CROWN ZELLERBACH

1981 Annual Report

C

HIGHLIGHTS

	1981	1980
Sales and Earnings		
Net sales	$3,148,300,000	$3,066,600,000
Income before income taxes	$ 101,100,000	$ 127,800,000
Taxes on income	$ 25,800,000	$ 30,400,000
Net income	$ 75,300,000	$ 97,400,000
Financial Position		
Working capital	$ 398,900,000	$ 378,900,000
Total assets	$2,614,100,000	$2,372,700,000
Long-term debt	$ 626,400,000	$ 486,100,000
Preferred stock	$ 125,000,000	$ 125,000,000
Common stock equity	$1,097,200,000	$1,060,200,000
Per Share of Common Stock		
Net income	$ 2.47	$ 3.46
Common dividends declared	$ 2.30	$ 2.25
Common stock equity	$40.86	$41.43
Additional Information		
Internal funds generated	$ 197,700,000	$ 273,500,000
Dividends declared	$ 71,200,000	$ 66,500,000
Additions to properties	$ 345,700,000	$ 281,600,000
Depreciation, amortization, depletion and cost of timber harvested	$ 118,900,000	$ 116,100,000
Average common shares outstanding	25,834,270	25,505,984
Holders of record of common shares	26,328	26,485
Employees	28,407	30,569

SUMMARY OF RESULTS

The recession and the worst depression in housing and forest products since World War II reduced 1981 earnings to $75.3 million, or $2.47 per share, including unusual items, on sales of $3.15 billion.

With mortgage interest rates of nearly 18 percent, with total domestic housing starts, lumber demand and lumber prices the lowest in more than 30 years, and with prices and volume of log exports to Japan the weakest in a decade, Timber and Wood Products reported an operating loss of $14 million. This contrasted with that Group's 1980 operating earnings of $39 million, and eroded gains from other businesses.

Results of the Containers and Packaging Group, for example, improved sharply, reflecting major productivity improvement in corrugated container operations and good markets for specialty packaging. The Energy Group doubled its earnings on continued oil and gas leasing on CZ land in Louisiana and Mississippi. Pulp and Paper results were ahead slightly, but those of Wholesale Distribution were slightly behind 1980 because of recessionary pressures on margins. Pulp and Paper benefitted from a more profitable product mix and improved operating effectiveness.

Sales and earnings of Crown Zellerbach International, which are consolidated in group results, declined due to major weakness in the lumber and plywood markets of Crown Zellerbach Canada Limited, a six-week industry-wide strike in western Canada, and weakness in Canadian market pulp sales in the final quarter.

TO OUR SHAREHOLDERS, CUSTOMERS & EMPLOYEES

Nearly all of you are aware that housing is the economy's most severely depressed industry, that the timber and wood products industry is nearly as bad and that portions of the paper industry have been hard-hit.

Although we fared better than a number of our competitors, Crown did not escape the impact of the recession and particularly the worst housing slump in 35 years, and earnings were severely affected as a result. However, a number of important and constructive factors are taking shape within Crown Zellerbach. Chief among these is that we have in place a strong, committed and high quality management team, consisting of 10 senior officers and an aggressive, rapidly rising younger management cadre. This team has moved quickly and decisively to solve immediate problems, while at the same time looking beyond them to deal with long-range needs and opportunities and set challenging goals for the future.

The principal issue before senior management for the past several months has been a detailed review of major strategic directions of the company. At the same time, essential near-term actions to make Crown more cost-effective are proceeding. To reduce the earnings erosion, we cut planned fourth-quarter expenses by more than $20 million. The size of the salaried work force has been reduced 10 percent, and the hourly work force decreased through necessary lay-offs and mill and plant closures. No bonus payments to management were awarded for 1981, since return on shareholders' equity, before unusual items, did not reach the required level.

Capital investment to modernize facilities and reduce operating costs was brought to a total of $346 million from $282 million in 1980. Accordingly, modernization and expansion at our Camas and Wauna mills on the Columbia River, at the Bogalusa, Louisiana, and Antioch, California, containerboard mills, and at other operations are moving ahead. Our program of consolidation of operations, disinvestments, and monetization of assets continues, with the sale of a previously closed Los Angeles flexible packaging plant, and the closures of a wood products complex at Rainier, Oregon, and, early in 1982, of an electrographic papers plant at Florence, Kentucky, a small pulp recycling mill at Moreau, New York, and a corrugated box plant at Memphis, Tennessee.

Several actions also strengthened Crown's balance sheet and improved liquidity. An exchange of 1.2 million shares of common stock for Crown Zellerbach debentures in October increased equity and retired $47 million of corporate debt. Also, early in 1982, we replaced $140 million of variable rate debt with intermediate fixed rate private placements. Such actions will enable Crown Zellerbach, in contrast to many companies, to sustain a high level of capital spending while maintaining a sound balance sheet.

Your management believes that further progress will be evident by next year, and I wish to express my appreciation to all whose shared commitment to our objectives will make that possible.

W. T. Creson

WT Creson

President
Chairman of the Board and
Chief Executive Officer

March 10, 1982
San Francisco, California

PRODUCTIVITY & COST EFFECTIVENESS

Crown Zellerbach's carefully developed strategic plan—backed by a $2.1 billion commitment to capital investment and guided by a strong management team—is proceeding on schedule to modernize and restructure the company for maximum productivity and cost-effectiveness in its most profitable markets.

Crown is actually a portfolio of businesses, all closely related, but each with its individual characteristics and requirements.

Pulp and Paper is a capital and energy-intensive business in which Crown is among the largest producers in North America, with annual production of some 2.7 million tons of paper, containerboard and pulp.

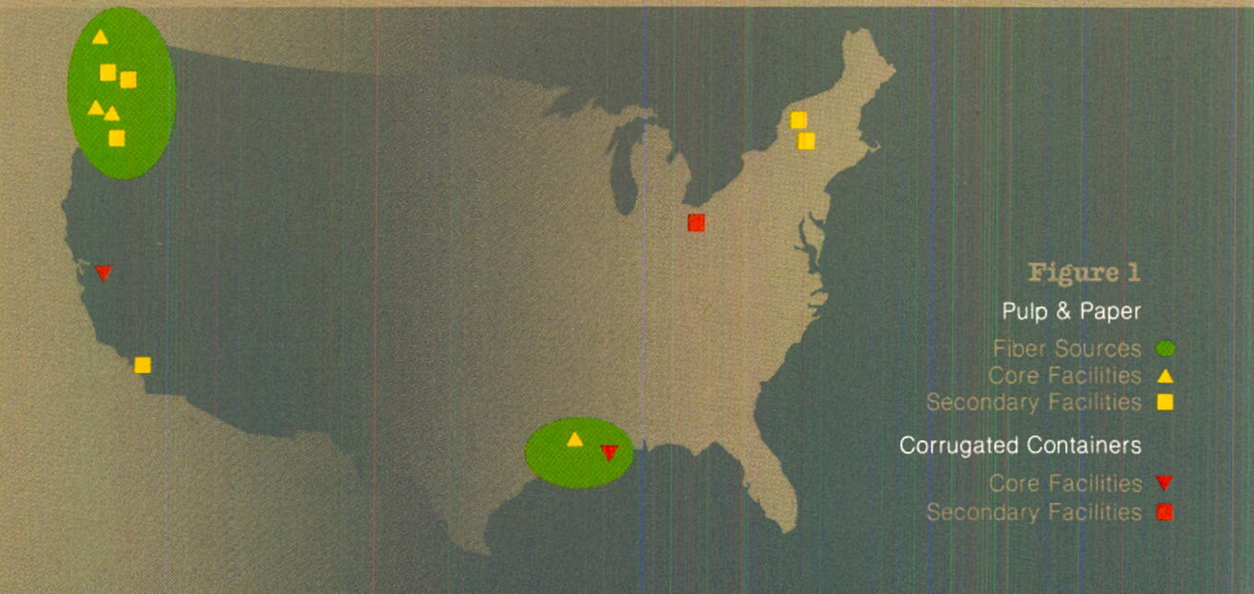
Timber and Wood Products is a mature business, highly dependent on the housing industry and strongly affected by log exports to Japan. Crown's 3.4 million acres of strategically located managed forests can provide more than half of its fiber needs for logs, lumber and plywood and for pulp and paper production.

Corrugated Containers is a mature industry in which Crown is also a major national supplier. It is closely linked to GNP, intensely competitive and requires strict cost control.

Specialty Packaging is a dynamic, fast-growing business in which Crown has firmly established national leadership. Strong demand by the food industry for specialty packaging makes this increasingly profitable business unusually recession-resistant.

Wholesale Distribution is a high-growth service business in which capital investment needs are quite moderate in relation to sales. The company's Distribution Group includes 59 wholesale outlets in 24 states, including Alaska and Hawaii, handling thousands of paper, office and related products.

Energy is a relatively new business for Crown with significant profit potential. Revenues at present come principally from granting oil and gas exploration leases



on company property in the South anc oil produced from shallow, low-cost wells which Crown operates in northwestern Louisiana.

Managing this portfolio for maximum productivity and profit requires, first, a skilled, versatile management team; second, identifying markets in each business where Crown can achieve strong positions; third, channeling the company's capital and other resources into cost-effective facilities which best serve those markets, and, fourth, reducing or eliminating operations that do not meet those standards.

Markets for business and publication papers, for example, have held up fairly well through the recession and will regain momentum rapidly as business conditions improve. Corrugated containers, basically a commodity, also should enjoy increasing demand as the economy recovers, and newsprint has been a consistently strong market.

Since 1977 we have been making major capital investments to strengthen Crown's positions in these markets. Currently we are investing more than $400 million to convert our largest pulp and paper facility at Camas, Washington, from a multi-line specialty mill to a modern, high-efficiency producer of business papers and sanitary papers. Another $16 million has been spent to expand production of business papers at the Wauna, Oregon, mill, and nearly $20 million to expand and improve our production of coated publication papers at St. Francisville, Louisiana, and West Linn, Oregon. More than $140 million has been spent to make our linerboard and corrugated container operations fully competitive and cost-effective, and more than $150 million has been invested to construct one of the industry's largest newsprint machines at Crown Zellerbach Canada's Elk Falls mill in British Columbia. This machine, the third at Elk Falls, is the centerpiece of a $250 million program to modernize CZ Canada's facilities.

