BROWN COMPANY Report to Stockholders 1966

COVER: This unique photograph of the American bald eagle was made available through the courtesy of the National Audubon Society. The soaring eagle logotype of the "New Brown" was inspired by the qualities of determination and boundless aspiration symbolized by this proud bird.

Photographed by Olen S. Hanson

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Blaw-Knox Company

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Assistant Treasurer

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Assistant Controller

L. E. HICKEY

BROWN COMPANY Highlights of the Report

Year Ended November 30

For the Year	1966	1965
Net Sales	$212,695,000	$ 67,418,000
Operating Income	8,970,000	1,548,000
Interest on Funded Debt	3,163,000	147,000
Income Before Taxes and Preacquisition Earnings of KVP	6,619,000	1,758,000
Income Taxes	2,100,000	
Preacquisition Earnings of KVP	685,000	
Net Income	3,834,000	1,758,000
Preferred Dividends	1,238,000	
Net Income Available to Common Stock	2,596,000	1,758,000
Net Income Per Share of Common Stock	1.02	.70*
Common Dividends Declared—$.60 Per Share	1,526,000	1,510,000
Depreciation and Depletion	7,944,000	3,131,000
Cash Flow (Income, Depreciation and Depletion)	11,778,000	4,889,000
Cash Flow Per Share of Common Stock	4.56	1.93
Capital Expenditures	26,808,000	4,320,000

*If loss carry-overs had not been available (see Note 6 to Financial Statements), net income per common share would have been $.44 in 1965.

End of Year		
Working Capital	$ 50,801,000	$ 18,920,000
Total Assets	191,066,000	61,923,000
Funded Debt	65,781,000	3,174,000
Stockholders' Equity	88,680,000	50,323,000
Book Value Per Common Share	20.26	19.86

Common Shares Outstanding	2,585,363	2,533,961
Preferred Shares Outstanding	1,100,040	
Number of Common Stockholders	6,228	6,069
Number of Preferred Stockholders	6,896	

President's Message to the Stockholders

President Peterson: even more significant than Brown's expansion in 1966 was the corporate realignment into profit-oriented operating divisions.

Fiscal 1966 marks the end of the first year and a half of stewardship by the present management which took over in April 1965.

Several significant events took place in 1966 as a result of the prior year's planning—events that have already put the company on the road to growth.

In January, 1966, Brown acquired a controlling interest in KVP Sutherland Paper Company and in May this company was merged into Brown.

This merger tripled the size of Brown Company and necessitated a drastic realignment of corporate activity. In the past year more than $200,000,000 of productive capacity was decentralized into eight operating divisions. A sweeping realignment of corporate management has been completed to provide management for these divisions and corporate staff support.

Modern management control systems have been installed to insure that the new organization with its greatly enlarged product lines has the required information to provide prompt and effective action for future profitability.

A $54,000,000 capital expenditure program to revitalize the company has been largely accomplished. This program will triple timber utilization and increase production by more than 50 per cent.

Your management looks forward with confidence to the reflection of these activities in profitability and growth in the latter part of 1967 and in the years ahead.

The year 1965 was a year of planning; 1966 has been a year of consolidation. We continue our basic philosophy—to maximize the return on your equity.

WHAT HAPPENED IN 1966

Significant Gains	1965	1966
Timberlands (acres)	800,000	4,500,000
Pulpwood Utilization (cords)	195,000	450,000
Paper Production (tons)	163,000	334,000
Board Production (tons)	20,000	216,000
Paper Machines	16	33
Sales	$67,000,000	$212,000,000

It is gratifying to report that significant progress has been made in the basic areas cited for action in the 1965 annual report.
Here are the highlights of progress in 1966:

- Sales tripled, principally as a result of the KVP merger.
- Timber resources increased from 800,000 to 4,500,000 acres through external expansion.
- The company's product line and grade structure was drastically realigned, eliminating unprofitable lines and further diversifying the product mix.
- Productivity rates at Berlin-Gorham were improved.
- The kraft pulp mills undergoing expansion at Berlin-Gorham, New Hampshire and Espanola, Ontario will commence production in the first half-year with an increased capacity of 200,000 tons annually.
- The entire corporate structure was realigned for effective management control and marketing and manufacturing efficiency.
- Research, technical development and manufacturing were reorganized under strong staff direction.
- More than 95 per cent of unionized employees have concluded long-term contracts and employee relations are excellent.
- The reorganization of the company into profit-oriented divisions resulted in broad changes in marketing. Our distributive systems are being realigned to meet the special needs of each division.

FINANCIAL

Applying the yardstick of financial results, sales increased to $212,695,000 in 1966 from $67,418,000 in fiscal 1965. Net after tax income for this period was $3,834,000 as opposed to $1,758,000 for 1965.

After providing for preferred dividends of $1,238,000, the net after tax income attributable to our common shares was $2,596,000 or $1.02 per common share.

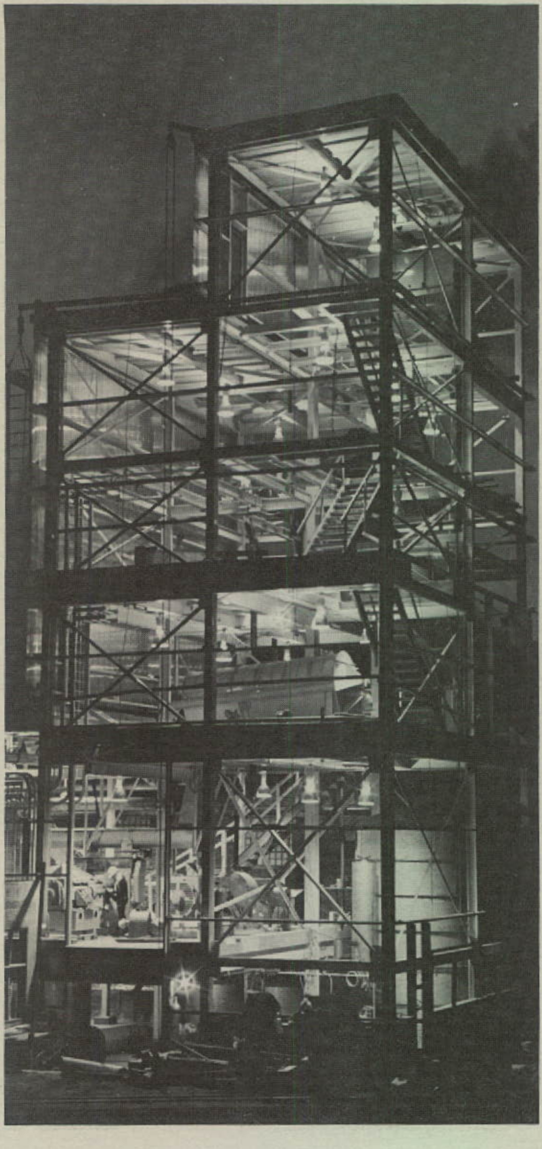
It is significant to note that the 1965 income of $1,758,000 or 70¢ a common share was after application of loss carryovers from previous years. Had such loss carryovers not been available, earnings for fiscal 1965 would have been $1,108,000 or 44¢ a share.

