



**AVERY  
DENNISON**

self-adhesive technology makes



that

peel and stick and



with testers built in. Our



brand

products, from



and



for home and office,

to



for your high-tech kids, make work more fun.

We make labels for



and the tape that seals



packages. Our **FASION** brand materials identify



and

label



. Around the house and around the world...

FC 9365



re everywhere you look!

AVERY DENNISON 1996 ANNUAL REPORT



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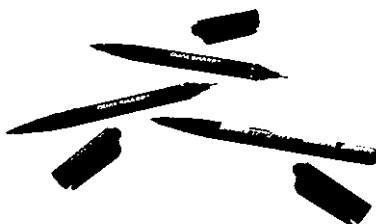


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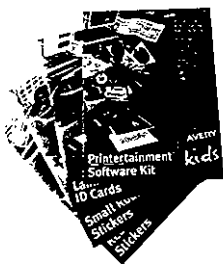


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Avery Dennison...we're everywhere you look!

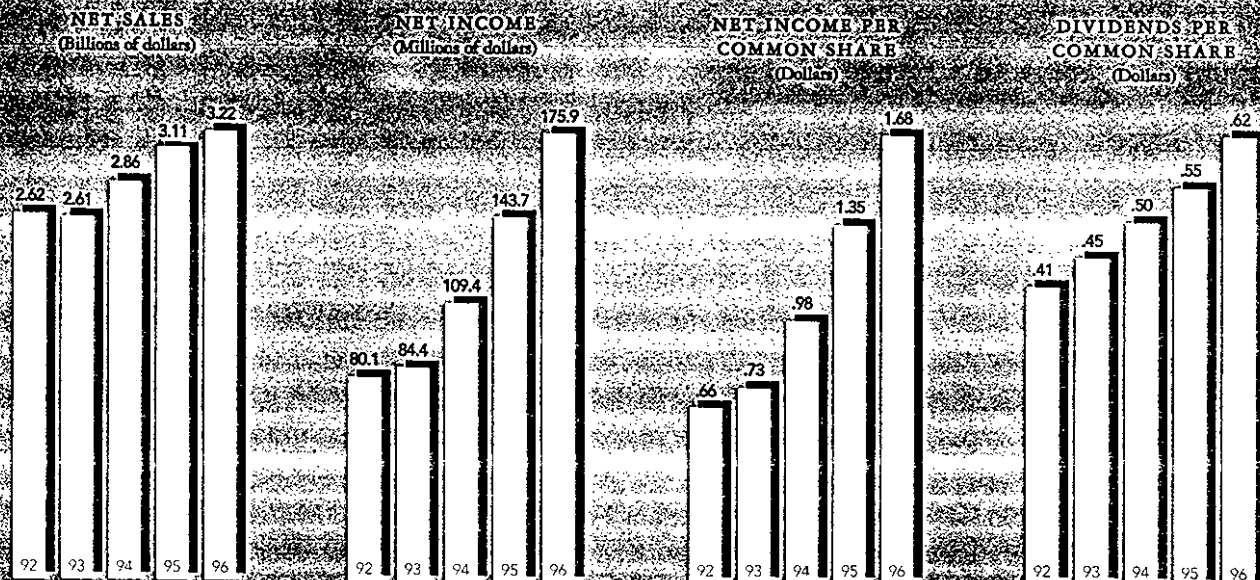
## FINANCIAL HIGHLIGHTS

(Dollars and shares in millions)

	1996	1995	1994
<b>FOR THE YEAR:</b>			
Net sales	\$3,222.5	\$3,113.9	\$2,856.7
Income before taxes	270.6	224.7	172.9
Income before taxes as a percent of sales	8.4	7.2	6.1
Net income	\$ 175.9	\$ 143.7	\$ 109.4
Net income as a percent of sales	5.5	4.6	3.8
Net income per common share	\$ 1.68	\$ 1.35	\$ .98
Dividends per common share	.62	.55	.50
Average common shares outstanding	105.0	106.5	111.1
Capital expenditures	\$ 187.6	\$ 190.3	\$ 163.3
<b>AT YEAR END:</b>			
Working capital	\$ 110.6	\$ 127.6	\$ 122.8
Total assets	2,036.7	1,963.6	1,763.1
Shareholders' equity	832.0	815.8	729.0
Return on average shareholders' equity (percent)	21.4	18.6	14.8
Common shares outstanding	103.6	106.1	107.1
Shareholders of record	10,949	9,895	9,594
Number of employees	15,800	15,500	15,400

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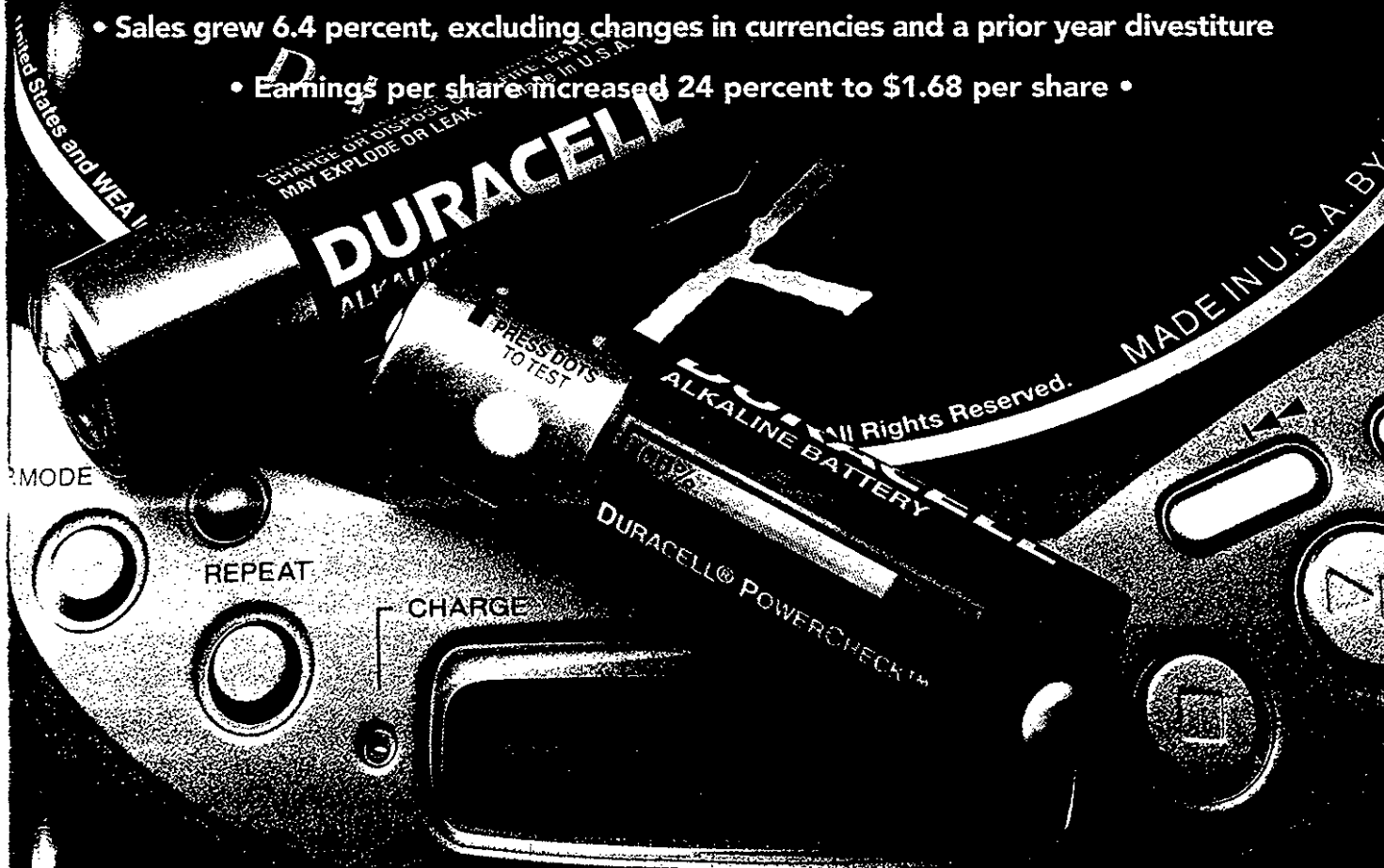
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Our brand names – Avery, Fasson and Avery Dennison – consistently deliver value to our customers around the world. In retail markets, consumers look for the Avery brand for innovative office and consumer products. In industrial markets, customers specify Fasson for quality labeling materials, and Avery Dennison for unique labeling solutions, like battery tester labels. In the global marketplace, our brands give us the competitive edge.

#### KEY ACHIEVEMENTS IN 1996

- Avery Dennison recorded its sixth consecutive year of improved profitability •
  - Reported record sales, net income and earnings per share •
    - Return on equity increased to 21.4 percent •
    - Return on total capital increased to 16.4 percent •
    - Dividends increased for the 21st consecutive year •
    - Net income increased 22 percent to \$175.9 million •
- Sales grew 6.4 percent, excluding changes in currencies and a prior year divestiture •
  - Earnings per share increased 24 percent to \$1.68 per share •



Avery Dennison proprietary pressure-sensitive technology for battery tester label applications

## A MESSAGE FROM CHUCK MILLER



Charles D. Miller  
Chairman and  
Chief Executive Officer

### TO OUR SHAREHOLDERS:

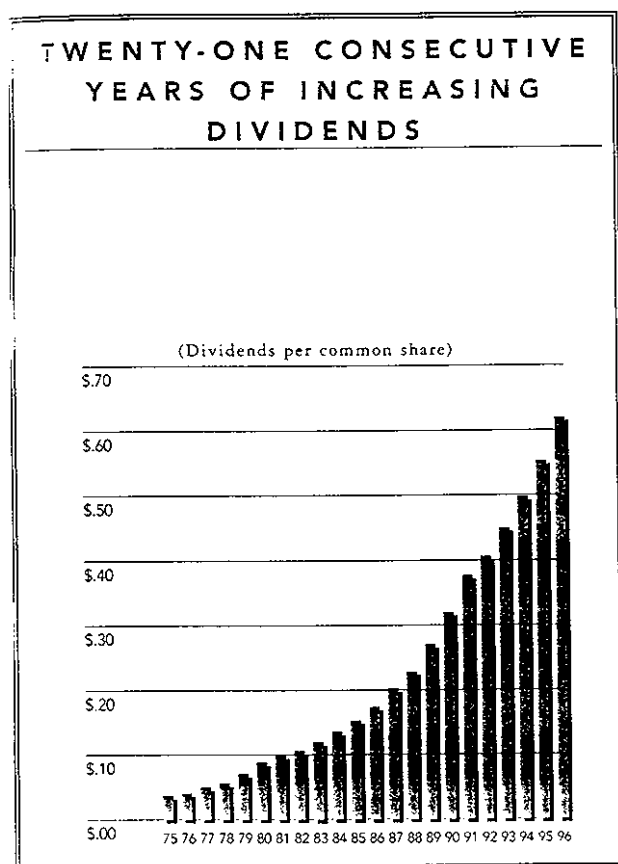
By every measure, 1996 was an outstanding year. Avery Dennison achieved record sales, net income and earnings per share. This was the sixth consecutive year of improved financial results and increased shareholder value. To top it off, Avery Dennison stock rose 43 percent in 1996, culminating in a 2-for-1 stock split in December. All in all, a terrific year.

- Earnings per share increased 24.4 percent to \$1.68 per share.
- Net income rose 22.4 percent to \$175.9 million.
- Sales grew 6.4 percent to \$3.2 billion, excluding currency changes and a prior-year divestiture. Reported sales increased 3.5 percent.

We met our long-range targets for earnings per share and return on total capital. Key ratios and operating measurements also improved over last year, establishing several new benchmarks for the Company:

- Return on shareholders' equity increased to a 30-year high of 21.4 percent. Return on total capital increased to 16.4 percent from 14.4 percent in 1995. We are earning well above our cost of capital.

- The quarterly dividend was increased 13.3 percent – for our twenty-first consecutive year of dividend increases.
- Excellent cash flow during the year enabled the Company to repurchase 3.8 million shares of Avery Dennison stock for a total cost of \$109.3 million, while maintaining a total debt to total capital ratio of 35.9 percent.
- Capital spending to support worldwide growth reached \$188 million, with approximately \$190 to \$200 million in new spending planned for 1997.
- We achieved average working capital, as a percent of sales, of 9.1 percent.



Our strategies are working. We are creating genuine shareholder value. Over the past three years, our shareholders have earned a 37.6 percent annualized return on their investment including stock price appreciation and total dividends. Avery Dennison's stock price has increased by 141 percent – clearly outpacing the 59 percent growth of the S&P 500 Index during the same three-year period. Our total return on shareholders' equity reached a record high of 21.4 percent in 1996 and, at year end, our total market value stood at \$3.7 billion, an increase of \$2.1 billion over the last three years.

**CLEAR VISION. DISCIPLINED MANAGEMENT. SOLID CORE BUSINESSES. GREAT PRODUCTS.** We have a consistent and clear vision. We create innovative products with high growth potential in expanding economies and in any market. We have advanced technology which is largely proprietary, to support our core businesses. And we have invested more than four decades in two powerful brand

names – Avery and Fasson – that are recognized and respected in consumer and industrial markets worldwide. Our two operating sectors, pressure-sensitive adhesives and materials, and consumer and converted products, provide the solid structure for sustained and vigorous growth.

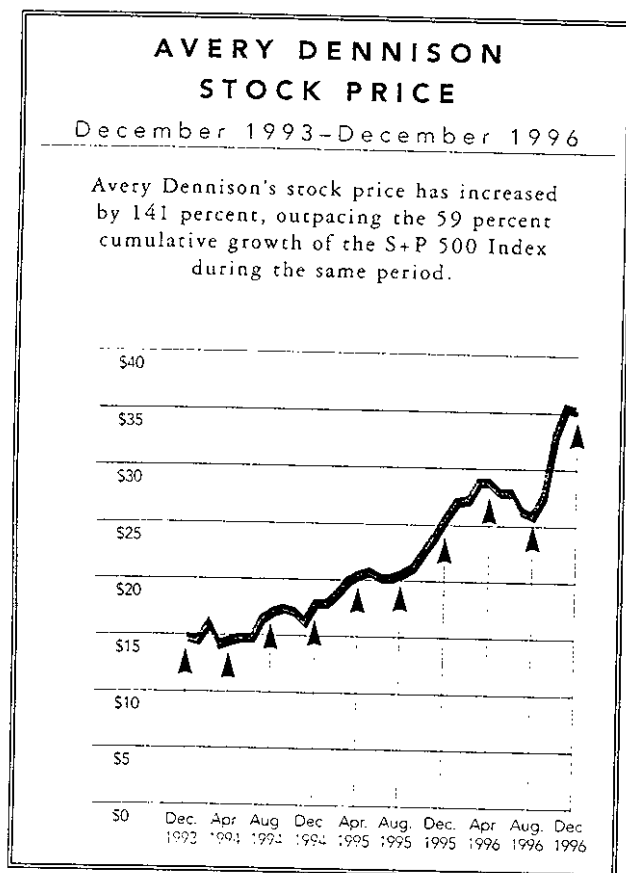
Our exceptionally strong financial position is the result of a disciplined approach to financial management. We work relentlessly to improve our margins, keep our debt to total capital in the 35 to 40 percent range, hold working capital as a percent of sales at 9 to 11 percent, buy back stock with cash flow and increase our dividends each year.

We achieved both our short- and long-term growth targets in 1996. The benefits of a strong financial foundation, critical mass, market presence and technical capability now enable the Company to attain greater heights even faster than before.

We serve a broad spectrum of consumer and industrial markets all over the world, from graphics and packaging, to variable imprinting, to automotive, to home and office products. Our products fit the changing needs of both advanced and developing economies. Our major brands are attached to products that are consumed and used up every day. We are the number one or number two manufacturer in the major markets we serve. If we aren't, we get out.

#### WHY SO MANY SELF-ADHESIVE LABELS IN THE WORLD?

The external forces that are changing our lives in every way are the same unrelenting forces that drive the demand for self-adhesive products and continue to shape our strategies for global growth.



Demand for more informative labels. As consumers demand and get more information on products, packaging labels become critical sales and communication devices. Not only must the label describe, among other things, a product's contents, ingredients, instructions and other attributes, it must induce the consumer to purchase. That's a lot of work for "just a label." Innovative, attractive and inviting product labels and precision printing demand advanced pressure-sensitive materials – and continue to drive Avery Dennison's growth and technology.

Expanded use of personal computers. As the worldwide market for personal computers continues to soar, opportunities multiply for creative and functional labels to be fed through laser and ink-jet printers. Our penetration of this market is still quite low – and that's the good news – giving us almost unlimited opportunity to extend the power of our

Avery brand, the most recognized brand in the world for self-adhesive products for the office and home. We are limited only by our ability to do it well.