The fastest growing of Crown's markets is specialty packaging, and substantial capital has been invested in new equipment and technology in flexible packaging and film products. And to capitalize on the steady growth in wholesale distribution, $30 million has been spent to maximize customer service and expand the reach of our operations.

Figure 2

Timber & Wood Products

Basic to Crown's planning is the concept of serving our markets from closely integrated systems that include three essential components:

1. Readily available, low-cost resources
2. Cost-effective production facilities and
3. Efficient marketing capabilities.

The company's capital resources, human resources and natural resources are all focused on the development of these systems, which generally consist of central, or "*core*" units and supporting, or secondary units.

The implementation of this concept is best illustrated by Crown's pulp and paper and corrugated container operations (See Figure 1). Five of our "*core*" facilities—Camas, Wauna, Elk Falls, St. Francisville and Bogalusa in Louisiana—are located within the company's major wood producing areas in the Pacific Northwest and South, assuring them of long-term, low-cost fiber supplies. The sixth, a containerboard recycling mill at Antioch, California, is well located with respect to recyclable paper. All are also well positioned to serve major paper markets in the West and Southeast, and all are situated at or near deep water ports, giving them full export capability. The company's smaller waste paper recycling mills in southern California, northern New York State and Baltimore, Ohio, are similarly well located with respect to recyclable paper supplies and attractive markets. The continuing viability of secondary facilities, which include mills at Port Angeles and Port Townsend, Washington, and West Linn, Oregon, depends on maintaining their profitability without further major capital investment. Future decisions regarding such facilities will not affect the availability of the CZ products they currently supply, since contingency plans provide for shifting those products to one or more of the "*core*" mills.

In timber and wood products, Crown's domestic "*core*" units are our forest operations in the Columbia River area and in east Louisiana. Integral to the east Louisiana area are a recently completed, high-productivity log processing center at Holden and a sawmill at Ponchatoula (See Figure 2). Crown Zellerbach Canada also has "*core*" wood products facilities in both the coastal and interior areas of British Columbia.

Timber and wood products "*core*" units are closely integrated with our major pulp and paper mills to provide dependable sources of wood residuals—chips and

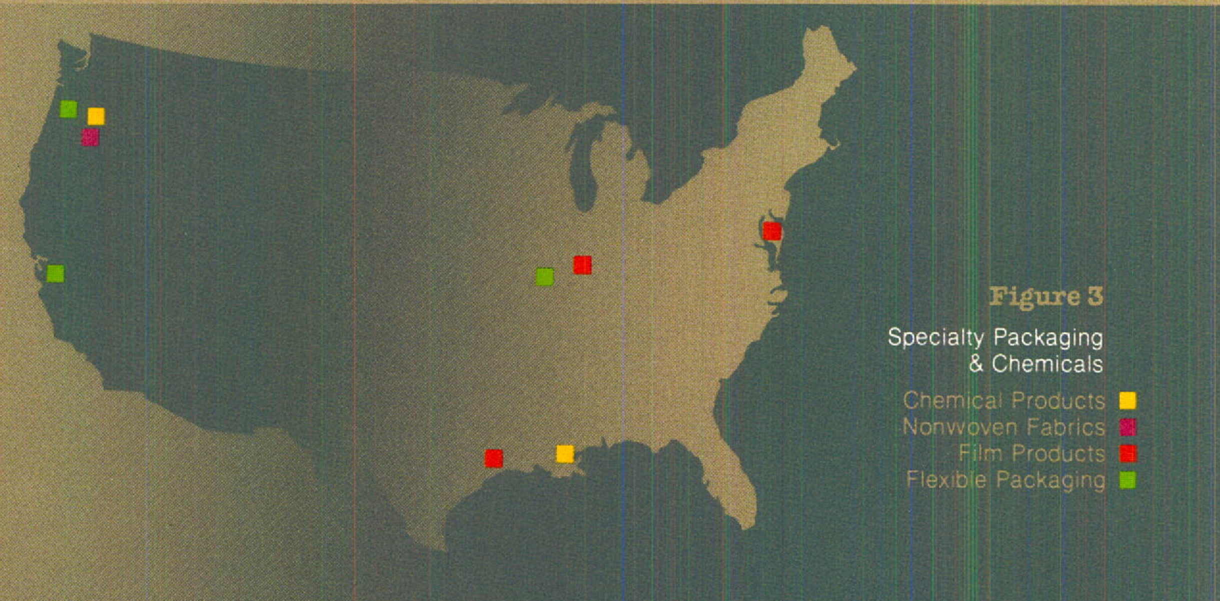


Figure 3
Specialty Packaging & Chemicals

sawdust for papermaking and wood waste for boiler fuel—as well as pulp logs. Timberlands and facilities which are not integrated with these systems are being phased out or sold, and the proceeds reinvested in improving Crown's other businesses.

The packaging field is one of constantly changing technology, and Crown has allocated a large share of its capital investment to bringing new technology to the marketplace (See Figure 3). Group facilities now include two of the industry's largest film plants at Greensburg, Indiana, and Orange, Texas, a third at New Castle, Delaware, and high-technology flexible packaging plants in Portland, Oregon, San Leandro, California, and St. Louis that serve some of the nation's most active specialty packaging markets.

This Group is also building a strong market position in chemical products used in manufacturing plastics, pharmaceuticals, and building materials, and is becoming an increasingly important factor in the field of nonwoven fabrics. Construction is underway at Camas on a new nonwoven fabrics plant that will triple Crown's output of these polypropylene textiles, which are used in a variety of construction and consumer products.

In the past few years, wholesale distribution has grown from a western regional operation—Zellerbach Paper Company—to a national system extending from Hawaii and Alaska, through the western states and across the Sun Belt to the eastern seaboard, with commensurate growth in sales (See Figure 4). Since 1976, the Distribution Group has added 33 outlets in 18 states, including 9 in 1981, and many of its operations have been computerized to provide better customer service and inventory control.

Crown's role in oil and gas exploration requires little capital investment but provides substantial revenue, with the possibility of greater profits in the future. The company owns the mineral rights on approximately 640,000 acres in Louisiana and Mississippi, of which more than 300,000 acres are under lease to major petroleum companies for deep exploration. Since 1978 these leases have returned $29 million in fees and bonuses, $21 million of it in 1981, and Crown has the option of participating in the earnings from any significant discoveries that may be made. The company itself operates a field of inexpensively drilled, shallow wells in Louisiana that produced $12 million of income in 1981.

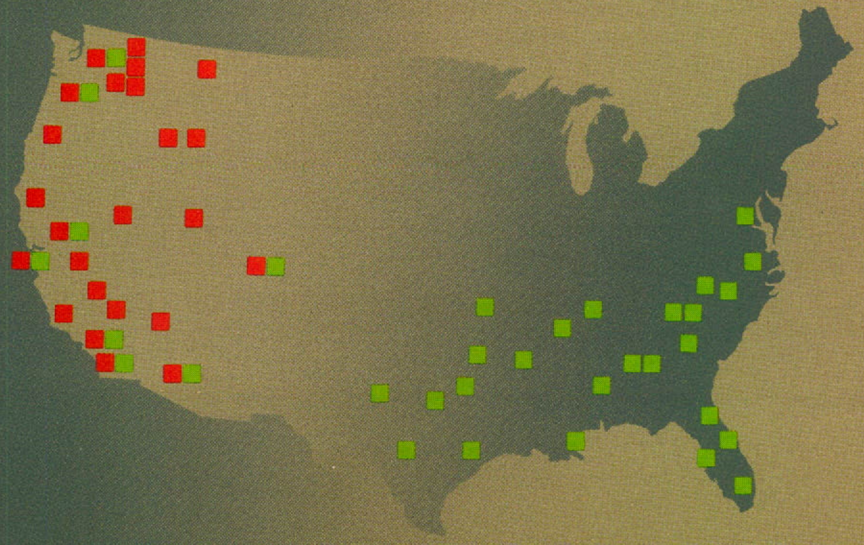


Figure 4
Distribution

OPERATIONS REVIEW

Overview

In spite of the worldwide recession, sales increased moderately in all of Crown Zellerbach's lines of business except Timber and Wood Products. As a result of the exceptionally depressed state of the housing industry, that Group's sales declined, and earnings fell from a profit of $39 million in 1980 to a loss of $14 million in 1981. Recessionary pressure also limited the Pulp and Paper Group's earnings to a 2 percent increase and caused the Distribution Group's earnings to decline 4 percent, on a year-to-year basis. By contrast, the Containers and Packaging Group reported earnings of $22 million, compared with a loss of $6 million in 1980, due to improved productivity at the newly-modernized Bogalusa, Louisiana, containerboard mill and gains in sales and profit margins of the Group's Flexible Packaging and Nonwoven Fabrics Divisions. 1981 earnings of the Energy Group were approximately double those of 1980, primarily due to an increase in nonrecurring bonus payments for oil and gas leases. The company's capital investment program continued uninterrupted by the state of the economy. CZ invested $346 million in modernization and productivity-enhancing projects in 1981, compared with $282 million in 1980.

In October, the exchange of approximately $47 million in sinking fund debentures for 1.2 million shares of Crown Zellerbach common stock resulted in a gain of $16 million. This increased shareholders' equity by $47 million and decreased long-term debt by a similar amount.

The writeoff of an investment in an affiliated company in The Netherlands reduced net income by $5.9 million.

