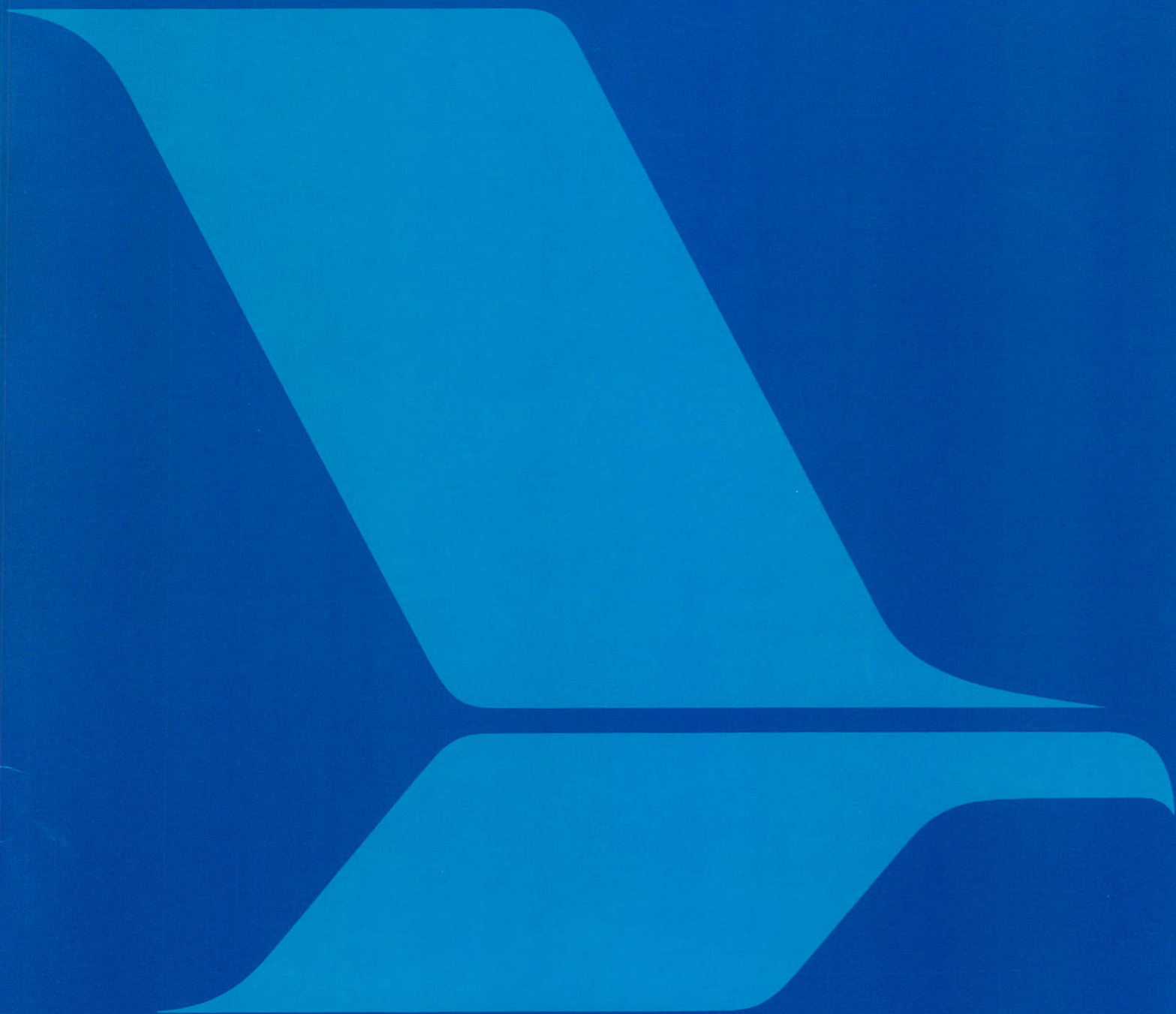


Brown Company 1977 Annual Report

2



Paper Products
Building Products

A Gulf+Western Company

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SUPPLEMENTAL INFORMATION

A copy of the Company's current annual report filed with the Securities and Exchange Commission on Form 10-K may be obtained free of charge by writing to the Treasurer, Brown Company, 251 South Lake Avenue, Pasadena, California 91101

Brown Company Highlights

Effective July 31, 1976, Brown Company changed its fiscal year-end from a year ending November 30 to a year ending July 31. In the following highlights, in the paper and building products group discussion and in the five year comparison appearing on page 18, prior years have been restated on an unaudited basis to reflect operating results for years ended July 31.

	1977	1976
Year ended July 31 (a):		
Net sales	\$453,828,000	\$430,210,000
Earnings before income taxes	8,447,000	27,227,000
Income tax provision	676,000	9,614,000
Net earnings	7,771,000	17,613,000
Net earnings per share	1.12	2.51
Dividends per share30	.225
Capital expenditures	31,164,000	27,279,000
At July 31:		
Working capital	\$ 90,768,000	\$ 74,844,000
Total assets	331,743,000	298,125,000
Long-term debt	111,562,000	93,889,000
Shareholders' equity	145,967,000	136,063,000
Shareholders' equity per share	20.41	20.20
Number of shareholders	5,100	5,300
Number of employees	8,900	8,600

(a) 1976 unaudited

Report to Shareholders

Sales for the year ended July 31, 1977 were \$453.8 million compared with \$430.2 million in the year ended July 31, 1976 and net earnings were \$7.8 million in 1977 compared with \$17.6 million in 1976. Net earnings per share were \$1.12 in 1977 and \$2.51 in 1976.

Fiscal 1977 was not a good year for Brown Company. Although results of operations of the Building Products Group were at record levels, Paper Products Group results, which account for about 80 percent of total sales, declined substantially.

Operating income from paper products was \$7.2 million in 1977 compared with \$26.7 million in 1976. Brown Company makes and sells hardwood pulp and a substantial quantity of other commodity-grade paper products such as printing and writing papers. The lower operating results were caused mainly by weak markets for these products accompanied by rising operating costs that could not be offset by price increases.

A substitute for virgin pulp is made at our recycled pulp mill in Kalamazoo, Michigan and is used by Brown in the manufacture of certain specialty papers. Production at this facility was suspended during the last quarter of fiscal 1977 because of unfavorable market conditions. Pulp production will resume when market conditions improve.

Brown Company is continuing to study ways and taking action to improve the profitability of its paper operations. Several things were done in 1977. An unprofitable fine papers line of business was sold. A new plastic cup plant was completed to penetrate this fastest-growing segment of the disposable cup market and to expand Brown's line of food service disposables. A small Ladysmith, Wisconsin paper mill was acquired to increase capacity to produce towels and tissues. A Pennsylvania business that manufactures parchment paper was leased which upgrades certain commodity-type paper production to a higher margin waterleaf paper used to make parchment.

We are continuing to improve the productivity and efficiency of our manufacturing facilities. Recent improvements include new printing presses at our folding carton operations, paper machine rebuilds, and the addition of a process control computer to a paper machine in Berlin, New Hampshire.