We intend to maintain our market and brand-name leadership with a stream of new, clever and functional products. Once introduced to our products, consumers in North America, Latin America, Europe and Asia love them. These products are easy to use and satisfy real office and consumer needs. And, thanks to the alliances we have with leading companies like Microsoft, Hewlett-Packard, and now Mattel, for our new Avery Kids children's line, our consumers get a first-class introduction to our Avery-brand products.

Bar-coded variable information. We have talked before about the proliferation of bar codes. We love bar codes because they are printed mainly on

pressure-sensitive labels. Our specialty coated products are designed to work with high-speed printers and scanning devices that must flawlessly read and record those ubiquitous vertical black lines. There is no end in sight for bar-code demand, and we will continue to provide the best products to meet this demand – particularly as bar codes go global.

Industrial growth and innovation. We see virtually unlimited applications for self-adhesive products in business and industry. Witness the positive experience consumers report with self-adhesive postage stamps and self-adhesive on-battery labels. While the first fundamental change in postage stamps took nearly 200 years, it demonstrates the advantages self-adhesive products offer to improve the convenience of everyday products. We're delighted with the suc-

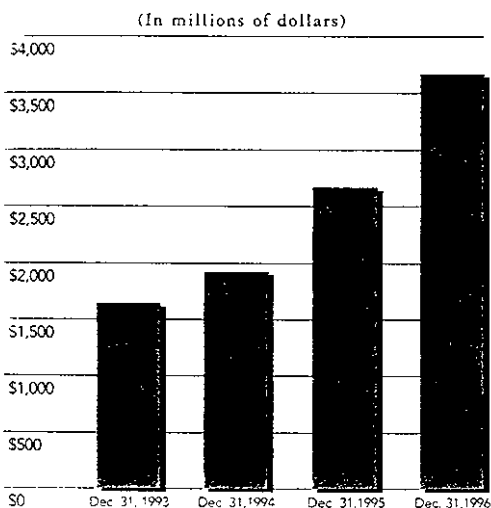
cess of self-adhesive stamps, which now account for more than 60 percent of all U.S. postage stamps.

We have partnered with Duracell in developing the PowerCheck power-testing on-battery label, which has won kudos from consumers in both the United States and Europe. This proprietary electronically active label has taken Avery Dennison's label-converting technology to a higher level. The PowerCheck line will further expand in 1997 to include a broader range of Duracell batteries and will be marketed throughout most parts of the world.

The deceptively simple concept of conventional self-adhesive labels belies the complex technology involved – much of it proprietary to Avery Dennison – that makes self-adhesive postage stamps and power-testing on-battery labels possible. As new technologies emerge, so do the demands for increasingly sophisticated self-adhesive components that improve and expand a product's performance, ease of use and consumer friendliness. Our researchers relentlessly push the edge of the self-adhesive technology envelope to applications limited only by our imagination.

#### MARKET CAPITALIZATION

Avery Dennison's market capitalization increased over \$2 billion from 1993 to 1996.



Rise of consumer spending in developing countries. Recognizing and seizing growth opportunities in developing nations is certainly not a new strategy for Avery Dennison. We have set the footprint to serve the nascent consumer markets in Latin America, Asia and Eastern Europe, just as our Company has grown with the post-war industrial and consumer expansion in North America and Western Europe during the past five decades. The difference today, however, is that we are leapfrogging over incremental technological developments of the past to serve new markets better and faster.

We intend to leverage the leadership we have developed in major consumer and industrial markets and build on our strengths as the self-adhesive technology leader. It is our challenge to bring creative initiatives to the

forces driving our Company's growth as we move forward into new markets and continue our penetration of current ones.

#### EXPANDING OUR VISION.

Our vision evolves as new market opportunities become solid business realities. We recently expanded our vision: *to be the global leader in self-adhesive base materials, self-adhesive consumer and office products and specialized label systems.* The growing prominence of our consumer-related products and the expansion of our specialized label-converting capabilities have prompted us to expand our sights and to fully recognize the strategic importance of these markets. Our vision is focused in those geographic markets and product areas where our technological strengths and manufacturing capabilities can

sustain market leadership.

Our recent investments to establish a strong business base in Asia Pacific, Latin America and Eastern Europe have taken hold. We have a way yet to go to achieve the projected volume and profit goals we established three years ago, but we are getting there faster than originally planned.

During 1996, we expanded our penetration in many parts of the world. We acquired a majority interest in Avery Dennison Dover in Argentina, the "southern cone" market leader in premium pressure-sensitive materials. We expanded the capacity of our materials business in Mexico. We purchased land in Germany for the construction of what will be Avery Dennison's largest film materials manufacturing facility to serve our central and eastern European markets for pressure-sensitive film materials; start-up is scheduled for 1998. In Denmark, we are adding capacity in our label-converting business to meet growing European demand for Duracell's PowerCheck battery. In Asia Pacific, we are already doubling the capacity in our two-year-old Shanghai

materials manufacturing facility, and we have established distribution centers for pressure-sensitive materials in India, Thailand and Indonesia and completed our new and expanded Hong Kong manufacturing and distribution facility.

Our plans for global investment in 1997 are just as ambitious as we further expand our foundation in these fast-growing and developing markets. We will build or expand our distribution and manufacturing base for pressure-sensitive materials in India, Thailand and China, as well as in Eastern Europe and Latin America. Our strategy to invest only in our high-return core businesses is working well and producing the desired results.

In a world that is increasingly complex, our vision is simple. It makes sense, and it works.

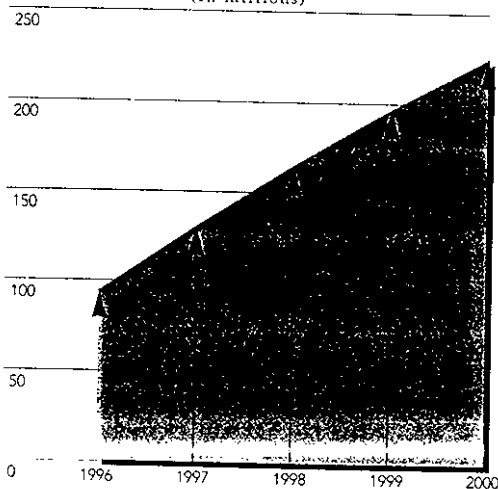
#### GROWTH OF ELECTRONIC PRINTERS WORLDWIDE

1996-2000

Total Laser and Ink-Jet Printers

Spurred by the increased use of computers in emerging countries, the growing base of electronic printers worldwide will more than double over the next few years, assuring consumer demand for desktop-printer and PC-related products.

(In millions)



International Data Corporation

OUR FOCUS: STRATEGIC, GLOBAL AND LONG-TERM. A large measure of our success comes from understanding this business and our markets. Most of our businesses are global businesses, and we manage them on that basis. We see growth opportunities where others may not. We see the world in terms of where there can be more self-adhesive products. We develop strategies with an experienced understanding of what works and what doesn't. We move fast and with flexibility. We focus on what we know best.

We have always been a company that sees opportunities to grow – as markets, packaging concepts or technologies change. The infinite variety of self-adhesive products constantly creates new ways to make the next product better. This is a true strategic capability and one that is intrinsic to our culture.

Avery Dennison has recently reached a fundamentally higher level in

leveraging its capabilities. Our self-adhesive products are consistently successful in growing markets. We operate from a common technology platform, within a common value system based on a culture that encourages new ideas and new thinking. Most importantly, our capabilities now match our imagination. We can do whatever we dream of doing, and we do what we say.

Our focus on the principles of value-based management is working. We generated more than \$50 million in economic value added in 1996, significantly exceeding our value-creation target for the year. We frame every decision within the context of whether we create or destroy economic value, over time.

For the first time in nearly 50 years, every Avery Dennison employee and operating unit is unified under a common corporate image in support of three powerful and leading brands, Avery, Fasson and Avery Dennison. We intend to aggressively support and build upon the common attributes that define our brands – quality, customer loyalty, positive image, market recognition and innovative pro-

proprietary advantages. These brands are among our most important assets.

We enter 1997 with strong operating momentum and a high level of confidence in our ability to deliver another year of solid growth in sales and earnings.

Sincerely,

Charles D. Miller  
Chairman and Chief Executive Officer

March 1, 1997

**GROWTH OF PRESSURE-SENSITIVE MATERIALS FOR BAR-CODING AND OTHER VARIABLE-IMAGING USES**

(TO YEAR 2000)

Within the pressure-sensitive roll materials industry, annual projected growth rates for variable-imaging materials indicate rapidly expanding applications.



Ink-jet Materials Growth 30-35%



Laser/copier Materials Growth 15-17%



Thermal Materials Growth 14-17%

Labeling Consultancy

## OPERATIONS REVIEW



Philip M. Neal  
President and  
Chief Operating Officer

Our global operations performed exceptionally well in 1996, demonstrating the soundness of our management strategies, as well as our ability to respond quickly and decisively to changing market conditions.

We advanced boldly on many fronts – asserting our pressure-sensitive materials leadership with aggressive investments in capital and in labeling technology and by implementing a winning global strategy to build worldwide demand for our innovative Avery-brand office automation products.

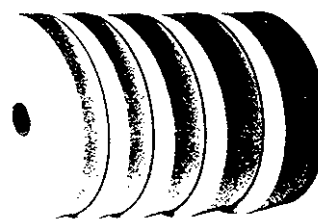
Global expansion – significant to our growth strategy – continued to be a major driving force behind our operating decisions. Our top-performing products and services, with well-established customers in North America and Europe, continued to build on this success abroad, finding a new base of customers in the rapidly growing markets of Latin America, Asia Pacific and Eastern Europe. Brand strength is an undeniably powerful competitive force in our global growth strategy.

### PRESSURE-SENSITIVE ADHESIVES AND MATERIALS

Our pressure-sensitive adhesives and materials sector reported improved sales and profitability in 1996 in both our U.S. and international operations. Successful new products and service initiatives in core markets, combined with aggressive capital investments in new geographic markets, advanced our leadership position worldwide.

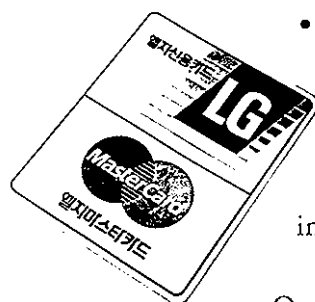
> Our unique EXACT program has defined a higher industry standard for service, allowing roll material customers to order the precise roll width they need, eliminating excess stock.

- Our industry-first, proprietary Fasson-brand EXACT service program, which allows customers to order materials in exactly the widths they need, rather than in fixed sizes, is a hit with customers, prompting us to expand EXACT throughout North America and to distribution centers in Europe, as well as to extend this service to additional product lines.



- Customer-driven demand for tailor-made services and products also inspired the creation of a fast-turnaround, custom-product operation in California to serve the western region for custom-coated products.
- We expanded our films-coating capacity in North America to support the strong global growth of our premium Fasson-brand FasClear and PRIMAX film label products for consumer packaging.
- We invested in manufacturing capacity for a proprietary new hot-melt adhesive that promises to redefine adhesive performance for consumer package labeling. In addition, the proven success of our new Fasson-brand liner for bar-coded labels provides entree to a whole new liner system to be launched in early 1997.
- To support market growth of our roll label material for variable-imprinting applications, we made process enhancements to improve overall product quality and plan to increase the production capacity of our new Greenfield, Indiana, plant by 50 percent.

> Multinational companies in developing markets in Asia Pacific, as well as major population centers in Latin America and Eastern Europe, demand our quality pressure-sensitive adhesive products, such as durable Avery-brand marking films, for product and image promotions.



- In Europe, we opened a new distribution center in Poland to supply Fasson-brand roll paper and film products to the Eastern European market, while completing planning for a 40-acre site for a major new films production plant in Gotha, Germany.
- Our Canadian solvent-free materials business doubled its capacity to manufacture custom-designed products, as well as office automation and variable-information printing label products.
- Rapid expansion developments in Asia Pacific were highlighted by the establishment of distribution centers in Beijing and Hong Kong to support our growing Chinese roll materials operation, as well as business centers in Thailand and Indonesia, and the acquisition of a materials manufacturing business in Bangkok.

► Appealing to a whole new category of consumers within the home computer market, Avery Kids Software and Supplies... our new Avery Kids consumer package design – targets the 57 million households with PCs and 37 million with printers.

International Division

- While we reshaped our binder business to streamline product categories, we enjoyed growing market acceptance of our Avery-brand divider products – such as Avery Direct Print Dividers, the first full-size divider that can be printed directly through a desktop laser printer.



- Capitalizing on the rapidly growing base of computers and desktop printers in Asia and Latin America, we established office products organizations to serve those regions and introduced a portfolio of Avery-brand PC-related products to key consumer markets.
- In our converted products businesses, our star performer was the proprietary on-battery tester label for the Duracell PowerCheck battery, which has received excellent consumer acceptance since its market launch by Duracell Inc. last spring. Behind the scenes, a remarkable Company-wide team effort in product development and manufacturing scale-up, and an exceptional strategic alliance with Duracell, contributed to the success of this unique on-battery label.
- Consumer demand clearly established the “peel & stick” postage stamp as the stamp of choice among U.S. Postal Service customers. We increased our stamp production by 25 percent and expanded stamp formats to include sheetlets, booklets and bulk coils. In addition, the explosive growth of ATM sites in retail locations, such as supermarkets and retail malls, doubled the number of sites now offering our ATM self-adhesive stamps.

► Our unique on-battery-testing label for Duracell PowerCheck batteries demonstrates the Company's ability to develop sophisticated pressure-sensitive technologies for a wide range of consumer and industrial market applications.



- Increased demand for security and warning labels for automotive and durable goods continued to drive the growth of our U.S. industrial label products business, which broke ground last year for a new production facility to serve the expanding durable goods market.

- We relocated our Hong Kong apparel/retail tag and ticket business into a new manufacturing center and business complex for Asia Pacific operations.

- We made significant progress in our Latin American business strategy with the formation of a new operating group, as well as the acquisition of a majority interest in the largest pressure-sensitive base materials supplier in Argentina, which will manufacture premium-quality paper and film base materials for our label customers throughout Latin America.
- Reorganized to serve global markets, our marking films business continued to capitalize on the increased demand for digital printing technologies, as well as on the growing market for cast, calendared and reflective pressure-sensitive films for signage applications throughout the world.

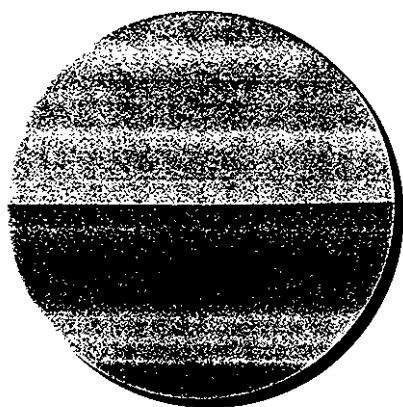
#### CONSUMER AND CONVERTED PRODUCTS

Our consumer and converted products businesses had an outstanding year in 1996. We continued to deliver highly creative, easy-to-use solutions for PC users, while expanding into new product and geographic markets. We

developed and took to market proprietary, technology-driven self-adhesive products that are defining a strategic new direction for Avery Dennison.