Timber and Wood Products

(In millions of dollars)

	1981	1980	1979
Sales	$545	$600	$682
Operating Earnings	$ (14)	$ 39	$117
% of Total Operating Earnings	(8)	21	38

The severe slump in housing construction due to high interest rates and scarce mortgage funds caused declines in both sales and earnings. Housing starts in 1981 dropped to slightly more than 1 million from 1.3 million in 1980 and 1.7 million in 1979. The export market, principally logs for Japan, also declined by 38 percent. As a result, lumber and log prices declined substantially. This led to curtailments and shut-downs in CZ timber and wood products operations in the Pacific Northwest and in the South. Logging operations at the Clackamas, Oregon, and Clallam, Washington, managed forests were suspended, and the Rainier, Oregon, sawmill was closed permanently.

Timber harvest for the year was 304 million cubic feet, compared with 360 million cubic feet in 1980. Lumber production was 717 million board feet, compared with 770 million in 1980, and plywood production was 487 million square feet, compared with 561 million in the prior year. CZ's consolidated results also were significantly affected by lower sales and earnings of its Canadian affiliate, Crown Zellerbach Canada Limited, due to weak lumber and plywood markets and a forest products and paper industry strike in July and August.

Pulp and Paper

(In millions of dollars)

	1981	1980	1979
Sales	$1,296	$1,239	$1,013
Operating Earnings	$ 107	$ 105	$ 142
% of Total Operating Earnings	59	56	47

Pulp and paper sales, which tend to parallel the rate of growth of the general economy, gained 5 percent in 1981. Profits, on the other hand, are determined not only by the firmness of markets, but by the costs of energy and process chemicals and by the cost and availability of wood fiber, the raw material. As in most manufacturing industries, energy and chemical costs have risen sharply in recent years. In addition, reduced operating rates in lumber and plywood manufacturing caused scarcities of the lowest-cost source of fiber, wood residuals from sawmills and plywood plants, and forced costs upward in 1980. This was offset by improved prices in 1981, but the forest products and paper industry strike in Canada negated these gains.

Demand for sanitary products was strong throughout 1981. Markets for unbleached coarse papers, some business papers and Canadian market pulp became soft in the second half.

CZ made significant strides toward improved productivity during the year. We modernized a large paper machine at our Wauna, Oregon, mill, increasing the mill's output of register bond used for computer, copier and other business papers by 50 percent. CZ's largest pulp and paper mill at Camas, Washington, is being thoroughly modernized to achieve state-of-the-art production capability, greatly improved cost-effectiveness and a better balance between pulp production and paper machine capacities. A new merchandise bag manufacturing facility with a capacity of more than 20,000 tons a year was opened at North Portland, Oregon, in June.

Containers and Packaging

(In millions of dollars)

	1981	1980	1979
Sales	$607	$562	$487
Operating Earnings	$ 22	$ (6)	$ 9
% of Total Operating Earnings	12	(3)	3

Consolidated United States and Canadian earnings of the Containers and Packaging Group increased substantially on a moderate increase in sales. Corrugated container markets are highly sensitive to economic conditions. But the decline in economic activity was more than offset by the increased efficiency of the Bogalusa, Louisiana, containerboard mill, which supplies raw material to 12 eastern CZ box plants. 1980 results also reflected start-up costs at Bogalusa and the closure of the obsolete containerboard mill at Lebanon, Oregon.

Reconstruction was completed in mid-November, four months ahead of schedule, on a recovery boiler at Bogalusa that was heavily damaged by fire in 1980. Construction began on a new $18 million power co-generating complex at the Antioch, California, containerboard mill. With its start-up in the fourth quarter of 1982, Antioch will become energy self-sufficient and produce surplus electricity to sell.

Sales and profit margins in specialty packaging held up well throughout the year. Year-to-year earnings comparisons also reflect the cost of closing an obsolete film products plant in Los Angeles in 1980.

Two other components of the Containers and Packaging Group are Nonwoven Fabrics and Chemicals. Construction began at Camas on a $22 million facility that will triple CZ's nonwoven fabrics production capacity, beginning in late 1982. In addition to their established use in sanitary and medical products, nonwoven fabrics are gaining increasing acceptance in the construction industry, a market CZ is pursuing aggressively. CZ's specialty chemicals are used in construction, plastics and artificial fibers, animal feed supplements, industrial cleaning, pharmaceutical manufacturing and oil well drilling.

Distribution

(In millions of dollars)

	1981	1980	1979
Sales	$1,034	$954	$849
Operating Earnings	$ 29	$ 31	$ 25
% of Total Operating Earnings	17	16	8

Distribution Group sales in the United States and Canada increased 8 percent and exceeded $1 billion for the first time, but the Group reported a decline in profit for the first time in five years. In line with the overall economy, sales growth slowed from the pace of recent years, and this factor, coupled with increased pressure on margins, caused earnings to decline.

During the year, the Group made significant progress toward its long-term goals. A substantial reorganization was completed which will focus management efforts and resources on markets with the highest growth potential in the decade ahead. These include office products, ranging from office supplies to furniture, printing papers for what is expected to be a robust market as the economy recovers, and industrial products, which are primarily paper and plastic film, packaging equipment and supplies, and personal service items.

In the West, a separate Zellerbach Office Products Division was formed to concentrate on the vigorous office products market. The division opened new distribution facilities in Portland, Sacramento and San Diego, in addition to expanding the office products distribution capabilities of its San Francisco, Los Angeles, Phoenix and Seattle offices. In the

South, Stationers Distributing Company, which serves office products dealers throughout the Sunbelt, opened new facilities in Kansas City and Nashville.

In a redeployment of assets, Zellerbach Paper Company sold its Mass Market Division, a merchandising operation specializing in school supplies and related items.

Customer service was further enhanced by the installation of nearly 100 customer service computer terminals. These are leased to Office Products customers and are tied directly to Zellerbach's on-line order entry system to facilitate placing orders and determining product availability.

Energy

(In millions of dollars)

	1981	1980	1979
Sales	$24	$ 23	$ 13
Operating Earnings	$36	$ 18	$ 12
% of Total Operating Earnings	20	10	4

Energy Group earnings exceeded 1980 earnings, with non-recurring bonuses from oil and natural gas exploration leases on CZ lands in Louisiana and Mississippi accounting for the increase. Production of oil and gas equivalents from company-owned wells and CZ's share of the production of others amounted to 763,000 barrels in 1981, about the same as in 1980. Leases and bonuses brought earnings of $21 million.

Exploration activity on and around CZ lands declined from 1980 levels, however. The amount invested in drilling—almost entirely by lease-holders, either on CZ lands or on drilling or producing units in which CZ had an interest— declined in 1981 to $109 million from $241 million in 1980. 1981 drilling totaled 496,000 feet in 35 wells, compared with 806,000 feet in 52 wells during the prior year.

Other

Other income, miscellaneous, net, went from $14.2 million in 1980 to $20.5 million in 1981. Gains on disposition of capital assets increased $11.2 million, and foreign currency translation effects improved by $5.3 million. Interest income decreased $10.0 million.

Interest expense remained level. Although the Corporation borrowed more, and at higher rates, the additional funds went into projects under construction. Interest capitalized on those projects, in accordance with generally accepted accounting principles, was $30.3 million in 1981, compared with $12.1 million in 1980. The effective rate of taxes on income in 1981 was 25.5 percent, compared with 23.8 percent in 1980.

Unusual items in 1981 included a nontaxable $16.2 million gain on the acquisition of $47 million of 8⅞ percent and 9¼ percent debentures to meet future sinking fund requirements. A total of 1.2 million shares of common stock was issued in exchange for the debentures. The Corporation made a $5.9 million after-tax writeoff of the carrying value of its equity investment in an affiliated company in The Netherlands because it is believed that the likelihood of economic return on the investment is remote.

Financial Review

The year-end current ratio was 1.8, unchanged from 1980. Working capital increased $20 million, to $399 million, to accommodate a slightly higher sales volume.

Capital expenditures for the year totaled $346 million, compared to $282 million in 1980. They are expected to be $330 million in 1982, of which approximately two-thirds is earmarked for new plant capacity and cost reduction. Major projects in progress during 1981 were the Elk Falls expansion and the Camas modernization.

(In millions of dollars)

	1981	1980	% Change
Improvements to existing facilities	$100	$101	– 1
New plant capacity and cost reduction	239	167	+ 43
Land and timberlands	7	14	– 50
Capital expenditures	$346	$282	+ 23

External financing will be necessary to supplement internally generated funds to pay for the capital improvement program. Covenants in existing loan agreements permit borrowing of up to an additional $600 million on a long-term basis.

The Corporation maintains short-term credit lines of $100 million and long-term credit lines of $380 million with domestic and foreign banks, and borrows in the commercial paper market. At December 31, 1981, $283 million of these sources had been used. Early in 1982, the Corporation made arrangements with private lenders to borrow $140 million under intermediate term notes.

Long-term debt at year-end was 30 percent of total capitalization compared with 26 percent at December 31, 1980.

(In millions of dollars)

December 31,	1981	1980	% Change
Long-term debt	$ 626	$ 486	+29
Deferred income taxes	178	158	+13
Minority interest	47	44	+ 7
Convertible preferred stock	125	125	–
Common stock equity	1,097	1,060	+ 3
Total capitalization	$2,073	$1,873	+11

1980 Compared to 1979

Net income was $97 million, or $3.46 per share, from sales of $3.1 billion. 1979 net income was $134 million, or $5.24 per share, from sales of $2.8 billion. After a reasonably good first quarter, 1980 operating earnings declined on a quarter-to-quarter basis. This was due principally to the world-wide recession, especially the slump in United States housing construction and a decline in demand for containers and some paper products. Other adverse factors were sharply rising costs for wood fiber and energy and non-recurring expenses associated with Crown Zellerbach's modernization program.

Timber and Wood Products was the first of Crown's businesses to feel the full impact of the recession. Earnings fell sharply as rising interest rates and decreasing mortgage availability reduced home construction activity. The rate of housing starts for 1980 was 1.3 million, substantially below the 1979 rate of 1.7 million. Foreign housing construction markets also were depressed, particularly in Japan, which resulted in a 20 percent decline in log exports, another important market for Crown Zellerbach. Many timber and wood products operations were temporarily suspended or curtailed during the year, resulting in an operating rate of 68 percent.

