*	(9)	(190)	35	(163)
Unrecognized net (gain) loss	(308)	20	(261)	(1)
Unrecognized prior service cost	—	4	3	—
Net pension liabilities recognized in the Consolidated Balance Sheets	<u>\$ (317)</u>	<u>\$ (166)</u>	<u>\$ (223)</u>	<u>\$ (164)</u>

* Plans whose accumulated benefits exceeded assets primarily relate to RJRN's foreign defined benefit pension plans and RJRN's unfunded supplemental benefit pension plans.

At December 31, 1990, 93 percent of the plans' assets were invested in listed stocks and bonds and other highly liquid investments. The balance consisted of various income producing investments.

In addition to providing pension benefits, RJRN provides certain health care and life insurance benefits for retired employees and their dependents. Substantially all of its regular full-time employees, including certain employees in foreign countries, may become eligible for those benefits if they reach retirement age while working for RJRN. RJRN has not yet adopted Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," which will be effective for years beginning after 1992 and will require the accrual of costs for retirees' health and other postretirement benefits other than pensions and the recognition of an unfunded and unrecognized accumulated benefit obligation for these benefits. However, in connection with the purchase cost allocation as of February 9, 1989, RJRN recorded an estimated present-valued obligation for these benefits, and accordingly, an accrual of approximately \$1.1 billion is reflected in RJRN's Consolidated Balance Sheet at December 31, 1990. Accretion of \$86 million and \$75 million with respect to this accrual was charged to operations for the year ended December 31, 1990 and the period February 9, 1989 through December 31, 1989, respectively. Claim payments, insurance premiums and other costs for retired employees and their dependents, which amounted to \$35 million and \$30 million for the year ended December 31, 1990 and the period February 9, 1989 through December 31, 1989, respectively, were charged to this accrual. The corresponding claim payments of \$30 million in 1988 were charged to operations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 17—Segment Information

Industry Segment Data

Holdings classifies its continuing operations into two industry segments which are described in Management's Discussion and Analysis of Financial Condition and Results of Operations, appearing elsewhere herein. Summarized financial information for these operations is shown in the following tables.

	Successor		Predecessor	
	Year Ended December 31, 1990	February 9, 1989 through December 31, 1989	January 1, 1989 through February 8, 1989	Year Ended December 31, 1988
Net sales:				
Tobacco	\$ 8,053	\$ 6,655	\$326	\$ 7,068
Food	5,826	5,459	324	5,567
Consolidated net sales	<u>\$13,879</u>	<u>\$12,114</u>	<u>\$650</u>	<u>\$12,635</u>
Operating income:				
Tobacco(1)	\$ 2,326	\$ 1,596	\$ 52	\$ 1,923
Food(1)	597	568	(25)	610
Corporate	(105)	(124)	(14)	(166)
Consolidated operating income	<u>\$ 2,818</u>	<u>\$ 2,040</u>	<u>\$ 13</u>	<u>\$ 2,367</u>
Capital expenditures:				
Tobacco	\$ 145	\$ 229	\$ 14	\$ 459
Food	253	254	17	316
Corporate	28	5	3	62
Consolidated capital expenditures	<u>\$ 426</u>	<u>\$ 488</u>	<u>\$ 34</u>	<u>\$ 837</u>
Depreciation expense:				
Tobacco	\$ 262	\$ 230	\$ 17	\$ 203
Food	178	169	14	163
Corporate	10	18	1	14
Consolidated depreciation expense	<u>\$ 450</u>	<u>\$ 417</u>	<u>\$ 32</u>	<u>\$ 380</u>
Assets:		December 31, 1990	December 31, 1989	
Tobacco		\$21,033	\$22,037	
Food		10,870	10,835	
Corporate(2)		1,012	1,240	
		<u>32,915</u>	<u>34,112</u>	
Net assets available for sale		—	2,300	
Consolidated assets		<u>\$32,915</u>	<u>\$36,412</u>	

- (1) Includes amortization of trademarks and goodwill for Tobacco and Food, respectively, for the year ended December 31, 1990, of \$403 million and \$205 million; for the period February 9, 1989 through December 31, 1989, of \$368 million and \$189 million; for the period January 1, 1989 through February 8, 1989, of \$0 and \$10 million and for the year ended December 31, 1988, of \$1 million and \$120 million.
- (2) All cash and cash equivalents are included in Corporate assets.

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Note 17—Segment Information—(Continued)

Geographic Data

The following tables show certain financial information relating to Holdings' continuing operations in various geographic areas.

	Successor		Predecessor	
	Year Ended December 31, 1990	February 9, 1989 through December 31, 1989	January 1, 1989 through February 8, 1989	Year Ended December 31, 1988
Net sales:				
United States (including U.S. export sales)	\$12,125	\$10,521	\$530	\$10,968
Canada	881	827	63	853
Europe	875	661	49	730
Other geographic areas	184	256	16	230
Less transfers between geographic areas(1)	(186)	(151)	(8)	(146)
Consolidated net sales	<u>\$13,879</u>	<u>\$12,114</u>	<u>\$650</u>	<u>\$12,635</u>
Operating income:				
United States	\$ 2,696	\$ 1,964	\$ 17	\$ 2,241
Canada	111	83	3	76
Europe	86	82	6	95
Other geographic areas	30	35	1	121
Corporate	(105)	(124)	(14)	(166)
Consolidated operating income(2)	<u>\$ 2,818</u>	<u>\$ 2,040</u>	<u>\$ 13</u>	<u>\$ 2,367</u>
		<u>December 31, 1990</u>	<u>December 31, 1989</u>	
Assets:				
United States		\$29,128	\$30,250	
Canada		1,183	1,366	
Europe		1,200	969	
Other geographic areas		392	287	
Corporate		1,012	1,240	
		<u>32,915</u>	<u>34,112</u>	
Net assets available for sale		—	2,300	
Consolidated assets		<u>\$32,915</u>	<u>\$36,412</u>	
Liabilities of Holdings' continuing operations located in foreign countries				
		<u>\$ 1,307</u>	<u>\$ 1,199</u>	

(1) Transfers between geographic areas (which consist principally of tobacco transferred principally from the United States to Europe) are generally made at fair market value.