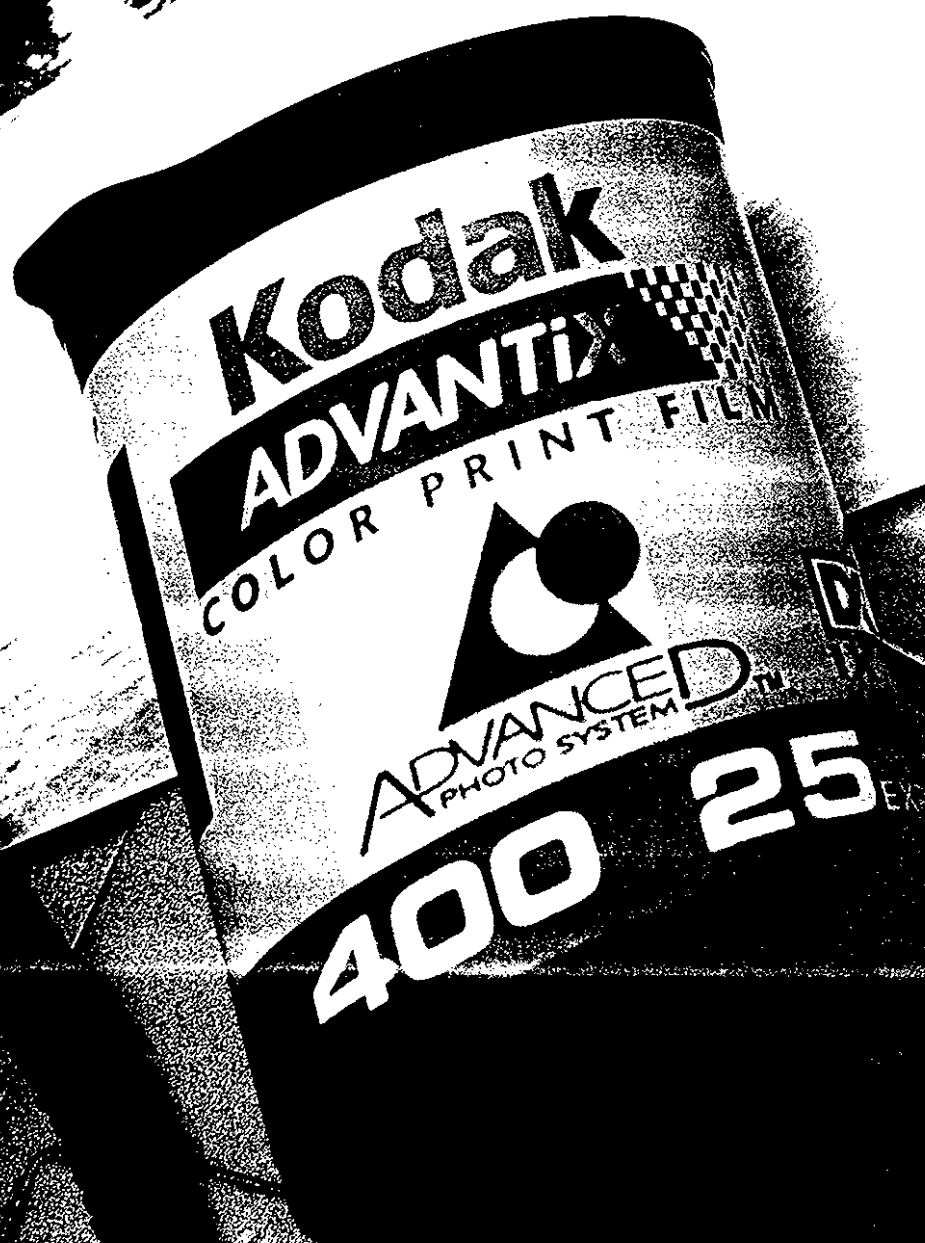
#### SALES BY BUSINESS SECTOR

Consumer and Converted Products  
\$1.67 Billion



Pressure-Sensitive Adhesives and Materials  
\$1.69 Billion

- Our North American consumer products businesses completed the largest systems implementation in the Company's history with the start-up of an integrated warehousing, order-entry and accounts receivable system for Avery-brand products. This new integrated system will significantly enhance our ability to service key accounts.
- Expanding our offering of Avery-brand desktop printer products beyond the traditional office market, we successfully launched our new Avery Kids line of printable supplies for children, which complements creative software programs and features a successful tie-in with the Barbie Print'n Play CD-ROM from Mattel.
- Other promising new Avery-brand product introductions include StaySharp and DualSharp pocket markers, a line of SmartFolio expandable paper carriers and dual-branded Avery and Eastpak binder packs for students.
- Building on our strategic partnerships with major software manufacturers, we teamed with Microsoft to develop our new Avery Wizard software, which can be added to Microsoft Word for Windows, and within Word, makes it easier to format and print Avery-brand laser and ink-jet products.



## THE POWER OF OUR BRANDS

**Our brand names are competitive weapons,  
with equity as real as our manufacturing  
plants or equipment or people. That's why  
major consumer product manufacturers  
specify our Fasson-brand labeling materials to  
create just the right look for their products –  
like the bright, bold canister label for photo-  
graphic film. In short, our brands have power.**

Fasson-brand PRIMAX film materials for consumer package labeling

XYZ

# WORLD TRAVEL

800-1



Margaret



## LOYALTY

**Loyalty is at the core of our brands' equity,**

**a measure of the attachment customers**

**have to our brands. Value they know, and**

**can depend on. Our Avery-brand office**

**automation products promise value.**

**Time and again, they succeed by**

**keeping that promise.**

**Avery-brand laminated rotary cards for laser and ink-jet printers**

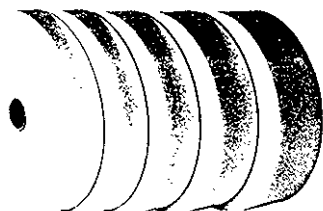


Our Avery, Fasson and Avery Dennison

brands deliver what they promise. Our

branded products and services have earned

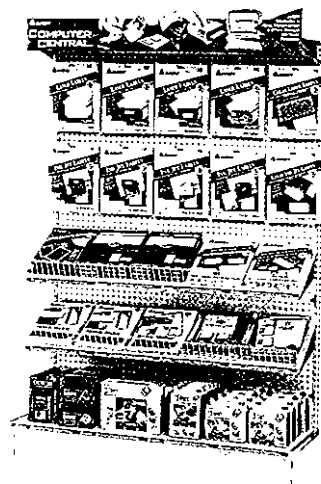
an enviable position of customer satisfaction and trust



through a consistent record of

excellence over five decades. We build

strong customer relationships.



#### 1 AVERY-BRAND CARD PRODUCTS FOR INK-JET PRINTERS

Preferred by PC users worldwide who demand superior product performance, our growing line of Avery-brand ink-jet products addresses the needs of the rapidly expanding ink-jet printer market – expected to reach an installed base of 80 million by the year 2000. Our newest Avery ink-jet card products hold special appeal for the burgeoning number of small office/home office (SOHO) users, who can promote their businesses with a professional touch, using Avery note, greeting and business cards.

#### 2 FASSON-BRAND FILM MATERIALS FOR CONSUMER PRODUCT PACKAGING

In the competitive beverage industry, where shelf impact is critical to a product's success, manufacturers specify Fasson-brand labeling materials to complement the upscale image of their products. Foster's Ice Beer – one of Britain's five top-selling lagers – demonstrates the clear superiority of Fasson-brand crystal clear film label stock, which won't scratch, discolor, tear, run or fall off, despite high-heat pasteurization or refrigerator storage.

#### 3 FASSON-BRAND EXACT SERVICE PROGRAM

Pressure-sensitive label converters around the world rely on the unique customer-tailored benefits of our Fasson-brand EXACT Program to get the exact roll widths they want. EXACT service helps to reduce inventory and overhead costs, providing customers with a distinct competitive advantage. In return, this program, based on our technical, logistics and production management expertise, enhances customer loyalty – a synergistic solution that benefits all concerned.

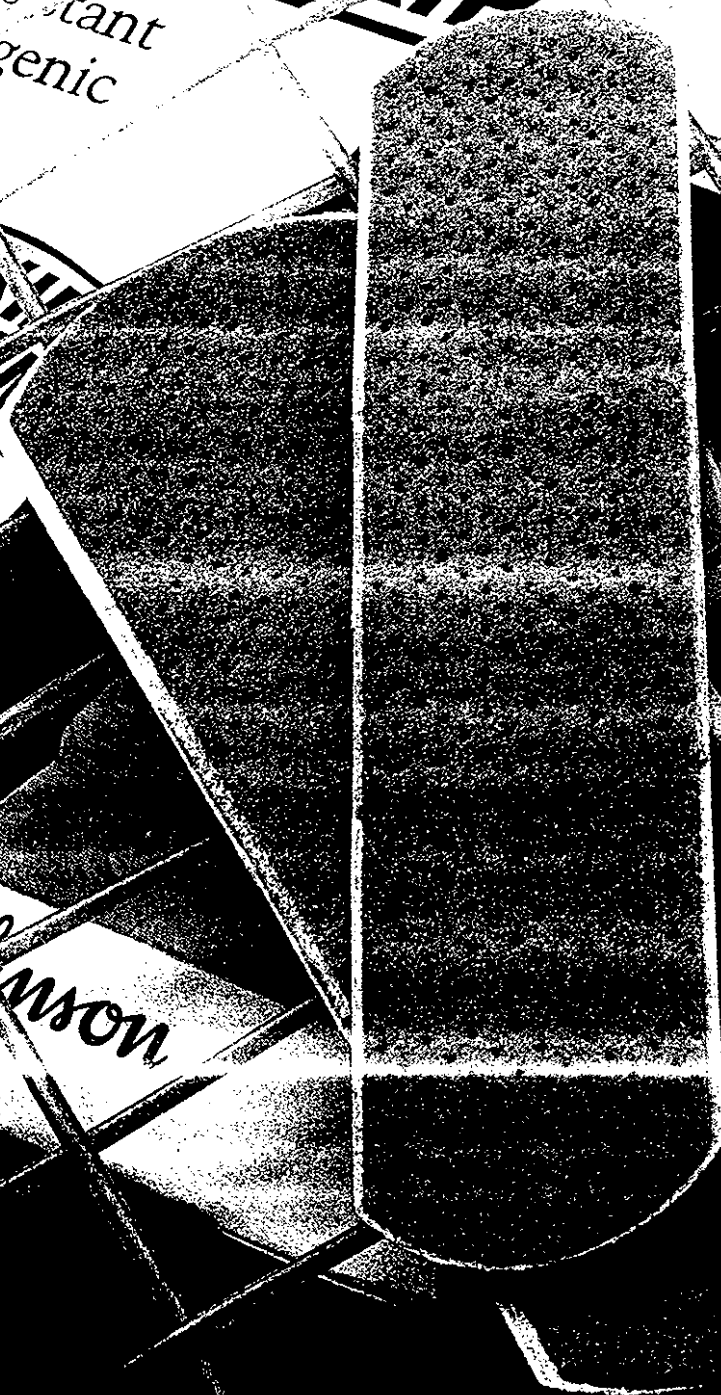
#### 4 AVERY COMPUTER CENTRAL RETAIL DISPLAY

Building upon the strong equity of the Avery brand as a platform for global growth, we recently launched Avery Computer Central – a one-stop shopping source for a wide range of Avery-brand PC-related products, including convenient 10-sheet packages of our most popular laser and ink-jet printer products. Based on its success – with distribution in more than 9,000 major mass market retail outlets in the United States in its first year alone – plans are underway to expand distribution internationally.

**DAVID-AID®**  
BRAND ADHESIVE  
**SPORT STRIP™**  
BANDAGES

Water Resistant  
Hypoallergenic

**HEALTH CARE**

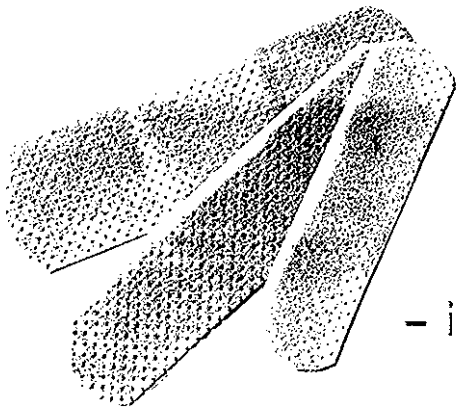


*Johnson*

**I M A G E**

**Mention our Avery Dennison name,  
and consumer product manufacturers take  
notice. Small wonder. The performance of  
their products – like adhesive bandages –  
depends on our branded adhesives.**

**Our brand names establish a powerful  
"reason to buy." In a sea of brands,  
our brands stand apart.**



Our brands are market leaders

- instantly recognizable to our

customers, who demand our products and



services by name. The solid reputation of our Avery,

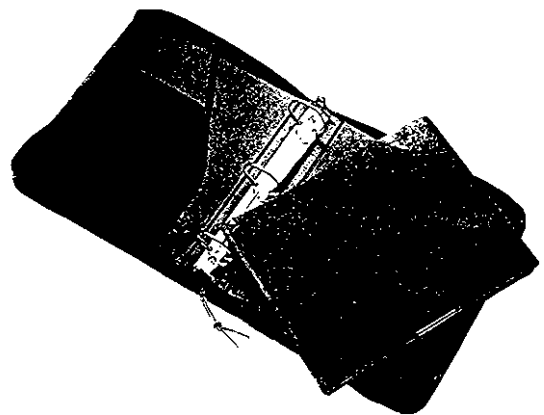


Fasson and Avery Dennison brands paves

the way for new products - continually expanding our

customer base and our reach

into new global markets.



#### 1 AVERY DENNISON-BRAND MEDICAL-GRADE TAPES

When Johnson & Johnson – the world's foremost health-care product manufacturer – wanted to create next-generation Band-Aid brand adhesive bandage products, it turned to Avery Dennison. As a global pressure-sensitive technology leader and producer of medical-grade tapes for two decades, Avery Dennison helped develop the highly popular, water-resistant Band-Aid brand Sport Strip bandage, a new type of adhesive bandage designed to stay on during sports and exercise.

#### 2 FASSON-BRAND FASCLEAR FILM FOR CONSUMER PACKAGE LABELING

Capturing the essence of a product, projecting the right look, creating the mood and feel. Beginning with the label, that's the tough assignment of today's consumer package – and why Avery Dennison is the recognized industry leader in quality labeling materials that meet packagers' exacting needs. Our versatile Fasson-brand FasClear label film, for example, provides a no-label look for Vaseline skin products, enhancing the product's image and appeal on retail shelves around the world.

#### 3 CLEAR ADVANTAGE THERMAL-TRANSFER LABELING FOR GLASS BOTTLES

The superior colors, durability and crisp, photographic-quality graphics of Avery Dennison ClearADvantage thermal-transfer labeling technology provide consumer product manufacturers with clear competitive advantages for identifying and promoting their products. That's why The Coca-Cola Company specifies ClearADvantage to enhance the look of its distinctive glass bottle for beverage promotions and to create a consistent graphic image for its Coca-Cola bottles worldwide.

#### 4 AVERY-BRAND BINDERPACK

What happens when two market leaders – Avery and Eastpak – form a strategic alliance and associate their highly recognizable and respected brand names? Greater leverage for both in the mass market channel, as demonstrated by our new Avery BinderPack. Part of the Avery Eastpak product line, which includes new NotePack and PencilPack binder accessories, the durable, fabric-covered BinderPack promises to appeal to its target youth audience because it resembles the popular Eastpak backpack – and because of the combined equity of the Eastpak and Avery names.



## Q U A L I T Y

**Quality is a given. The assurance that our**

**products will deliver what our product-**

**labeling customers desire. Be consistent.**

**Reliable. The quality of our Fasson-brand**

**labeling materials imparts an image of**

**quality and distinction that enhances their**

**products – like wine label graphics.**

**Our brands can be trusted.**

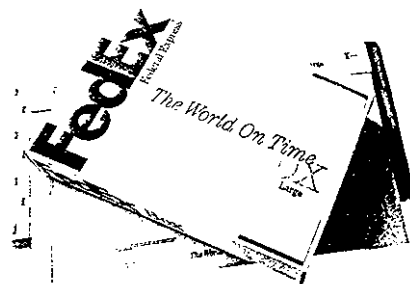
**Fasson-brand Mirage extruded film for bottle labeling**



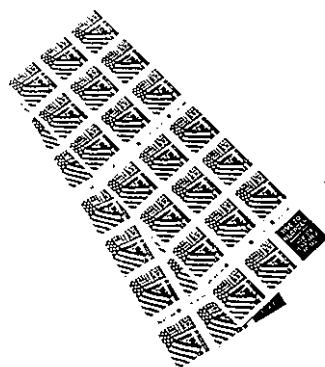
When it comes to quality, we let our customers

speak for us. "Avery Dennison gets it right

the first time." "I can count on Fasson



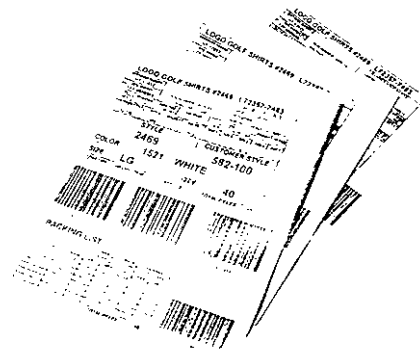
products." "If it says 'Avery,' I know I'm getting top-of-



the-line quality." "World-class service and

the best-performing label stock in the industry. That's

Fasson." "I ask only for Avery."



"They're the best."

## 1 FASSON-BRAND MIRAGE EXTRUDED FILM FOR BOTTLE LABELING

Attracted by the exceptional print quality, aesthetics and production versatility offered by pressure-sensitive labeling systems, premium wineries are increasingly switching from conventional glue-applied labels to Fasson-brand pressure-sensitive paper and film materials to enhance the shelf image of their wines. The beauty and no-label appearance of our Fasson Mirage extruded film promise wine manufacturers, and wine lovers alike, the crystal clear look of quality.