The Corporation's 1980 timber harvest was 10 percent less than in 1979. Lumber production was down 27 percent from 1979, and plywood production was 9 percent below the prior year's output.

The Pulp and Paper Group reported lower earnings due to sharp increases in raw material costs, combined with declining demand in some markets. Overall demand was approximately the same as in 1979.

The slowdown in the lumber and wood products industry reduced the supply of sawmill and plywood residuals for papermaking. By the second half of 1980, prices in the Northwest for sawdust and wood chips had increased 120 percent over 1979, and by year end had eased only slightly. The cost for purchased energy rose 30 percent and for pulping chemicals 20 percent. As a result, operating margin was reduced 39 percent. Earnings were also affected by non-recurring expenses of $3.7 million associated with closing small-scale towel and tissue operations.

Corrugated container and specialty packaging sales increased 15 percent over 1979. Results reflect the high operating cost of old equipment at the Bogalusa mill during the first half of 1980 and approximately $16 million in startup costs related to the $120 million modernization program there during the second half. Also contributing to the loss was the write-off of $3.3 million for the closure of the Lebanon, Oregon, containerboard mill.

Corrugated container volume was essentially flat, but prices improved. However, the improvement was negated by escalating energy, material and labor costs.

Markets for specialty packaging remained fairly strong throughout the year, with margins relatively stable. These products are less sensitive to economic downturns than many others. Results reflected the $3.4 million cost of closing a 31-year-old film products plant in Los Angeles.

Distribution Group earnings were 24 percent ahead of 1979, on a 12 percent increase in sales. Margins held firm despite competitive pressures and a change in product mix.

In 1980 the principal source of Energy earnings was oil production from nearly 400 wells in a shallow formation known as the Colgrade Field in north-central Louisiana. While a portion of the Group's earnings growth resulted from increases in the volumes of oil and gas produced, the bulk of it came from increases in the prices of petroleum products.

Statement of Management Responsibility

The consolidated financial statements and other financial information of Crown Zellerbach and subsidiaries contained in this annual report to shareholders have been prepared, using generally accepted accounting principles, under the direction of management, which is responsible for the quality of the data and the evaluations and judgements required.

Management is responsible for the maintenance of the systems of internal accounting control and the review of their effectiveness. These internal control systems are designed to provide assurance that transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles, and that assets are safeguarded. Although there are inherent limitations in any system of internal control, management believes that its systems provide effective controls consistent with reasonable cost.

Through written communication of policies and procedures, careful selection and training of personnel, organizational arrangements that provide division of responsibility, and a program of monitoring compliance by internal audits and follow-up, management augments the systems of internal control.

The Audit Committee of the Board of Directors is composed of outside (non-employee) directors. It is responsible for recommending, annually, the firm of outside accountants to be engaged as independent auditors, subject to the approval of the shareholders. The committee also reviews the annual financial statements of the Corporation and the report of the independent auditors thereon, and considers matters relating to internal controls and auditing procedures. The Audit Committee meets regularly with the independent auditors and the Corporation's internal auditors to discuss these matters. Both the independent auditors and the internal auditors have free and independent access to the Audit Committee.

Statements of Income

(In millions of dollars, except per share amounts)

Years ended December 31,	1981	1980	1979
Income			
Net sales	$3,148.3	$3,066.6	$2,806.1
Other income:			
From operations, net	23.9	3.2	5.8
Miscellaneous, net	20.5	14.2	22.0
	3,192.7	3,084.0	2,833.9
Expenses			
Cost of goods sold	2,709.3	2,615.0	2,287.1
Selling and administrative costs	350.9	327.2	279.2
Interest on debt	36.7	37.1	46.5
	3,096.9	2,979.3	2,612.8
Income before unusual items and income taxes	95.8	104.7	221.1
Unusual items			
Gain on early retirement of debt	16.2	–	–
Share of operating loss and writedowns of investments in affiliates	(10.9)	(31.9)	(10.0)
Gain on disposal of investment	–	35.0	–
Gain on involuntary conversion	–	20.0	–
	5.3	23.1	(10.0)
Income before income taxes	101.1	127.8	211.1
Federal, state and foreign income taxes	25.8	30.4	77.6
Net income	$ 75.3	$ 97.4	$ 133.5
Net income per share of common stock	$ 2.47	$ 3.46	$ 5.24

The accompanying notes are an integral part of these financial statements.

Balance Sheets

(In millions of dollars)

December 31,	1981	1980
Assets		
Current Assets		
Cash	$ 11.9	$ 3.6
Short-term investments, at cost (approximates market)	48.1	54.4
Trade accounts receivable, net of allowances for losses (1981: $7.5; 1980: $6.8)	289.0	270.9
Other receivables	55.8	51.1
Inventories	445.9	433.7
Prepaid expenses	48.6	44.5
Total current assets	899.3	858.2
Properties, at cost		
Buildings, machinery and equipment	2,364.8	2,076.1
Less allowances for depreciation	970.4	902.5
	1,394.4	1,173.6
Land, timberlands and logging facilities, net of amortization and cost of timber harvested	258.9	256.2
Oil and gas properties (on successful efforts basis), net of depletion and amortization	9.1	8.8
Total properties	1,662.4	1,438.6
Other Assets		
Investments in affiliates	20.6	14.7
Other investments (at cost) and receivables	12.8	38.3
Deferred charges	19.0	22.9
Total other assets	52.4	75.9
	$2,614.1	$2,372.7
Liabilities and Shareholders' Equity		
Current Liabilities		
Commercial paper notes payable	$ 53.8	$ 84.0
Notes payable, banks	17.0	17.6
Accounts payable, trade	168.0	148.4
Accrued federal, state and foreign income taxes	19.8	2.6
Accrued payrolls	81.8	70.1
Other current liabilities	127.7	123.5
Long-term debt, installments due within one year	32.3	33.1
Total current liabilities	500.4	479.3
Other Liabilities		
Long-term debt	626.4	486.1
Deferred income taxes	177.7	157.9
Other	40.9	20.2
Total other liabilities	845.0	664.2
Minority Interest in Canadian Subsidiary	46.5	44.0
Shareholders' Equity		
$4.625 Cumulative convertible preferred stock	125.0	125.0
Common stock, outstanding 1981: 26,854,356 shares; 1980: 25,588,710 shares	134.3	127.9
Other capital	93.9	67.4
Income retained in the business	869.0	864.9
Total shareholders' equity	1,222.2	1,185.2
	$2,614.1	$2,372.7

The accompanying notes are an integral part of these financial statements.

Statements of Changes in Financial Position

(In millions of dollars)

Years ended December 31,	1981	1980	1979
Cash and short-term investments, January 1	$ 58.0	$ 92.0	$162.7
Financial resources were provided by			
Net income	75.3	97.4	133.5
Charges (credits) to income not affecting cash:			
Depreciation, amortization, depletion and cost of timber harvested	118.9	116.1	110.2
Net (gain) loss on disposition of properties	(11.0)	5.8	(10.0)
Gain on early retirement of debt	(16.2)	–	–
Share of operating loss and writedowns of investments in affiliates	10.9	31.9	10.0
Gain on involuntary conversion	–	(20.0)	–
Provision for deferred income taxes	19.8	42.3	22.0
Internal funds generated	197.7	273.5	265.7
Issuance of preferred stock, net of expenses	–	121.0	–
Issuance of common stock	33.2	5.8	.5
Increase in long-term debt	224.9	42.6	20.6
Increase in other liabilities	20.7	3.5	9.3
Proceeds from disposition of properties	21.1	5.9	15.8
Decrease in other investments and receivables	14.6	1.6	.9
	512.2	453.9	312.8
Financial resources were used for			
Additions to properties	345.7	281.6	215.5
Retirement of long-term debt, net of gain on early retirement	69.2	93.6	33.9
Dividends declared:			
On preferred stock	11.6	9.1	.2
On common stock	59.6	57.4	52.1
Investments in affiliates	3.7	2.4	–
Retirement of preferred stock	–	–	13.3
Net increase in other working capital items	17.2	25.8	53.5
Miscellaneous, net	3.2	18.0	15.0
	510.2	487.9	383.5
Net increase (decrease) in cash and short-term investments	2.0	(34.0)	(70.7)
Cash and short-term investments, December 31	$ 60.0	$ 58.0	$ 92.0

Net increase (decrease) in other working capital items			
Accounts receivable	$ 22.8	$ 41.1	$ 50.5
Inventories	12.2	37.1	91.0
Prepaid expenses	4.1	(2.3)	16.4
Notes payable	30.8	(61.7)	(39.9)
Accounts payable, trade	(19.6)	(10.8)	(25.9)
Accrued federal, state and foreign income taxes	(17.2)	48.1	(14.5)
Accrued payrolls and other current liabilities	(15.9)	(25.7)	(24.1)
	$ 17.2	$ 25.8	$ 53.5

The accompanying notes are an integral part of these financial statements.

Statement of Shareholders' Equity

(In millions of dollars, except per share amounts)

	Preferred stock	Common stock	Other capital	Income retained in the business
Balances, January 1, 1979, as previously reported	$ 13.0	$127.0	$65.8	$756.6
Retroactive recognition of vacation liabilities	–	–	–	(3.8)
Balances, January 1, 1979, as restated	13.0	127.0	65.8	752.8
Retirement of 130,214 shares of $4.20 cumulative preferred stock	(13.0)	–	(.3)	–
Net income	–	–	–	133.5
Cash dividends declared:				
On $4.20 cumulative preferred stock, $2.46 per share	–	–	–	(.2)
On common stock, $2.05 per share	–	–	–	(52.1)
Other	–	.1	.2	–
Balances, December 31, 1979	–	127.1	65.7	834.0
Proceeds from sale of $4.625 cumulative convertible preferred stock	125.0	–	(4.0)	–
Net income	–	–	–	97.4
Cash dividends declared:				
On $4.625 cumulative convertible preferred stock, $3.65 per share	–	–	–	(9.1)
On common stock, $2.25 per share	–	–	–	(57.4)
Other	–	.8	5.7	–
Balances, December 31, 1980	125.0	127.9	67.4	864.9
Issuance of 1,199,922 common shares in exchange for debentures	–	6.0	24.8	–
Net income	–	–	–	75.3
Cash dividends declared:				
On $4.625 cumulative convertible preferred stock	–	–	–	(11.6)
On common stock, $2.30 per share	–	–	–	(59.6)
Other	–	.4	1.7	–
Balances, December 31, 1981	$125.0	$134.3	$93.9	$869.0

The accompanying notes are an integral part of this financial statement.