(2) Includes amortization of trademarks and goodwill of \$608 million and \$557 million for the 1990 and 1989 Successor periods, respectively, and \$10 million and \$121 million for the 1989 and 1988 Predecessor periods, respectively.

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Note 18—Quarterly Results of Operations (Unaudited)

The following is a summary of the quarterly results of operations for Holdings (Successor) and RJRN (Predecessor) for the quarterly periods of 1990 and 1989:
(Dollars in Millions Except Per Share Amounts)

	Successor			
	First	Second	Third	Fourth
1990				
Net sales	\$3,204	\$3,459	\$3,529	\$3,687
Operating income	602	735	706	775
Income (loss) from continuing operations(1)	(222)	(108)	(194)	62
Net income (loss)(2)	(222)	(108)	(86)	(13)
Income (loss) from continuing operations per common share	(0.72)	(0.35)	(0.36)	0.02
Net income (loss) per common share	(0.72)	(0.35)	(0.16)	(0.10)
	Predecessor		Successor	
	January 1, 1989 through February 8, 1989	February 9, 1989 through March 31, 1989	Second	Third
			Fourth	
1989				
Net sales(3)	\$ 650	\$2,276	\$3,300	\$2,999
Operating income(3)	13	389	547	652
Income (loss) from continuing operations(4)	(197)	(54)	(341)	(442)
Net income (loss)	(173)	(66)	(319)	(144)
Income (loss) from continuing operations per common share	(0.89)	(0.18)	(1.13)	(1.46)
Net income (loss) per common share	(0.78)	(0.22)	(1.06)	(1.47)

- (1) The third quarter of 1990 includes \$75 million of advisory fees that were incurred in connection with the Recapitalization Program and the establishment of fixed interest rates on the Converting Debentures and Group Debentures.
- (2) In connection with the early extinguishments of debt of Holdings, Group and Capital pursuant to the Recapitalization Program, an extraordinary gain of \$108 million, net of income taxes, was recorded in the third quarter of 1990 and an extraordinary loss of \$75 million, net of income taxes, was recorded in the fourth quarter of 1990.
- (3) The third and fourth quarters of 1989 include the effects of the implementation of a plan to eliminate excess domestic trade inventories of tobacco products which reduced operating income by an estimated \$230 million in the third quarter of 1989 and \$130 million in the fourth quarter of 1989.
No gain or loss has been recognized for financial statement purposes in respect of the businesses divested post-Merger since the estimated net proceeds in such transactions reflect fair values of such businesses as of the date of Holdings' acquisition of RJRN.
- (4) Predecessor results for the period ended February 8, 1989 reflect a nonrecurring charge of \$247 million attributable to change in control costs in connection with the closing of the Offer on February 9, 1989.

Note 19—Subsequent Event

On March 2, 1991, Holdings accepted for exchange and payment approximately \$1.176 billion of principal amount of Group Debentures pursuant to the 1991 Exchange Offer. Pursuant to the terms of the 1991 Exchange Offer, Holdings is paying approximately \$547 million in cash and is issuing approximately 129.4 million shares of Holdings Common Stock in respect of the Group Debentures purchased in connection with the 1991 Exchange Offer.

SCHEDULE III

RJR NABISCO HOLDINGS CORP.

SCHEDULE III—CONDENSED FINANCIAL INFORMATION OF REGISTRANT
CONDENSED STATEMENTS OF INCOME AND RETAINED EARNINGS

(Dollars in Millions)

	Year Ended December 31, 1990	February 9, 1989 through December 31, 1989
Administrative expenses	\$ (11)	\$ —
Interest expense and amortization of debt issuance costs	(277)	(241)
Other income (expense), net	17	—
Income (loss) before income taxes	(271)	(241)
Provision (benefit) for income taxes	(92)	(82)
	(179)	(159)
Equity in income (loss) of subsidiary from operations of continuing businesses, net of income taxes	(283)	(816)
Income (loss) from continuing operations	(462)	(975)
Equity in income (loss) of subsidiary from operations of discontinued businesses, net of income taxes	—	(1)
Income (loss) before extraordinary item	(462)	(976)
Extraordinary item—gain on early extinguishments of debt, net of income taxes (including extraordinary gain of \$112 from subsidiary)	33	—
Net income (loss)	(429)	(976)
Less preferred stock dividends	50	—
Net income (loss) applicable to common stock	(479)	(976)
Retained earnings (accumulated deficit) at beginning of period	(976)	—
Add preferred stock dividends charged to paid-in capital	50	—
Retained earnings (accumulated deficit) at end of period	<u>\$ (1,405)</u>	<u>\$ (976)</u>

See Notes to Condensed Financial Information.

SCHEDULE III

RJR NABISCO HOLDINGS CORP.