## 2 AVERY DENNISON DOUBLE-COATED ADHESIVE TAPE

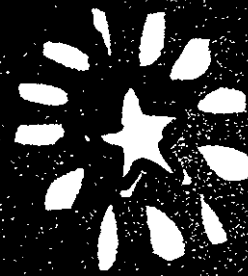
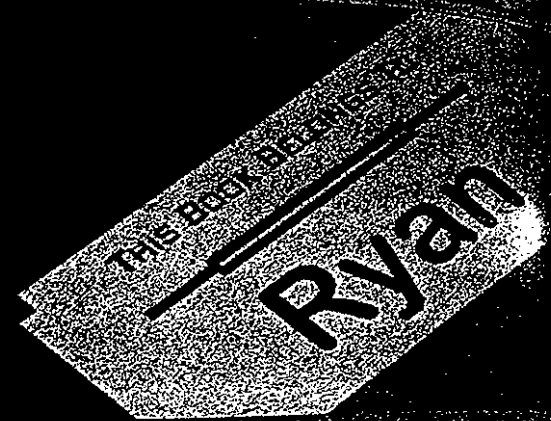
When FedEx needed a secure, quick-stick closure system to seal its mailing boxes and tubes, Avery Dennison delivered. Since that time, the bond between the two worldwide industry leaders has continued to strengthen. Today, the overnight delivery service expert relies on our advanced double-coated adhesive tape – with the FedEx logo imprinted on its liner – to assure that packages remain securely sealed until they reach their final destination.

## 3 SELF-ADHESIVE POSTAGE STAMPS

Responding to growing consumer demand for peel & stick stamps, Avery Dennison has produced more than 490 million 20-stamp convertible booklets of self-adhesive Flag Over Porch design stamps since 1995, which included the largest single order for a self-adhesive definitive stamp convertible booklet in U.S. Postal Service history. As the only fully integrated U.S. supplier of adhesive coating, security printing and converting technologies for postage stamp production, Avery Dennison continues to benefit from the increasing popularity of self-adhesive stamps, which accounted for 60 percent of all U.S. first-class stamps sold last year, compared to 25 percent in 1995.

## 4 FASSON-BRAND LABEL MATERIALS FOR VARIABLE- INFORMATION PRINTING APPLICATIONS

The speed and accuracy of today's bar-code driven world depends on the quality of the printed bar code – which predominantly relies on self-adhesive labels to carry the machine-scannable information. For product tracking, inventory control, distribution, logistics management and a multitude of other uses, our Fasson-brand pressure-sensitive label stocks set the industry standard for variable-information printing applications with self-adhesive materials that ensure superior bar-code printing, accurate scanning and trouble-free adhesion to a wide range of surfaces.



totally  
**AWESOME**

## R E C O G N I T I O N

**Our brands represent value, genuine worth that goes far beyond our products themselves. The reliable Avery brand evokes instinctive, positive associations that influence consumers to use our office automation products more creatively, and to try new Avery-brand products.**

Avery Kids Software and Supplies



Our customers love our brands.

Through decades of consistent

product excellence, technological inno-



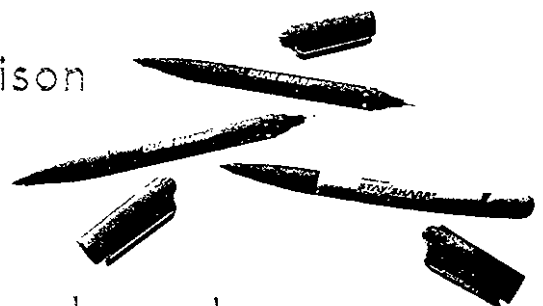
vation, and exceptional customer service, our brands



have created real value. Our Avery office

products mean innovation. Our Fasson label materials

guarantee quality. Our Avery Dennison



name stands for excellence. Our brands work.

## 1 AVERY KIDS SOFTWARE AND SUPPLIES

Reinforcing consumers' perception of the Avery brand as an innovative market leader, our Avery Kids Software and Supplies represents a totally new retail category – one with exciting potential. Launched in the fall of 1996 to widespread consumer acceptance, the easy-to-format "print shop" line makes it possible for computer-savvy children ages 4 to 13 to use pre-set layouts in leading children's software programs and CD-ROMs – such as Barbie Print'n Play from Mattel – to create kid-friendly stickers and cards on their desktop printers.

## 2 FASSON-BRAND PRIMAX FILM MATERIALS FOR CONSUMER PRODUCT PACKAGING

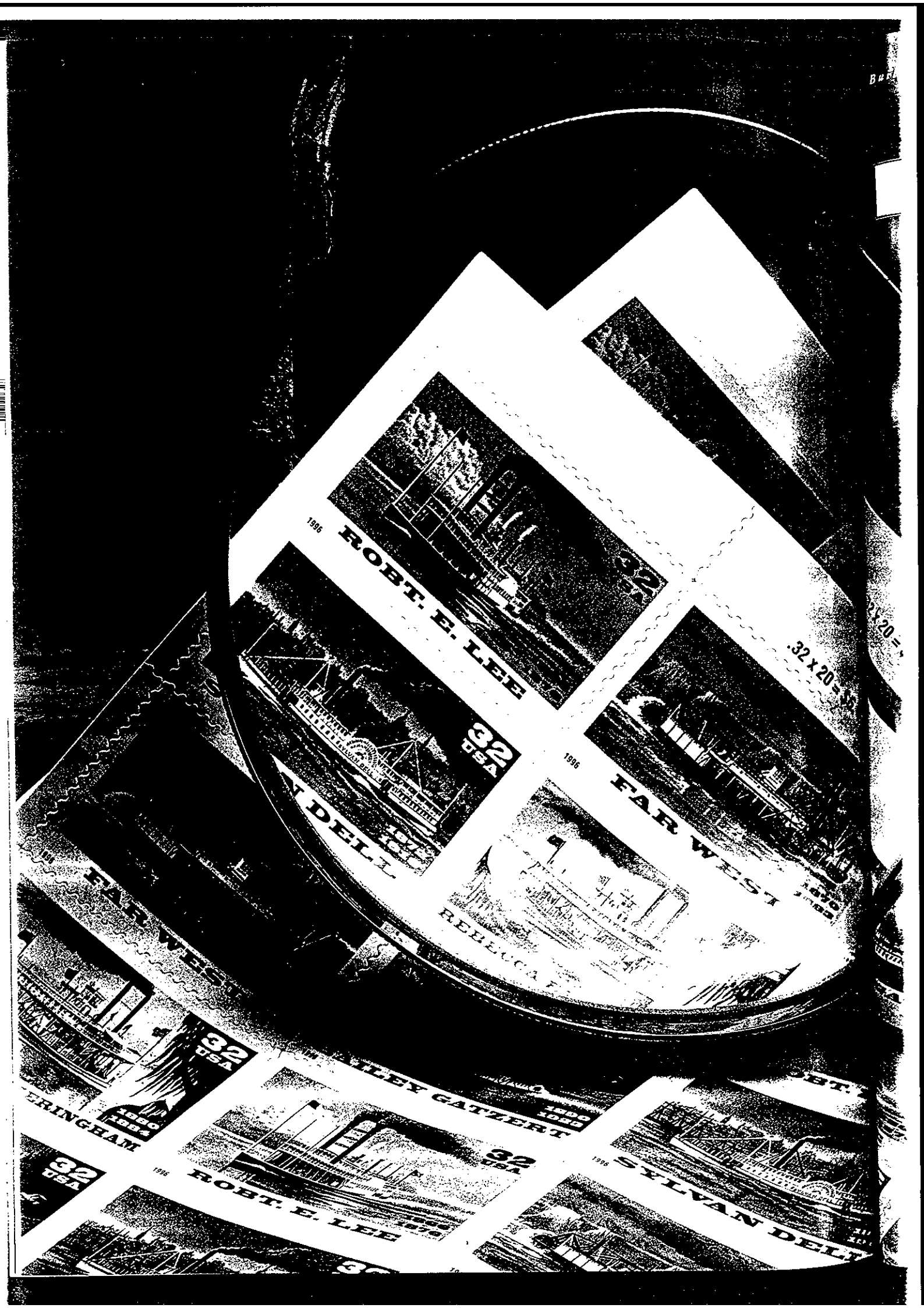
When the product you're selling depends on the image of quality – and the quality of image – there's no compromise. You go for the best. That's why Kodak depends on our Fasson-brand PRIMAX premium opaque film to identify its new Kodak Advantix photographic film. The unique characteristics of our proprietary pressure-sensitive film label create high-performance packaging systems that assure an immediate, and lasting, impression of quality.

## 3 AVERY-BRAND MARKING FILMS FOR COMMERCIAL SIGNAGE

In today's increasingly global marketplace, Avery Dennison is supplying high-quality, durable marking films to an expanding base of international customers. Our Avery-brand translucent pressure-sensitive marking films deliver superior graphics for service stations in India and other countries around the world.

## 4 AVERY-BRAND STAYSHARP AND DUALSHARP MARKERS

Creative solutions and the Avery name go hand-in-hand. Take our new Avery-brand StaySharp fine-point permanent marker, for example. StaySharp marker provides a fray-resistant tip that stays 25 percent sharper than the competition. Its companion marker, our new Avery-brand DualSharp marker with two writing tips, is the only pocket-sized marker of its kind made by a leading U.S. manufacturer.



## PROPRIETARY ADVANTAGE

**Our brands stake first claim, denoting special capabilities that they alone possess.**

**We apply our proprietary self-adhesive technology to create useful, innovative products – like peel & stick stamps – that consumers want. Our brands have leverage, influence, impact, presence. Clout.**

Self-adhesive stamps with peel-apart backing



We are the best at what we do. We

originated the self-adhesive label – the first

Avery label – and were first to market



with labels for copiers and laser and ink-jet printers.



Our Fasson pressure-sensitive

papers and films set the pace for the industry.

We create "labels" that post our mail



and check battery charges. We innovate. We lead.

## 1 SELF-ADHESIVE STAMPS WITH PEEL-APART BACKING

To manufacture the nation's first-ever self-adhesive commemorative stamp pane with a peel-apart backing, the U.S. Postal Service turned to Avery Dennison. As a major supplier to the USPS, sole supplier of self-adhesive ATM stamps and pressure-sensitive stamp pioneer, we used our expertise to develop an innovative die-cutting technology that makes it possible to remove an individual stamp from a 20-stamp pane intact with its liner – a feature that appeals to consumers and stamp collectors alike.

## 2 AVERY WIZARD SOFTWARE

Proprietary new Avery Wizard add-in software – an exciting extension of our alliances with more than 100 leading software manufacturers – makes it possible for Microsoft Word for Windows users to create reusable mailing lists, and to merge and print on more than 100 Avery-brand laser and ink-jet products. This easy-to-use software program, which works within the leading word processing software program, has the potential to introduce millions of consumers worldwide to the breadth of Avery-brand office automation products.

## 3 AVCOAT DRY PAINT FILM LAMINATE FOR AUTOMOTIVE APPLICATIONS

Avery Dennison's patented, high-performance Avcoat pressure-sensitive Dry Paint film provides automotive OEMs a durable, economical and environmentally friendly alternative to spray painting. Chrysler Corporation recently selected high-gloss Avcoat film to black out the window pillar area of its 1997 Dodge Dakota truck extended cab models. To assure ease of application and an ultra-smooth result, we engineered our proprietary film laminate to the precise sizes and shapes needed for the Dakota – a process developed in partnership with Dodge.

## 4 BATTERY TESTER LABELS

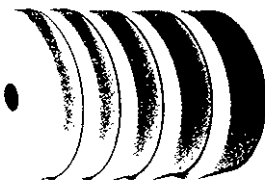
Working in strategic partnership with Duracell Inc., Avery Dennison developed a pressure-sensitive on-battery label design so revolutionary that it recently won the World Label Association's highly regarded Innovation Award. The world's only alkaline battery with a fuel-gauge-like on-battery tester – which permits an electrically conductive resistor circuit to convert battery power to heat – the Duracell PowerCheck battery began shipping in size AA in North America last summer and ultimately will be distributed globally in most battery sizes.

## BUSINESS SECTORS

Avery Dennison's businesses are divided into the following sectors and operating groups:

### WORLDWIDE OPERATING GROUPS/Growth Drivers

#### PRESSURE-SENSITIVE ADHESIVES AND MATERIALS SECTOR



Fasson-brand EXACT service program

##### MATERIALS - AMERICAS, ASIA AND EUROPE

- Technical advances in adhesive products for fabricating and bonding applications
- Changing market requirements for improved printing capability, clear package labeling and environmentally friendly products
- Expanded ingredient and nutritional labeling requirements
- Customer demand for service advantages

##### SPECIALTY TAPE

- Technical advances in adhesive products for fabricating and bonding applications

##### MARKING FILMS

- Adoption of wide format digital printing technologies for short-term and promotional graphics

##### CHEMICAL

- Use of pressure-sensitive adhesives applications

#### CONSUMER AND CONVERTED PRODUCTS SECTOR

##### OFFICE AND CONSUMER PRODUCTS

- Market acceptance of innovative products that support office and consumer automation and simplify office procedures
- Continuing growth and evolution of variable-information printing technologies
- Growth of superstores and mass market outlets in North America and Europe
- Demand for vendor-managed inventory systems and other service enhancements

##### CONVERTED PRODUCTS - NORTH AMERICA AND EUROPE

- Growth in demand for film material applications in automotive, durable goods, security labeling and other markets
- Continued demand for high-quality product identification graphics and automatic application systems
- Demand for inventory management systems using bar-coded labels

##### VIP CONVERTED PRODUCTS NORTH AMERICA AND FASTENER WORLDWIDE

- Retail demand for floor-ready merchandise and growing need to control and secure in-store merchandise
- Demand for automated high-speed application of product identification items
- Expansion of laser printing technologies in industrial applications

##### SECURITY PRINTING

- Consumer demand for ease-of-use products that take advantage of innovative label designs and constructions

##### AUTOMOTIVE

- Demand for cars, light trucks and sport utility vehicles
- Design trends for automobile, commercial fleet and recreational vehicle graphics

##### MERCHANT PRODUCTS

- Growing digital printing market
- Growing Eastern European market

##### ASIA PACIFIC AND LATIN AMERICA

- Growing demand for high-quality means of product identification as consumer-based markets develop
- Growth in computers and laser/ink-jet printers in Asia Pacific and Latin America for addressing and variable-information printing
- Continued growth in the sourcing of apparel from Asian countries and retail demand for pre-identified merchandise



ClearADvantage thermal transfer labeling for glass containers



Avery-brand card products for ink-jet printers

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Major Markets/Products

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Operations in the United States, Europe, Latin America, South Africa and Asia Pacific manufacture and market pressure-sensitive coated papers, films and foils in roll form, which are sold to label printers and converters. Fasson-brand paper and film stocks are used in a variety of industrial, commercial and consumer applications. Major markets include industrial, business and thermal labeling, promotional and decorative applications. Certain units also manufacture and market proprietary film facestocks and release-coated materials.

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Specialty tapes are sold to industrial and medical converters, original equipment manufacturers and disposable diaper producers worldwide.

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High-performance and retroreflective films are sold in the decorative graphics (commercial sign, digital printing, transportation and promotional), corporate graphics, traffic and safety, architectural and automotive markets; and government and traffic applications markets. Digital imaging films are used in the industrial label and office markets.

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Operations in the United States and Europe produce a range of emulsion-based acrylic polymer adhesives, protective coatings and electroconductive resins and binders.

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Businesses manufacture a wide range of Avery-brand products for office, home and school uses, including: pressure-sensitive labels, laser and ink-jet printer labels, cards and software, three-ring binders, dividers, presentation and organizing systems and marking pens.

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North American operations produce custom pressure-sensitive and heat-transfer labels for the automotive and durable goods industries and custom pressure-sensitive labels and specialty combination products for the electronic data-processing market. European operations produce custom and stock labels, labeling machinery and data printing systems, which are marketed to a wide range of industrial users.

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Operations produce tags, labels, printing systems, integrated shipping and receiving systems, marking systems, plastic fasteners, ties and application devices for apparel and retail markets, as well as for industrial users worldwide.

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Security Printing manufactures self-adhesive stamps for the U.S. and international postal services, and state-of-the-art on-battery-testing labels.

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Automotive operations manufacture and convert films for vehicle finishes, striping and identification. Avloy Dry Paint film laminate is supplied to global automotive original equipment manufacturers.

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Businesses manufacture pressure-sensitive sheeted and die-cut papers and films, which are sold through fine-paper merchants.

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Operations established in Asia Pacific and Latin America manufacture and market roll materials and consumer and converted products to customers in those geographic markets.