Notes to Financial Statements

Summary of Significant Accounting Policies

Consolidation
The consolidated financial statements include the accounts of Crown Zellerbach Corporation and subsidiaries.

Inventories
Inventories are valued at the lower of cost or market. Cost elements included in inventory are materials, transportation, direct labor and manufacturing overhead. Cost is generally determined by standard cost, which approximates a moving average cost, for all items except the cost of domestic distribution inventories, which is determined by the last-in, first-out method.

Properties
Depreciation is reported for financial statement purposes on a straight-line or units-of-production basis over the useful lives of depreciable assets.

Timberland reforestation costs are capitalized. Timberland carrying costs are charged against income. Cost of timber harvested is based generally on the book value of specific tracts from which the timber is removed. Amortization of logging facilities costs is based on the estimated recoverable timber to be removed over the facilities.

Oil and Gas Activities
The successful efforts method of accounting is followed for oil and gas activities.

Taxes
Investment and energy tax credits are reflected in income using the flow-through method.

Pension Plans
Pension plan costs include amortization of prior service costs under the Corporation's pension plans over periods ranging from 15 to 30 years. The Corporation's policy is to fund pension costs accrued.

Net Income per Share of Common Stock
Net income per share is calculated by dividing net income attributable to common stock (net income after deducting dividends on preferred stock) by the weighted average number of shares of common stock outstanding during the period.

Unusual Items

Retirement of Debt
In October, 1981, the Corporation exchanged 1,199,922 shares of its common stock for $30.1 million of its 8⅞ percent sinking fund debentures and $16.7 million of its 9¼ percent sinking fund debentures. The debentures were acquired to satisfy future sinking fund requirements. The exchange resulted in a nontaxable gain of $16.2 million.

Investments in Affiliates
In 1980, after a review of the competitive cost and productivity prospects for its 50 percent owned affiliate in The Netherlands, Van Gelder Papier, the Corporation concluded that the likelihood of future economic return was such that its investment in Van Gelder had become permanently impaired. To reflect this impairment, the Corporation charged to income $31.9 million, representing its total equity investment at December 31, 1979. The writedown, and the Corporation's share in the losses of Van Gelder, are shown as unusual items and include a foreign exchange translation gain of $2.6 million in 1980 and a foreign exchange translation loss of $3.8 million in 1979. No income tax benefit was recognized.

During the fourth quarter of 1981, a preferred stock investment of $10.9 million in an affiliate of Van Gelder was written off, because it is believed that the likelihood of economic return on the investment is remote. The write-off is shown before income tax effect.

Disposal of Investment
Elk River Timber Company, Ltd., a Canadian corporation in which the Corporation's 85 percent owned Canadian subsidiary, Crown Zellerbach Canada Limited, held a one-third stock interest, sold its principal assets in 1980. The portion of the gain on sale attributable on distribution to the Corporation's subsidiary, $35.0 million, was recorded with no provision for income taxes since such distribution is a nontaxable dividend for Canadian income tax purposes. The gain was reported net of minority interest of $4.2 million.

Involuntary Conversion
In 1980, a chemical recovery boiler at the Corporation's Bogalusa, Louisiana containerboard mill was destroyed by fire. The boiler was insured for its replacement cost, which was estimated to be $20.0 million in excess of its carrying value.

Inventories

Inventories are as follows:

December 31,	1981	1980
	(In millions of dollars)	
Finished products	$265.4	$235.5
In process	26.6	25.7
Raw materials	116.2	132.8
Supplies	37.7	39.7
	$445.9	$433.7

The current cost of inventories accounted for by the last-in, first-out method exceeds carrying value by $30.2 million and $27.9 million at December 31, 1981 and 1980, respectively.

Properties

The major classes of property, plant and equipment are as follows:

December 31,	1981	1980
	(In millions of dollars)	
Buildings, machinery and equipment:		
Buildings and improvements	$ 433.3	$ 409.1
Machinery and equipment	1,667.1	1,529.0
Construction in progress	264.4	138.0
	$2,364.8	$2,076.1
Other properties, net of allowances for amortization and cost of timber harvested:		
Land	$ 24.6	$ 24.9
Timberlands and cutting rights	202.9	201.5
Logging facilities	27.7	25.6
Other	3.7	4.2
	$ 258.9	$ 256.2
Oil and gas properties, net of allowances for amortization and depletion	$ 9.1	$ 8.8

Effective January 1, 1980, the Corporation adopted Statement of Financial Accounting Standards No. 34, which requires capitalizing interest cost as part of the historical cost of acquiring certain properties (excepting timberlands) which require a period of time to prepare them for their intended use. Interest expense for 1981 and 1980 is net of $30.3 million and $12.1 million, respectively, capitalized on projects in progress.

Lease Commitments

Premises and equipment are leased under agreements which provide in some instances for renewal privileges at reduced annual rentals or for purchase at option prices established in the lease agreements. Certain of these agreements are capital leases, as defined by Statement of Financial Accounting Standards No. 13.

The composition of capital leases included in properties is:

December 31,	1981	1980
	(In millions of dollars)	
Buildings and improvements	$45.6	$47.9
Machinery and equipment	14.5	22.1
	60.1	70.0
Less allowances for amortization	42.7	47.4
	$17.4	$22.6

Future minimum rentals under leases in effect at December 31, 1981 are:

	Capital leases	Operating leases
	(In millions of dollars)	
1982	$ 8.0	$15.9
1983	5.9	11.4
1984	3.0	10.7
1985	2.6	9.9
1986	2.0	4.2
Later periods	9.8	21.3
Total minimum payments required	31.3	$73.4
Less executory expenses included above	.2	
	31.1	
Less amount representing interest	6.9	
Present value of net minimum capital lease payments	24.2	
Long-term debt, installments due within one year	5.4	
	$18.8	

Rental expense under operating leases was $16.1 million in 1981, $16.2 million in 1980, and $10.5 million in 1979.

In addition to the above leases, pollution control and industrial revenue bonds are issued by political subdivisions in which the Corporation operates and the proceeds used to construct facilities and equipment, which are leased or sold to the Corporation. Included as long-term debt in the accompanying balance sheet in addition to the above amounts is $28.6 million in capital leases which underlie revenue bond issues.

Oil and Gas Activities

Capitalized costs related to oil and gas properties are as follows:

(In millions of dollars)

December 31,	1981	1980
Machinery and equipment	$ 8.0	$ 6.4
Less allowance for depreciation	2.4	1.9
	5.6	4.5
Oil and gas properties:		
Proved	5.8	5.5
Unproved	3.3	3.3
	9.1	8.8
	$14.7	$13.3

Revenues from production of oil and gas, net of production costs, were $22.6 million in 1981 and $22.2 million in 1980.

Costs incurred in oil and gas activities were:

(In millions of dollars)

	1981	1980
Exploration	$ .6	$ .3
Development	2.3	2.6
Production	1.5	1.1
	$4.4	$4.0
Depreciation, amortization, and depletion	$1.5	$1.2

Income Taxes

The components of income before income taxes were taxed under the following jurisdictions:

(In millions of dollars)

	1981	1980	1979
United States	$ 86.3	$ 77.4	$156.2
Foreign	14.8	50.4	54.9
	$101.1	$127.8	$211.1

The provision for income taxes and the deferred taxes related to specific timing differences consisted of:

(In millions of dollars)

	1981	1980	1979
Current:			
U.S. federal	$ .5	$(22.6)	$27.1
State	.9	.9	5.6
Foreign	4.4	10.1	22.9
Total current	5.8	(11.6)	55.6
Deferred:			
U.S. federal–			
Depreciation	21.1	18.1	9.9
Tax credits	(15.2)	–	–
Foreign exchange	–	6.3	(.3)
Interest capitalized	9.3	5.6	–
Log inventories	–	(3.9)	–
Investment writeoff	(5.0)	–	–
Other, net	1.5	.4	(1.2)
Total U.S. federal	11.7	26.5	8.4
Foreign–			
Depreciation	3.3	15.2	11.8
Interest capitalized	4.8	–	–
Other, net	.2	.3	1.8
Total foreign	8.3	15.5	13.6
Total deferred	20.0	42.0	22.0
	$25.8	$30.4	$77.6

Investment and energy tax credits included in the U.S. federal provision were $14.6 million in 1981, $19.8 million in 1980, and $16.7 million in 1979.

A reconciliation between the federal statutory tax rate and the effective tax rate follows:

	1981	1980	1979
Statutory tax rate	46.0%	46.0%	46.0%
Earnings taxed at the capital gains rate	–	–	(4.7)
Investment and energy tax credits	(14.5)	(15.5)	(7.9)
Nontaxable gain on early retirement of debt	(7.4)	–	–
Foreign income taxes	1.2	(12.0)	(2.0)
Share of operating (income) loss and writedown of investment in affiliates recorded net of income taxes	(1.4)	9.6	2.5
Provision for state income taxes	.5	.4	1.4
All other, net	1.1	(4.7)	1.5
Effective tax rate	25.5%	23.8%	36.8%

Due to reinvestment policies and available tax credits, no additional tax liability is considered necessary on approximately $221 million of undistributed earnings of affiliates and foreign subsidiaries at December 31, 1981.

Vacation Liabilities

In the first quarter of 1981 the Corporation adopted Statement of Financial Accounting Standards No. 43, to accrue the cost of employee vacations over the period during which they are earned. Prior year vacation liabilities have been retroactively restated. The effect of the restatement on income in 1979 and 1980 is insignificant and it has not been restated.