SCHEDULE III—CONDENSED FINANCIAL INFORMATION OF REGISTRANT
 CONDENSED STATEMENTS OF CASH FLOWS
 (Dollars in Millions)

	Year Ended December 31, 1990	February 9, 1989 through December 31, 1989
Cash flows from (used in) operating activities:		
Net income (loss)	\$ (429)	\$ (976)
Adjustments to reconcile net income (loss) to net cash flows from (used in) operating activities:		
Deferred income tax provision	39	—
Non-cash interest expense and amortization of debt issuance costs	277	241
Extraordinary item—(gain) loss on early extinguishments of debt	22	—
Equity in (income) loss of subsidiary, net of income taxes	171	817
Other, net	(68)	(82)
Total adjustments	441	976
Net cash flows from (used in) operating activities	12	—
Cash flows from (used in) investing activities:		
Dividends received from subsidiary	800	—
Investment in subsidiary	(1,504)	(1,500)
Net cash flows from (used in) investing activities	(704)	(1,500)
Cash flows from (used in) financing activities (Note A):		
Repayments of long-term debt (including early extinguishments of debt in 1990)	(799)	—
Proceeds from issuance of common stock and warrants	1,701	1,757
Financing and advisory fees paid	(28)	(11)
Repurchase of and cancellation of common stock	(1)	—
Other, net—including intercompany transfers	36	(246)
Net cash flows from (used in) financing activities	909	1,500
Net change in cash and cash equivalents	217	—
Cash and cash equivalents at beginning of period	—	—
Cash and cash equivalents at end of period	<u>\$ 217</u>	<u>\$ —</u>

See Notes to Condensed Financial Information.

SCHEDULE III

RJR NABISCO HOLDINGS CORP.

SCHEDULE III—CONDENSED FINANCIAL INFORMATION OF REGISTRANT
CONDENSED BALANCE SHEETS

(Dollars in Millions)

	<u>December 31, 1990</u>	<u>December 31, 1989</u>
ASSETS		
Current assets:		
Cash and cash equivalents (including \$200 held as dividend reserve at December 31, 1990) (Note B)	\$ 217	\$ —
Accounts and notes receivable	<u>1</u>	<u>85</u>
Total current assets	<u>218</u>	<u>85</u>
Investment in subsidiary	4,582	3,166
Other assets and deferred charges	<u>59</u>	<u>10</u>
	<u><u>\$4,859</u></u>	<u><u>\$3,261</u></u>
 LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued accounts	<u>\$ 54</u>	<u>\$ 4</u>
Total current liabilities	<u>54</u>	<u>4</u>
Intercompany payable (receivable), net	55	(26)
Long-term debt (Note C)	351	1,806
Interest accrued	110	240
Commitments and contingencies (Note D)		
Redeemable convertible preferred stock—72,032,000 shares issued and outstanding	1,795	—
Common stockholders' equity:		
Common stock—580,023,513 and 308,090,813 shares issued and outstanding at December 31, 1990 and 1989, respectively	6	3
Paid-in capital	3,860	2,213
Cumulative translation adjustments	35	1
Retained earnings (accumulated deficit)	(1,405)	(976)
Unamortized value of restricted stock	<u>(2)</u>	<u>(4)</u>
Total common stockholders' equity	<u>2,494</u>	<u>1,237</u>
	<u><u>\$4,859</u></u>	<u><u>\$3,261</u></u>

See Notes to Condensed Financial Information.

RJR NABISCO HOLDINGS CORP.

SCHEDULE III — CONDENSED FINANCIAL INFORMATION OF REGISTRANT

NOTES TO CONDENSED FINANCIAL INFORMATION

Note A—Supplemental Cash Flows Information

On November 1, 1990, \$1.859 billion of the sum of principal of plus accrued and unpaid interest on the Converting Debentures and \$541 million of the sum of principal of plus accrued and unpaid interest on the Group Debentures were exchanged for an aggregate of approximately \$800 million in cash and approximately \$1.6 billion stated value of Holdings Preferred Stock (64,032,000 shares) pursuant to the 1990 Exchange Offers. On July 16, 1990, Holdings issued 8,000,000 unregistered shares of Holdings Preferred Stock (\$25 stated value per share) in exchange for \$200 million of the sum of principal of and accrued and unpaid interest on Capital's Partnership Debt Securities held by a partnership affiliated with KKR. On November 1, 1990, Holdings exchanged such shares in a share for share exchange for 8,000,000 registered shares of Preferred Stock. (See Note 11 to the Consolidated Financial Statements).

During 1989, Holdings issued Converting Debentures of \$2.257 billion (including \$452 million equity value) in exchange for RJRN (Predecessor) common stock in connection with the Merger (See Note 1 to the Consolidated Financial Statements).

Note B—Dividend Reserve

During 1990, Holdings set aside \$200 million of the \$1.7 billion cash proceeds received in connection with the purchase by a partnership affiliated with KKR of 272,000,000 shares of Common Stock to create a dividend reserve initially available to fund the 1991 cash dividend payments on the Preferred Stock. On January 15, 1991, Holdings paid the initial dividend on the Preferred Stock of approximately \$50 million with funds from the dividend reserve. Substantially all of the remaining funds in the dividend reserve were subsequently released in connection with the completion of the 1991 Exchange Offer.

Note C—Long-term Debt

See Note 11 to the Consolidated Financial Statements for information relating to the Converting Debentures.

Note D—Commitments and Contingencies

Holdings has guaranteed the indebtedness of Capital under the 1990 Credit Agreements, the 1989 Credit Agreement and the debentures. Holdings has also guaranteed the obligations of RJRN and its subsidiaries under the working capital agreement. The guarantees rank *pari passu* with the Converting Debentures and are secured by a pledge of the capital stock of Group owned by Holdings. For a discussion of certain restrictive covenants associated with these debt obligations, see Note 11 to the Consolidated Financial Statements.