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## ELEVEN-YEAR SUMMARY

(Dollars and shares in millions)	Compound Growth Rate		1996	1995
	5 Year	10 Year		
FOR THE YEAR				
Net sales	4.8%	5.8%	\$3,222.5	\$3,113.9
Gross profit	5.0	5.1	1,018.3	957.3
Marketing, general and administrative expense <sup>(2), (3)</sup>	1.7	4.5	712.4	689.8
Interest expense	(.1)	3.5	37.4	44.3
Income before taxes	20.9	7.4	270.6	224.7
Taxes on income	17.8	4.5	94.7	81.0
Net income	22.8	9.4	175.9	143.7
Research and development expense	2.3	3.9	54.6	52.7
Depreciation	3.8	7.2	100.2	95.3
Average common shares outstanding <sup>(1)</sup>	(3.3)	(.9)	105.0	106.5
PER COMMON SHARE INFORMATION <sup>(1)</sup>				
Net income per common share	26.9%	10.3%	\$ 1.68	\$ 1.35
Dividends per common share	10.3	13.8	.62	.55
Book value at fiscal year end	3.6	4.6	8.03	7.69
Market price at fiscal year end	23.1	14.4	35.88	25.07
Market price range			23.88 to 35.88	16.63 to 25.07
AT YEAR END				
Working capital			\$ 110.6	\$ 127.6
Property, plant and equipment, net			962.7	907.4
Total assets			2,036.7	1,963.6
Long-term debt			370.7	334.0
Total debt			466.9	449.4
Shareholders' equity			832.0	815.8
Number of employees			15,800	15,500
STATISTICS				
Gross profit margin			31.6%	30.7%
Marketing, general and administrative expense as a percent of sales			22.1	22.2
Income before taxes as a percent of sales			8.4	7.2
Net income as a percent of sales			5.5	4.6
Effective tax rate			35.0	36.0
Research and development expense as a percent of sales			1.7	1.7
Long-term debt as a percent of total long-term capital			30.8	29.0
Total debt as a percent of total capital			35.9	35.5
Return on average shareholders' equity			21.4	18.6
Return on average total capital			16.4	14.4

<sup>(1)</sup> Per common share amounts and average common shares outstanding for years prior to 1996 have been restated to reflect the December 1996 two-for-one common stock split.

<sup>(2)</sup> In 1990, the Company incurred \$85.2 million in pretax charges related to the merger of Avery International Corporation and Dennison Manufacturing Company and \$13.8 million of merger-related costs. After adjusting for these charges, 1990 net income was \$71.7 million, or \$.58 per common share.

<sup>(3)</sup> In 1987, a restructuring resulted in pretax charges of \$25.2 million, which decreased net income by \$25 million, or \$.21 per common share.

1994	1993	1992	1991	1990 <sup>(2)</sup>	1989	1988	1987 <sup>(3)</sup>	1986
\$2,856.7	\$2,608.7	\$2,622.9	\$2,545.1	\$2,590.2	\$2,490.9	\$2,291.4	\$2,165.1	\$1,828.4
907.8	818.1	838.2	796.2	808.3	806.7	780.2	734.6	620.1
691.9	642.7	665.7	653.9	752.7	591.0	554.7	571.2	460.6
43.0	43.2	42.3	37.5	40.0	35.1	35.5	32.4	26.6
172.9	132.2	130.2	104.8	15.6	180.6	190.0	131.0	132.9
63.5	48.9	50.1	41.8	9.7	66.4	73.0	60.8	61.0
109.4	84.4	80.1	63.0	5.9	114.2	117.0	70.2	71.9
49.1	45.5	46.7	48.7	53.7	51.0	47.4	41.5	37.3
87.9	84.1	83.8	83.1	80.8	71.5	63.8	58.8	49.9
111.1	115.9	120.8	123.9	123.9	124.2	123.4	120.6	114.6
\$ .98	\$ .73	\$ .66	\$ .51	\$ .05	\$ .92	\$ .95	\$ .58	\$ .63
.50	.45	.41	.38	.32	.27	.23	.21	.17
6.81	6.40	6.82	6.73	6.83	6.55	6.25	5.75	5.13
17.75	14.69	14.38	12.69	10.75	15.94	11.00	9.32	9.35
13.32 to	12.75 to	11.63 to	9.69 to	7.82 to	10.50 to	8.57 to	8.00 to	8.63 to
17.88	15.57	14.44	12.75	16.50	15.94	13.00	14.57	11.88
\$ 122.8	\$ 141.6	\$ 222.6	\$ 226.0	\$ 298.8	\$ 323.9	\$ 314.3	\$ 325.8	\$ 319.8
831.6	758.5	779.9	814.2	821.7	714.1	667.3	574.2	512.8
1,763.1	1,639.0	1,684.0	1,740.4	1,890.3	1,715.9	1,652.2	1,558.5	1,352.4
347.3	311.0	334.8	329.5	376.0	317.8	298.8	301.0	320.3
420.7	397.5	427.5	424.0	510.4	418.9	411.3	393.2	384.3
729.0	719.1	802.6	825.0	846.3	811.3	769.6	705.9	585.8
15,400	15,750	16,550	17,095	18,816	19,215	19,114	19,360	19,156
31.8%	31.4%	32.0%	31.3%	31.2%	32.4%	34.0%	33.9%	33.9%
24.2	24.6	25.4	25.7	25.2	23.7	24.2	26.4	25.2
6.1	5.1	5.0	4.1	.6	7.3	8.3	6.1	7.3
3.8	3.2	3.1	2.5	.2	4.6	5.1	3.2	3.9
36.7	37.0	38.5	39.9	62.2	36.8	38.4	46.4	45.9
1.7	1.7	1.8	1.9	2.1	2.0	2.1	1.9	2.0
32.3	30.2	29.4	28.5	30.8	28.1	28.0	29.9	35.3
36.6	35.6	34.8	33.9	37.6	34.1	34.8	35.8	39.6
14.8	11.0	9.7	7.7	.7	14.7	16.0	10.5	12.8
12.1	9.3	8.3	6.7	1.5	12.0	12.7	8.3	10.6

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

## RESULTS OF OPERATIONS

(In millions)	1996	1995	1994
Net sales	\$3,222.5	\$3,113.9	\$2,856.7
Cost of products sold	2,204.2	2,156.6	1,948.9
Gross profit	1,018.3	957.3	907.8
Marketing, general and administrative expense	712.1	689.8	691.9
Net gain on divestitures and restructuring charges	2.1	1.5	—
Earnings before interest and taxes	\$ 308.0	\$ 269.0	\$ 215.9

Sales increased 3.5 percent to \$3.22 billion in 1996, compared to \$3.11 billion in 1995. Excluding the impact of business divestitures and changes in foreign currency exchange rates, sales increased 6.4 percent. In 1995, sales increased 9 percent over 1994 sales of \$2.86 billion. Excluding the impact of sales from the divested operations and changes in foreign currency exchange rates for 1995, sales increased approximately 7 percent. During the fourth quarter of 1995, the Company sold a portion of its North American label converting operations. These businesses accounted for approximately 2 percent of the Company's 1995 total sales. Each of the Company's 1996, 1995 and 1994 fiscal years consisted of 52 weeks.

Gross profit margins for the years ended 1996, 1995 and 1994 were 31.6 percent, 30.7 percent and 31.8 percent, respectively. Gross profit margins during 1996 improved compared to 1995 due primarily to an improved product mix, new products, cost reduction and control programs and increased capacity utilization. There was also a \$3.2 million LIFO benefit reported during 1996. The decline in the gross profit percentage during 1995 was primarily due to a shift in product mix, plant and major production line start-ups, and \$1.6 million in expense related to LIFO inventories compared to a benefit of \$400,000 for 1994.

Marketing, general and administrative expense as a percent of sales was 22.1 percent in 1996, 22.2 percent in 1995 and 24.2 percent in 1994. The improvement in 1996 over 1995 was primarily attributable to cost control and reduction efforts throughout the Company and was achieved despite major investments in geographic expansion, business realignment and new product programs. The improvement during 1995 was primarily attributable to benefits from the Company's cost reduction programs, a shift in product mix and increased sales.

During the third quarter of 1996, restructuring actions were taken, resulting in a net pretax gain of \$2.1 million. The Company sold its equity interest in a label operation in Japan for \$28.4 million, resulting in

a pretax gain of \$17.9 million. The Company also recorded \$15.8 million of restructuring charges, which included an asset impairment write-down of \$6.3 million for long-lived assets held in the Company's Consumer and converted products sector. The restructuring program also included the reorganization of certain manufacturing, distribution and administrative sites. These costs consisted of severance and related costs for approximately 200 positions worldwide (\$7.1 million) and the discontinuance of product lines and related asset write-offs (\$2.1 million). These actions are expected to be completed during 1997 and are expected to result in estimated annual savings of approximately \$9 million to \$11 million when fully implemented.

Business restructuring actions taken during the fourth quarter of 1995 resulted in a net pretax gain of \$1.5 million. Certain businesses which no longer met the Company's strategy for converting technology were sold for \$95 million. A \$40.7 million pretax gain on the sale of these businesses was offset by restructuring charges of \$39.2 million which included the closure of four plants and the reorganization of certain manufacturing, distribution and administrative sites. These costs consisted of severance and related costs for approximately 400 positions worldwide (\$16.2 million), discontinuance of product lines and related asset write-offs (\$13.1 million), and plant closure and other costs (\$9.9 million). This program is also expected to be completed during 1997 and is expected to result in estimated annual savings of \$14 million to \$17 million when fully implemented. The 1996 and 1995 programs are an integral part of the Company's ongoing effort to identify opportunities to improve its administrative and manufacturing cost structures.

Interest expense as a percent of sales was 1.2 percent in 1996, 1.4 percent in 1995 and 1.5 percent in 1994. The decrease in 1996 was primarily due to the expiration of interest rate swap agreements during the fourth quarter of 1995 and an overall lower cost of borrowing. Interest expense increased in 1995 due to higher debt levels, but was more than offset by the impact of increased sales.

Income before taxes, as a percent of sales, was 8.4 percent for 1996, 7.2 percent for 1995 and 6.1 percent for 1994. The improvement during 1996 was primarily due to higher gross profit margins and lower interest expense as a percent of sales. The improvement during 1995 was primarily due to lower operating and interest expenses as a percent of sales. The effective tax rate was 35 percent in 1996, 36 percent in 1995, and 36.7 percent in 1994.

(In millions, except per common share amounts)	1996	1995	1994
Net income	\$175.9	\$143.7	\$109.4
Net income per common share	1.68	1.35	.98
Net income per fully-diluted common share	1.62	1.31	.96
Average common shares outstanding	105.0	106.5	111.1
Average fully-diluted common shares outstanding	108.3	109.3	113.7

Net income increased to \$175.9 million in 1996 compared to \$143.7 million in 1995, reflecting a 22 percent increase over 1995. Net income in 1994 was \$109.4 million. Net income, as a percent of sales, was 5.5 percent, 4.6 percent and 3.8 percent in 1996, 1995 and 1994, respectively.

Net income per common share reached \$1.68 in 1996 compared to \$1.35 in 1995, a 24 percent increase over prior year. Net income per common share was \$.98 in 1994. Primarily due to the significant increase in the Company's stock price during 1996 and share repurchases, the Company is now required to report net income per share on a fully-diluted basis. Net income per fully-diluted common share was \$1.62 in 1996, \$1.31 in 1995 and \$.96 in 1994.

#### RESULTS OF OPERATIONS BY BUSINESS SECTOR

Effective fourth quarter 1996, the Company realigned the reporting of its businesses from three sectors to two — Pressure-sensitive adhesives and materials, and Consumer and converted products. The realignment reflects the broadening and related scope of the Company's consumer businesses to include products such as battery labels, postage stamps and children's school supplies. In addition, certain businesses previously in the Pressure-sensitive adhesives and materials sector that emphasize converting technology were reclassified into the Consumer and converted products sector. This change more effectively aligns the Company's financial reporting with manufacturing processes and end markets. Sector information for 1995 and 1994 has been reclassified to conform with the 1996 sector presentation.

#### Pressure-sensitive adhesives and materials:

(In millions)	1996	1995	1994
Net sales	\$1,693.5	\$1,589.7	\$1,389.7
Income from operations before interest and taxes	157.7	144.8	138.8

The Pressure-sensitive adhesives and materials sector reported increased sales and profits for 1996 compared to 1995. The sector's income results include restructuring charges of \$7.1 million in 1996 and \$15.1 million in 1995. The U.S. operations reported sales growth for the year primarily due to increased volume and new products. Profitability improved as a result of cost reduction actions, increased capacity utilization and improved operating efficiencies. The international businesses reported increased sales primarily due to its geographic expansion in emerging markets and increased

volume. Profitability for the international businesses increased primarily due to the extent of restructuring charges taken in 1995 compared to 1996. This increase was partially offset by costs related to continued investments in geographic expansion and major equipment start-up costs.

The Pressure-sensitive adhesives and materials sector reported increased sales and profitability for 1995 compared to 1994. Profitability for the sector increased despite the \$15.1 million in restructuring charges taken in 1995. The U.S. operations reported a significant increase in sales due to unit volume growth and pricing actions. Profitability improvement was primarily due to sales growth and lower operating expenses as a percent of sales, but was partially offset by plant and major equipment start-up costs for capacity expansion, and the reorganization of certain manufacturing sites. Sales for the European operations increased significantly primarily as a result of volume growth from improved economic conditions over 1994, pricing actions and changes in foreign currency rates. Profitability increased, despite costs taken for restructuring programs, primarily as a result of sales growth, lower operating expenses as a percent of sales and a more favorable product mix.

#### Consumer and converted products:

(In millions)	1996	1995	1994
Net sales	\$1,670.5	\$1,588.6	\$1,488.6
Income from operations before interest and taxes	159.0	147.8	102.1

The Consumer and converted products sector reported increased sales and profitability for 1996 compared to 1995. The sector's income results include restructuring charges of \$8.7 million for 1996 compared to a \$16.6 million net gain on divestitures and restructuring charges in 1995. The U.S. operations reported increased sales primarily due to the growth of its battery label business and for its Avery-brand products. Profitability improved primarily due to increased sales volume, new products and operating improvements, including improved logistics. The international businesses reported higher sales due to geographic expansion and growth of its office label businesses; however, this sales increase was partially offset by sales declines in a portion of the French operations. Profitability in 1996 for the international businesses was comparable to 1995. Profit improvements from cost control programs and product pruning were offset by lower sales in one of the French operations and start-up costs related to geographic expansion.

The Consumer and converted products sector reported increased sales and profits for 1995 compared to 1994. Profits in 1995 included a \$40.7 million gain from the sale of certain nonstrategic North American label converting operations, which was partially offset by \$24.1 million in restructuring charges. The U.S. operations reported increased sales for 1995 primarily due to sales growth of its Avery-brand and postage stamp

businesses. Profitability increased for the U.S. operations due to successful new products, an improved product mix and cost reduction actions, including the consolidations of distribution warehouses and sales forces in the United States. The international businesses reported increased sales as a result of new products, an improved European economy and changes in foreign currency rates. A more favorable product mix coupled with cost reduction actions taken in previous years and lower operating expenses as a percent of sales resulted in significantly higher profitability over 1994.

#### FINANCIAL CONDITION

Average working capital, excluding short-term debt, as a percent of sales was 9.1 percent in 1996, 9.6 percent in 1995 and 10 percent in 1994. The decrease in 1996 was primarily due to higher sales and an increase in current liabilities. Average inventory turnover was 9.3 in 1996, 9.0 in 1995 and 9.3 in 1994; the average number of days sales outstanding in accounts receivable was 55 days in 1996, 1995 and 1994.

Net cash flow from operating activities was \$304 million in 1996, \$187.9 million in 1995 and \$265 million in 1994. The increase in net cash flow in 1996 was due primarily to the change in working capital requirements and the Company's improved profitability. The decrease in 1995 was primarily due to a change in working capital requirements which was partially offset by the increase in net income.

Total debt increased \$17.5 million to \$466.9 million compared to year end 1995. Total debt to total capital was 35.9 percent at year end 1996 compared to 35.5 percent at year end 1995. Long-term debt as a percent of total long-term capital increased to 30.8 percent from 29 percent at year end 1995.

In October 1996, the Company established the Avery Dennison Corporation Employee Stock Benefit Trust (the "Trust") to fund a portion of the Company's obligations arising from various current and future

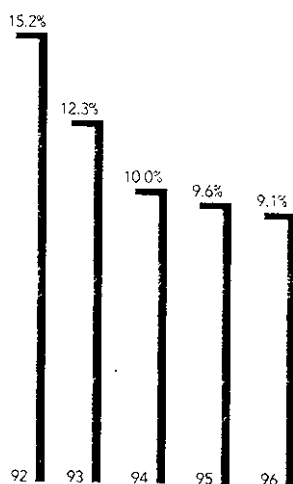
employee benefit plans. As a result, the Company sold 18 million shares of treasury stock to the Trust at fair market value. This transaction had no impact on the Company's financial condition. The Trust has a 15-year life during which it will utilize the stock to satisfy certain Company obligations.