Credit Agreements

The Corporation has short-term credit lines with domestic and foreign banks aggregating $100 million at December 31, 1981. In addition, the Corporation has negotiated long-term bank credit facilities totaling $380 million which expire in 1983-1986.

The majority of these agreements requires commitment fees or compensating balances in accordance with standard banking practice.

Long-Term Debt

Long-term debt due after one year at December 31, 1981 consists of:

	(In millions of dollars)
Commercial paper notes	$100.0
Notes payable, banks	112.0
Sinking fund debentures – 8⅞%, payable $4.9 in 1989, $5.0 annually from 1990-1999, balance at maturity in 2000	64.9
Sinking fund debentures – 9¼%, payable $.1 in 1988, $3.4 annually from 1989-2004, balance at maturity in 2005	58.3
Unsecured notes – 8⅛%, payable $6.5 annually from 1984-1994, $9.5 from 1995-1997	100.0
Unsecured notes – 4.8%, payable $6.0 annually through 1989, balance at maturity in 1990	46.0
Mortgage bonds – 8⅛%, payable annually in varying amounts through 1994	31.1
Unsecured notes – 8¼%, payable annually in varying amounts in 1983 and 1984	13.0
Mortgage bonds – 5%, payable in 1983	2.2
Mortgage note – 9¼%, payable $.5 annually through 1989	3.0
Pollution control and industrial development revenue bonds – payable annually in varying amounts through 2009	57.6
Capitalized lease obligations	18.8
Other	19.5
	$626.4

Commercial paper notes, and notes payable, banks, in the amounts of $100.0 million and $112.0 million, respectively, have been classified as long-term debt because the Corporation intends to renew them. The Corporation has available long-term commitments from banks, expiring in 1983-1986, adequate for such renewals.

Pollution control and industrial development revenue bonds comprise 35 separate issues of local governmental units with interest rates ranging from 5.0 percent to 12.0 percent.

Annual maturities of long-term debt during the next five years are as follows:

	(In millions of dollars)
1982	$ 32.3
1983	93.8
1984	82.2
1985	99.9
1986	42.9

Dividends which can be declared from income retained in the business are restricted by agreements related to long-term debt. There is $357 million of income retained in the business available for dividends at December 31, 1981.

Properties of the Corporation with a book value of $102 million are collateral for the mortgage bonds and notes.

Capital Stock

The authorized capital stock of the Corporation consists of 10 million shares of preferred stock and 100 million shares of common stock. In 1980, the Corporation issued 2.5 million shares of $4.625 cumulative preferred stock, convertible into common stock at $47.25 per share. There are 2,645,500 shares of common stock reserved for its conversion.

Stock Option Plans

Under the Corporation's nonqualified stock option plans, options are granted for periods not exceeding ten years. They become fully exercisable after a two-year waiting period, are exercisable only while the optionee is an employee and terminate when the optionee ceases to be an employee, except in cases of death and certain retirements.

At December 31, 1981, there are 1,684,175 shares of authorized and unissued common stock reserved for options, including 750,000 shares for a new plan approved by the shareholders at their meeting on May 14, 1981.

Activity in outstanding options was as follows:

	Number of shares	Average price per share
Balance, December 31, 1980	888,807	$37.19
Granted	115,450	41.63
Exercised	(85,607)	30.37
Cancelled	(9,700)	35.61
Balance, December 31, 1981	908,950	$38.42

At December 31, 1981, options for 585,600 shares are exercisable.

Stock appreciation rights (SARs) may be granted in conjunction with an option grant. They offer the grantee the alternative, instead of exercising the option, of receiving an amount equivalent to the difference between the option price and the market value of the shares at the date of exercise. This amount may be paid in cash or in shares at the discretion of the Corporation.

At December 31, 1981, SARs with respect to options for 37,100 shares, at prices of from $28.00 to $41.88, are fully exercisable.

Pension Plans

The Corporation contributed to several pension plans, including joint trusteed plans, covering substantially all of its eligible employees, including certain employees in foreign countries. Annual pension expenses, including amortization of prior service costs, were $30.4 million in 1981, $46.5 million in 1980, and $61.2 million in 1979.

A summary of the present value of plan benefits and assets available for benefits is as follows:

(In millions of dollars)

December 31,	1981	1980
Actuarial present value:		
Vested benefits	$479	$426
Nonvested benefits	47	43
Fair value of assets available for benefits	515	511
Primary discount rate	8½%	8½%

In 1981 the Corporation changed from the entry age normal actuarial method to the unit credit-projected benefit prorated on service method for determining the pension expense for its U.S. plan. In 1980 and in 1981 it increased the assumed rate of return on plan investments used in calculating the liability for that plan.

Foreign Operations

Foreign operations consolidated in the financial statements are primarily in Canada. Foreign sales, operating earnings, and identifiable assets were as follows:

(In millions of U.S. dollars)

	1981	1980	1979
Sales:			
To unaffiliated customers	$511.5	$514.1	$451.9
Intercompany	88.1	97.3	99.1
	$599.6	$611.4	$551.0
Operating earnings	$ 36.1	$ 70.3	$ 94.6
Identifiable assets	$617.9	$501.6	$392.1

Foreign currency translation gains were $.3 million in 1981, and losses were $5.0 million and $1.2 million in 1980 and 1979 respectively, and are included in other income, miscellaneous, net.

Deductions for income accruing to the minority interest in Crown Zellerbach Canada included in other income, miscellaneous, net, were $2.7 million in 1981, $4.5 million in 1980, and $6.3 million in 1979.

Business Segment Information

The Corporation's business segments are: Timber and Wood Products, Pulp and Paper, Containers and Packaging, Distribution, and Energy. A summary by business segments of sales, operating earnings, identifiable assets, depreciation, amortization, depletion and cost of timber harvested, and capital expenditures for 1981, 1980, and 1979 follows.

Sales and transfers to other segments of the business are made both at cost and at an approximate market price. Operating earnings not allocated to segments include the Corporation's share in the earnings and losses of affiliates, certain general and administrative expenses, interest income and expense and other nonoperating revenue and expense items which cannot be associated with specific business segments. Assets not allocated consist principally of cash and short-term investments and investments in affiliates.

(In millions of dollars)

	Timber and Wood Products	Pulp and Paper	Containers and Packaging	Distribution	Energy	Eliminations and Other	Total
1981							
Sales and transfers							
To unaffiliated customers	$429.5	$1,100.2	$564.8	$1,029.7	$24.1	$ –	$3,148.3
To other segments	115.8	195.5	42.2	4.0	–	(357.5)	–
	$545.3	$1,295.7	$607.0	$1,033.7	$24.1	$(357.5)	$3,148.3
Operating earnings	$ (14.2)	$ 106.8	$ 22.0	$ 29.3	$36.3	$ (84.4)	$ 95.8
Assets	$565.6	$1,080.2	$529.9	$ 260.2	$16.4	$ 161.8	$2,614.1
Depreciation, amortization, depletion and cost of timber harvested	$ 40.8	$ 45.4	$ 24.1	$ 3.3	$ 1.5	$ 3.8	$ 118.9
Capital expenditures	$ 53.0	$ 215.6	$ 59.0	$ 8.0	$ 2.8	$ 7.3	$ 345.7
1980							
Sales and transfers							
To unaffiliated customers	$522.7	$1,047.8	$522.8	$ 950.0	$23.3	$ –	$3,066.6
To other segments	77.1	191.1	38.7	3.9	–	(310.8)	–
	$599.8	$1,238.9	$561.5	$ 953.9	$23.3	$(310.8)	$3,066.6
Operating earnings	$ 39.4	$ 104.8	$ (6.3)	$ 30.6	$17.8	$ (81.6)	$ 104.7
Assets	$557.2	$ 927.0	$461.0	$ 235.4	$15.0	$ 177.1	$2,372.7
Depreciation, amortization, depletion and cost of timber harvested	$ 45.8	$ 42.0	$ 20.8	$ 3.0	$ 1.2	$ 3.3	$ 116.1
Capital expenditures	$ 57.3	$ 127.0	$ 78.1	$ 8.8	$ 3.2	$ 7.2	$ 281.6
1979							
Sales and transfers							
To unaffiliated customers	$643.8	$ 849.1	$454.7	$ 845.6	$12.9	$ –	$2,806.1
To other segments	38.4	164.1	31.8	3.9	–	(238.2)	–
	$682.2	$1,013.2	$486.5	$ 849.5	$12.9	$(238.2)	2,806.1
Operating earnings	$117.1	$ 141.6	$ 9.4	$ 24.6	$12.4	$ (84.0)	$ 221.1
Assets	$521.2	$ 797.2	$395.0	$ 203.9	$12.6	$ 230.7	$2,160.6
Depreciation, amortization, depletion and cost of timber harvested	$ 46.0	$ 39.1	$ 18.4	$ 2.4	$ 1.4	$ 2.9	$ 110.2
Capital expenditures	$ 57.6	$ 84.7	$ 63.9	$ 6.5	$ 1.0	$ 1.8	$ 215.5

Report of Certified Public Accountants

To the Board of Directors and Shareholders
Crown Zellerbach
San Francisco, California

We have examined the consolidated balance sheets of Crown Zellerbach and Subsidiaries as of December 31, 1981 and 1980, and the related consolidated statements of income, shareholders' equity and changes in financial position for each of the three years in the period ended December 31, 1981. 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 above mentioned financial statements present fairly the consolidated financial position of Crown Zellerbach and Subsidiaries at December 31, 1981 and 1980, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1981, in conformity with generally accepted accounting principles consistently applied during the period except for the change, with which we concur, in accounting for interest costs as described in the note "Properties".

Coopers & Lybrand
San Francisco, California

January 25, 1982

Supplementary Information (Unaudited)

Impact of Inflation on Financial Data

The financial statements presented elsewhere in this report were prepared in accordance with generally accepted accounting principles. The amounts reported are stated at historical cost and do not reflect the effects of increasing prices and changes in the purchasing power of the dollar. Because of the worldwide inflation rate in recent years, there is a growing concern in the financial community that historical cost financial statements do not reflect today's economic reality. In recognition of this concern, the Financial Accounting Standards Board (FASB) has prescribed two experimental methods of adjustment, which are to be disclosed on a supplemental basis: constant dollar and current cost. Disclosure of the Corporation's results under each of these methods is presented on the opposite page.

