During 1993, the Company's largest customer substantially reduced the price of its premium brand cigarettes in order to regain market share which had been lost to generic or "no frills" type cigarettes. The generic cigarettes sold at a discount to premium brands and had captured a substantial share of the U.S. cigarette market. In addition, cigarette inventories at distributors were reduced by abandoning the practice of loading distributors with cigarettes at the end of each quarter. As a result of these actions, the Company sold less licorice extract to the cigarette industry in 1993 than in previous years. In 1994, the Company's sales volume to the cigarette industry increased as production volumes in the cigarette industry returned to pre 1993 levels. This trend continued in 1995 and 1996.

Year ended December 31, 1996 compared with the year ended December 31, 1995.

Net sales in 1996 and 1995 were $103.4 million and $103.2 million, respectively. U.S. sales increased $0.6 million in 1996 to $63.3 million. The increase is due to higher average selling prices in 1996 as compared to 1995 of $1.5 million, partially offset by decreased shipment volume of $0.9 million due to decreased demand from the Company's smokeless tobacco customers. The higher selling prices were a result of changes in the mix of licorice products sold to customers. Foreign sales in 1996 decreased by $0.4 million to $40.1 million in 1996. The decrease was due to lower average selling prices in 1996.

Cost of sales was $57.4 million in 1996 as compared to $60.0 million in 1995. The decrease of $2.6 million was due to lower material costs and a gain on an insurance claim of $0.5 million. As a percentage of net sales, cost of sales decreased to 55.5% in 1996 from 58.1% in 1995 as a result of the lower material costs and the insurance gain.

Selling, general and administrative ("SG&A") expenses were $9.4 million in 1996 and $9.2 million in 1995. The increase of $0.2 million resulted from higher compensation and pension benefit expenses in 1996 offset in part by a bad debt recovery of $0.8 million. As a percentage of net sales, SG&A expenses were 9.1% and 8.9% in 1996 and 1995, respectively.

As a result of the increased sales and lower costs and the non-recurring gains from the insurance claim and from the bad debt recovery in 1996, operating income increased to $36.6 million from $34.0 million in 1995, an increase of $2.6 million or 7.6%.

Interest expense was $12.5 million in 1996 and $13.5 million in 1995, a decrease of $1.0 million due to lower debt outstanding at lower average interest rates in 1996.

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The Company's 1996 provision for income taxes as a percentage of income before income taxes decreased to 37.7% in 1996 from 39.0% in 1995. The decrease relates primarily to a reduction in the valuation allowance which represents the Company's net operating loss carryforwards, which are expected to be utilized. Based upon the results of operations of the Company over the last several years and taking into consideration the current operating environment of the tobacco industry, the Company believes that it is more likely than not that these tax benefits will be realized. However, realization of the net deferred tax assets and future reversals of the valuation allowance will depend on future earnings and accordingly the valuation allowance will be evaluated on a periodic basis.

The Company recorded an extraordinary loss of $0.6 million, net of a $0.3 million tax benefit as a result of prepaying its Senior Term Loans in December 1996. Deferred debt issuance costs which were being amortized over the term of the loans were expensed as extraordinary.