During the year, \$5.2 million of pollution control revenue bonds were sold to finance the cost of pollution control at our Michigan specialty papers operation. Since 1973, more than \$35 million of bonds have been sold to finance pollution control costs and by the end of fiscal 1977 Brown had completed

substantially all of the projects required to meet current pollution control requirements. Wastewater treatment facilities are now operating at Berlin and Gorham, New Hampshire; Eau Claire, Wisconsin; and Kalamazoo, Michigan and are making a major contribution toward a cleaner environment.

Hardwood pulp and uncoated printing and writing papers are major Brown Company products. The market for these commodity-grade products has been depressed. Although there should be some improvement in Brown's paper operations in fiscal 1978, any significant change will depend largely upon market conditions for hardwood pulp and uncoated printing and writing papers.

Operating income from building products rose to \$8.3 million in 1977 from \$5.3 million in 1976 reflecting strong gains in construction activity, especially in the last quarter of the year when commercial and industrial building awards rose significantly. Although most of Brown's building products are used in non-residential construction, a significant part of our Southern California rock, sand and gravel business is derived from the residential market. The California residential construction market experienced unusual growth during the year.

Steps were taken in 1977 to improve Brown's

building products business. Overseas markets for concrete forming equipment were expanded to increase foreign sales. New lightweight aluminum and fiber glass forming systems were developed to broaden product lines. Our ability to serve customers was enhanced by opening two new stores to distribute products manufactured by others, such as concrete finishing machines and sealants that are used by contractors who buy Brown's forming systems.

Construction activity is expected to remain strong during the coming year, especially non-residential construction which showed considerable strength in recent months. Brown's Building Products Group should have another good year in 1978.

In January 1977, Gulf + Western Industries, Inc. exercised warrants to purchase 368,529 shares of Brown Company common stock at a price of \$10.43 per share. This increased Gulf + Western's ownership of Brown to 81 percent from 80 percent and provided Brown with \$3.8 million of additional capital.



Merrill L. Nash
Chairman of the Board and President

September 13, 1977

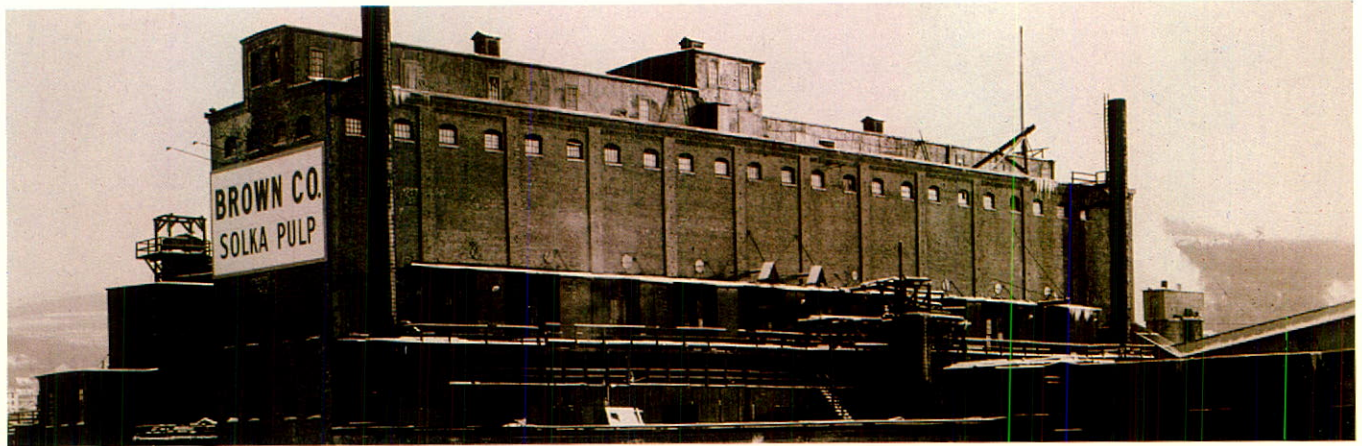


Brown Company Paper Products Group

Operations of the Paper Products Group include the manufacture and sale of pulp, a variety of papers, towels and tissues, food service disposables, paperboard and paperboard products, packaging materials and book matches. Manufacturing facilities include a pulp and paper mill in Berlin, New Hampshire, paper and paperboard mills and folding carton operations in Kalamazoo and Parchment, Michigan and Castleton-on-Hudson, New York, towel and tissue mills in Eau Claire and Ladysmith, Wisconsin, match plants in Chicago, Illinois and San Jose, California and a paper mill in Holyoke, Massachusetts. Results of operations for the Paper Products Group for the past five years are summarized below:

	Years Ended July 31				
	1977	1976(a)	1975(a)	1974(a)	1973(a)
Sales (millions):					
Pulp, paper and paperboard	\$193.4	\$193.8	\$173.8	\$179.4	\$131.1
Towels, tissues and food service disposables	107.2	95.6	91.5	80.9	36.4
Folding cartons	55.4	53.1	51.3	44.7	39.6
Matches	9.3	9.5	9.0	8.7	8.5
Total	<u>\$365.3</u>	<u>\$352.0</u>	<u>\$325.6</u>	<u>\$313.7</u>	<u>\$215.6</u>
Operating income (millions)	\$ 7.2	\$ 26.7	\$ 28.4	\$ 29.1	\$ 11.3
Pulp produced (1,000's of tons)	283.4	242.1	206.4	248.5	244.3
Paper produced (1,000's of tons)	354.7	346.3	310.8	399.4	322.1
Paperboard produced (1,000's of tons)	149.1	137.4	114.6	131.2	132.0
Corrugating medium produced (1,000's of tons)	89.6	82.5	71.1	92.5	89.9

(a) Unaudited



Founded over 120 years ago, Brown Company began as a lumber company. The Company later became the first to process and produce hardwood pulps and kraft toweling, and was one of the earliest producers of groundwood and bleached and unbleached pulps. The Company has been responsible for many industry firsts, such as the SOLKA-FLOC® line of pulverized cellulose, which is used in such varied products as welding rods and foods.

More than 700 tons per day of pulp are produced at Brown's Berlin, New Hampshire mill which is served by 800,000 acres of New England timberlands owned or controlled by the Company. Pulp is made from northern trees featuring birch, maple, beech, spruce and fir.





In 1920, Brown Company formed the Absorbent Products Division to manufacture and market industrial sanitary paper products. Over the years the Division became a sales and technological leader in both industrial and consumer paper products.

Among its industry firsts, the Division developed the first control type cabinet and the wet-strength ingredient for paper towels that allows users to wipe their hands thoroughly without the towel disintegrating. In recognition of his many outstanding achievements, the Absorbent Products Division honored William E. Corbin, mill superintendent, by choosing as its trademark the word NIBROC® – Corbin spelled backwards – which it uses to this day.



As its industrial paper products sales grew, the Absorbent Products Division began expanding its manufacturing base to increase its viability as a principal manufacturer and supplier of sanitary paper products. In 1973, Sterling Pulp and Paper Company of Eau Claire, Wisconsin was acquired. In addition to increasing Brown's paper making capacity, this move put the Division into the consumer absorbent products business.