I call to your attention that the earnings for 1966 are after providing for interest on funded debt of $3,163,000 as opposed to $147,000 in fiscal 1965.

Of further significance, the company's 1966 earnings are after the start-up expenses of our new plant and equipment in excess of $500,000.

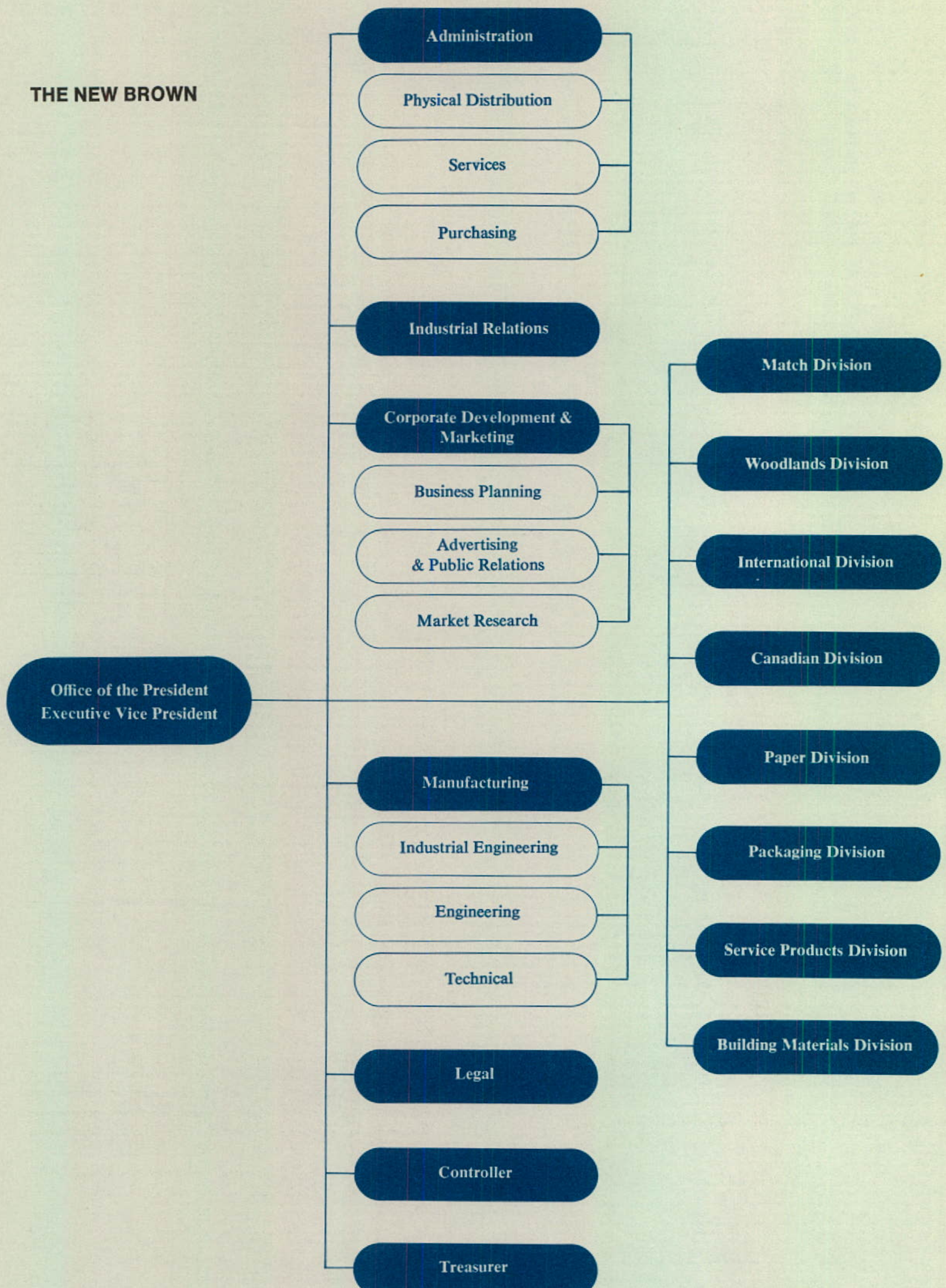
As you will note from the financial highlights tabulation, the operating income for the company has increased by $7,422,000.

Bare arithmetic does not tell the full story of this transitional year. The temporary loss of productivity while plants and equipment were modernized and rebuilt and the costs of restructuring our company and its marketing programs were necessary for future growth. However, these had the effect of reducing the company's sales and earnings in 1966.



This new NSCC pulp mill at Berlin is a model of efficiency. It produces at a rate of 200 tons a day.

THE NEW BROWN



One of the paramount tasks of 1966 was the development of an organizational structure to assimilate the KVP Sutherland Paper Company into Brown in a manner that would provide an efficient and effective corporate complex to manage the business.

A sweeping reorganization was put into effect.

Eight operating divisions were established, each with responsibility for the manufacture and marketing of its own group of products. This is a business or profit center concept under which the eight divisions operate like separate business enterprises with the added strength of corporate planning and guidance.

Each division management, headed by a general manager, is responsible for its own profit and cost control. The performance of the division is measured against what its competitors in the same field are doing and by the return on invested capital.

While the divisional reorganization was being carried out, the corporate staff was further strengthened and lines of communications clarified. The staff has two basic functions. One is to coordinate and service the divisions in such areas as administration, industrial relations, marketing, advertising, public relations, manufacturing, engineering, technical development, research, law and finance.

The second function is corporate strategy and development—planning where the company should be in the years ahead in products, markets, plant and financial structure.

It is one of the major accomplishments of 1966 that this fundamental reorganization of the company was successfully carried out in a little more than seven months.

Our people represent the company's most essential asset, the value of which cannot be properly displayed on our balance sheet. The merger with KVP Sutherland added to our ranks thousands of skilled and loyal employees, thereby strengthening our production, marketing, technical and managerial resources. Our total work force now numbers 11,100.

All of the company's 9,500 hourly employees are organized. We have 44 labor agreements with 17 different international unions. Relations with employees represented by bargaining units throughout the company are excellent. In 1966 thirty-one labor agreements were successfully negotiated with the result that more than 95 per cent of our contract relationships have been concluded on a long-term basis, assuring us of an uninterrupted period in which to carry out our growth and expansion program.

In management, effective direction is assured by the wealth of talent made available by merger and through the addition of experienced personnel from outside the company. The efforts to strengthen our executive and technical team continue vigorously.

Our corporate staff has been strengthened by the addition of John W. V. O'Brien as Vice President and Controller and Michael A. Hoffmann as Vice President and Director of Administration. Mr. O'Brien was formerly financial vice president of Hudson Pulp and Paper Company and Mr. Hoffman was director of materials management for Oxford Paper Company.

Early this year Charles Sweitzer, formerly of Diamond International Corporation, became resident manager of paper and board facilities at Kalamazoo.