For disclosure of additional contingent liabilities, see Note 12 to the Consolidated Financial Statements.

SCHEDULE III

RJR NABISCO HOLDINGS GROUP, INC.

SCHEDULE III—CONDENSED FINANCIAL INFORMATION OF REGISTRANT
CONDENSED STATEMENTS OF INCOME AND RETAINED EARNINGS

(Dollars in Millions)

	Year Ended December 31, 1990	February 9, 1989 through December 31, 1989
Interest expense and amortization of debt issuance costs	\$(607)	\$(539)
Other income (expense), net.....	(1)	—
Income (loss) before income taxes	(608)	(539)
Provision (benefit) for income taxes	(207)	(94)
	(401)	(445)
Equity in income (loss) of subsidiary from operations of continuing businesses, net of income taxes	118	(371)
Income (loss) from continuing operations	(283)	(816)
Equity in income (loss) of subsidiary from operations of discontinued businesses, net of income taxes	—	(1)
Income (loss) before extraordinary item	(283)	(817)
Extraordinary item—gain on early extinguishments of debt, net of income taxes (including extraordinary loss of \$28 from subsidiary)	112	—
Net income (loss)	(171)	(817)
Retained earnings (accumulated deficit) at beginning of period	(817)	—
Retained earnings (accumulated deficit) at end of period	<u>\$(988)</u>	<u>\$(817)</u>

See Notes to Condensed Financial Information.

SCHEDULE III

RJR NABISCO HOLDINGS GROUP, INC.

SCHEDULE III—CONDENSED FINANCIAL INFORMATION OF REGISTRANT
CONDENSED STATEMENTS OF CASH FLOWS

(Dollars in Millions)

	Year Ended December 31, 1990	February 9, 1989 through December 31, 1989
Cash flows from (used in) operating activities:		
Net income (loss)	\$ (171)	\$ (817)
Adjustments to reconcile net income (loss) to net cash flows from (used in) operating activities:		
Deferred income tax provision	82	37
Non-cash interest expense and amortization of debt issuance costs	607	539
Extraordinary item—(gain) loss on early extinguishments of debt	(204)	—
Equity in (income) loss of subsidiary, net of income taxes	(90)	372
Other, net	(224)	(131)
Total adjustments	<u>171</u>	<u>817</u>
Net cash flows from (used in) operating activities	<u>—</u>	<u>—</u>
Cash flows from (used in) investing activities:		
Dividends received from subsidiary	<u>800</u>	<u>(1,500)</u>
Net cash flows from (used in) investing activities	<u>800</u>	<u>(1,500)</u>
Cash flows from (used in) financing activities (Note A):		
Repayments of long-term debt (including early extinguishments of debt in 1990)	(1,504)	—
Financing and advisory fees paid	(22)	(25)
Capital contribution from parent	1,504	—
Dividends paid to parent	(800)	—
Other, net—including intercompany transfers	<u>22</u>	<u>1,525</u>
Net cash flows from (used in) financing activities	<u>(800)</u>	<u>1,500</u>
Net change in cash and cash equivalents	—	—
Cash and cash equivalents at beginning of period	<u>—</u>	<u>—</u>
Cash and cash equivalents at end of period	<u>\$ —</u>	<u>\$ —</u>

See Notes to Condensed Financial Information.

SCHEDULE III

RJR NABISCO HOLDINGS GROUP, INC.

SCHEDULE III—CONDENSED FINANCIAL INFORMATION OF REGISTRANT
CONDENSED BALANCE SHEETS

(Dollars in Millions)

	<u>December 31, 1990</u>	<u>December 31, 1989</u>
ASSETS		
Current assets:		
Accounts and notes receivable	\$ —	\$ 94
Total current assets	<u>—</u>	<u>94</u>
Intercompany receivable (payable), net	92	(25)
Investment in subsidiary	7,357	7,677
Other assets and deferred charges	78	23
	<u>\$7,527</u>	<u>\$7,769</u>
LIABILITIES AND STOCKHOLDER'S EQUITY		
Long-term debt (Note B)	\$2,864	\$4,500
Interest accrued	81	103
Commitments and contingencies (Note C)		
Common stockholder's equity:		
Common stock, 1,000 issued and outstanding shares	—	—
Paid-in capital	5,535	3,982
Cumulative translation adjustments	35	1
Retained earnings (accumulated deficit)	(988)	(817)
Total common stockholder's equity	<u>4,582</u>	<u>3,166</u>
	<u>\$7,527</u>	<u>\$7,769</u>

See Notes to Condensed Financial Information.

RJR NABISCO HOLDINGS GROUP, INC.**SCHEDULE III—CONDENSED FINANCIAL INFORMATION OF REGISTRANT
NOTES TO CONDENSED FINANCIAL INFORMATION****Note A—Supplemental Cash Flows Information**

On November 1, 1990, \$1.859 billion of the sum of principal of plus accrued and unpaid interest on the Converting Debentures and \$541 million of the sum of principal of plus accrued and unpaid interest on the Group Debentures were exchanged for an aggregate of approximately \$800 million in cash and approximately \$1.6 billion stated value of Holdings Preferred Stock (64,032,000 shares) pursuant to the 1990 Exchange Offers. On July 16, 1990, Holdings issued 8,000,000 unregistered shares of Preferred Stock (\$25 stated value per share) in exchange for \$200 million of the sum of principal of and accrued and unpaid interest on Capital's Partnership Debt Securities held by a partnership affiliated with KKR. On November 1, 1990, Holdings exchanged such shares in a share for share exchange for 8,000,000 registered shares of Preferred Stock. (See Note 11 to the Consolidated Financial Statements.)