Shareholders' equity increased to \$832 million from \$815.8 million at year end 1995. During 1996, the Company repurchased 3.8 million shares of common stock at a cost of \$109.3 million. The cost of treasury stock held, after the sale of shares to the Trust and net of shares reissued under the Company's stock option and incentive plans, at year end 1996 decreased \$212.4 million to \$67.5 million from year end 1995. In January 1995, the Board of Directors authorized the repurchase of an additional ten million shares of the Company's outstanding common stock for an aggregate of 30.4 million shares authorized for repurchase. As of year end 1996, a cumulative 25.4 million shares of common stock had been purchased under this authorization.

The return on average shareholders' equity was 21.4 percent in 1996, 18.6 percent in 1995 and 14.8 percent in 1994. The improvements during 1996 and 1995 were primarily due to a significant increase in profitability and the impact from share repurchases. The return on average total capital for those three years was 16.4 percent, 14.4 percent and 12.1 percent, respectively. The increases during those years were primarily due to profitability improvements and more effective utilization of the Company's assets.

The Company, like other U.S. corporations, has periodically received notices from the U.S. Environmental Protection Agency and state environmental agencies alleging that the Company is a potentially responsible party (PRP) for past and future cleanup costs at hazardous waste sites. The Company has received requests for information, notices and/or claims with respect to 17 waste sites in which the Company has no ownership

AVERAGE WORKING  
CAPITAL, EXCLUDING  
SHORT-TERM DEBT, AS A  
PERCENT OF SALES



COMMON SHARES  
OUTSTANDING AT YEAR END  
(in millions)



interest. Litigation has been initiated by a governmental authority with respect to four of these sites, but the Company does not believe that any such proceedings will result in the imposition of monetary sanctions.

Environmental investigatory and remediation projects are also being undertaken on property presently owned by the Company. The Company has accrued liabilities for all sites where it is probable that a loss will be incurred and the minimum cost or amount of the loss can be reasonably estimated. However, because of the uncertainties associated with environmental assessments and remediation activities, future expense to remediate the currently identified sites, and sites which could be identified in the future for cleanup, could be higher than the liability currently accrued. Based on current site assessments, management believes that the potential liability over the amounts currently accrued would not materially affect the Company.

#### LIQUIDITY AND CAPITAL RESOURCES

In addition to cash flow from operations, the Company has more than adequate financing arrangements, at competitive rates, to conduct its operations.

During the fourth quarter of 1996, the Company registered with the Securities and Exchange Commission \$150 million in principal amount of medium-term notes. As of year end 1996, no notes had been issued. Proceeds from the medium-term notes will be used to reduce debt and for other general corporate purposes. The Company's currently outstanding medium-term notes have maturities from 1997 through 2025 and have a weighted-average interest rate of 7.2 percent.

The Company's restructuring programs included the 1996 \$28.4 million sale of its equity interest in a label operation in Japan and the 1995 \$95 million sale of certain non-strategic label converting businesses. The restructuring programs had an estimated cost of \$15.8 million and \$39.2 million for 1996 and 1995, respectively. At year end 1996 and 1995, \$16 million and \$24.5 million, respectively, remained accrued for both

programs and related primarily to employee severance and plant closure costs. By year end 1996 and 1995, total cash expenditures paid for both restructuring programs totalled \$14.5 million and \$1.5 million, respectively, and related primarily to employee severance and plant closure costs.

Capital expenditures were \$187.6 million in 1996 and \$190.3 million in 1995. Capital expenditures for 1997 are expected to be approximately \$190 to \$200 million.

The annual dividend rate per share increased to \$.62 in 1996 from \$.55 in 1995 and \$.50 in 1994.

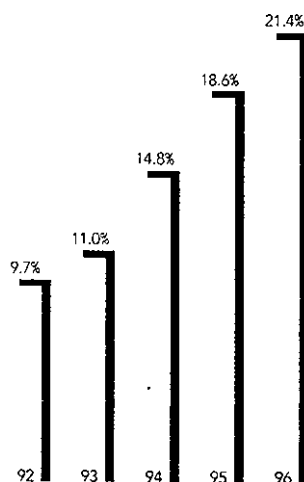
The Company continues to expand its operations in Asia Pacific, Latin America and Europe. The Company's future results are subject to changes in economic conditions and the impact of fluctuations in foreign currency exchange and interest rates. To manage its exposure to these fluctuations, the Company may enter into forward exchange and interest rate contracts, where appropriate.

Effective 1997, Mexico will be treated as a hyperinflationary economy for accounting purposes due to the cumulative inflation rate over the past three years. As a result, the functional currency of subsidiaries operating in Mexico will change from the peso to the dollar and translation gains and losses will be included in net income. These operations, including those located in Brazil which also operate in a hyperinflationary economy, are not significant to the Company's consolidated financial position.

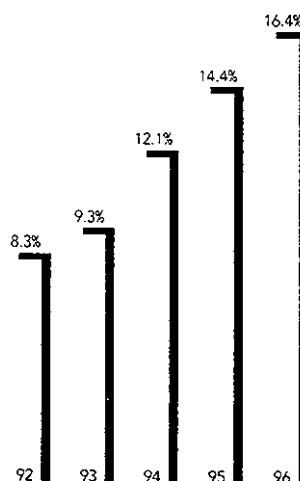
#### FUTURE ACCOUNTING REQUIREMENTS

In July 1996, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". The standard revised the guidelines for recognition, measurement and disclosure of transfers and servicing of financial assets and extinguishment of debt. It will be effective for transactions occurring after December 31, 1996. The Company will implement the standard during the first quarter of 1997, if applicable; however, the impact has yet to be determined.

RETURN ON AVERAGE  
SHAREHOLDERS' EQUITY



RETURN ON AVERAGE  
TOTAL CAPITAL



## CONSOLIDATED BALANCE SHEET

(Dollars in millions)	1996	1995
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 3.8	\$ 27.0
Trade accounts receivable, less allowance for doubtful accounts of \$17.5 and \$17.6 for 1996 and 1995, respectively	448.5	444.1
Inventories, net	244.4	223.2
Other receivables	25.7	24.8
Prepaid expenses	17.8	21.9
Deferred taxes	64.3	59.1
Total current assets	804.5	800.1
Property, plant and equipment, at cost:		
Land	37.7	37.8
Buildings	405.3	388.9
Machinery and equipment	1,180.3	1,089.1
Construction-in-progress	144.6	136.3
	1,767.9	1,652.1
Accumulated depreciation	805.2	744.7
	962.7	907.4
Intangibles resulting from business acquisitions, net	135.9	124.3
Non-current deferred taxes	7.1	5.8
Other assets	126.5	126.0
	\$2,036.7	\$1,963.6
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Short-term and current portion of long-term debt	\$ 96.2	\$ 115.4
Accounts payable	230.7	169.9
Accrued payroll and employee benefits	134.3	132.2
Other accrued liabilities	208.2	215.1
Income taxes payable	23.0	39.0
Deferred taxes	1.5	.9
Total current liabilities	693.9	672.5
Long-term debt	370.7	334.0
Long-term retirement benefits and other accrued liabilities	96.6	99.8
Non-current deferred taxes	43.5	41.5
Shareholders' equity		
Common stock, \$1 par value, authorized - 200,000,000 shares; issued - 124,126,624 shares at year end 1996 and 1995	124.1	124.1
Capital in excess of par value	475.4	129.6
Retained earnings	945.6	837.8
Cumulative foreign currency translation adjustment	28.3	33.8
Cost of unallocated ESOP shares	(29.4)	(27.0)
Minimum pension liability	(.2)	(2.6)
Employee stock benefit trust, 17,959,358 shares	(644.3)	—
Treasury stock at cost, 2,551,808 shares and 18,007,526 shares at year end 1996 and 1995, respectively	(67.5)	(279.9)
Total shareholders' equity	832.0	815.8
	\$2,036.7	\$1,963.6

See Notes to Consolidated Financial Statements

## CONSOLIDATED STATEMENT OF INCOME

(In millions, except per share amounts)	1996	1995	1994
Net sales	\$3,222.5	\$3,113.9	\$2,856.7
Cost of products sold	2,204.2	2,156.6	1,948.9
Gross profit	1,018.3	957.3	907.8
Marketing, general and administrative expense	712.4	689.8	691.9
Net gain on divestitures and restructuring charges	2.1	1.5	—
Interest expense	37.4	44.3	43.0
Income before taxes	270.6	224.7	172.9
Taxes on income	94.7	81.0	63.5
Net income	\$ 175.9	\$ 143.7	\$ 109.4
Net income per common share	\$ 1.68	\$ 1.35	\$ .98
Net income per fully-diluted common share	1.62	1.31	.96
Average shares outstanding:			
Common shares	105.0	106.5	111.1
Fully-diluted common shares	108.3	109.3	113.7
Common shares outstanding at year end	103.6	106.1	107.1

See Notes to Consolidated Financial Statements

## CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(Dollars in millions)	Common stock, \$1 par value	Capital in excess of par value	Retained earnings	Cumulative foreign currency translation adjustment	Cost of unallocated ESOP shares	Minimum pension liability	Employee stock benefit trust	Treasury stock
Fiscal year ended 1993	\$124.1	\$132.4	\$698.9	\$(10.1)	\$(53.2)	\$(8.9)	—	\$(164.1)
Repurchase of 6.4 million shares for treasury								(105.7)
Stock issued under option plans, net of tax and dividends paid on stock held by leveraged ESOPs		(1.4)						16.4
Net income			109.4					
Dividends: \$.50 per share			(55.1)					
Translation adjustments, net of tax				26.8				
ESOP transactions, net					15.6			
Minimum pension liability						3.9		
Fiscal year ended 1994	124.1	131.0	753.2	16.7	(37.6)	(5.0)	—	(253.4)
Repurchase of 1.7 million shares for treasury								(35.1)
Stock issued under option plans, net of tax and dividends paid on stock held by leveraged ESOPs		(1.4)						8.6
Net income			143.7					
Dividends: \$.55 per share			(59.1)					
Translation adjustments, net of tax				17.1				
ESOP transactions, net					10.6			
Minimum pension liability						2.4		
Fiscal year ended 1995	124.1	129.6	837.8	33.8	(27.0)	(2.6)	—	(279.9)
Repurchase of 3.8 million shares for treasury								(109.3)
Stock issued under option plans, net of tax and dividends paid on stock held by leveraged ESOPs		9.0						11.2
Net income			175.9					
Dividends: \$.62 per share			(68.1)					
Translation adjustments, net of tax				(5.5)				
Employee stock benefit trust transactions, net		336.8					(644.3)	310.5
ESOP transactions, net					(2.4)			
Minimum pension liability						2.4		
Fiscal year ended 1996	\$124.1	\$475.4	\$945.6	\$28.3	\$(29.4)	\$(.2)	\$(644.3)	\$ (67.5)

See Notes to Consolidated Financial Statements

## CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(Dollars in millions)	Common stock, \$1 par value	Capital in excess of par value	Retained earnings	Cumulative foreign currency translation adjustment	Cost of unallocated ESOP shares	Minimum pension liability	Employee stock benefit trust	Treasury stock
Fiscal year ended 1993	\$124.1	\$132.4	\$698.9	\$(10.1)	\$(53.2)	\$(8.9)	—	\$(164.1)
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Stock issued under option plans, net of tax and dividends paid on stock held by leveraged ESOPs		(1.4)						16.4
Net income			109.4					
Dividends: \$.50 per share			(55.1)					
Translation adjustments, net of tax				26.8				
ESOP transactions, net					15.6			
Minimum pension liability						3.9		
Fiscal year ended 1994	124.1	131.0	753.2	16.7	(37.6)	(5.0)	—	(253.4)
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Stock issued under option plans, net of tax and dividends paid on stock held by leveraged ESOPs		(1.4)						8.6
Net income			143.7					
Dividends: \$.55 per share			(59.1)					
Translation adjustments, net of tax				17.1				
ESOP transactions, net					10.6			
Minimum pension liability						2.4		
Fiscal year ended 1995	124.1	129.6	837.8	33.8	(27.0)	(2.6)	—	(279.9)
Repurchase of 3.8 million shares for treasury								(109.3)
Stock issued under option plans, net of tax and dividends paid on stock held by leveraged ESOPs		9.0						11.2
Net income			175.9					
Dividends: \$.62 per share			(68.1)					
Translation adjustments, net of tax				(5.5)				
Employee stock benefit trust transactions, net		336.8					(644.3)	310.5
ESOP transactions, net					(2.4)			
Minimum pension liability						2.4		
Fiscal year ended 1996	\$124.1	\$475.4	\$945.6	\$28.3	\$(29.4)	\$(.2)	\$(644.3)	\$(67.5)

See Notes to Consolidated Financial Statements

## CONSOLIDATED STATEMENT OF CASH FLOWS

(In millions)	1996	1995	1994
<b>OPERATING ACTIVITIES</b>			
Net income	\$175.9	\$143.7	\$109.4
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	100.2	95.3	87.9
Amortization	13.2	12.6	14.6
Net gain on divestitures and restructuring charges	(2.1)	(1.5)	—
Deferred taxes	.8	(17.6)	(6.7)
Changes in assets and liabilities, net of the effect of foreign currency translation, business acquisitions and divestitures, and restructuring charges:			
Trade accounts receivable, net	(.9)	(52.5)	(24.6)
Inventories, net	(18.1)	(18.5)	(19.2)
Other receivables	1.2	1.8	2.8
Prepaid expenses	3.7	(5.3)	(2.6)
Accounts payable and accrued liabilities	45.7	18.6	96.4
Taxes on income	(12.4)	11.4	(.8)
Long-term retirement benefits and other accrued liabilities	(3.2)	(.1)	7.8
Net cash provided by operating activities	304.0	187.9	265.0
<b>INVESTING ACTIVITIES</b>			
Purchase of property, plant and equipment	(187.6)	(190.3)	(163.3)
Acquisitions, sale of assets and business divestitures	12.1	96.7	16.2
Other	(2.1)	(19.1)	(10.2)
Net cash used in investing activities	(177.6)	(112.7)	(157.3)
<b>FINANCING ACTIVITIES</b>			
Increase in long-term debt	51.0	100.0	100.5
Decrease in long-term debt	(14.3)	(107.9)	(49.3)
Net (decrease) increase in short-term debt	(18.8)	40.5	(16.0)
Dividends paid	(68.1)	(59.1)	(55.1)
Purchase of treasury stock	(109.3)	(35.1)	(105.7)
Other	9.9	10.2	15.0
Net cash used in financing activities	(149.6)	(51.4)	(110.6)
Effect of foreign currency translation on cash balances	—	.1	.2
(Decrease) increase in cash and cash equivalents	(23.2)	23.9	(2.7)
Cash and cash equivalents, beginning of year	27.0	3.1	5.8
Cash and cash equivalents, end of year	\$ 3.8	\$ 27.0	\$ 3.1

See Notes to Consolidated Financial Statements

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## Nature of Operations

The Company is a worldwide manufacturer of pressure-sensitive adhesives and materials, and consumer and converted products. The Company's major markets are in office products, data processing, health care, retail, transportation, industrial and durable goods, food and apparel. The Pressure-sensitive adhesives and materials sector and the Consumer and converted products sector each contribute approximately 50 percent of the Company's total sales. Sales are generated primarily in the United States, continental Europe and the United Kingdom.

## Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all of its majority-owned subsidiaries. Investments in certain affiliates (20 percent to 50 percent ownership) are accounted for by the equity method of accounting. Certain prior year amounts have been reclassified to conform with current year presentation. In addition, all per common share amounts and average common shares outstanding have been restated to reflect the December 1996 two-for-one common stock split effected in the form of a stock dividend.

## Fiscal Year

The Company's financial reporting calendar for fiscal years 1996, 1995 and 1994 reflected 52-week periods ending December 28, 1996, December 30, 1995 and December 31, 1994, respectively. Generally each fiscal year consists of 52 weeks, but every fifth or sixth fiscal year consists of 53 weeks.

## Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions for the reporting period and as of the financial statement date. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities, and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

## Cash and Cash Equivalents

The Company considers cash on hand, deposits in banks and short-term investments, with maturities of three months or less when purchased, as cash and cash equivalents. The carrying amounts of these assets approximate fair value due to the short maturity of the instruments. At year end 1995, \$23.6 million was held in short-term investments. Cash paid for interest and taxes was as follows:

(In millions)	1996	1995	1994
Interest, net of capitalized amounts	\$40.0	\$46.7	\$42.7
Income taxes, net of refunds	115.9	87.2	70.6

## Inventories

Inventories are stated at the lower of cost or market value. Cost is determined using both the first-in, first-out (FIFO) and last-in, first-out (LIFO) methods. Inventories valued using the LIFO method comprised 37 percent, 40 percent and 41 percent of inventories before LIFO adjustment at year end 1996, 1995 and 1994, respectively.