Without the dedication and diligent application of our people, the tremendous job of transforming your company into its new corporate organization could not have been done nearly so quickly or so well.

CAPITAL EXPENDITURE PROGRAM—$54,000,000

Project	What it is	What it does	In production
Berlin			
NSSC pulp mill and 9 pt. paper machine for production of corrugating medium	Neutral sulphite semi-chemical pulp mill and 178-inch fourdinier producing 200 tons per day. Machine speed 1,100 feet per minute.	Adds $10 million dollars to sales, provides for greater utilization of hardwoods, waste kraft pulp and paper machine broke.	November, 1966
Increase kraft pulp mill capacity from 330 to 625 tons per day	Expansion program with attendant installations proceeding on schedule. Major components going into mill include digesters, 3 washers, evaporators, causticizing equipment, recovery boiler, chip storage bins, lime kiln.	Doubles Berlin kraft pulp production. Substantially reduces pulp purchases from outside sources with resulting economies. Provides some pulp for outside market.	April, 1967
Increase capacity of kraft bleachery from 250 to 700 tons per day	Provides facilities to bleach entire kraft pulp mill production.	Gives company the latitude necessary in manufacturing bleached or unbleached papers as called for in the market place.	April, 1967
Re-establish pulp drying facilities	Rebuild No. 2 pulp dryer to produce 100 per cent drying of excess pulp.	Improves company's position in market pulp business.	April, 1967
Rebuild No. 10 paper machine	Miss Nibroc, machine used in manufacture of toilet tissue, had new Yankee installed and headbox relocated.	Increases production by 50%.	November, 1966
Install Hayssen wrapper	Equipment for automatic wrapping of cut sized papers, bond, duplicator and mimeo.	Speeds up production of office copy papers, reduces costs, materially improves packaging of same.	October, 1966
Rebuild No. 1 paper machine	148-inch paper machine used for manufacture of various converting grades.	Increases production by 30%.	November, 1966
Espanola, Ontario			
Increase production of bleached kraft mill from 325 to 650 tons per day	Installation of 4 new digesters, washers, expanded wood handling facilities, 400,000 pounds-per-hour steam boiler. Bleach plant capable of producing pulp with 90 GE brightness.	Doubles pulp production in Canada.	April, 1967 New lime kiln already in production.
Kalamazoo			
Rebuild 3 paper machines	For production of lightweight printing papers.	Increases production by 15-20 per cent.	December, 1966
Rebuild No. 5 board machine	To improve quality of the product.	Increases production by 15-20 per cent.	November, 1966
Installation of Beloit polyethylene extruder and other equipment in new 96,000 sq. ft. building	Put coating of polyethylene on paper or paperboard to be converted into cartons, cups, plates, and locker paper.	Reduces costs, increases production of items for Service Products and Packaging Divisions.	April, 1966
Construction of new warehouse facilities	Shipping and warehousing facilities to be housed in new 167,000 sq. ft. building.	Increases efficiency, speeds deliveries, permits better balanced inventories.	November, 1966

EXPANSION

In my report to you last year, the importance of adding new facilities and improving existing ones was cited as a major factor in the company's drive for increased profitability. A substantial portion of our $54 million capital expenditure program was completed in 1966 and the balance will go on stream this year.

The new neutral sulphite semi-chemical pulp mill and nine-point paper machine went into production in the last quarter of 1966. It is designed to produce 80,000 tons per year of corrugating medium—a product never before produced by Brown and add $10 million in sales.

During the second quarter of 1967, the expanded kraft pulp mills and supporting facilities at Berlin-Gorham, New Hampshire and Espanola, Ontario will commence operation with an increased capacity of 200,000 tons annually.

Five paper machines were rebuilt in 1966 at a cost of $8 million. On one machine, toilet tissue production was increased 50 per cent; on another converting paper output went up 30 per cent; on three machines production of lightweight printing papers was improved 20 per cent.

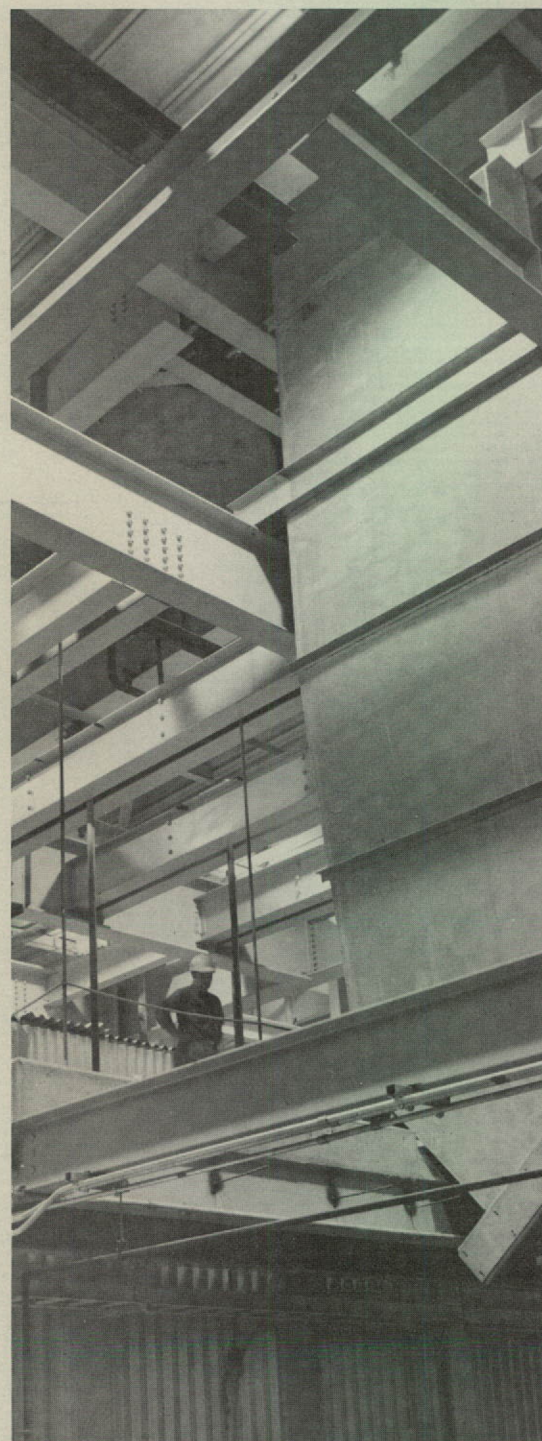
A polyethylene extruder installed in the last quarter of the year, together with other added equipment, expands our packaging capabilities.

A new gravure press at Hamilton, Ontario, will open up new opportunities in flexible packaging.

In Kalamazoo, the construction of a new 167,000 square foot warehousing and shipping facility in the fourth quarter of 1966 will contribute substantially in increased efficiency, faster deliveries and better balanced inventories.

A battery of flexible bag machines have added growth opportunities to the Packaging Division.

A highly visible result of this expansion program is the increase in pulpwood utilization from 450,000 cords in 1966 to an estimated 600,000 cords in 1967.