Brown Company, through its predecessor, Sutherland Paper Company, has been a leading supplier of recycled paperboard and folding cartons since the 1920's. Today it is one of the world's largest manufacturers of ice cream cartons. The Company introduced many innovations to ice cream packaging including the use of common inks and combination printing, the first sealed package, and a library of stock designs for customers.

Brown has the capacity to produce more than 150,000 tons of recycled paperboard a year at its plants in Kalamazoo, Michigan and Castleton-on-Hudson, New York. Wastepaper from the Company's carton plants and recycling center in Kalamazoo and from other industrial plants and offices is used to manufacture this product.

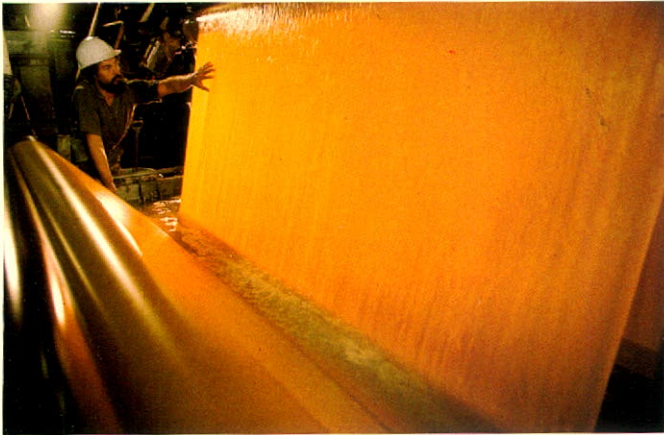
Because of its broad range of paperboard grades, Brown Company can provide packaging for a wide variety of products. These include ice cream, meat, frozen foods, candy, cereal, cake mixes, pet food, toys, hardware, soap, tobacco and medicinal products.



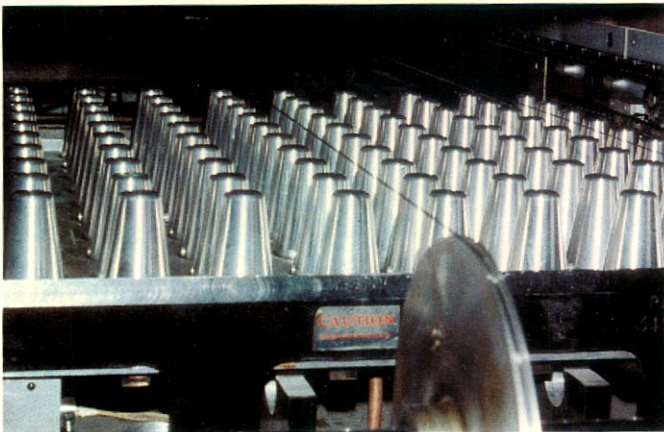


Brown Company is a leading supplier of special lines of publishing and communications papers (upper left) that provide unique opacified lightweight and customized characteristics.

As the world's largest supplier of genuine vegetable parchment, Brown Company manufactures (center) industrial papers for the building trades, automotive and garment industries. It also markets parchment papers for synthetic yarn, pressure-sensitive labels, greeting cards and the printing industry.



A full line of PAPER MAID® plastic cups is produced (lower left) at a new facility in Kalamazoo. These plastic cups are used in kitchens and bathrooms in many households across the country.







Brown's PAPER MAID® products include a line of coffee filters for all brands and styles of home coffee brewing machines. Other products sold by Brown Company under the PAPER MAID® brand name include FREEZER WRAP, a specially treated paper that helps prevent freezer burn. PAPER MAID® baking cups, pan liners and plastic cups are well established in the home-use market.



The mass feeding industry — from school lunch rooms to large institutions, from corner pizza parlors to fast-food chains — depends in part on specially treated papers to preserve the freshness and appeal of ready-to-eat products. Brown Company provides the industry with an extensive line of food trays, pails, plastic cups, carry-out containers, hot dog trays and dry waxed papers.



A wide variety of book matches used for promotion and advertising are marketed through independent agents and jobbers. They are produced in Chicago, Illinois and San Jose, California and are sold under the well-known SUPERIOR and MONARCH brand names. Among the users of this advertising medium are restaurants, cocktail lounges, banks, beauty shops, insurance agencies, clubs and fraternal organizations.



Brown Company Building Products Group

Operations of the Building Products Group are all related to concrete construction and include the mining and processing of rock, sand and gravel, and the manufacture of reusable forms and accessory items used in concrete construction. The Livingston-Graham Division mines and processes rock, sand and gravel into aggregate, and manufactures and distributes transit mixed concrete in Southern California. Most of the group's concrete forming equipment and accessories are manufactured and sold by Symons Corporation, a subsidiary of Brown Company with manufacturing plants in Chicago and Centralia, Illinois and New Braunfels, Texas and with distribution centers located throughout the United States. Accessory items for concrete construction are also manufactured and sold by Brown's subsidiary, Richmond Screw Anchor Company, whose major facilities are located in Fort Worth, Texas and Tremont, Pennsylvania. Results of operations for the Building Products Group for the past five years are summarized below.

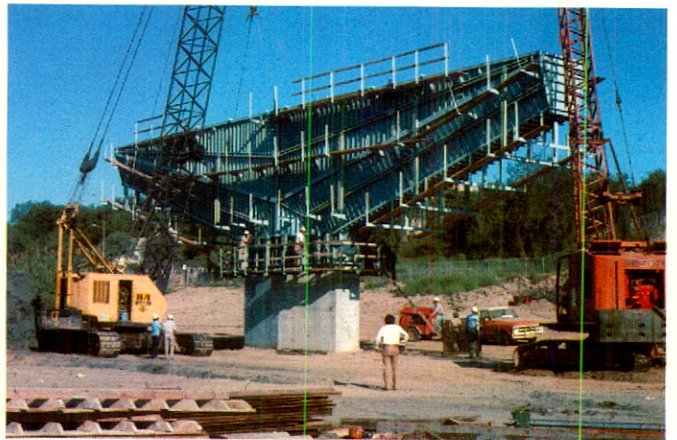
	Years Ended July 31				
	1977	1976(a)	1975(a)	1974(a)	1973(a)
Sales (millions):					
Rock, sand, gravel and transit mixed concrete	\$41.7	\$34.1	\$30.1	\$30.8	\$31.0
Concrete forming equipment and related services ..	46.8	44.1	54.9	60.1	41.2
Total	\$88.5	\$78.2	\$85.0	\$90.9	\$72.2
Operating income (millions)	\$ 8.3	\$ 5.3	\$ 6.3	\$ 3.8	\$ 5.1
Rock, sand and gravel produced (1,000's of tons)	6,110	5,720	5,856	6,574	6,621

(a) Unaudited

Started in 1901, when Arthur Henley Symons developed an adjustable steel column clamp in his small machine shop in Kansas City, Kansas, Brown's subsidiary, Symons Corporation, is today a leading manufacturer of reusable concrete forming equipment used in the construction of office buildings, bridges, hotels, atomic power plants, pollution control facilities and other industrial and residential structures.