The constant dollar method revalues selected assets (inventories and properties) and related expenses (cost of goods sold and depreciation, amortization, depletion and cost of timber harvested) based on changes in the U.S. Consumer Price Index (CPI) since the acquisition date of the related assets. The objective of this method is to provide financial information in amounts that represent dollars of equivalent purchasing power.

The current cost method, on the other hand, revalues these assets and expenses based on specific price changes for resources actually owned and used by the Corporation. The price levels for these resources may change at rates that are significantly different from the change in the CPI. The objective of this method is to value the Corporation's resources, and their consumption, at the current cost of replacement rather than at the historical cost actually expended to acquire them.

The current cost of buildings, machinery and equipment reflects replacement of these facilities in kind, without recognition of probable new technology which could affect productivity and/or operating expenses. It has been determined by applying appropriate indexes to historical cost amounts. Depreciation as adjusted for both constant dollar and current cost is based on the same asset lives and depreciation methods used in the historical cost financial statements. The current cost of timberlands is the same as the constant dollar value for these assets, in accordance with FASB provisions. Cost of timber harvested, as adjusted, reflects the same method used in the historical cost financial statements. The current cost of inventories represents recent purchase prices and manufacturing costs.

Unrealized Purchasing Power Gain

A monetary asset represents money or a claim to receive money without reference to future prices of specific goods or services. Similarly, a monetary liability is an obligation to pay a sum of money the amount of which is fixed or determinable without reference to future prices. Since the Corporation's monetary liabilities exceed its monetary assets, an important hedge against inflation is provided as this net monetary liability position will be paid in dollars which have a lower purchasing power than the dollars originally received in return for the obligations. Under FASB provisions, this important factor is not included in the determination of net income. It is shown under the caption "Unrealized purchasing power gain on net monetary liabilities".

Holding Gains

During periods of inflation, assets become more valuable with the passage of time. In historical cost accounting, operating income is presented without considering cost changes. The current cost disclosures show holding gains resulting from such cost changes separately from net income, recognizing that it is not practicable to realize them without disposing of the asset and its related productive capacity, and paying income taxes on the gains.

The amount disclosed as "Increase in current cost of inventories and properties" is the difference between the effects of general inflation and the effects of changes in specific prices during the year.

Comments

Net income as computed by the constant dollar and current cost methods is significantly lower than net income reported in the historical cost financial statements. These decreases are due to increases in the cost of goods sold, reflecting both higher inventory and property costs. The Corporation's businesses are predominantly capital intensive, and its properties have been put into service at various dates during its extended history. Adjusting costs from those dates to 1981 results in a significant increase, which is reflected in the cost of properties and in depreciation, amortization, depletion and cost of timber harvested.

Although net income is reduced under the constant dollar and current cost methods, purchasing power gains on net monetary liabilities and holding gains on inventories and properties, which are not included in net income, offset the impact of inflation on the Corporation's financial results.

Income tax expense is not adjusted for the increases in costs determined under the constant dollar and current cost methods because such increases are not deductible for income tax purposes. This demonstrates the inadequacy of the current tax laws, which generally ignore the effects of inflation. Deductions based on historical cost rather than replacement cost do not permit adequate accumulation of funds to replace worn-out or obsolete facilities.

Although the supplementary financial information is determined in accordance with the computational techniques prescribed by the FASB, it is limited only to certain assets and expenses and is not intended to reflect all of the effects of inflation or the other economic factors that affect the operation of the Corporation's businesses. Moreover, development of the inflation data involves the use of judgment, assumptions and estimates. Therefore, in accordance with the experimental nature of the statement, the data should only be used with careful consideration of the underlying concepts used in its preparation.

Effects of Changing Prices—1981

(In millions of dollars)

	Historical	Constant dollar	Current cost
Income statement			
Net sales and other income	$3,193	$3,193	$3,193
Cost of goods sold	2,709	2,837	2,849
Selling and administrative costs	351	356	357
Interest on debt	37	37	37
	3,097	3,230	3,243
Income (loss) before unusual items and income taxes	96	(37)	(50)
Unusual items	5	5	5
Income (loss) before income taxes	101	(32)	(45)
Federal, state and foreign income taxes	26	26	26
Net income (loss)	$ 75	$ (58)	$ (71)
Depreciation, amortization, depletion and cost of timber harvested	$ 119	$ 219	$ 234
Unrealized purchasing power gain on net monetary liabilities		$ 70	$ 70
Increase in current cost of inventories and properties:			
From general inflation			$ 259
From changes in specific prices			251
Excess of increases from general inflation over changes in specific prices			$ 8
Current cost at December 31:			
Inventories			$ 485
Properties			2,664

Five Year Summary of Effects of Changing Prices

(In millions of dollars, except per share amounts)

	1981	1980	1979	1978	1977
Net sales:					
Historical	$3,148	$3,067	$2,806	$2,458	$2,342
Adjusted for general inflation	3,148	3,385	3,516	3,426	3,514
Net income (loss):					
Historical	75	97	134		
Adjusted for general inflation	(58)	(39)	39		
Adjusted for specific price changes	(71)	(80)	29		
Net income (loss) per share:					
Historical	2.47	3.46	5.24		
Adjusted for general inflation	(2.68)	(1.92)	1.53		
Adjusted for specific price changes	(3.18)	(3.54)	1.14		
Cash dividends declared per common share:					
Historical	2.30	2.25	2.05	1.90	1.85
Adjusted for general inflation	2.30	2.48	2.57	2.65	2.78
Net assets at December 31:					
Historical	1,222	1,185	1,027		
Adjusted for general inflation	2,246	2,277	2,170		
Adjusted for specific price changes	2,292	2,346	2,298		
Unrealized purchasing power gain on net monetary liabilities	70	94	98		
Current cost of inventories and properties-excess of increases from general inflation over changes in specific prices	8	22	90		
Market price per common share at December 31:					
Historical	29	48½	43½	31	34
Adjusted for general inflation	28	51	51½	41⅝	49¾
Average level of the Consumer Price Index (1967 = 100)	272.4	246.8	217.4	195.4	181.5

Oil and Gas Activities

In accordance with the requirements of the Financial Accounting Standards Board and the Securities and Exchange Commission, this section provides supplemental information on the Corporation's oil and gas producing activities.

Oil and Gas Reserves

Presented below is information about the quantities and values of the Corporation's oil and gas reserves, developed by independent petroleum engineers. The information relates only to proved reserves, which are defined as the estimated quantities of oil and gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reserves under existing economic and operating conditions. The presumption of the continuance of existing economic conditions is also inherent in estimating future revenues and future operating and development costs, which are assumed to remain stable at current levels.

Estimated quantities of proved reserves, all of which are located in the United States, and changes in the reserves are as follows:

(Oil in thousands of barrels, gas in millions of cubic feet)

	Oil	Gas
1981		
Balances, January 1	3,750	3,709
Revisions of previous estimates	(75)	1,710
Extensions, discoveries and other additions	130	883
Production	(578)	(1,107)
Balances, December 31	3,227	5,195
1980		
Discoveries and other additions	259	628
Production	(576)	(1,130)

Annual estimated future net revenues from proved reserves less estimated future expenditures for development and production are as follows:

(In millions of dollars)

1982	$ 18.0
1983	18.2
1984	15.1
Remainder	64.8
	$116.1

The present values of estimated future net revenues and changes, using an annual discount rate of 10 percent, are:

(In millions of dollars)

1981	
Balance, January 1	$76.9
Additions, revisions of previous estimates and accretion of discount, less related estimated future development costs	17.6
Previously estimated development costs incurred	1.5
Sales of oil and gas, net of production costs of $1.5 and severance and windfall profits taxes of $5.0	(17.6)
Balance, December 31	$78.4
1980	
Additions, less related estimated future development and production costs	$ 8.4
Sales of oil and gas, net of production costs of $1.1 and severance and windfall profits taxes of $4.5	$17.7

The independent petroleum engineers did not make an estimate of reserves, or of future revenues, at January 1, 1980.

Reserve Recognition Accounting

Reserve recognition accounting (RRA), as prescribed by the Securities and Exchange Commission, is an experimental accounting method in which income is recognized in the year proved reserves are discovered rather than at the time oil or gas is sold. All costs associated with proved reserves are accrued and expensed in the year of discovery.

The following summary sets forth the results of the Corporation's oil and gas producing activities based on RRA.

(In millions of dollars)

	1981	1980
Present value of revenues from additions to estimated proved oil and gas reserves, gross	$ 5.9	$10.0
Revisions of previous estimates:		
Price changes	3.1	–
Other	1.3	–
Accretion of discount	7.7	7.8
	18.0	17.8
Evaluated acquisition, exploration, development and production costs – Costs incurred, including impairments	2.9	2.9
Present value of estimated future development and production costs	.4	1.6
	3.3	4.5
Additions to proved reserves over evaluated costs	14.7	13.3
Provision for income taxes	7.7	6.5
Results of oil and gas producing activities on the basis of RRA	$ 7.0	$ 6.8
Results of oil and gas producing activities on the basis of generally accepted accounting principles	$ 8.6	$ 8.7

Quarterly Information

(In millions of dollars, except per share amounts)

	Sales	Gross profit on sales	Net income	Net income per share
1981				
First quarter	$ 765.3	$112.0	$18.4	$ .61
Second quarter	823.6	128.0	20.8	.70
Third quarter	790.4	92.2	6.9	.15
Fourth quarter	769.0	106.8	29.2[1]	1.01
	$3,148.3	$439.0	$75.3	$2.47
1980				
First quarter	$ 738.4	$118.4	$24.3[2]	$ .93
Second quarter	756.9	121.6	29.0[2,3]	1.03
Third quarter	787.1	98.1	8.8	.23
Fourth quarter	784.2	113.5	35.3[4]	1.27
	$3,066.6	$451.6	$97.4	$3.46

1 Includes unusual items: Gain on early retirement of debt, $16.2; writedown of investment in affiliated company, net of income taxes, $5.9.
2 Includes unusual item: Share of operating earnings (loss) and writedown of investment in 50 percent owned affiliate, first quarter, $2.0, second quarter, $(33.9).
3 Includes unusual item: Gain on disposal of investment, $35.0.
4 Includes unusual item: Gain on involuntary conversion, net of income taxes, $10.8.