Number II Recovery boiler in Espanola showing the breaching which conducts fluid gases. The equipment sharply reduces the amount of flyash released into the atmosphere.

OUTLOOK

On balance the prospects for Brown Company starting in 1967 are encouraging.

The efficiencies in manufacturing and marketing brought about through corporate reorganization, sharply increased productive capacity and improved product mix have put your company in an excellent position to get a better share of the forest products market.

The long-term outlook for our industry is one of dynamic growth domestically and in the underdeveloped world market.

However, in assessing company prospects for fiscal 1967, several factors should be taken into account.

Effects of the down-time and start-up costs of modernizing and rebuilding plant and equipment in the current expansion program will be felt, particularly in the first half of the fiscal year.

There are indications that the slowdown in the rate of our national growth will be reflected in our industry. This will intensify competition and add pressure to our price structure.

Increased Federal taxation in the second half of the year would tend to narrow profit margins.

However, we believe that the demand for our products will continue strong in the current year. The projected production of paper and paperboard in North America in 1967 is 60 million tons—an all-time high.

The increase in our long-term debt to $75,000,000, which was completed in January of 1967, has made it possible for us to enlarge the company's profit base through external and internal expansion.

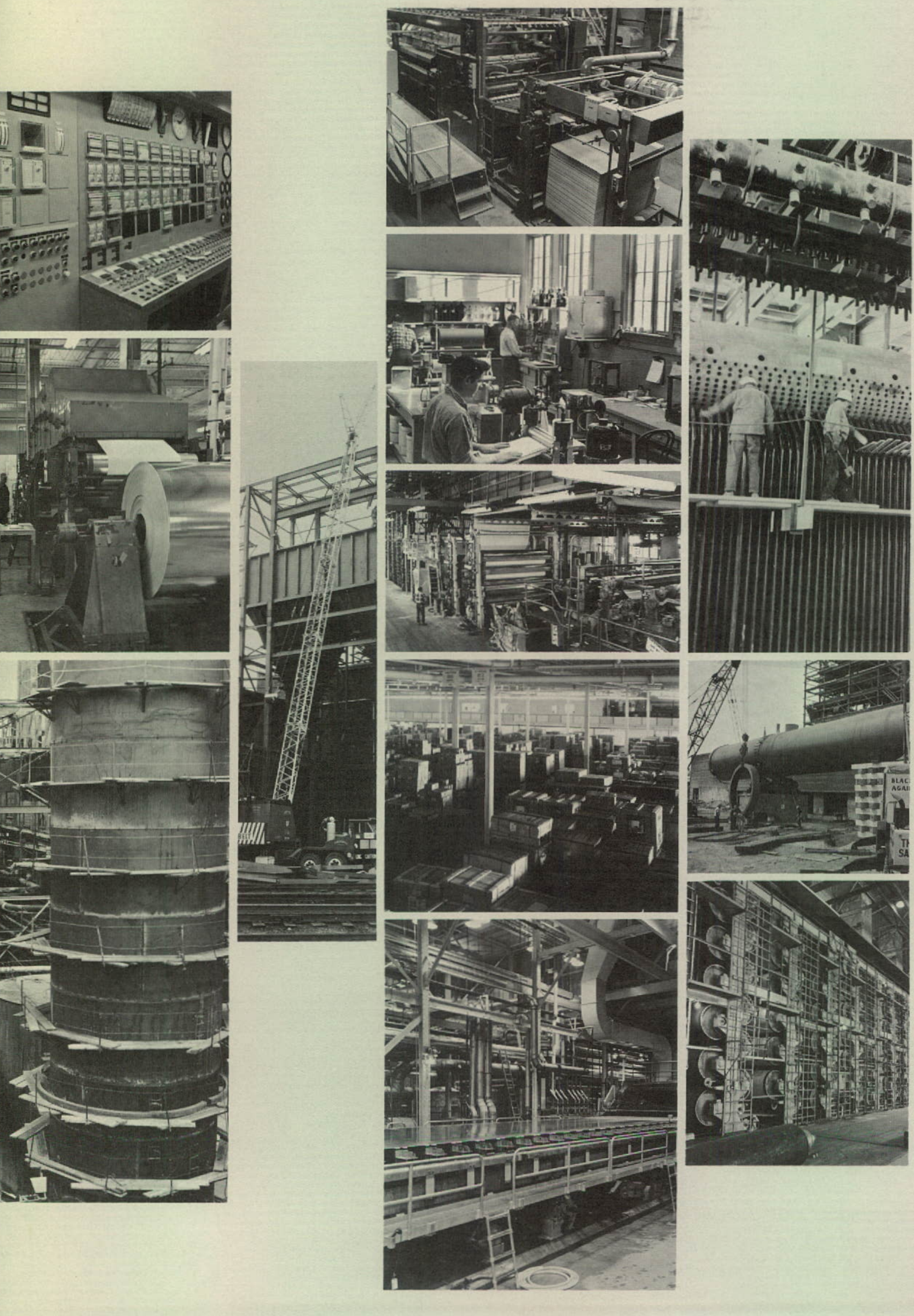
Debt, with safe provision for service through cash generation, is a tool whose leverage will continue to be used to serve Brown's growth.

The impact of the $54 million expansion and modernization program throughout the company should be reflected in our sales and earnings in the latter half of 1967.

We wish to thank you—our shareholders, employees, customers and the communities in which we operate—for your support as we build the "New Brown" and to express our determination to merit that support in 1967 and the years ahead.