During 1996, certain inventories were reduced resulting in the liquidation of LIFO inventory carried at lower costs prevailing in prior years as compared with current costs. The effect was to reduce 1996 cost of products sold by \$3.2 million. Inventories at year end were as follows:

(In millions)	1996	1995
Raw materials	\$ 82.7	\$ 78.5
Work-in-process	72.4	72.4
Finished goods	123.4	109.6
LIFO adjustment	(34.1)	(37.3)
	<u>\$244.4</u>	<u>\$223.2</u>

## Property, Plant and Equipment

Depreciation is generally computed using the straight-line method over the estimated useful lives of the assets. Maintenance and repair costs are expensed as incurred; renewals and betterments are capitalized. Upon the sale or retirement of properties, the accounts are relieved of the cost and the related accumulated depreciation, with any resulting profit or loss included in income.

## Intangibles Resulting From Business Acquisitions

Intangibles resulting from business acquisitions consist primarily of the excess of the acquisition cost over the fair value of net assets acquired and are amortized over a 25-to-40 year period using the straight-line method.

The Company evaluates the carrying value of its goodwill on an ongoing basis and recognizes an impairment when the estimated future undiscounted cash flows from operations are less than the carrying value of the goodwill. Accumulated amortization at year end 1996 and 1995 was \$46.6 million and \$40.3 million, respectively.

#### Foreign Currency Translation

Financial statements of international operations are translated into U.S. dollars at current rates, except for revenue, costs and expenses which are translated at average current rates during each reporting period. Gains and losses resulting from foreign currency transactions, other than those transactions described below, are included in income currently. Gains and losses resulting from hedging the value of investments in certain international operations and from translation of financial statements are excluded from the statement of income and are recorded directly to a separate component of shareholders' equity. Translation gains and losses of subsidiaries operating in hyperinflationary economies are included in net income currently.

Transaction and translation losses decreased net income in 1996, 1995 and 1994, by \$1.6 million, \$1.8 million, and \$1.5 million, respectively.

#### Financial Instruments

The Company enters into forward exchange and interest rate contracts to manage exposure to fluctuations in foreign currency exchange and interest rates. Gains and losses on contracts that hedge specific foreign currency commitments are deferred and subsequently recognized in net income in the period in which the underlying transaction is consummated. The net amounts paid or received on interest rate agreements are recognized as adjustments to interest expense over the terms of the agreements. Contract premiums paid, if any, are amortized to interest expense over the terms of the underlying instruments.

#### Revenue Recognition

Sales, provisions for estimated sales returns, and the cost of products sold are recorded at the time of shipment.

#### Research and Development

Research and development costs are expensed as incurred. Research and development expense for 1996, 1995 and 1994 was \$54.6 million, \$52.7 million and \$49.1 million, respectively.

#### Stock-Based Compensation

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation". The Company has adopted the disclosure-only provisions of SFAS No. 123. As a result, the Company has disclosed the pro forma amounts of net income and net income per common share as if the compensation cost for the stock option plans had been determined based on the fair value of the outstanding options (see Note 7).

#### Environmental Expenditures

Environmental expenditures that do not contribute to current or future revenue generation are expensed. Expenditures for newly acquired assets and those which extend or improve the economic useful life of existing assets are capitalized and amortized over the remaining asset life. The Company reviews, on a quarterly basis, its estimates of costs of compliance with environmental laws and the cleanup of various sites, including sites in which governmental agencies have designated the Company as a potentially responsible party. When it is probable that obligations have been incurred and where a minimum cost or a reasonable estimate of the cost of compliance or remediation can be determined, the applicable amount is accrued. For other potential liabilities, the timing of accruals coincides with the related ongoing site assessments. Potential insurance reimbursements are not recorded or offset against the liabilities until received, and liabilities are not discounted.

#### Net Income Per Share

Net income per common share is computed by dividing net income by the weighted-average number of common shares outstanding. Common share equivalents outstanding were excluded from the computation as they were not dilutive. Net income per fully-diluted common share is computed by dividing net income by the weighted-average number of common and common share equivalents outstanding. Common share equivalents include shares issuable upon the assumed exercise of outstanding stock options and stock warrants.

### Future Accounting Requirements

In June 1996, the Financial Accounting Standards Board issued SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". The standard revised the guidelines for recognition, measurement and disclosure of transfers and servicing of financial assets and extinguishment of debt. It will be effective for transactions occurring after December 31, 1996.

### NOTE 2. DIVESTITURES AND RESTRUCTURING

During the third quarter of 1996, business restructuring actions resulted in a net pretax gain of \$2.1 million. The Company sold its equity interest in a label operation in Japan for \$28.4 million, resulting in a net gain of \$17.9 million. The Company also recorded charges for certain restructuring actions which had an estimated cost of \$15.8 million.

The 1996 restructuring actions included the reorganization of certain manufacturing, distribution and administrative sites. These costs consisted of severance and related costs for approximately 200 positions worldwide (\$7.4 million) and the discontinuance of product lines and related asset disposals (\$2.1 million). In addition, an asset impairment write-down of \$6.3 million was recognized for long-lived assets held in the Company's Consumer and converted products sector.

Total cash expenditures for the 1996 restructuring program are estimated at \$7.4 million of which \$5.5 million had been paid by year end 1996; \$1.9 million in employee severance costs remained accrued. The Company's 1996 restructuring program is expected to be completed during 1997 and result in estimated annual savings of \$9 million to \$11 million when fully implemented.

During 1995, the Company took specific actions to restructure certain businesses to improve future profitability. These actions, which included the sale of non-strategic businesses and restructuring programs, resulted in a net pretax gain of \$1.5 million.

The portion of the North American label converting operations which no longer met the Company's strategy for converting technology was sold during the fourth quarter of 1995 for \$95 million. These businesses accounted for approximately 2 percent of the Company's 1995 total sales. The \$40.7 million pretax gain on the sale of these businesses was offset by charges related to the Company's 1995 restructuring program.

The Company's 1995 restructuring program resulted in a one-time pretax charge of \$39.2 million and included the closure of four plants and the reorganization of certain manufacturing, distribution and administrative sites. The costs consisted primarily of employee severance and related costs (\$16.2 million) for approximately 400 positions worldwide, discontinuance of product lines and related asset write-offs (\$13.1 million) and plant closure and other costs (\$9.9 million). At year end 1996, \$14.1 million remained accrued which related mainly to employee severance and plant closure costs. During 1996, cash expenditures and non-cash charges totaled \$9 million and \$1.4 million, respectively. The Company's 1995 restructuring program is expected to result in annual savings of \$14 million to \$17 million when fully implemented.

### NOTE 3. DEBT

Long-term debt at year end was as follows:

(In millions)	1996	1995
Medium-term notes (6.1% to 8.0% at year end)	\$300.0	\$365.0
Domestic variable-rate short-term borrowings refinanced on a long-term basis	51.0	—
Industrial Revenue Bonds (3.7% to 9.9% at year end)	22.0	22.0
Other long-term debt (7.0% to 8.5% at year end)	20.2	25.9
	393.2	412.9
Less: Amount classified as current	(22.5)	(78.9)
	<u>\$370.7</u>	<u>\$334.0</u>

The Company has a revolving credit agreement with four domestic banks to provide up to \$250 million in borrowings through July 1, 2001, with all amounts borrowed under this agreement due on the same date. The Company may annually extend the revolving period and due date under certain conditions with approval of the banks. The financing available under this revolving credit agreement will be used, as needed, to repay short-term and currently maturing long-term debt, and to finance other corporate requirements.

In addition to the above revolving credit agreement, the Company had short-term lines of credit available aggregating \$305.7 million at the end of 1996, of which \$73.7 million was utilized at variable interest rates ranging from 4 to 14 percent.

During the fourth quarter of 1996, the Company registered with the Securities and Exchange Commission \$150 million in principal amount of medium-term notes. At year end 1996, no notes had been issued. Proceeds from the medium-term notes will be used to reduce debt and for other general corporate purposes.

The Company's currently outstanding medium-term notes have maturities from 1997 through 2025 and have a weighted-average interest rate of 7.2 percent.

The amount of long-term debt outstanding at the end of 1996, which matures during 1997 through 2001, is \$22.5 million, \$6.2 million, \$1 million, \$2.1 million and \$4.7 million, respectively.

The fair value of the Company's debt is estimated based on the discounted amount of future cash flows using the current rates offered to the Company for debt of the same remaining maturities. At year end 1996 and 1995, the fair value of the Company's total debt was \$408.3 million and \$456.1 million, respectively.

The terms of the various loan agreements in effect at year end require maintenance of specified amounts of consolidated tangible net worth and consolidated net income before interest and taxes to consolidated interest. Under the most restrictive provisions, \$163.5 million of retained earnings was not restricted at year end 1996.

The Company's total interest expense in 1996, 1995 and 1994 was \$40.9 million, \$47.5 million and \$45.7 million, respectively, of which \$3.5 million, \$3.2 million and \$2.7 million, respectively, was capitalized as part of the cost of assets constructed for the Company's use. Included in interest expense was \$.4 million for 1996, \$.3 million for 1995 and \$.6 million for 1994 relating to the Company's operations in Brazil. The 1994 amount reflects extraordinarily high nominal rates of interest resulting from hyperinflationary conditions in that country, prior to July, 1994.

#### NOTE 4. FINANCIAL INSTRUMENTS

The Company enters into forward exchange contracts to reduce risk from exchange rate fluctuations associated with receivables, payables, loans and commitments denominated in foreign currencies that arise primarily as a result of its operations outside the United States. At the end of 1996 and 1995, the Company had forward exchange contracts with a notional value of \$166.7 million and \$221.2 million, respectively, substantially all of which were denominated in European currencies. In general, the maturities of the contracts coincide with the underlying exposure positions they are intended to hedge. All contracts outstanding have maturities within 12 months. The carrying value approximates the fair value, which, based on quoted market prices of comparable instruments, was a net liability of approximately \$4.5 million and \$.2 million at the end of 1996 and 1995, respectively.

The counterparties to forward exchange contracts and interest rate agreements consist of a large number of major international financial institutions. The Company centrally monitors its positions and the financial strength of its counterparties. Therefore, while the Company may be exposed to losses in the event of non-performance by these counterparties, it does not anticipate losses.

At the end of 1996, the Company had letters of credit outstanding totaling \$22.6 million which guaranteed various trade activities. The aggregate contract amount of all outstanding letters of credit approximates fair value.

As of year end 1996 and 1995, approximately 26 percent and 20 percent of trade accounts receivables, respectively, were from 7 domestic customers. While the Company does not require its customers to provide collateral, the financial position and operations of these customers are monitored on an ongoing basis. Although the Company may be exposed to losses in the event of nonpayment, it does not anticipate such losses.

The Company has an agreement with a bank whereby it has the right to sell certain accounts receivable. The available commitment of this agreement at the end of 1996 was \$70 million, subject to limited recourse provisions. At the end of 1996 and 1995, no trade receivables had been sold. Should the agreement be utilized during 1997, the contract will be modified to comply with the future requirements of SFAS No. 125.

#### NOTE 5. COMMITMENTS

Minimum annual rentals on operating leases for the years 1997 to 2001 are \$28.1 million, \$24.6 million, \$20.8 million, \$19.3 million and \$18 million, respectively. Operating leases relate primarily to office and warehouse space, EDP and transportation equipment.

The Company has an agreement to purchase certain information technology services through June 30, 2002; however, the agreement may be terminated at the Company's option on June 30, 2000. Total commitments remaining under the agreement approximated \$17.4 million as of December 28, 1996.

Rent expense for 1996, 1995 and 1994 was \$39 million, \$39.4 million and \$39.7 million, respectively.

# Taxes Based on Income

Taxes based on income were as follows:

(In millions)	1996	1995	1994
Current:			
U.S. Federal tax	\$55.9	\$51.8	\$54.9
State taxes	12.3	10.2	6.8
International taxes	28.1	34.6	28.0
	96.3	96.6	69.7
Deferred:			
U.S. taxes	(4.7)	(1.4)	(2.1)
International taxes	5.1	(11.2)	(4.1)
	(1.6)	(15.6)	(6.2)
Taxes on income	\$94.7	\$81.0	\$63.5

The principal items accounting for the difference in taxes as computed at the U.S. statutory rate and as recorded were as follows:

(In millions)	1996	1995	1994
Computed tax at 35% of income before taxes	\$94.7	\$78.7	\$60.5
Increase (decrease) in taxes resulting from:			
State taxes, net of federal tax benefits	8.0	6.6	4.4
Other items, net	(8.0)	(1.3)	(1.4)
Taxes on income	\$94.7	\$81.0	\$63.5

Consolidated income before taxes for U.S. and international operations was as follows:

(In millions)	1996	1995	1994
U.S.	\$176.1	\$145.3	\$97.6
International	94.2	79.4	75.3
	\$270.6	\$224.7	\$172.9

U.S. income taxes have not been provided on undistributed earnings of international subsidiaries (\$350.5 million at year end 1996) because such earnings are considered to be reinvested indefinitely or because U.S. income taxes on dividends would be substantially offset by foreign tax credits.

Operating loss carryforwards for international subsidiaries aggregating \$48.6 million are available to reduce income taxes payable, of which \$19.8 million will expire over the period from 1997 through 2002, while \$28.8 million can be carried forward indefinitely.

Deferred income taxes reflect the temporary differences between the amounts at which assets and liabilities are recorded for financial reporting purposes and the amounts utilized for tax purposes. The primary components of the temporary differences which give rise to the Company's deferred tax assets and liabilities were as follows:

(In millions)	1996	1995
Accrued expenses not currently deductible	\$76.7	\$71.2
Net operating losses and foreign tax credit carryforwards	23.2	17.7
Postretirement and postemployment benefits	11.1	10.6
Pension costs	(3.9)	3.3
Valuation allowance	(6.5)	(8.9)
Depreciation	(71.2)	(60.6)
Other items, net	—	(2.8)
Total net deferred tax assets	\$26.4	\$22.5

## NOTE 7. SHAREHOLDERS' EQUITY Common Stock and Common Stock Repurchase Program

The Company's Certificate of Incorporation authorizes five million shares of \$1 par value preferred stock, with respect to which the Board of Directors may fix the series and terms of issuance, and 200 million shares of \$1 par value voting common stock.

On October 24, 1996, the Company's Board of Directors authorized a two-for-one stock split of the Company's common stock effected in the form of a 100 percent stock dividend to shareholders of record as of December 6, 1996. Par value of \$1 per share remained unchanged. An amount equal to the \$1 par value of the additional common shares was transferred from capital in excess of par value to common stock. Accordingly, all weighted-average share and per common share amounts, as well as stock plan data, have been restated to reflect the stock split.

During 1988, the Company issued preferred stock purchase rights, declaring a dividend of one such right on each outstanding share of common stock and since such time the Company has issued such rights with each share of common stock that has been subsequently issued. When exercisable, each new right will entitle its holder to buy one one-hundredth of a share of Series A Junior Participating Preferred Stock at a price of \$47.50 per one one-hundredth of a share until July 1998. The rights will become exercisable if a person acquires 20 percent or more of the Company's common stock or makes an offer, the consummation of which will result

in the person's owning 20 percent or more of the Company's common stock. In the event the Company is acquired in a merger, each right entitles the holder to purchase common stock of the acquiring company having a market value of twice the exercise price of the right. If a person or group acquires 20 percent or more of the Company's common stock, each right entitles the holder to purchase the Company common stock with a market value equal to twice the exercise price of the right. The rights may be redeemed by the Company at a price of half a cent per right at any time prior to a person's or group's acquiring 20 percent of the Company's common stock. The 20 percent threshold may be reduced by the Company to as low as 10 percent at any time prior to a person's acquiring a percent of Company stock equal to the lowered threshold.

The Board of Directors has authorized the repurchase of an aggregate 30.4 million shares of the Company's outstanding common stock. The acquired shares may be reissued under the Company's stock option and incentive plans. At year end 1996, approximately 25.4 million shares had been repurchased pursuant to this authorization.

### Stock Option and Incentive Plans

In October 1996, the Company established the Avery Dennison Corporation Employee Stock Benefit Trust (the "Trust") to fund a portion of the Company's obligations arising from various employee benefit plans. The Company sold 18 million shares of treasury stock to the Trust in exchange for a promissory note of \$564.8 million that bears an interest rate of 8 percent per annum. The Trust has a 15-year life during which it will utilize the common stock to satisfy certain Company obligations. The common stock in the Trust is carried at market value with changes in share price from prior reporting periods reflected as an adjustment to capital in excess of par value.

The Company maintains various stock option and incentive plans which are fixed employee stock-based compensation plans. Under the plans, incentive stock options and stock options granted to directors may be granted at not less than 100 percent of the fair market value of the Company's common stock on the date of the grant, whereas nonqualified options granted to executives may be issued at prices no less than par value. Options granted generally vest ratably over a four year period. Unexercised options expire ten years from the date of grant.