The construction industry is finding wider use for fiberglass concrete forms (center). These products are lightweight, easily handled, and produce a smooth concrete finish all of which are advantageous to contractors. Symons produces fiberglass forms for building columns, piers, beams, waffle slabs, floors, joists and other structures.

Bridges, tunnels, dams and many industrial structures require strong and durable concrete construction forms. Many construction requirements are unique and custom-designed forms are often needed. Steel forms made by Symons meet these requirements.





Brown's Livingston-Graham Division, a prominent name in Southern California's construction industry, is a principal supplier of rock, sand, gravel and ready-mixed concrete. Founded approximately 60 years ago, Livingston was acquired by Brown Company in 1970.

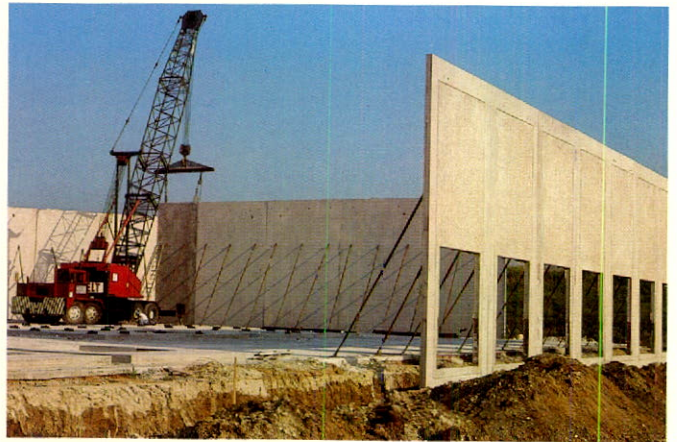
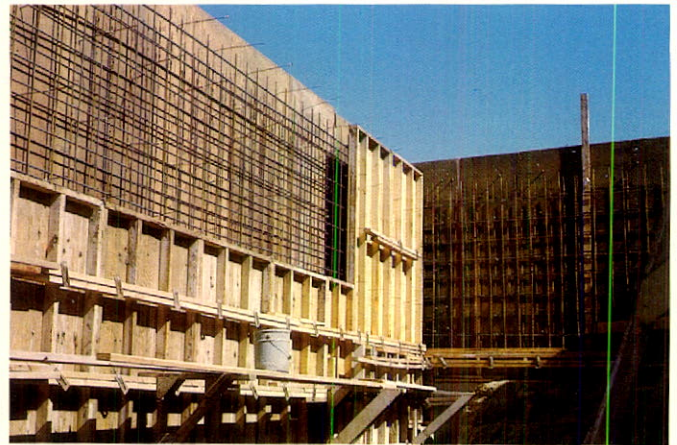
Five aggregate producing plants and 13 concrete batching plants service general contractors and concrete sub-contractors engaged in construction projects ranging from highways, freeways, harbor improvements, flood control, skyscrapers and housing down to do-it-yourselfers building a backyard patio. Transit mixed concrete is delivered to customers in Livingston's modern fleet of mixer trucks from the 13 batching plants. Many independent ready-mix producers also rely on Livingston-Graham's quality aggregate for use in their products.

Continuing effort is devoted to developing alternative uses for Livingston's digging sites (lower left) after depletion of the valuable sand and gravel deposits. Current plans envision the establishment of a water-oriented recreation area at one site and the development of another as a land-fill refuse dump. Such rehabilitative projects not only restore otherwise useless and unattractive land to productive uses, but also provide needed facilities in areas where they would be otherwise unavailable.

Brown's subsidiary, Richmond Screw Anchor Company, founded the prefabricated form-tying industry when it developed the original SCREW ANCHOR in 1911. Richmond has introduced and perfected many specialized products used in the forming of concrete including the SNAP-TY®, TYHOLDER and TYSCRU® form-tying products.

Contractors engaged in medium and heavy concrete construction are the largest users of Richmond products. Richmond's TYSCRU®, TYLAG, LAGSTUD, TYLOOP, FLEX-TY, TYFRAME, SCREW ANCHOR, TAPER-TY and SHE-BOLT form-tying products are some of the better known lines used in projects such as bridges, piers, high-rise buildings and retaining walls.

Richmond is a leading supplier of concrete forming accessories for the construction of facilities that control the environment or produce energy. The Company's products are widely used to build sewage treatment plants, wastewater treatment plants, water purification plants, energy producing plants (nuclear, fossil and petro-chemical), dams, spillways and locks.



Brown Company and Subsidiaries
Five Year Comparison
Years Ended and at July 31

	1977	1976(a)	1975(a)	1974(a)	1973(a)
For the year (000):					
Sales and other revenues(b)	\$453,955	\$430,302	\$410,745	\$404,597	\$287,983
Operating costs	438,465	398,278	375,976	371,718	271,567
Operating income	15,490	32,024	34,769	32,879	16,416
Interest expense	7,948	5,428	5,771	7,768	7,171
Interest income	905	631	1,489	1,919	734
Earnings before income taxes	8,447	27,227	30,487	27,030	9,979
Income tax provision	676	9,614	12,361	9,842	2,201
Net earnings	7,771	17,613	18,126	17,188	7,778
Net earnings per share(c)	1.12	2.51	2.61	2.50	1.57
Depreciation and depletion	13,203	11,471	10,351	9,165	8,626
Capital expenditures	31,164	27,279	40,486	19,989	8,683
End of year (000):					
Working capital	\$ 90,768	\$ 74,844	\$ 63,443	\$ 63,271	\$ 58,040
Net properties	171,826	151,673	137,490	108,345	95,948
Total assets	331,743	298,125	280,414	247,692	208,041
Long-term debt	111,562	93,889	91,651	91,747	84,460
Shareholders' equity	145,967	136,063	119,823	86,552	68,035
Shareholders' equity per share	20.41	20.20	17.85	15.65	13.17
Ratio of long-term debt to equity	.76	.69	.76	1.06	1.24

(a) Unaudited except July 31, 1976 end of year amounts.

(b) Includes other revenues of \$127,000 in 1977, \$92,000 in 1976, \$114,000 in 1975, \$35,000 in 1974 and \$134,000 in 1973.

(c) Net earnings per share have been retroactively adjusted to reflect a five-for-four stock split effected in February 1976 as though it had occurred at the beginning of the years presented.

Brown Company and Subsidiaries

Management Discussion and Analysis of Change in Earnings

Net Sales (Including Other Revenues) and Operating Income

Sales for the year ended July 31, 1977 were 5.5 percent above sales for the year ended July 31, 1976 and operating costs rose by 10.1 percent causing a 51.6 percent drop in operating income. The decrease in operating income was due mainly to weak conditions in the pulp and paper products market restricting the Company's ability to increase product selling prices to offset increased costs of labor, energy, raw materials and services. Moderate selling price increases for most paper products were offset by a decline in pulp selling prices plus an increase in the proportion of lower margin commodity grades sold. Labor rates increased about 10 percent during the year, the cost of wastepaper rose about 20 percent and energy costs increased by about 19 percent. An improvement in both sales and operating income from building products operations reflects improved market conditions, especially in the latter months of the year ended July 31, 1977.