Frank Peterson

President and Chief Executive Officer
February 15, 1967



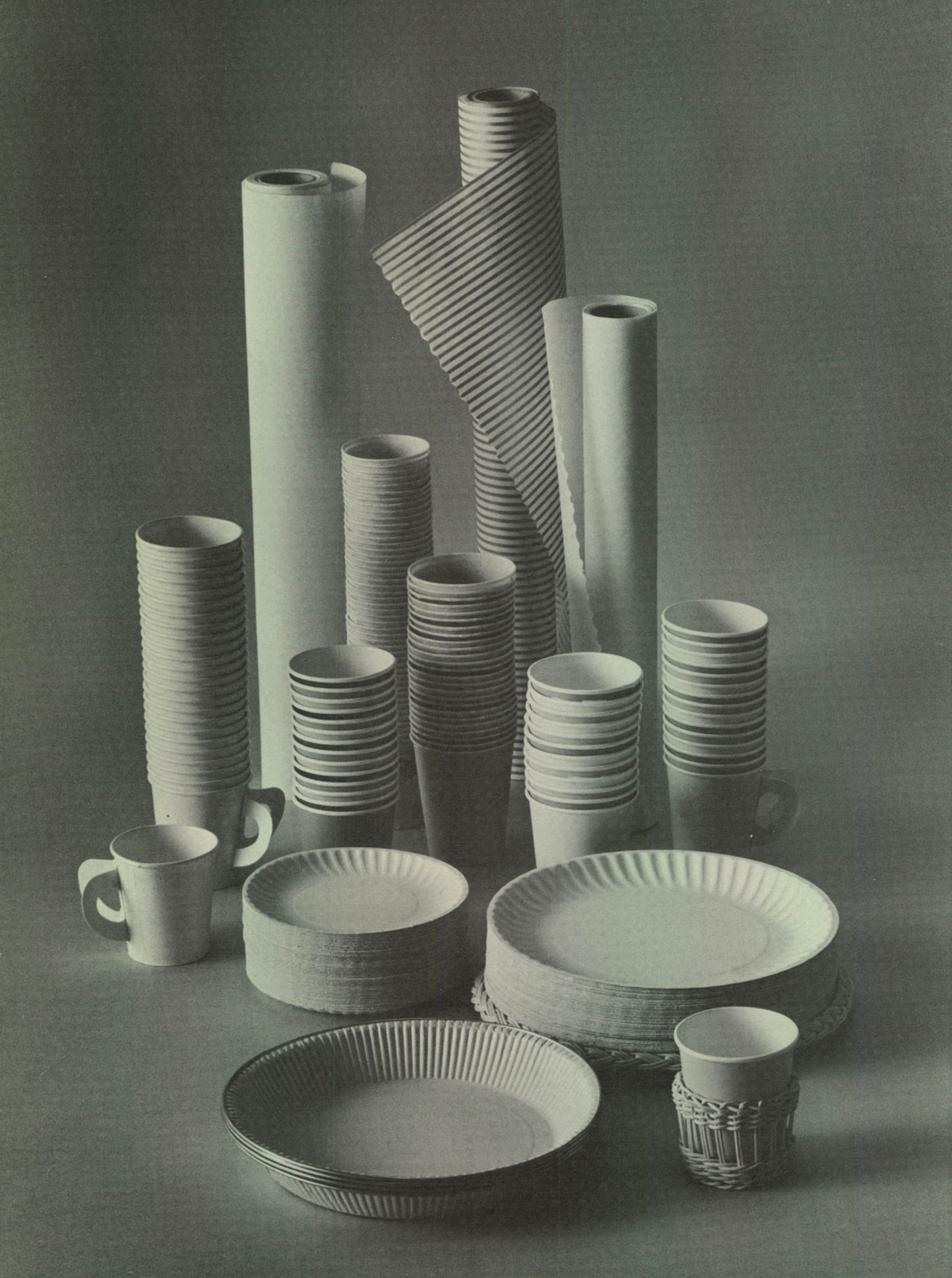
Facilities at Berlin-Gorham, Kalamazoo and Espanola were busy with construction work as the $54 million expansion program was kept on schedule.

The Eight Divisions of Brown

Service Products Division manufactures and markets hundreds of paper and board products for the grocery, bakery and food service industries; absorbent towels and tissues for industry and institutions; a wide variety of popular consumer products such as paper cups, plates, freezer wrap and shelf lining under "Paper Maid"® brand name. Since the bulk of the division's output is marketed through paper merchants, the distribution setup has been drastically revamped with franchises going to selected top distributors in each of the four main product groups. Backing up this marketing organization is a greatly improved centralized manufacturing and servicing capability. The entire line of packaging for the division's products is being redesigned in a smart, modern format consistent with the image of the "New Brown".

Pulp, Paper and Board Division products go into consumer packaging, shipping containers, printing and office papers and technical industrial products. A new corrugating mill acclaimed as the most efficient in the country, has gone on stream. This facility is beginning to pump $10 million in sales annually into the company. The productive capacity of the Berlin-Gorham complex has been sharply improved. Kraft pulp production will be doubled when the expanded pulp mills go on stream in the first half of the year. Paper machines have been rebuilt. Quality control has been stressed to complement the division's intensified marketing effort. The Linweave line of fine text papers was acquired from U.S. Envelope to strengthen the division's position in the graphic arts field. The changes wrought through reorganization and expansion in this division will play an important role in Brown's progress in 1967.

This year for the first time Brown entered the consumer market with broad production including paper cups, plates, freezer and shelf wrap, and gift wrapping.



Packaging Division is one of the leading creators of packaging and packaging systems for food and other consumer products. Its customers include an imposing number of the leading national and regional companies in the ice cream, meat, egg marketing, cookie, cracker, frozen food, cereal, detergent, drug, food wrap, toy and hobby fields, to name only a few. Packaging materials are paper and paperboard with polyethylene laminations added in recent years. In the fourth quarter the installation of film converting equipment enabled the division to produce plastic films, singly and in combinations as well as laminations of films, foil and paper. This facility will further strengthen the division's strong position in the industry.

Match Division is a substantial manufacturer of advertising book matches. The three Superior and Monarch match plants in Chicago and Frankfort, Ill. and San Jose, Cal. are completely self-sufficient with the latest one-, two- and four-color presses for offset, letterpress and process embossed printing. The market for book matches for advertising and resale is constantly expanding. Almost every business which deals with the public is a prospective customer for the division's products and contract users – purchasers of large quantities of book matches – include national and regional grocery chains, tobacco companies, bottling plants, cosmetic and proprietary drug companies, automotive manufacturers and many others. The division uses thousands of tons of Brown paperboard stem and cover stock annually, a consumption which will increase with the steadily expanding market for book matches.

International Division represents a radical departure in Brown's overseas operations. While Brown (and formerly KVP) products had wide acceptance abroad, the full potential of international growth had not been realized. The International Division was formed to put the company's overseas operations on a planned basis and to handle all Brown Company North American export sales.

Our European operations include an interest in Cheverton and Laidler Limited, a British paper converter which produces paper plates, food trays, bakery boxes, meat wrapping papers and waxed paper. SAIFECS, a fiberboard manufacturing and converting plant near Verona, Italy with annual sales of $6 million was purchased in November. The company produces on machines of its own design a special fiberboard widely used in the manufacture of luggage, containers, shoes, automobiles, transformers and electric motors. The overseas market potential for Brown products manufactured in North America and abroad is an important building block for future growth and the accomplishments of 1966 augur well for 1967 and the years ahead.

Brown Forest Industries Limited (formerly The KVP Company Ltd.) in itself is one of Canada's largest producers of pulp, paper, packaging and consumer products with plants in Espanola and Hamilton, Ontario and in Montreal. The pulp operation at the Espanola mill will be doubled in April, 1967, at a capital expenditure of more than $20 million. The expanded mill will have a capacity of 650 tons per day of sulphate bleached and unbleached pulps compared to the previous 325 tons. A modern 8-color gravure press will go into operation in 1967 at the Hamilton plant which will open up markets in the flexible packaging field. In addition, new converting facilities will go on stream in 1967 and the growing educational market for school papers is being expanded.

Building Materials Division is a major producer of decorative hardwood plywood which is now marketed under the "Stratford"® brand name. It also manufactures doorskins and veneers and "Bermico"® bituminous fibre pipe. The downturn in housing starts affected sales of this division in 1966 but this was somewhat offset by an increase in the home improvement market. Indications are that lower interest rates will ease the mortgage market and aid the building industry in 1967 with a corresponding increase of division sales. An upsurge in underground communications systems assures continuing production of fibre pipe throughout the year.