During 1989, Group issued \$4.065 billion stated value of cumulative exchangeable preferred stock in exchange for RJRN (Predecessor) common stock in connection with the Merger (See Note 1 in the Consolidated Financial Statements.) The shares of cumulative exchangeable preferred stock were subsequently exchanged for \$4.065 billion aggregate principal amount of Group Debentures. In addition, during 1990 and 1989, Group issued \$557 million and \$435 million, respectively, of additional Group Debentures in lieu of cash interest to the holders of such debentures.

Note B—Long-term Debt

See Note 11 to the Consolidated Financial Statements for details of the Group Debentures.

Note C—Commitments and Contingencies

Group has guaranteed the indebtedness of Capital under the 1990 Credit Agreement, the 1989 Credit Agreement and the debentures. Group has also guaranteed the obligations of RJRN and its subsidiaries under the working capital agreement. The guarantees rank senior to the Group Debentures and are secured by a pledge of the capital stock of Capital owned by Group. For a discussion of certain restrictive covenants associated with these debt obligations, see Note 11 to the Consolidated Financial Statements.

For disclosure of additional contingent liabilities, see Note 12 to the Consolidated Financial Statements.

SCHEDULE V

RJR NABISCO HOLDINGS CORP.
RJR NABISCO HOLDINGS GROUP, INC.
RJR NABISCO CAPITAL CORP.
RJR NABISCO, INC.

SCHEDULE V—PROPERTY, PLANT AND EQUIPMENT
For the Year Ended December 31, 1990 and
the Period February 9, 1989 through December 31, 1989
(Dollars in Millions)

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at Beginning of Period	Additions at Cost	Retirements	Other Changes Add (Deduct)	Balance at End of Period
Year ended December 31, 1990:					
Land and land improvements..	\$ 266	\$ 1	\$ (4)	\$ 1	\$ 264
Buildings and leasehold improvements	1,550	20	(25)	59	1,604
Machinery and equipment	3,162	65	(150)	433	3,510
Construction-in-process	458	340	(24)	(371)	403
	<u>\$ 5,436</u>	<u>\$426</u>	<u>\$(203)</u>	<u>\$ 122 (A)</u>	<u>\$5,781</u>
Period February 9, 1989 through December 31, 1989:					
Land and land improvements..	\$ 264	\$ 2	\$ (3)	\$ 3	\$ 266
Buildings and leasehold improvements	1,533	16	(17)	18	1,550
Machinery and equipment	2,891	101	(190)	360	3,162
Construction-in-process	630	369	(4)	(537)	458
	<u>\$ 5,318 (B)</u>	<u>\$488</u>	<u>\$(214)</u>	<u>\$(156)(C)</u>	<u>\$5,436</u>

(A) Includes balances of the Nabisco International businesses at December 31, 1990 which were previously classified as "Net assets available for sale", reclassifications and miscellaneous adjustments.

(B) The balance at beginning of period reflects the fair value amount developed in the final allocation of the purchase cost incurred by Holdings for the acquisition of RJRN on February 9, 1989.

(C) Includes divestments (\$75), reclassifications and miscellaneous adjustments.

Property, plant and equipment are depreciated principally by the straight-line method. Annual depreciation rates for new assets range principally from 4% to 8% for land improvements; 2% to 33% for buildings and leasehold improvements; and 5% to 33% for machinery and equipment. Correspondingly higher depreciation rates are applicable with respect to assets in service at the acquisition date, since these assets had been used by Predecessor.

SCHEDULE VI

RJR NABISCO HOLDINGS CORP.
RJR NABISCO HOLDINGS GROUP, INC.
RJR NABISCO CAPITAL CORP.
RJR NABISCO, INC.

SCHEDULE VI—ACCUMULATED DEPRECIATION, DEPLETION, AND AMORTIZATION
OF PROPERTY, PLANT AND EQUIPMENT

For the Year Ended December 31, 1990 and
the Period February 9, 1989 through December 31, 1989
(Dollars in Millions)

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Retirements	Other Changes Add (Deduct)	Balance at End of Period
Year ended December 31, 1990:					
Land and land improvements	\$ 4	\$ 5	\$ —	\$ 1	\$ 10
Buildings and leasehold improvements	60	67	(5)	20	142
Machinery and equipment	353	378	(42)	74	763
	<u>\$ 417</u>	<u>\$ 450</u>	<u>\$(47)</u>	<u>\$ 95(A)</u>	<u>\$ 915</u>
Period February 9, 1989 through December 31, 1989:					
Land and land improvements	\$ —	\$ 4	\$ —	\$ —	\$ 4
Buildings and leasehold improvements	—	61	(1)	—	60
Machinery and equipment	—	352	(10)	11	353
	<u>\$ —</u>	<u>\$ 417</u>	<u>\$(11)</u>	<u>\$ 11</u>	<u>\$ 417</u>

(A) Includes balances of the Nabisco International businesses at December 31, 1990 which were previously classified as "Net assets available for sale".

SCHEDULE VIII

RJR NABISCO HOLDINGS CORP.
RJR NABISCO HOLDINGS GROUP, INC.
RJR NABISCO CAPITAL CORP.
RJR NABISCO, INC.