Sales for the year ended July 31, 1976 were 4.8 percent above sales for the year ended July 31, 1975 and operating costs rose by 6.0 percent causing a 7.9 percent drop in operating income. There was a substantial improvement in paper industry operating rates in the year ended July 31, 1976 over the prior year and Brown's paper products operating levels improved also. However, operating income did not rise because of problems related to the start up of a new secondary fiber pulp mill, the fact that much of the gain in operating levels was in low margin commodity paper grades, and because selling price increases did not fully offset rising labor, material and energy costs. Building products operating results declined due to a general weakness in the building construction trade.

Interest Expense

Interest expense in the year ended July 31, 1977 was 46.4 percent above interest expense for the year ended July 31, 1976 mainly because of an increase in long-term debt.

Interest Income

Interest income for the year ended July 31, 1976 was 57.6 percent below interest income for the year ended July 31, 1975 reflecting a reduction in the amount of funds available for temporary investment and a decline in the rate of interest earned on such investments.

Income Taxes

The effective income tax rate varies because of changes in the amount of earnings before income taxes in relation to investment tax credits, capital gains from timber cutting, depletion allowances and differences in the tax and financial reporting basis of certain assets.

Brown Company and Subsidiaries
Consolidated Statements of Earnings

	Year Ended July 31 1977	Eight Months Ended July 31 1976
Revenues:		
Net sales	\$453,828,000	\$281,433,000
Other	127,000	91,000
	<u>453,955,000</u>	<u>281,524,000</u>
Operating costs:		
Cost of sales	389,287,000	234,728,000
Selling, administrative and general expenses	49,178,000	31,200,000
	<u>438,465,000</u>	<u>265,928,000</u>
Operating income	15,490,000	15,596,000
Interest cost:		
Interest expense — Note D	9,372,000	4,831,000
Interest income	(905,000)	(259,000)
Net interest cost capitalized — Notes A and H	(1,424,000)	(1,186,000)
	<u>7,043,000</u>	<u>3,386,000</u>
Earnings before income taxes	8,447,000	12,210,000
Income tax provision — Notes A and I	676,000	3,907,000
Net earnings	<u>\$ 7,771,000</u>	<u>\$ 8,303,000</u>
Net earnings per common and common equivalent share — Notes A and J	<u>\$ 1.12</u>	<u>\$ 1.19</u>
Cash dividends declared per common share	<u>\$.30</u>	<u>\$.225</u>

See notes to consolidated financial statements.

Brown Company and Subsidiaries
Consolidated Statements of Changes in Financial Position

	Year Ended July 31 1977	Eight Months Ended July 31 1976
Funds provided from operations:		
Net earnings	\$ 7,771,000	\$ 8,303,000
Items recognized in net earnings which did not affect working capital:		
Depreciation and depletion	13,203,000	7,894,000
Deferred income taxes	3,770,000	1,863,000
	<u>24,744,000</u>	<u>18,060,000</u>
Other funds provided:		
Asset dispositions	308,000	580,000
Debt issued	23,177,000	17,200,000
Stock issued	4,219,000	122,000
Transfers from funds reserved to pay pollution control costs	3,766,000	1,071,000
	<u>31,470,000</u>	<u>18,973,000</u>
Total funds provided	56,214,000	37,033,000
Funds used:		
Plant additions	31,164,000	16,992,000
Business purchased, less working capital acquired	2,500,000	—
Reduction in long-term debt and other liabilities	5,614,000	13,495,000
Cash dividends declared	2,086,000	1,518,000
Other	(1,074,000)	1,285,000
Total funds used	40,290,000	33,290,000
Increase in working capital	\$15,924,000	\$ 3,743,000
Elements of change in working capital:		
Increase (decrease):		
Cash including short-term investments	\$ 9,693,000	\$(7,217,000)
Accounts receivable	2,313,000	4,446,000
Inventories	5,813,000	3,147,000
Prepaid expenses	486,000	94,000
Notes payable	2,000,000	1,500,000
Current long-term debt maturities	(377,000)	1,255,000
Accounts payable	(1,300,000)	2,953,000
Accrued expenses	(4,349,000)	(3,099,000)
Income taxes payable	1,645,000	664,000
Increase in working capital	\$15,924,000	\$ 3,743,000

See notes to consolidated financial statements.

Brown Company and Subsidiaries Consolidated Balance Sheets

	July 31 1977	July 31 1976
ASSETS		
Current assets:		
Cash including short-term investments — Notes A and N	\$ 14,461,000	\$ 4,768,000
Accounts receivable (less allowance of \$1,059,000 in 1977 and \$1,013,000 in 1976)	57,629,000	55,316,000
Inventories — Notes A and B	73,310,000	67,497,000
Prepaid expenses	1,688,000	1,202,000
	<u>147,088,000</u>	<u>128,783,000</u>
Properties — Notes A, D and K:		
Land and improvements	9,801,000	9,491,000
Timberlands and quarries	9,940,000	9,914,000
Buildings, machinery and equipment	322,091,000	292,448,000
Accumulated depreciation and depletion	(170,006,000)	(160,180,000)
	<u>171,826,000</u>	<u>151,673,000</u>
Other assets:		
Funds restricted for pollution control facilities	6,199,000	9,965,000
Investments and non-current receivables — Note N	2,541,000	1,712,000
Other	4,089,000	5,992,000
	<u>12,829,000</u>	<u>17,669,000</u>
	<u>\$331,743,000</u>	<u>\$298,125,000</u>

See notes to consolidated financial statements.

	July 31 1977	July 31 1976
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Notes payable — Note C	\$ —	\$ 2,000,000
Current long-term debt maturities	5,512,000	5,135,000
Accounts payable	14,827,000	13,527,000
Accrued expenses — Note N	34,866,000	30,517,000
Income taxes payable	1,115,000	2,760,000
	<u>56,320,000</u>	<u>53,939,000</u>
Other liabilities:		
Long-term debt — Note D	111,562,000	93,889,000
Deferred income taxes	17,693,000	13,923,000
Other	201,000	311,000
	<u>129,456,000</u>	<u>108,123,000</u>
Shareholders' equity — Notes A, D and E:		
Common stock	7,164,000	6,750,000
Treasury stock	(156,000)	(156,000)
Other capital	56,713,000	52,908,000
Retained earnings	82,246,000	76,561,000
	<u>145,967,000</u>	<u>136,063,000</u>
Commitments and contingencies — Notes D, F, K and L	<u><u>\$331,743,000</u></u>	<u><u>\$298,125,000</u></u>

Brown Company and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity

	Year Ended July 31 1977	Eight Months Ended July 31 1976
Common stock:		
Beginning balance	\$ 6,750,000	\$ 6,736,000
Cash payment in lieu of fractional shares in connection with stock split	—	(2,000)
Warrants exercised — Note E	369,000	—
Stock options exercised — Note E	45,000	16,000
Ending balance	<u>\$ 7,164,000</u>	<u>\$ 6,750,000</u>
Other capital:		
Beginning balance	\$52,908,000	\$52,824,000
Warrants exercised — Note E	3,475,000	—
Stock options exercised — Note E	330,000	106,000
Other	—	(22,000)
Ending balance	<u>\$56,713,000</u>	<u>\$52,908,000</u>
Retained earnings:		
Beginning balance	\$76,561,000	\$69,776,000
Net earnings	7,771,000	8,303,000
Dividends	(2,086,000)	(1,518,000)
Ending balance	<u>\$82,246,000</u>	<u>\$76,561,000</u>

See notes to consolidated financial statements.