Woodlands Division has the responsibility of conserving and harvesting 4,500,000 acres of timber resources, one of the largest available to any company in North America. As in other industries, new techniques have superseded the picturesque and traditional. Huge trucks have supplanted the "river drive" to bring logs to the mill. The pace of mechanization in timber harvesting was accelerated in 1966. A basic goal of management has been to utilize these woodland resources. Pulpwood utilization will rise from 450,000 cords in 1966 to approximately 600,000 cords in 1967. Our timber resources, scientifically cultivated, and renewed by nature, are a vital asset.

Brown's timber resources increased five and a half times in 1966 with the addition of cutting rights to 3,400,000 acres in Ontario.

BROWN COMPANY Consolidated Statement of Financial Position

November 30

	1966 (Note 1)	1965
Current assets:		
Cash	$ 8,692,000	$ 2,192,000
Marketable securities, at cost (approximate market)		4,437,000
Accounts receivable, less allowance for doubtful accounts ($367,000 in 1966 and $115,000 in 1965)	22,646,000	7,298,000
Inventories (Note 3)	41,647,000	10,642,000
Prepaid expenses	2,031,000	1,100,000
Total current assets	75,016,000	25,669,000
Less current liabilities:		
Accounts payable and accrued expenses	22,598,000	6,368,000
Funded debt payable within one year	817,000	
Dividends payable	800,000	381,000
Total current liabilities	24,215,000	6,749,000
Working capital	50,801,000	18,920,000
Property plant and equipment, less accumulated depreciation and depletion (Note 4)	110,899,000	34,328,000
Investments, at cost, and noncurrent receivables (Note 7)	2,866,000	1,635,000
Deferred charges and other assets (Note 7)	2,285,000	291,000
Working capital and other assets	166,851,000	55,174,000
Deductions:		
Funded debt (Note 5)	65,781,000	3,174,000
Deferred United States and Canadian taxes on income (Note 6)	9,118,000	1,360,000
Deferred credit arising from merger (Note 1)	2,521,000	
Other deferred credits and noncurrent liabilities	751,000	317,000
Excess of assets over liabilities	$ 88,680,000	$50,323,000
Stockholders' equity (Notes 1, 5 and 7):		
Preferred stock, par value $1 per share:		
Authorized—2,500,000 shares series preferred		
Issued—1,100,040 shares series A $1.50 cumulative convertible, at stated value of $33 per share	$ 36,301,000	
Common stock, par value $1 per share:		
Authorized—5,000,000 shares in 1966 and 3,500,000 shares in 1965 Issued—2,596,015 shares in 1966 and 2,539,661 shares in 1965	2,596,000	$ 2,540,000
Other capital	10,326,000	9,319,000
Retained earnings	39,613,000	38,543,000
	88,836,000	50,402,000
Less cost of common stock held in the treasury (10,652 shares in 1966 and 5,700 shares in 1965)	156,000	79,000
Commitments and contingent liabilities (Notes 2 and 10)		
Total stockholders' equity	$ 88,680,000	$50,323,000

BROWN COMPANY Consolidated Statement of Income and Retained Earnings

Year Ended November 30

	1966 (Note 1)	1965
Net sales	$212,695,000	$67,418,000
Costs and operating expenses (Notes 4 and 8):		
Cost of goods sold	184,265,000	60,962,000
Selling, general and administrative expenses	19,460,000	4,908,000
	203,725,000	65,870,000
Operating income	8,970,000	1,548,000
Other income (charges):		
Interest on funded debt	(3,163,000)	(147,000)
Other interest (net)	259,000	172,000
Amortization of deferred credit arising from merger (Note 1)	250,000	
Miscellaneous	303,000	185,000
	(2,351,000)	210,000
Income before provision for taxes on income and deduction of preacquisition earnings of KVP	6,619,000	1,758,000
Provision for United States and Canadian taxes on income (Note 6)	2,100,000	
	4,519,000	1,758,000
Income of KVP applicable to periods prior to acquisition (Note 1)	685,000	
Net income	3,834,000	1,758,000
Retained earnings at beginning of year	38,543,000	38,295,000
Cash dividends declared:		
Preferred stock—$1.125 per share	(1,238,000)	
Common stock—$.60 per share	(1,526,000)	(1,510,000)
Retained earnings at end of year	$ 39.613,000	$38,543,000
Net income per share of common stock (Note 9)	$1.02	*

*As a result of the carry-over of abandonment losses (Note 6 to financial statements) no provision was required for federal income taxes in 1965. If the loss carry-over resulting from these abandonments had not been available there would have been charges to income for federal income taxes currently payable and for deferred taxes which would have reduced reported net income for 1965 by $650,000 from $1,758,000 ($.70 per share) to $1,108,000 ($.44 per share).

BROWN COMPANY Statement of Source and Application of Funds

Year Ended November 30

	1966	1965
Source of funds:		
Provided from operations:		
Net income	$ 3,834,000	$1,758,000
Depreciation and depletion (less $2,617,000 provided in 1966 by KVP prior to merger)	5,327,000	3,131,000
Deferred United States and Canadian taxes on income (less $523,000 provided in 1966 by KVP prior to merger)	1,357,000	
Other items not requiring the use of working capital	(108,000)	37,000
	10,410,000	4,926,000
Proceeds from the sale of 6¼% notes	65,204,000	
Series A $1.50 cumulative convertible preferred stock issued to former shareholders of KVP—1,100,069 shares at stated value of $33 per share (Note 1)	36,302,000	
Proceeds from the sale of plant assets	151,000	134,000
Proceeds from stock options exercised	66,000	266,000
Market value of 50,800 shares of common stock issued under provisions of Executive Stock Incentive Plan, less $946,000 excess of the market value over proceeds charged to Deferred Charges and Other Assets (Note 7)	51,000	
Proceeds from the sale of 40,767 shares of common stock sold under provisions of stock purchase agreement, less portion of proceeds represented by 4½% note receivable in the amount of $465,000 due December 15, 1967		65,000
	112,184,000	5,391,000
Application of funds:		
Net assets (except working capital of $28,595,000) acquired from KVP (Note 1)	46,541,000	
Additions to plant assets	26,808,000	4,320,000
Retirement of 4½% debentures	3,174,000	127,000
Dividends declared—preferred stock	1,238,000	
—common stock	1,526,000	1,510,000
Other (net)	1,016,000	891,000
	80,303,000	6,848,000
Increase (decrease) in working capital	$ 31,881,000	($1,457,000)

BROWN COMPANY Notes to Financial Statements

Note 1—Merger with KVP Sutherland Paper Company In January 1966 the Company purchased 1,108,930 shares of the common stock of KVP Sutherland Paper Company (KVP) for cash. In May 1966 KVP was merged into the Company in accordance with an Agreement of Merger approved by the stockholders of both companies. The Company issued 1,100,069 shares of its Series A $1.50 cumulative convertible preferred stock in exchange for 1,100,069 shares of common stock of KVP and 8,863 shares of KVP common stock were purchased from dissenting stockholders. This acquisition has been accounted for as a purchase and accordingly the accompanying consolidated financial statements include the results of operations of KVP applicable to the Company's interests in KVP for the respective periods of ownership.