SCHEDULE VIII—VALUATION AND QUALIFYING ACCOUNTS
For the Year Ended December 31, 1990 and
the Period February 9, 1989 through December 31, 1989
(Dollars in Millions)

Column A	Column B	Column C		Column D	Column E
Description	Balance at Beginning of Period	Additions		Deductions (B)	Balance at End of Period
		(1) Charged to Costs and Expenses	(2) Charged to Other Accounts (A)		
Those valuation and qualifying accounts which are deducted in the balance sheet from the assets to which they apply:					
Year ended December 31, 1990:					
For discounts and doubtful accounts	\$58	\$44	\$10	\$(42)	\$ 70
Other assets	<u>25</u>	<u>22</u>	<u>1</u>	<u>(17)</u>	<u>31</u>
	<u>\$83</u>	<u>\$66</u>	<u>\$11</u>	<u>\$(59)</u>	<u>\$101</u>
Period February 9, 1989 through December 31, 1989:					
For discounts and doubtful accounts	\$67	\$12	\$(5)	\$(16)	\$ 58
Other assets	<u>18</u>	<u>19</u>	<u>1</u>	<u>(13)</u>	<u>25</u>
	<u>\$85(C)</u>	<u>\$31</u>	<u>\$(4)</u>	<u>\$(29)</u>	<u>\$ 83</u>

(A) Miscellaneous adjustments.

(B) Principally charges against the accounts.

(C) The balance at beginning of period reflects the fair value amount developed in the final allocation of the purchase cost incurred by Holdings for the acquisition of RJRN on February 9, 1989.

SCHEDULE IX

RJR NABISCO HOLDINGS CORP.
RJR NABISCO HOLDINGS GROUP, INC.
RJR NABISCO CAPITAL CORP.
RJR NABISCO, INC.

SCHEDULE IX—SHORT-TERM BORROWINGS
For the Year Ended December 31, 1990 and
the Period February 9, 1989 through December 31, 1989
(Dollars in Millions)

Column A	Column B	Column C	Column D	Column E	Column F
Category of Aggregate Short-term Borrowings	Balance at End of Period(A)	Weighted Average Interest Rate	Maximum Amount Outstanding During the Period	Average Amount Outstanding During the Period(B)	Weighted Average Interest Rate During the Period(C)
Year ended December 31, 1990:					
Banks	\$287	11.63%	\$ 889	\$285	17.53%
Commercial paper holders(D)	8	12.31%	59	27	14.42%
Period February 9, 1989 through December 31, 1989:					
Banks	\$142	10.38%	\$1,577	\$520	17.19%
Commercial paper holders(D)	39	12.09%	43	24	12.35%

(A) Varying maturity dates with no provision for extension at maturity.

(B) Primarily daily average balance of total short-term debt.

(C) Short-term interest expense as a percentage of the average balance of interest bearing short-term debt. High interest rates reflect nominal borrowing rates in high inflationary countries, primarily Latin America.

(D) Commercial paper interest rates reflect nominal Canadian borrowing costs.

SCHEDULE X

RJR NABISCO HOLDINGS CORP.
RJR NABISCO HOLDINGS GROUP, INC.
RJR NABISCO CAPITAL CORP.
RJR NABISCO, INC.

SCHEDULE X—SUPPLEMENTARY INCOME STATEMENT INFORMATION
For the Year Ended December 31, 1990 and
the Period February 9, 1989 through December 31, 1989
(Dollars in Millions)

Column A	Column B	
Item	Charged to Costs and Expenses	
	1990	1989
Maintenance and repairs.....	<u>\$280</u>	<u>\$253</u>
Advertising costs.....	<u>\$668</u>	<u>\$614</u>
Amortization of trademarks.....	<u>\$250</u>	<u>\$229</u>
Amortization of goodwill.....	<u>\$358</u>	<u>\$328</u>

SCHEDULE V

RJR NABISCO, INC. AND SUBSIDIARIES
SCHEDULE V—PROPERTY, PLANT AND EQUIPMENT
For the Period January 1, 1989 through February 8, 1989
(Dollars in Millions)

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at Beginning of Period	Additions at Cost	Retirements	Other Changes Add (Deduct)	Balance at End of Period
Land and land improvements	\$ 190	\$—	\$—	\$(1)	\$ 189
Buildings and leasehold improvements	1,432	1	—	6	1,439
Machinery and equipment	4,394	7	(1)	(5)	4,395
Construction-in-process	<u>674</u>	<u>26</u>	<u>—</u>	<u>(7)</u>	<u>693</u>
	<u>\$6,690</u>	<u>\$34</u>	<u>\$(1)</u>	<u>\$(7)</u>	<u>\$6,716</u>

Property, plant and equipment are depreciated principally by the straight-line method. Annual depreciation rates range principally from 5% to 10% for land improvements; 2% to 10% for buildings and leasehold improvements; and 5% to 33% for machinery and equipment.

SCHEDULE VI

RJR NABISCO, INC. AND SUBSIDIARIES

SCHEDULE VI—ACCUMULATED DEPRECIATION, DEPLETION, AND AMORTIZATION
OF PROPERTY, PLANT AND EQUIPMENT

For the Period January 1, 1989 through February 8, 1989
(Dollars in Millions)

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Retirements	Other Changes Add (Deduct)	Balance at End of Period
Land and land improvements	\$ 20	\$—	\$—	\$ (1)	\$ 19
Buildings and leasehold improvements	306	5	—	72	383
Machinery and equipment	<u>1,427</u>	<u>27</u>	<u>—</u>	<u>(79)</u>	<u>1,375</u>
	<u>\$1,753</u>	<u>\$32</u>	<u>\$—</u>	<u>\$ (8)(A)</u>	<u>\$1,777</u>

(A) Reclassifications and miscellaneous adjustments.