Brown Company and Subsidiaries
Notes to Consolidated Financial Statements
Year Ended July 31, 1977 and Eight Months Ended July 31, 1976

Note A — Summary of Accounting Policies

The accompanying consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. Significant inter-company accounts, transactions, and profits have been eliminated. At July 31, 1977, Gulf + Western Industries, Inc. owned 80.7 percent of the Company's common stock.

Short-term investments are stated at cost which approximates market value.

Inventories are generally valued at the lower of average cost or market.

Properties are stated at cost. Expenditures for maintenance and repairs are charged to income. Betterments and renewals are charged to the appropriate property account. The cost of assets and the related accumulated depreciation are eliminated from the accounts when assets are retired or otherwise disposed of. Gains or losses on disposition of assets are reflected in income in the year of disposal.

Depreciation is, in general, computed using the straight-line method over the estimated useful lives of the various classes of properties. The estimated useful lives fall largely within the following ranges:

Buildings and other structures	10-50 years
Automotive equipment	3-10 years
Machinery (including capitalized financing leases), furniture and other equipment	2-25 years

The Company capitalizes the net interest cost during construction on bonds issued to finance pollution control facilities since interest during construction was included in the proceeds from the sale of the bonds and such interest is considered part of the cost of the pollution control facilities. Net interest cost capitalized consists of bond interest expense less interest income received on the investment of bond proceeds until such proceeds are used to pay for the facilities.

Provisions for income taxes reflect the recognition of investment tax credits in the year realized (flow-through method). The Company and its subsidiaries are included in the consolidated Federal income tax return of Gulf + Western Industries, Inc. The Company's provision for Federal income taxes is computed (and payment made to Gulf + Western) as if the Company filed a separate consolidated return.

Contributions are made to pension trusts to fund accrued pension expense, including amounts needed to amortize the unfunded cost of past service over 30 years.

Brown Company and Subsidiaries
Notes to Consolidated Financial Statements (continued)

Note B — Inventories

Inventories at July 31, 1977 and July 31, 1976 were classified as follows:

	July 31 1977	July 31 1976
Raw materials, work in process and supplies	\$34,889,000	\$28,503,000
Paper and other manufactured products	38,421,000	38,994,000
Total	<u>\$73,310,000</u>	<u>\$67,497,000</u>

The following inventories were used in computing the cost of sales:

November 30, 1975	\$64,350,000
July 31, 1976	67,497,000
July 31, 1977	73,310,000

Note C — Notes Payable

At July 31, 1977, there were no short-term notes payable. At July 31, 1976, short-term notes of \$2,000,000 were payable to banks with an average interest rate of 7.0 percent. Additional information concerning short-term notes is shown below:

	Year Ended July 31 1977	Eight Months Ended July 31 1976
Maximum outstanding at any month-end	\$ 9,500,000	\$10,000,000
Average amount outstanding (total of months-end outstanding principal balances divided by 12 and 8 respectively)	1,500,000	3,250,000
Average interest rate (total interest expense for the period divided by the weighted total outstanding borrowings)	6.9%	7.0%

The Company has line of credit arrangements with banks totalling \$21,000,000 which do not have termination dates, but are reviewed annually for renewal. The Company is not required to maintain material compensating balances in connection with these arrangements and at July 31, 1977 none of the credit lines were being used.

Brown Company and Subsidiaries
Notes to Consolidated Financial Statements (continued)

Note D — Long-Term Debt

	July 31 1977	July 31 1976
Senior long-term debt:		
7% to 9 ⁷ / ₈ % notes payable to institutional investors 1978 to 1986	\$ 33,152,000	\$ 37,452,000
11% notes payable to institutional investors 1980 to 1991	30,000,000	15,000,000
Capitalized financing leases (effective interest rates of 9 ³ / ₈ % to 10.4%)	2,019,000	—
6 ³ / ₄ % to 9% pollution control revenue bonds payable 1981 to 2006	36,800,000	31,600,000
Other notes (5% to 9%) payable 1978 to 1987	5,139,000	5,008,000
	<u>107,110,000</u>	<u>89,060,000</u>
Current maturities	(5,512,000)	(5,135,000)
Total senior long-term debt	101,598,000	83,925,000
9% subordinated debentures due 1995	9,964,000	9,964,000
Total long-term debt	<u>\$111,562,000</u>	<u>\$ 93,889,000</u>

The following payments are required on the above long-term debt during the five years ending July 31, 1982:

1978	\$ 5,512,000
1979	5,547,000
1980	7,931,000
1981	7,420,000
1982	7,878,000

Note agreements with institutional investors provide for the possible future mortgage (if certain conditions are not met) of the Company's New England timberlands and properties in Berlin and Gorham, New Hampshire and Kalamazoo and Parchment, Michigan. Certain pollution control revenue bonds are secured by a mortgage on approximately 79,000 acres of New England timberlands.

Certain long-term loan agreements restrict the payment of dividends. Under the most restrictive of the agreements, retained earnings at July 31, 1977 of \$13,451,000 were not restricted.

Interest expense is primarily attributable to long-term debt.

Brown Company and Subsidiaries
Notes to Consolidated Financial Statements (continued)

Note E — Capital Stock

There are 10,000,000 shares of \$1 par value common stock and 2,500,000 shares of preferred stock authorized. At July 31, 1977 there were 7,151,411 shares of common stock outstanding and at July 31, 1976 there were 6,737,257 shares outstanding excluding 12,280 treasury shares. Each share is entitled to one vote. No preferred stock is outstanding.

In January 1977, Gulf + Western Industries, Inc. exercised warrants to purchase 368,529 shares of Brown Company common stock at a price of \$10.43 per share. At July 31, 1977, unissued shares of common stock were reserved as follows for the exercise of warrants and options:

Warrants exercisable to May 15, 1980 at \$13.20 per share	1,356,682
Employee stock options outstanding	92,500
Employee stock options available for grant	121,250
Total	<u>1,570,432</u>

The Company's stock option incentive plans provide for the grant of qualified stock options to key employees to buy common stock of the Company at a price not less than fair market value on date of grant. Subject to termination of employment, the options expire five years from the date of grant or on May 20, 1981 with respect to any options granted after May 20, 1976.