The net assets acquired from KVP exceeded the consideration paid and the Company's equity in earnings of KVP prior to the date of the merger by $8,171,000. Of this amount, $5,400,000 was recorded as additional accumulated depreciation and $2,771,000 as a deferred credit. The deferred credit is being amortized over eight years.

Note 2—Basis of Consolidation The accompanying financial statements include the accounts of Brown Company and its wholly-owned subsidiaries operating in the United States and Canada.

The accounts of the Canadian subsidiaries have been converted at appropriate rates of exchange. Accounts of subsidiaries operating in Europe have not been consolidated. These unconsolidated subsidiaries include one domestic subsidiary, $5,000,000 of whose borrowings have been guaranteed by the Company in connection with such subsidiary's acquisition in November, 1966 of a company in Italy. Considered in the aggregate, the net assets and results of operations of the unconsolidated subsidiaries are not significant.

Note 3—Inventories Inventories are stated on the basis of cost or market, whichever lower, cost representing current average or current standard cost, except for inventories of pulpwood amounting to about $978,000 at November 30, 1966 and $175,000 at November 30, 1965 which are stated at cost determined by the last-in, first-out method of valuation. The inventories comprise:

	November 30 1966	1965
Pulpwood, logs and logging operations in progress	**$ 5,685,000**	$ 820,000
Other material and supplies	**14,919,000**	4,326,000
Paper and other manufactured products	**21,043,000**	5,496,000
	$41,647,000	$10,642,000

Note 4—Property, Plant and Equipment Properties, carried at cost less depreciation and depletion provided, are as follows:

	November 30 1966	1965
Land	**$ 2,373,000**	$ 1,416,000
Roads, buildings, machinery and equipment	**206,180,000**	68,967,000
Construction in progress	**28,187,000**	1,644,000
	236,740,000	72,027,000
Less—Depreciation	**128,040,000**	39,972,000
	108,700,000	32,055,000
Timberlands	**8,635,000**	8,611,000
Less—Depletion	**6,436,000**	6,338,000
	2,199,000	2,273,000
	$110,899,000	$34,328,000

Costs and operating expenses include charges for depreciation and depletion of $7,944,000 in 1966 and $3,131,000 in 1965.

Note 5—Funded Debt Funded debt at November 30, 1966 is as follows:

6¼% notes payable	$65,204,000
2% bearer notes due October 1, 1968 (semiannual prepayments of $288,750 required to 1968)	1,394,000
	66,598,000
Less—Amount payable within one year	817,000
	$65,781,000

The 6¼% notes which are due November 30, 1967 have been included in funded debt since, in accordance with the terms of the agreements relating to their sale, arrangements were completed for their retirement in connection with the sale by the Company in January 1967 of $18,750,000 of its 6¼% Senior Notes due January 26, 1972 to banks and $56,250,000 of its 6½% Senior Notes due November 30, 1986 together with Stock Purchase Warrants evidencing the right to purchase 56,250 shares of the Common Stock $1 par value at a price of $28 per share to January 1972 and at a price of $31 per share through January 1977 to insurance companies. The agreements relating to the Senior Notes provide for fixed prepayments in the annual amount of $3,750,000 commencing in January 1968 with respect to the 6¼% Senior Notes and in January 1973 with respect to the 6½% Senior Notes.

In the agreements relating to the 6¼% notes due November 30, 1967, as amended, and to the Senior Notes, there are restrictions on the payment of cash dividends on the Company's common stock. For the year ending November 30, 1967 such dividends are limited to 75% of Consolidated Net Income for the year ending November 30, 1967 reduced by dividends paid on the Series A preferred stock and any other distributions with respect to its capital stock.

Note 6—United States and Canadian Taxes on Income No provision was required for taxes on income for the year ended November 30, 1965 because of the carry-over of abandonment losses from 1962 and 1964. For federal income tax purposes the Company had a net operating loss carry-over amounting to approximately $1,600,000 at November 30, 1966 which can be applied against subsequent taxable income. The loss carry-over for book purposes (which is less than the tax loss carry-over because of the difference between the book and tax basis of certain assets, resulting principally from the use of accelerated depreciation for tax purposes) amounting to approximately $200,000 at November 30, 1965 was fully utilized during the year. Consequently, in addition to provisions for taxes on income relating to the income of KVP pior to merger and to the income for the year of the Canadian subsidiaries, a provision for federal income taxes on the income of the Company is required for book purposes for the year ended November 30, 1966. Since no taxes are payable by the Company, liability for such taxes has been recorded as deferred federal income taxes. The Company has also accumulated an investment tax credit carry-over (none of which expires before November 30, 1969) of approximately $1,500,000 which is available to reduce taxes which would otherwise be payable for future years. As it is expected that these credits will be fully utilized as credits against taxes payable, the Company has adopted the flow-through method of accounting for the investment tax credit and accordingly reduced the provision for deferred federal income taxes by $175,000 representing the amount of such credits it would have been able to use if no difference existed between the book and tax basis of assets. The consolidated provision for taxes on income has been reduced by additional investment tax credits in the amount of $230,000 relating to the income tax provisions of KVP and its domestic subsidiaries prior to the merger.

Note 7—Stock Options, Stock Purchase Agreement and Executive Incentive Plan At November 30, 1966 options, all then exercisable, were held by certain officers and employees to purchase 54,830 shares of the Company's common stock at prices ranging from $10.43 to $14.38 per share, an aggregate of $709,567. Under the Company's stock option plans, options for 100,000 additional shares may be granted prior to April 19, 1975 at not less than the fair market value of the shares on the date the options are granted.

The Company has agreed to sell 100,000 shares of its common stock at $13 per share to an investment company controlled by its President. As of November 30, 1966, the Company had issued 40,767 of these shares for $65,000 in cash and a 4½% note of the investment company for $465,000 due December 15, 1967 (included in Investments and Noncurrent Receivables). As provided in the agreement the remaining 59,233 shares will be issued prior to December 15, 1967 to the extent of cash payments received therefor from the investment company. The Company may transfer from time to time additional shares from the treasury upon receipt of the investment company's 4½% notes due December 15, 1967 in payment therefor. All of the shares issued under the provisions of the agreement are to be held by the Company as security for the payment of the notes.

Under the terms of the Executive Stock Incentive Plan, approved by the stockholders in 1966, the Company may issue to key executives up to 100,000 shares of the Company's common stock at the nominal cost of $1 per share as deferred bonuses to be earned on the basis of continued employment and corporate earnings improvement during a five-year period. Such shares are to be held in escrow until earned and any unearned shares are to be sold to the Company at a nominal price. As of November 30, 1966, 50,800 shares had been issued under this plan. Such shares are to be earned during the period ending November 30, 1970.

Other capital has been increased during the year by the $946,000 excess of the market value at time of issue over the amount received for the 50,800 shares of common stock issued under the Executive Stock Incentive Plan (with an offsetting charge to Deferred Charges and Other Assets) and by the $61,000 excess of amount received over the par value of 5,520 shares of common stock issued to fulfill stock options exercised.