Per Share Information

	1981	1980
Dividends Paid Per Share on Common Stock		
First quarter	$ .57½	$ .52½
Second quarter	.57½	.52½
Third quarter	.57½	.57½
Fourth quarter	.57½	.57½
	$2.30	$2.20
Common Stock Market Price Range *(High and low)*		
First quarter	$52 -$42	$54⅝-$33½
Second quarter	53⅜- 38⅜	46⅜- 33½
Third quarter	41⅝- 27⅛	53⅜- 45
Fourth quarter	32⅛- 25	62¾- 47

The principal market for the common stock is the New York Stock Exchange.

Five Year Summary of Selected Financial Data

	1981	1980	1979	1978	1977
Income *(In millions of dollars)*					
Net sales	$3,148.3	$3,066.6	$2,806.1	$2,457.7	$2,341.5
Income before unusual items and income taxes	95.8	104.7	221.1	149.1	168.9
Unusual items	5.3	23.1	(10.0)	12.1	(2.7)
Federal, state and foreign income taxes	25.8	30.4	77.6	49.1	55.1
Net income	$ 75.3	$ 97.4	$ 133.5	$ 112.1	$ 111.1
Per share of common stock					
Net income	$ 2.47	$ 3.46	$ 5.24	$ 4.39	$ 4.35
Common dividends declared	2.30	2.25	2.05	1.90	1.85
Common dividends paid	2.30	2.20	2.00	1.90	1.82½
Common stock equity	40.86	41.43	40.39	37.22	34.74
Common stock market price range:					
High	53⅜	62¾	44	38	45⅛
Low	25	33½	30⅞	29	32
Financial position *(In millions of dollars)*					
Assets:					
Current assets	$ 899.3	$ 858.2	$ 816.3	$ 729.1	$ 654.7
Properties, net	1,662.4	1,438.6	1,264.6	1,151.7	1,039.0
Other assets	52.4	75.9	79.7	82.9	101.5
Total assets	$2,614.1	$2,372.7	$2,160.6	$1,963.7	$1,795.2
Liabilities and Shareholders' Equity:					
Current liabilities	$ 500.4	$ 479.3	$ 421.1	$ 316.0	$ 293.0
Long-term debt	626.4	486.1	545.2	559.2	494.1
Deferred income taxes and other liabilities	218.6	178.1	132.3	101.0	87.7
Minority interest	46.5	44.0	35.2	28.8	24.9
Redeemable preferred stock	–	–	–	13.0	13.2
Nonredeemable preferred stock	125.0	125.0	–	–	–
Common stock equity	1,097.2	1,060.2	1,026.8	945.7	882.3
Total liabilities and shareholders' equity	$2,614.1	$2,372.7	$2,160.6	$1,963.7	$1,795.2

	1981	1980	1979	1978	1977
Other statistics *(In millions of dollars)*					
Internal funds generated	$197.7	$273.5	$265.7	$221.6	$227.8
Additions to properties	345.7	281.6	215.5	232.6	154.5
Depreciation, amortization, depletion and cost of timber harvested	118.9	116.1	110.2	104.9	97.8
Employment costs, excluding social security taxes	779.2	763.4	737.0	661.9	653.5
Retirement plan costs	30.4	46.5	61.2	60.6	58.2
All taxes	127.4	122.5	162.7	123.9	129.5
Ratio of current assets to current liabilities	1.8 to 1	1.8 to 1	1.9 to 1	2.3 to 1	2.2 to 1
Days sales in accounts receivable	31	30	31	31	30
Days inventories on hand	60	61	63	55	60
Debt as a percent of total capitalization	30%	26%	32%	34%	33%
Production					
Paper and containerboard *(In thousands of tons)*					
Newsprint	414	460	418	403	446
Other printing papers	405	392	352	372	389
Business and converting papers	558	567	565	517	634
Tissue and sanitary papers	330	321	333	261	301
Containerboard	671	637	694	669	661
	2,378	2,377	2,362	2,222	2,431
Pulp for sale *(In thousands of tons)*	301	290	267	245	271
Total paper, containerboard and pulp	2,679	2,667	2,629	2,467	2,702
Lumber *(In millions of board feet)*	717	770	1,059	1,039	1,044
Plywood *(In millions of square feet)*	487	561	614	624	601
Logs harvested *(In millions of cubic feet)*	304	360	402	397	388
Oil and gas equivalents *(In thousands of barrels)*	763	764	645	634	605
Natural resources					
Managed forest system *(In thousands of acres)*					
Owned in fee:					
United States	1,705	1,705	1,739	1,703	1,704
Canada	322	322	313	313	313
	2,027	2,027	2,052	2,016	2,017
Controlled:					
United States	370	375	381	373	374
Canada	985	981	1,017	1,010	1,011
	1,355	1,356	1,398	1,383	1,385
Total acres	3,382	3,383	3,450	3,399	3,402
Oil and gas reserves					
Oil *(In thousands of barrels)*	3,227	3,750	Data not available		
Gas *(In millions of cubic feet)*	5,195	3,709	Data not available		

Directors

W.T. Creson[1]
President
Chairman of the Board and
Chief Executive Officer

W.J. Bowen[3,4]
Chairman and Chief Executive
Officer, Transco Companies, Inc.,
Houston
An interstate gas pipeline and
petroleum exploration firm

H.C. Cornuelle[3,4]
President, H.C. Cornuelle Inc.,
Trustee, The Estate of James
Campbell, Honolulu
A private estate

M.S. Denman[1]
Executive Vice President

M.F. Granville[2,4]
Retired Chairman of the Board
and Chief Executive Officer
Texaco Inc.
White Plains, N.Y.

R.M. Hendrickson[2,4]
Senior Executive Vice President
and Chief Insurance Officer
The Equitable Life Assurance
Society of the U.S., New York City
A life insurance firm

L. W. Lane, Jr.[2,4]
Chairman of the Board, Lane
Publishing Co. and Publisher
Sunset Magazine
Menlo Park, Cal.

E.A. Mitchell[1]
President and Chief Executive Officer
Crown Zellerbach International, Inc.

M.C. Mumford[3,4]
Retired Chairman of the Board
Lever Brothers Company
New York City

R.W. Roth[3,4]
President and Chief Executive Officer
Jantzen Inc., Portland, Ore.
A sportswear manufacturer

Dr. Dorothy M. Simon[2,4]
Vice President, Research
AVCO Corporation, Greenwich, Conn.
A diversified financial, insurance and
manufacturing firm

W.J. Zellerbach[1]
President
Zellerbach Paper Company

1 Executive Committee
2 Audit Committee
3 Organization and Compensation Committee
4 Nominating Committee

Officers

Administration

William T. Creson
President
Chairman of the Board and
Chief Executive Officer

MacDonald S. Denman
Executive Vice President

Ernest A. Mitchell
Executive Vice President

Harry L. Fledderman
Senior Vice President
General Counsel and
Secretary

Dwight D. Taylor
Senior Vice President

Clarence A. Jennings
Vice President and
Controller

Sol Mosher
Vice President

Operating Groups

Timber and Wood Products
George L. Pearson
Senior Vice President

Richard L. Carlson
Vice President

William R. Corbin
Vice President

Pulp and Paper
Scott B. Weldon
Senior Vice President

Robert L. Appling
Vice President

Paul T. Gallagher
Vice President

Carroll G. Hornor
Vice President

Joseph F. Ronan
Vice President

Corrugated Containers
Allan G. Resnick
Senior Vice President

Specialty Packaging and Chemicals
James A. Toney
Senior Vice President

Robert M. Collier
Vice President

Harold W. Reed
Vice President

Distribution
William J. Zellerbach
Senior Vice President

Frederick J. Stabbert
Vice President

Energy
MacDonald S. Denman
Executive Vice President

Crown Zellerbach International

Ernest A. Mitchell
President and
Chief Executive Officer

Wayne F. Edwards
Vice President

Lee J. Ross
Vice President

Crown Zellerbach Canada Limited

Robert G. Rogers
Chairman of the Board

Thomas G. Rust
President and
Chief Executive Officer

Printed on CZ Capistrano Web Gloss #80

Executive Offices
One Bush Street
San Francisco, California 94104

Transfer Agent
The Bank of California, N.A.
San Francisco and New York City

Auditors
Coopers & Lybrand
Certified Public Accountants
San Francisco

Annual Meeting
The Annual Meeting of Stockholders of Crown Zellerbach Corporation will be held in the Masonic Auditorium, 1111 California Street, San Francisco, California, at 2:00 o'clock P.M. on Thursday, May 13, 1982. A notice of the meeting and proxy material will be mailed to stockholders on approximately April 1.

Requests for additional copies should be directed to:
Crown Zellerbach
Corporate Communications
One Bush Street
San Francisco, California 94104

10-K Available
The Crown Zellerbach Corporation Report on Form 10-K for the fiscal year ended December 31, 1981, filed with the Securities and Exchange Commission, is available without charge to shareholders on written request to:

Crown Zellerbach
Corporate Communications
One Bush Street
San Francisco, California 94104

Systematic Investment
A Systematic Investment service offers two convenient and cost-free plans for holders of CZ common or preferred stock to increase their investments in the company. Your dividends can be invested automatically in shares of common stock or fractions of shares, or you can acquire additional common shares by voluntary cash payments. For a free brochure explaining Systematic Investment write to:

CZ Systematic Investment Service
The Bank of California
P.O. Box 45005
San Francisco, CA 94145

R.F. Rush
Director of Investor Relations

CrownZellerbach

One Bush Street, San Francisco, CA 94104

An Equal Opportunity Employer