The following table summarizes information relating to common stock options outstanding at July 31, 1977 and July 31, 1976:

Year of Grant	Options Outstanding at July 31, 1977			Options Outstanding at July 31, 1976		
	Number of Shares	Option Price		Number of Shares	Option Price	
		Per Share(d)	Total		Per Share(d)	Total
1971(a)	—	\$ —	\$ —	1,250	\$ 5.70	\$ 7,130
1972(a)	2,500	8.45	21,120	2,500	8.45	21,120
1973(a)	15,375	8.35-8.90	133,327	34,875	8.35-8.90	296,191
1974(a)	7,125	8.25	58,767	38,875	8.25-8.60	321,521
1975(a)	2,500	8.80	22,000	5,000	8.80	44,000
1976(b)	65,000	10.45	679,120	75,000	10.45	783,600
1977(c)	—	—	—	—	—	—
Total	<u>92,500</u>		<u>\$914,334</u>	<u>157,500</u>		<u>\$1,473,562</u>

- (a) Year ended November 30.
- (b) Eight months ended July 31.
- (c) Year ended July 31.
- (d) Market price on date option was granted.

Brown Company and Subsidiaries
Notes to Consolidated Financial Statements (continued)**Note E — Capital Stock (continued)**

During the year ended July 31, 1977 options for 45,625 shares were exercised at a total price of \$374,981 and at prices ranging from \$5.70 to \$8.35 per share, and options for 57,344 shares became exercisable at a total price of \$558,619 and at prices ranging from \$8.25 to \$10.45 per share. The market value of the 45,625 shares at time of exercise was \$445,859 (ranging from \$9.25 to \$13.13 per share) and the market value of the 57,344 shares at the time the related options became exercisable was \$515,297 (ranging from \$8.88 to \$11.13 per share).

During the eight months ended July 31, 1976 options for 16,250 shares were exercised at a total price of \$122,160 and at prices ranging from \$5.35 to \$8.90 per share, and options for 20,156 shares became exercisable at a total price of \$169,424 and at prices ranging from \$8.25 to \$8.90 per share. The market value of the 16,250 shares at time of exercise was \$185,750 (ranging from \$11.00 to \$12.30 per share) and the market value of the 20,156 shares at the time the related options became exercisable was \$236,891 (ranging from \$10.38 to \$13.00 per share).

At July 31, 1977, options for 59,375 shares were exercisable. At July 31, 1976, options for 61,406 shares were exercisable. Options for 121,250 shares were available for future grants at July 31, 1977, and options for 101,875 shares were available for future grants at July 31, 1976. No charges were made to income for option transactions in 1977 or 1976. The excess of proceeds from the exercise of stock options over par value of shares of common stock issued is credited to other capital.

Note F — Pension Plans

Substantially all employees are covered by pension plans. Pension expense aggregated \$10,622,000 for the year ended July 31, 1977 and \$6,518,000 for the eight months ended July 31, 1976. On January 1, 1977 (the last actuarial valuation date), the actuarially computed value of vested benefits under the pension plans exceeded the actuarial value of pension trust assets and balance sheet accruals by approximately \$45,000,000 and the estimated unfunded past service liability under the plans approximated \$80,000,000.

Note G — Incentive Compensation Plans

The Company has incentive compensation plans for key management personnel under which at July 31, 1977 the amount payable to individual participants is limited to 25 percent of the participants' base salaries with an aggregate maximum payment under the plans limited to 10 percent of earnings before income taxes. The Company also has a deferred incentive compensation plan based on meeting certain return on shareholders' equity requirements. The charge to income for incentive compensation plans was \$1,076,000 for the year ended July 31, 1977 and \$727,000 for the eight months ended July 31, 1976.

Brown Company and Subsidiaries
Notes to Consolidated Financial Statements (continued)

Note H — Capitalized Interest

Net interest cost capitalized increased net earnings \$712,000 (ten cents per share) for the year ended July 31, 1977 and \$593,000 (eight cents per share) for the eight months ended July 31, 1976.

Note I — Income Taxes

An analysis of the income tax provision for the year ended July 31, 1977 and the eight months ended July 31, 1976 is shown below:

	Year Ended July 31 1977	Eight Months Ended July 31 1976
Current provision:		
Federal	\$(4,019,000)	\$1,433,000
State	925,000	611,000
Deferred Federal and state tax provision	3,770,000	1,863,000
Total income tax provision	<u>\$ 676,000</u>	<u>\$3,907,000</u>

The income tax provision was reduced by investment tax credits of \$3,029,000 in the year ended July 31, 1977 and \$1,667,000 in the eight months ended July 31, 1976. The income tax provision in 1977 reflects investment tax credits in excess of income taxes before credits. The utilization of all investment tax credits is assured for tax payable purposes as a reduction of taxes currently payable or as a carryback to recover taxes paid in prior years.

The provision for taxes on income is low in relation to earnings before taxes primarily because of investment tax credits, capital gain from timber cutting, depletion allowances and differences in the tax and financial reporting basis of certain assets. The income tax provision as a percent of earnings before income taxes for the 1977 and 1976 periods is less than the Federal statutory rate of 48 percent as explained below:

	Year Ended July 31 1977	Eight Months Ended July 31 1976
Statutory rate	48 %	48 %
Decrease arising from investment tax credits	(36)	(14)
Other items	(4)	(2)
Effective tax rate	<u>8 %</u>	<u>32 %</u>

Brown Company and Subsidiaries
Notes to Consolidated Financial Statements (continued)

Note I — Income Taxes (continued)

The deferred portion of the income tax provision for the 1977 and 1976 periods results from reporting income and deductions at different times for financial reporting and income tax purposes as follows:

	Year Ended July 31 1977	Eight Months Ended July 31 1976
Tax effect of:		
Excess depreciation for federal income tax purposes	\$2,959,000	\$1,468,000
Aggregate timing differences due to expense accruals deductible for income tax purposes when paid but deducted for financial reporting purposes when incurred	811,000	574,000
Other items — net	—	(179,000)
Deferred portion of income tax provision	<u>\$3,770,000</u>	<u>\$1,863,000</u>

Note J — Earnings Per Share

Net earnings per common and common equivalent share for the year ended July 31, 1977 and the eight months ended July 31, 1976 are based on weighted average common shares and dilutive common share equivalents (warrants and options) outstanding during the periods assuming that the warrants and options were exercised and the proceeds therefrom used first to buy 20 percent of the outstanding common shares for the treasury and the remainder to retire debt at market values.

Average common and common equivalent shares outstanding were 7,182,000 in the 1977 period and 7,257,000 in the 1976 period.

Note K — Operating Leases

Rental expense applicable to operating leases of various buildings, machinery and equipment totaled \$4,941,000 for the year ended July 31, 1977 and \$3,103,000 for the eight months ended July 31, 1976.

Brown Company and Subsidiaries
Notes to Consolidated Financial Statements (continued)

Note K — Operating Leases (continued)

Future rental commitments at July 31, 1977 for non-cancellable operating leases were:

1978	\$2,527,000
1979	2,074,000
1980	1,772,000
1981	1,530,000
1982	963,000
1983-1987	71,000
After 1987	—
Total	<u>\$8,937,000</u>

Certain of the above leases are in substance financing leases. If such financing leases were capitalized the impact on net income would not be material.