SCHEDULE VIII

RJR NABISCO, INC. AND SUBSIDIARIES
SCHEDULE VIII—VALUATION AND QUALIFYING ACCOUNTS
For the Period January 1, 1989 through February 8, 1989
(Dollars in Millions)

Column A	Column B	Column C		Column D	Column E
Description	Balance at Beginning of Period	Additions		Deductions (B)	Balance at End of Period
		(1) Charged to Costs and Expenses	(2) Charged to Other Accounts (A)		
Those valuation and qualifying accounts which are deducted in the balance sheet from the assets to which they apply:					
For discounts and doubtful accounts . . .	\$ 66	\$—	\$ 1	\$ —	\$ 67
Other assets	<u>439</u>	<u>11</u>	<u>—</u>	<u>(43)</u>	<u>407</u>
	<u>\$505</u>	<u>\$11</u>	<u>\$ 1</u>	<u>\$ (43)</u>	<u>\$474</u>

- (A) Miscellaneous adjustments.
(B) Principally charges against the accounts.

SCHEDULE IX

RJR NABISCO, INC. AND SUBSIDIARIES
SCHEDULE IX—SHORT-TERM BORROWINGS
For the Period January 1, 1989 through February 8, 1989
(Dollars in Millions)

Column A	Column B	Column C	Column D	Column E	Column F
Category of Aggregate Short-term Borrowings	Balance at End of Period (A)	Weighted Average Interest Rate	Maximum Amount Outstanding During the Period	Average Amount Outstanding During the Period (B)	Weighted Average Interest Rate During the Period (C)
Banks	\$431	10.67%	\$466	\$326	9.59%

(A) Varying maturity dates with no provision for extension at maturity.

(B) Primarily daily average balance of total short-term debt.

(C) Short-term interest expense as a percentage of the average balance of interest bearing short-term debt.

SCHEDULE X

RJR NABISCO, INC. AND SUBSIDIARIES
SCHEDULE X—SUPPLEMENTARY INCOME STATEMENT INFORMATION
For the Period January 1, 1989 through February 8, 1989
(Dollars in Millions)

Column A	Column B
Item	Charged to Costs and Expenses
Maintenance and repairs	<u>\$15</u>
Advertising costs	<u>\$43</u>

SCHEDULE V

RJR NABISCO, INC. AND SUBSIDIARIES
SCHEDULE V—PROPERTY, PLANT AND EQUIPMENT
Year Ended December 31, 1988
(Dollars in Millions)

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at Beginning of Period	Additions at Cost	Retirements	Other Changes Add (Deduct)	Balance at End of Period
Year ended December 31, 1988:					
Land and land improvements . . .	\$ 177	\$ 5	\$ (1)	\$ 9	\$ 190
Buildings and leasehold improvements	1,288	37	(13)	120	1,432
Machinery and equipment	4,077	141	(129)	305	4,394
Construction-in-process	499	654	1	(480)	674
	<u>\$6,041</u>	<u>\$ 837</u>	<u>\$(142)</u>	<u>\$ (46)(A)</u>	<u>\$6,690</u>

(A) Includes effects of divestments of (\$40), reclassifications and miscellaneous adjustments.

Property, plant and equipment are depreciated principally by the straight-line method. Annual depreciation rates range principally from 5% to 10% for land improvements; 2% to 10% for buildings and leasehold improvements; and 5% to 33% for machinery and equipment.

SCHEDULE VI

RJR NABISCO, INC. AND SUBSIDIARIES

SCHEDULE VI—ACCUMULATED DEPRECIATION, DEPLETION, AND AMORTIZATION
OF PROPERTY, PLANT AND EQUIPMENT

Year Ended December 31, 1988

(Dollars in Millions)

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Retirements	Other Changes Add (Deduct)	Balance at End of Period
Year ended December 31, 1988:					
Land and land improvements . . .	\$ 18	\$ 4	\$ (5)	\$ 3	\$ 20
Buildings and leasehold improvements	233	50	(9)	32	306
Machinery and equipment	<u>1,099</u>	<u>326</u>	<u>(77)</u>	<u>79</u>	<u>1,427</u>
	<u>\$1,350</u>	<u>\$380</u>	<u>\$(91)</u>	<u>\$114 (A)</u>	<u>\$1,753</u>

(A) Includes effects of divestments of (\$21), reclassifications of prior reserves of \$10 for buildings and leasehold improvements and \$77 for machinery and equipment and miscellaneous adjustments.

SCHEDULE VIII

RJR NABISCO, INC. AND SUBSIDIARIES
 SCHEDULE VIII—VALUATION AND QUALIFYING ACCOUNTS
 Year Ended December 31, 1988
 (Dollars in Millions)

Column A	Column B	Column C		Column D	Column E
Description	Balance at Beginning of Period	Additions		Deductions (B)	Balance at End of Period
		(1) Charged to Costs and Expenses	(2) Charged to Other Accounts (A)		
Year ended December 31, 1988:					
Those valuation and qualifying accounts which are deducted in the balance sheet from the assets to which they apply:					
For discounts and doubtful accounts . . .	\$ 45	\$ 21	\$ 5	\$ (5)	\$ 66
Other assets	<u>319</u>	<u>135</u>	<u>16</u>	<u>(31)</u>	<u>439</u>
	<u>\$364</u>	<u>\$156</u>	<u>\$21</u>	<u>\$(36)</u>	<u>\$505</u>

- (A) Miscellaneous adjustments.
 (B) Principally charges against the accounts.