Note 8—Retirement Plans for Employees The Company and its subsidiaries have retirement plans covering substantially all employees. During the year the companies charged to income $1,600,000 for expenses relating to these plans. At November 30, 1966 the actuarially computed value of vested benefits under these plans exceeded the total of pension fund assets and amounts accrued by the companies at November 30, 1966 by approximately $2,400,000.

Note 9—Net Income Per Share of Common Stock Per share data are based on the average number of common shares outstanding each year, after recognition in 1966 of the dividend requirements on the $1.50 cumulative convertible preferred stock.

Note 10—Lease Commitments Annual rental commitments under various leases, the unexpired terms of which are in excess of three years, aggregated $480,000 at November 30, 1966. In addition, the Company had commitments providing for the leasing of an additional $4,000,000 of equipment, construction of which is expected to be completed in 1967. At November 30, 1966 the Company had guaranteed approximately $1,600,000 of lessors interim financing.

Report of Independent Accountants

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF BROWN COMPANY

In our opinion, the accompanying statement of financial position, statement of income and retained earnings and statement of source and application of funds present fairly the consolidated financial position of Brown Company and consolidated subsidiaries at November 30, 1966 and the results of their operations and the supplementary information on funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of these statements was 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.

PRICE WATERHOUSE & CO.

Boston, Massachusetts
January 6, 1967

BROWN COMPANY Ten-Year Financial Review

Years ending November 30

For the Year (000 omitted)	1966	1965	1964
Net Sales	$ 212,695	$ 67,418	$ 68,134
Operating Income	8,970	1,548	2,388
Income Before Taxes	6,619(a)	1,758	2,246
Income Taxes	2,100		
Net Income	3,834	1,758	2,246
Depreciation and Depletion	7,944	3,131	3,050
Cash Flow (Income, depreciation and depletion)	11,778	4,889	5,296
Capital Expenditures	26,808	4,320	2,191
End of Year (000 omitted)			
Working Capital	$ 50,801	$ 18,920	$ 20,060
Property, Plant and Equipment, net	110,899	34,328	33,211
Total Assets	191,066	61,923	60,354
Funded Debt	65,781	3,174	3,305
Common Stockholders' Equity	52,379	50,323	49,358
Preferred Stock	36,301		
Common Stock			
Common Shares Outstanding—end of year	2,585,363	2,533,961	2,471,400
Number of Stockholders	6,228	6,069	6,350
Per Share: Net Income	$1.02	$ .70(b)	$ .91(b)
Dividends Declared	.60	.60	.60
Cash Flow	4.56	1.93	2.15
Book Value	20.26	19.86	19.97

1963	1962	1961	1960	1959	1958	1957
$ 67,888	$ 57,455	$ 56,272	$ 59,173	$ 58,888	$ 55,408	$ 61,158
2,309	996	2,215	2,604	1,328	1,776	3,504
2,372	731	2,291	2,287	944	1,390	3,180
		820	940	230	94	1,100
2,372	731	1,471	1,347	714	1,296	2,080
3,550	3,851	3,892	3,699	3,460	3,185	2,856
5,922	4,582	5,363	5,046	4,174	4,481	4,936
3,209	5,012	2,660	2,565	3,600	2,302	8,059
$ 19,319	$ 17,291	$ 18,811	$ 16,890	$ 14,696	$ 14,918	$ 13,350
35,260	36,014	43,714	45,065	46,354	46,157	46,974
63,186	61,480	69,350	68,877	70,070	69,259	71,390
3,612	3,822	4,028	4,229	4,377	4,677	4,863
51,211	50,128	58,020	57,632	56,546	56,644	56,012
2,469,400	2,481,000	2,562,681	2,621,981	2,638,981	2,588,651	2,588,651
7,001	7,895	7,929	8,593	8,173	7,622	7,648
$ .96(b)	$ .29	$ .57	$ .51	$ .27	$ .50	$ .80
.47½	.40			.30(c)	.55	1.00
2.40	1.81	2.08	1.91	1.59	1.73	1.91
20.74	20.20	22.64	21.98	21.43	21.88	21.64

(a) Also before deduction of pre-acquisition earnings of KVP in the amount of $685,000.

(b) If loss carryovers had not been available (See Note 6 to Financial Statements), earnings per share would have been $.44 in 1965, $.70 in 1964, and $.60 in 1963.

(c) In addition, a stock dividend of 2% was paid on March 1, 1959.

Diversified Forest Products

Nibroc® Converting Papers
Linweave® Creative Papers
Eagle-A Business Papers & Stationery
Bermico® Pipe
Stratford Hardwood Plywood—
Door Skins—Veneers
Solka-Floc®
Flexible Packaging
Folding Cartons
Packaging Systems
Industrial Technical Papers
Superior® & Monarch® Book Matches
Paper Maid® Paper Plates & Cups
Paper Maid Freezer Wrap
Nibroc® Towels, Tissues, & Wipers
Food Service Products
Grocery Supply Products
Bakery Products
Corrugating Medium
Market Pulps
Herculean Board
Adamas Fiber
Fiberboard
Electrical Insulation Board & Paper
Gasket Stock
Reconstituted Leather
Appleford® Products

Independent Accountants
Price Waterhouse & Co.

Transfer Agent
The Corporation Trust Company
New York and Jersey City, N. J.
277 Park Avenue, New York, N. Y. 10017

Registrar
Registrar and Transfer Company
New York, N. Y.

Annual Meeting
April 17, 1967, 10 a.m., E.S.T.
Summit Hotel
New York, N. Y.

Sales Offices and Plants

United States
Atlanta, Georgia
Berlin-Gorham, New Hampshire
Birmingham, Alabama
Boston, Massachusetts
Castleton-on-Hudson, New York
Chicago, Illinois
Cleveland, Ohio
Corvallis, Oregon
Des Plaines, Illinois
Detroit, Michigan
Frankfort, Illinois
Glendale, California
Griffin, Georgia
Holyoke, Massachusetts
Kalamazoo, Michigan
Minneapolis, Minnesota
Mount Holly, New Jersey
Narbeth, Pennsylvania
Needham, Massachusetts
New York, New York
North Stratford, New Hampshire
Philadelphia, Pennsylvania
St. Louis, Missouri
Santa Clara, California
San Jose, California
Sturgis, Michigan

Canada
Brown Forest Industries Limited
Espanola, Ontario
Hamilton, Ontario
Montreal, Quebec
Toronto, Ontario

Europe
Cheverton & Laidler Ltd.
Princes Risborough
Buckinghamshire, England
Hengoed, Glamorgan, Wales

SAIFECS
Piazzo Conciliazone, 1
Milano, Italy

San Giovanni Lupatoto
Italy

Executive Office
277 Park Avenue, New York, New York 10017

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Brown Company papers used in this report are:

COVER—lithographed on Linweave Velvetsheen, Bright White Satin, cover weight, substance 80

TEXT—lithographed on Linweave quality Tarotext, Gray text weight, substance 70