Note L — Contingencies

In February 1976, a Federal Grand Jury returned an indictment in the Federal District Court in Chicago, Illinois naming the Company and 22 other companies in the folding carton business as defendants in an action under the Sherman Act, alleging a conspiracy to fix, raise, maintain and stabilize prices of folding cartons from 1960 to 1974. In July 1976, the Company pleaded *nolo contendere* to this charge and in September 1976 was fined \$45,000. In relation to this matter, 69 private treble damage actions seeking unspecified amounts of damages have been filed against the Company and the other defendants. The amount of liability, if any, in these private actions is not presently determinable, but management, after taking into consideration the advice of counsel, is of the opinion that their ultimate resolution will have no material effect on the consolidated financial position of the Company and its subsidiaries.

Brown and its subsidiaries are defendants in various other lawsuits arising in the ordinary course of business. Damages requested in such lawsuits are covered by liability insurance or involve immaterial amounts.

Brown Company and Subsidiaries
Notes to Consolidated Financial Statements (continued)

Note M — Supplementary Earnings Statement Information

	Year Ended July 31 1977	Eight Months Ended July 31 1976
Maintenance and repairs	\$33,298,000	\$22,107,000
Taxes other than income taxes:		
Local property taxes	\$ 4,395,000	\$ 3,110,000
Payroll taxes	7,979,000	5,595,000
Other taxes	885,000	492,000
Total	<u>\$13,259,000</u>	<u>\$ 9,197,000</u>

Royalties, advertising and depreciation and amortization of intangible assets, preoperating costs and similar costs did not exceed 1 percent of net revenues.

Note N — Supplementary Balance Sheet Information

	July 31 1977	July 31 1976
Cash including short-term investments:		
Cash	\$ 8,080,000	\$ 4,166,000
Short-term investments	6,381,000	602,000
Total	<u>\$14,461,000</u>	<u>\$ 4,768,000</u>
Investments and non-current receivables:		
Amounts receivable from officers, directors and employees	\$ 462,000	\$ 228,000
Other	2,079,000	1,484,000
Total	<u>\$ 2,541,000</u>	<u>\$ 1,712,000</u>
Accrued expenses:		
Compensation and taxes thereon	\$ 7,073,000	\$ 7,406,000
Pensions	13,523,000	11,035,000
Dividends	—	506,000
Other	14,270,000	11,570,000
Total	<u>\$34,866,000</u>	<u>\$30,517,000</u>

Brown Company and Subsidiaries
Notes to Consolidated Financial Statements (continued)

Note O — Summary of Quarterly Results of Operations (unaudited)

	Quarter Ended October 31 1976	Quarter Ended January 31 1977	Quarter Ended April 30 1977	Quarter Ended July 31 1977
Sales	\$112,783,000	\$104,152,000	\$114,831,000	\$122,062,000
Gross profit	16,202,000	12,126,000	15,073,000	21,140,000
Net earnings (loss) ..	1,364,000	(1,186,000)	2,511,000	5,082,000
Per common share:				
Net earnings (loss) . . .	\$.20	\$ (.17)	\$.36	\$.73
Dividends075	.075	.075	.075
Market price:				
High	13½	10⅝	9¾	9½
Low	10¼	9⅝	8⅝	8½

Note P — Replacement Cost Information (unaudited)

In compliance with regulations of the Securities and Exchange Commission (SEC), the Company has estimated replacement cost of inventories and certain property, plant and equipment at July 31, 1977 and the related estimated effects (before income tax benefits) on cost of sales and depreciation expense for the year then ended. This information is included in the Company's annual report on Form 10-K filed with the SEC. The replacement cost information was prepared based on the generalized guidelines provided by the SEC which required the use of many hypothetical assumptions and subjective judgments and does not represent actual costs which will be incurred in future periods, nor the manner in which replacement of assets will occur.

Cost of sales and depreciation expense computed on a replacement cost basis (which does not reflect operating cost savings which would result from the replacement of existing assets) exceed comparable amounts computed on an historical cost basis as a result of the continuing impact of inflation on the prices of goods and services. Over the past several years, the Company's operating results have been subjected to these pressures of inflation; however, the Company has been able to offset certain of the effects of inflation through increased productivity, emphasis on cost and expense controls, and selective price increases.

**Report of Ernst & Ernst,
Independent Auditors**

To the Board of Directors and
Shareholders of Brown Company

We have examined the consolidated balance sheets of Brown Company and subsidiaries as of July 31, 1977 and July 31, 1976, and the consolidated statements of earnings, changes in shareholders' equity and changes in financial position for the year ended July 31, 1977 and the eight months ended July 31, 1976. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Brown Company and subsidiaries at July 31, 1977 and July 31, 1976, and the consolidated results of their operations and changes in their financial position for the aforementioned periods, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Ernst

New York, New York
September 13, 1977

Brown Company Directors and Officers

DIRECTORS

- John E. Cherrix — Vice President — Finance and Treasurer
† Sherwood C. Chillingworth — President, Adorada Corporation
(a real estate development company)
* David D. Davis — Senior Vice President
* Don F. Gaston — Executive Vice President, Gulf + Western Industries, Inc.
(a multi-industry company)
Leonard E. Hickey — Vice President and Controller
* David N. Judelson — President, Gulf + Western Industries, Inc.
James R. Maurer — Vice President, Secretary and General Counsel
* Merrill L. Nash — Chairman of the Board and President
† William T. Pascoe, III — Chairman of the Board, Amcord, Inc.
(a cement manufacturer)
† Herbert J. Seakwood — Management Consultant and Attorney

* Member of Executive Committee

† Member of Audit Committee

OFFICERS

- Merrill L. Nash — Chairman of the Board and President
David D. Davis — Senior Vice President
R. James Alexy — Vice President
John E. Cherrix — Vice President — Finance and Treasurer
Edgar T. Dean — Vice President
Leonard E. Hickey — Vice President and Controller
Richard S. Longnecker — Vice President
James R. Maurer — Vice President, Secretary and General Counsel
Robert J. Sherry — Vice President — Administration
Francis A. Somers — Vice President
Charles M. Williams — Vice President

Brown Company
Miscellaneous Data

COMMON STOCK TRANSFER AGENTS AND REGISTRARS

Manufacturers Hanover Trust Company, 40 Wall Street, New York,
New York 10015

Bank of America, 111 West Seventh Street, Los Angeles, California 90014

DEBENTURE TRUSTEE AND WARRANT AGENT

Manufacturers Hanover Trust Company, 40 Wall Street, New York,
New York 10015

STOCK EXCHANGE LISTINGS

Common Stock — New York Stock Exchange and Pacific Stock Exchange

\$13.20 Warrants — American Stock Exchange and Pacific Stock Exchange

Debentures Payable in 1995 — Pacific Stock Exchange

AUDITORS

Ernst & Ernst, 140 Broadway, New York, New York 10005

EXECUTIVE OFFICES

251 South Lake Avenue, Pasadena, California 91101

ANNUAL MEETING

The Annual Meeting of Stockholders will be held on Wednesday,
December 7, 1977 at 10:00 A.M. in the Yosemite Room of the Hilton Hotel,
150 South Los Robles, Pasadena, California.