SCHEDULE IX

RJR NABISCO, INC. AND SUBSIDIARIES
SCHEDULE IX—SHORT-TERM BORROWINGS
Year Ended December 31, 1988
(Dollars in Millions)

Column A	Column B	Column C	Column D	Column E	Column F
Category of Aggregate Short-term Borrowings	Balance at End of Period(A)	Weighted Average Interest Rate	Maximum Amount Outstanding During the Period	Average Amount Outstanding During the Period(B)	Weighted Average Interest Rate During the Period(C)
Year ended December 31, 1988:					
Banks	\$291	12.83%	\$291	\$ 87	84.65%(D)
Commercial paper holders	—	—	263	54	8.11%

- (A) Varying maturity dates with no provision for extension at maturity.
- (B) Primarily daily average balance of total short-term debt.
- (C) Short-term interest expense as a percentage of the average balance of interest bearing short-term debt.
- (D) Higher weighted average interest rate is principally due to Brazilian borrowings.

SCHEDULE X

RJR NABISCO, INC. AND SUBSIDIARIES
SCHEDULE X—SUPPLEMENTARY INCOME STATEMENT INFORMATION
Year Ended December 31, 1988
(Dollars in Millions)

Column A	Column B
Item	Charged to Costs and Expenses
Maintenance and repairs	<u>1988</u>
Advertising costs	<u>\$278</u>
	<u>\$660</u>

RJR NABISCO, INC.
COMPUTATIONS OF EARNINGS PER SHARE
(Dollars in Millions Except Per Share Amounts)

	<u>Predecessor</u>	
	<u>January 1, 1989 through February 8, 1989</u>	<u>Year Ended December 31, 1988</u>
Average number of common shares outstanding before adjustments (in thousands)	225,545	232,538
Add: Common shares that would be issued assuming that all stock options without SARs outstanding during the year were converted into common stock using the treasury stock method (in thousands)	—	832
Less: Unearned portion of restricted stock which was issued on the grant date (in thousands)	—	(783)
Average common shares outstanding assuming full dilution (in thousands)	<u>225,545</u>	<u>232,587</u>
Income (loss) from continuing operations	\$ (197)	\$ 1,171
Less preferred dividends	<u>(4)</u>	<u>(15)</u>
Income (loss) from continuing operations applicable to common stock	<u>\$ (201)</u>	<u>\$ 1,156</u>
Income (loss) from continuing operations per common share .	<u>\$ (0.89)</u>	<u>\$ 4.97</u>
Net income (loss) applicable to common stock	<u>\$ (177)</u>	<u>\$ 1,378</u>
Net income (loss) per common share	<u>\$ (0.78)</u>	<u>\$ 5.92</u>

The difference between primary income per share and fully diluted income per share is insignificant; therefore, primary income per share is not presented.

RJR NABISCO HOLDINGS CORP.
COMPUTATIONS OF EARNINGS PER SHARE
(Dollars in Millions Except Per Share Amounts)

	Year Ended December 31, 1990(A)		February 9, 1989 through December 31, 1989(A)	
	Primary	Fully Diluted	Primary	Fully Diluted
Average number of common and common equivalent shares outstanding during the period:				
Common stock issued and outstanding at beginning of period (in thousands)	308,091	308,091	300,000	300,000
Less: shares related to unamortized value of restricted stock	<u>(701)</u>	<u>(701)</u>	<u>—</u>	<u>—</u>
	307,390	307,390	300,000	300,000
Average number of shares of common stock issued during the period (including 272,000,000 shares issued July 16, 1990)	124,249	124,249	3,137	3,137
Average number of shares related to value of restricted stock earned during the period	179	179	563	563
Average number of stock warrants and options	—	51,158	—	39,475
Average shares issuable on conversion of redeemable convertible preferred stock	—	39,687	—	—
Average shares issuable on conversion of senior converting debentures	<u>—</u>	<u>113,171</u>	<u>—</u>	<u>130,611</u>
Average number of common and common equivalent shares outstanding during the period (in thousands)	<u>431,818</u>	<u>635,834</u>	<u>303,700</u>	<u>473,786</u>
Net income (loss) applicable to common stock:				
Income (loss) from continuing operations	\$ (462)	\$ (462)	\$ (975)	\$ (975)
Interest on senior converting debentures (net of income taxes)	—	182	—	158
Preferred stock dividends	<u>(50)</u>	<u>—</u>	<u>—</u>	<u>—</u>
Income (loss) from continuing operations applicable to common stock	(512)	(280)	(975)	(817)
Income (loss) from operations of discontinued businesses, net of income taxes	—	—	(1)	(1)
Extraordinary item—gain on early extinguishments of debt, net of income taxes	<u>33</u>	<u>33</u>	<u>—</u>	<u>—</u>
Net income (loss) applicable to common stock	<u>\$ (479)</u>	<u>\$ (247)</u>	<u>\$ (976)</u>	<u>\$ (818)</u>
Net income (loss) per common and common equivalent share:				
Continuing operations	\$ (1.19)	\$ (0.44)	\$ (3.21)	\$ (1.72)
Discontinued operations	—	—	—	(.01)
Extraordinary item	<u>0.08</u>	<u>0.05</u>	<u>—</u>	<u>—</u>
Net income (loss)	<u>\$ (1.11)</u>	<u>\$ (0.39)</u>	<u>\$ (3.21)</u>	<u>\$ (1.73)</u>

(A) The calculations of fully diluted earnings per share are antidilutive; therefore, primary earnings per share are used for financial statement purposes.