The following table sets forth stock option information relative to all plans:

(Options in thousands)	1996		1995	
	Weighted-average exercise price	Number of options	Number of options	Number of options
Outstanding at beginning of year	\$15.03	10,224.6	9,650.2	8,796.7
Granted	34.67	1,623.0	1,792.1	2,783.0
Exercised	11.96	(1,778.9)	(955.3)	(1,565.1)
Forfeited or expired	18.23	(293.0)	(262.4)	(364.4)
Outstanding at end of year	18.76	9,775.7	10,224.6	9,650.2
Options exercisable at year end		4,670.4	5,309.7	4,964.7

The following table summarizes information on fixed stock options outstanding at December 28, 1996 (options in thousands):

Range of exercise prices	Options outstanding			Options exercisable	
	Number outstanding	Weighted-average remaining contractual life	Weighted-average exercise price	Number exercisable	Weighted-average exercise price
\$ 7.54 - \$14.00	4,101.6	4.1 years	\$12.24	3,972.5	\$12.22
15.28 - 16.25	2,382.2	7.6 years	15.79	470.8	15.81
23.63 - 34.94	3,291.9	9.4 years	29.03	227.1	23.77
	9,775.7			4,670.4	

Pursuant to SFAS No. 123, no compensation cost was recognized in the Consolidated Statement of Income for the Company's stock option and incentive plans. Had compensation cost for the Company's stock-based compensation plans been recognized, the Company's pro forma net income and net income per common share would have been \$165.8 million and \$1.58, respectively for 1996 and \$137 million and \$1.29 for 1995, respectively. Net income per fully-diluted common share would have been \$1.53 and \$1.25 for 1996 and 1995, respectively.

The weighted-average fair value of options granted during 1996 and 1995 were \$9.51 and \$5.87, respectively. Option grant date fair values were determined using a Black-Scholes option pricing value. The underlying assumptions used were:

	1996	1995
Risk-free interest rate	6.40%	6.75%
Expected stock price volatility	18.57	17.99
Expected dividend yield	2.09	2.67
Expected option term	10 years	10 years

#### NOTE 8. CONTINGENCIES

The Company has been designated by the U.S. Environmental Protection Agency (EPA) and/or other responsible state agencies as a potentially responsible party (PRP) at 17 waste disposal or waste recycling sites which are the subject of separate investigations or proceedings concerning alleged soil and/or groundwater contamination and for which no settlement of the Company's liability has been agreed upon. Litigation has been initiated by a governmental authority with respect to four of these sites, but the Company does not believe that any such proceedings will result in the imposition of monetary sanctions. The Company is participating with other PRPs at all such sites, and anticipates that its share of cleanup costs will be determined

pursuant to remedial agreements entered into in the normal course of negotiations with the EPA or other governmental authorities.

The Company has accrued liabilities for all sites, including sites in which governmental agencies have designated the Company as a PRP, where it is probable that a loss will be incurred and the minimum cost or amount of loss can be reasonably estimated. However, because of the uncertainties associated with environmental assessment and remediation activities, future expense to remediate the currently identified sites, and sites which could be identified in the future for cleanup, could be higher than the liability currently accrued. Based on current site assessments, management believes the potential liability over the amounts currently accrued would not materially affect the Company.

The Company and its subsidiaries are involved in various other lawsuits, claims and inquiries, most of which are routine to the nature of the business. In the opinion of management, the resolution of these matters will not materially affect the Company.

#### NOTE 9. EMPLOYEE RETIREMENT PLANS Defined Benefit Plans

The Company sponsors a number of defined benefit plans covering substantially all U.S. employees, employees in certain other countries and non-employee directors. It is the Company's policy to make contributions to these plans sufficient to meet the minimum funding requirements of applicable laws and regulations, plus such additional amounts, if any, as the Company's actuarial consultants advise to be appropriate. Plan assets are invested in a diversified portfolio that consists primarily of equity securities. Benefits payable to employees are based primarily on years of service and employees' pay during their employment with the Company. Certain benefits provided by the Company's U.S. defined benefit plan are paid, in part, from an employee stock ownership plan.

The net pension cost and the funded status of the defined benefit plans are summarized as follows:

#### NET PENSION COST

(In millions)	1996	1995	1994
Service cost	\$ 9.1	\$ 8.7	\$ 9.5
Interest cost	27.0	26.4	24.5
Return on plan assets	(67.3)	(69.9)	(14.0)
Net amortization and deferral	28.8	34.6	(20.1)
Net pension income	\$ (2.4)	\$ (.2)	\$ (.1)
Assumptions used:			
Weighted-average discount rate	7.4%	7.4%	8.0%
Weighted-average rate of increase in future compensation levels	5.0	5.3	5.4
Weighted-average expected long-term rate of return on assets	9.7	9.7	9.7

## FUNDED STATUS OF PENSION PLANS

(In millions)	Fully-funded plans		Underfunded plans	
	1996	1995	1996	1995
Actuarial present value of:				
Vested benefits	\$207.2	\$196.0	\$150.5	\$132.3
Non-vested benefits	.4	.1	.2	.2
Accumulated benefit obligation	207.6	196.1	150.7	132.5
Effect of projected future salary increases	27.8	29.2	15.0	14.9
Projected benefit obligation	235.4	225.3	165.7	147.4
Plan assets at fair value	339.2	304.6	132.3	109.3
Plan assets in excess of (less than) projected benefit obligation	103.8	79.3	(33.4)	(38.1)
Unrecognized net (gain) loss	(16.4)	.7	16.5	19.3
Unrecognized prior service cost	(13.6)	(14.6)	7.7	8.0
Unrecognized net asset at year end	(22.6)	(24.8)	(1.4)	(1.6)
Adjustment to recognize minimum liability	—	—	(7.8)	(10.8)
Prepaid (accrued) pension cost	\$ 51.2	\$ 40.6	\$ (18.4)	\$ (23.2)

As a result of changes in assumptions used during 1996 and 1995, an additional liability of \$7.8 million and \$10.8 million, respectively, is reflected in the Company's balance sheet. These amounts are offset in 1996 and 1995 by a charge to equity of \$.2 million and \$2.6 million, respectively, and the recording of an intangible pension asset of \$7.6 million and \$8.2 million, respectively. Consolidated pension expense for 1996, 1995 and 1994 was \$1.5 million, \$2 million and \$2.4 million, respectively.

## Defined Contribution Plans

The Company sponsors various defined contribution plans covering its U.S. employees, including a 401(k) savings plan. The Company matches participant contributions to the 401(k) savings plan based on a formula within the plan. The Avery Dennison Corporation Employee Savings Plan (Savings Plan) has a leveraged employee stock ownership plan (ESOP) feature which allows the plan to borrow funds to purchase shares of the Company's common stock at market prices. Savings Plan expense consists primarily of stock contributions from the ESOP feature to participant accounts.

The Company also maintains another leveraged ESOP for employees not covered by a collective bargaining agreement. This ESOP also borrowed funds to purchase

shares of the Company's common stock at market prices.

ESOP expense is accounted for under three different methodologies: the cost of shares allocated method, the cash flow method and the fair value method. The following table sets forth certain information relating to the Company's ESOPs on a combined basis.

(In millions)	1996	1995	1994
Interest expense	\$2.7	\$3.4	\$2.3
Dividends on unallocated ESOP shares used for debt service	1.7	1.9	2.3
Total ESOP expense	8.9	7.5	10.5
Contributions to pay interest and principal on ESOP borrowings	8.8	7.4	10.1

Consolidated expense for all defined contribution plans, including total ESOP expense, for 1996, 1995 and 1994 was \$9.3 million, \$8.2 million and \$11.2 million, respectively. The ESOP shares for 1996 and 1995 were as follows:

(In millions)	1996	1995
Allocated shares	6.7	6.8
Unallocated shares	2.5	2.9
Total ESOP shares held	9.2	9.7

Of the total ESOP shares held, shares accounted for under the fair value method comprised of 167,800 allocated shares and 169,600 unallocated shares at year end 1996. Under the fair value method, unallocated shares were valued at \$6.1 million at year end 1996.

#### Other Postretirement Benefits

The Company provides postretirement health benefits to its retired employees up to the age of 65 under a cost-sharing arrangement, and supplemental Medicare benefits to certain U.S. retirees over the age of 65. The Company's policy is to fund the cost of the postretirement benefits on a cash basis. The following table sets forth the Company's unfunded obligation and amount recognized in the Consolidated Balance Sheet:

(In millions)	1996	1995
Actuarial present value of benefit obligation:		
Retirees	\$10.0	\$ 5.8
Fully eligible participants	4.9	7.8
Other active participants	13.5	19.9
Accumulated postretirement benefit obligation	28.4	33.5
Plan assets	—	—
Accumulated postretirement benefit obligation in excess of plan assets	28.4	33.5
Unrecognized net gain (loss)	3.0	(3.3)
Unrecognized prior service cost	(1.2)	(1.3)
Accrued postretirement benefit obligation	\$30.2	\$28.9

Net periodic postretirement benefit costs included the following components:

(In millions)	1996	1995	1994
Service cost	\$ .9	\$1.1	\$1.2
Interest cost	1.8	2.2	2.1
Net amortization and deferral	—	.1	.1
Net periodic postretirement expense	\$2.7	\$3.4	\$3.4

A health care cost trend rate of 11 percent was assumed for 1996 and will decline 1 percent annually to 6 percent by 2001 and remain at that level. The discount rates assumed for 1996 and 1995 was 7.25 percent. A 1 percent increase in the health care cost trend rate would cause the accumulated postretirement benefit obligation to increase by \$3.7 million and service and interest cost to increase by \$3.4 million for 1996.

#### Other Retirement Plans

The Company has deferred compensation plans which permit eligible employees and directors to defer a specific portion of their compensation. The deferred compensation, together with certain Company contributions, earn a specified rate of return. As of year end 1996 and 1995, the Company had accrued \$57.9 million and \$48.2 million, respectively, for its obligations under these plans. The Company's expense, which includes Company contributions and interest expense, was \$6 million, \$5.6 million and \$4 million for 1996, 1995 and 1994, respectively. A portion of the interest may be forfeited by participants in the event employment is terminated before age 55 other than by reason of death, disability or retirement.

To assist in the funding of these plans, the Company purchases corporate-owned life insurance contracts. Proceeds from the insurance policies are payable to the Company upon the death of the participant. The cash surrender value of these policies, net of outstanding loans, included in "Other assets" was \$21.6 million and \$16.4 million as of year end 1996 and 1995, respectively.

#### NOTE 10. SECTORS OF BUSINESS OPERATIONS

Effective in the fourth quarter of 1996, the Company realigned the reporting of its businesses from three sectors to two in an effort to better align its reporting with manufacturing processes and end markets. Accordingly, all prior year data has been reclassified to conform with the current realignment of the businesses.

The Company reports its operations as the production of pressure-sensitive adhesives and materials and the production of consumer and converted products. Operations in the Pressure-sensitive adhesives and materials sector sell primarily to converters and label printers, and includes the Fasson-brand papers, films and foils, specialty tape and specialty chemical businesses. Operations in the Consumer and converted products sector sell primarily to the retail industry and original equipment manufacturers, and includes the Avery-brand labels and other office products, customer label converters, high-performance specialty films and labels, merchant distributors, automotive and fastener businesses.

During the third quarter of 1996, the Company sold its equity interest in a label operation in Japan. A \$17.9 million gain was recorded in Corporate administrative and research and development expenses during 1996. In addition, the Company recorded an impairment for long-lived assets and restructuring actions, which combined, had an estimated pretax cost of \$15.8 million.

During the fourth quarter of 1995, the Company sold a portion of its North American label converting operations. These businesses accounted for approximately 4 percent, or \$63 million, of the 1995 Consumer and converted products' sector sales. A \$40.7 million gain from restructuring activities was recorded in the Consumer and converted products sector's income from operations before interest and taxes during 1995. The businesses sold, excluding the gain on sale and restructuring charges, accounted for \$2.6 million of the Consumer and converted products sector's profitability for 1995.

Intersector sales are recorded at or near market prices and are eliminated in determining consolidated sales. Income from operations represents total revenue less operating expenses. General corporate expenses, interest expense and taxes on income are excluded from the computation of income from operations. Beginning in 1996, the Company adopted a revised allocation methodology which more appropriately allocates corporate administrative expenses to each sector. The effect of this revised methodology increased expenses allocated to the two sectors by \$7.8 million and \$6.6 million for 1995 and 1994, respectively.

Financial information by industry and geographic sectors is set forth below:

(In millions)	1996 <sup>(1)</sup>	1995 <sup>(2)</sup>	1994
<b>Sales by industry sector:</b>			
Pressure-sensitive adhesives and materials	\$1,693.5	\$1,589.7	\$1,389.7
Consumer and converted products	1,670.5	1,588.6	1,488.6
Intersector	(141.5)	(128.1)	(106.8)
Divested operations	—	63.7	85.2
<b>Net sales</b>	<b>\$3,222.5</b>	<b>\$3,113.9</b>	<b>\$2,856.7</b>
<b>Income (loss) from operations before interest and taxes:</b>			
Pressure-sensitive adhesives and materials	\$ 157.7	\$ 144.8	\$ 138.8
Consumer and converted products	159.0	147.8	102.1
Divested operations	—	.1	(3.0)
	316.7	292.7	237.9
Corporate administrative and research and development expenses	(8.7)	(23.7)	(22.0)
Interest expense	(37.4)	(44.3)	(43.0)
<b>Income before taxes</b>	<b>\$ 270.6</b>	<b>\$ 224.7</b>	<b>\$ 172.9</b>
<b>Identifiable assets by industry sector:</b>			
Pressure-sensitive adhesives and materials	\$ 970.4	\$ 886.5	\$ 789.8
Consumer and converted products	883.0	857.3	796.9
Intersector	(30.0)	(26.6)	(24.5)
Corporate and divested operations	213.3	246.4	200.9
<b>Total assets</b>	<b>\$2,036.7</b>	<b>\$1,963.6</b>	<b>\$1,763.1</b>

- (1) Fiscal 1996 results include a pretax gain of \$17.9 million from the sale of its equity interest in a label operation in Japan which was included in Corporate's administrative expense. Fiscal 1996 results also include pretax restructuring charges of \$15.8 million. The restructuring charges were allocated as follows: \$7.1 million to the Pressure-sensitive adhesives and materials sector and \$8.7 million to the Consumer and converted products sector.
- (2) Fiscal 1995 results include a pretax gain of \$40.7 million from the sale of a portion of its North American label converting operations and was included in the Consumer and converted products 1995 operating results. Fiscal 1995 results also include pretax restructuring charges of \$39.2 million. The restructuring charges were allocated as follows: \$15.1 million to the Pressure-sensitive adhesives and materials sector and \$24.1 million to the Consumer and converted products sector.

The 1996 and 1995 restructuring charges, along with the gains on divestiture, were reported in the "Net gain on divestitures and restructuring charges" line of the Consolidated Statement of Income.

(In millions)	1996 <sup>(1)</sup>	1995 <sup>(2)</sup>	1994
Sales by geographic sector:			
U.S.	\$2,056.1	\$1,946.4	\$1,800.1
International	1,206.7	1,143.1	997.2
Intersector	(40.3)	(39.3)	(25.8)
Divested operations	—	63.7	85.2
Net sales	\$3,222.5	\$3,113.9	\$2,856.7
Income from operations before interest and taxes:			
U.S.	\$ 232.3	\$ 214.1	\$ 182.7
International	84.4	78.5	58.2
Divested operations	—	.1	(3.0)
	316.7	292.7	237.9
Corporate administrative and research and development expenses	(8.7)	(23.7)	(22.0)
Interest expense	(37.4)	(44.3)	(43.0)
Income before taxes	\$ 270.6	\$ 224.7	\$ 172.9
Identifiable assets by geographic sector:			
U.S.	\$1,051.9	\$1,009.5	\$ 906.1
International	792.6	723.1	666.0
Intersector	(21.1)	(15.4)	(9.9)
Corporate and divested operations	213.3	246.4	200.9
Total assets	\$2,036.7	\$1,963.6	\$1,763.1

(1) The 1996 restructuring charges were allocated as follows: \$13.8 million to the U.S. sector and \$2 million to the International sector. In addition, the 1996 pretax gain of \$17.9 million from the sale of its equity interest in a label operation in Japan, was included in Corporate's administrative expense.

(2) The 1995 restructuring charges were allocated as follows: \$18.8 million to the U.S. sector and \$20.4 million to the International sector. In addition, the 1995 pretax gain from the sale of its North American label converting operations was allocated as follows: \$38.4 million to the U.S. sector and \$2.3 million to the International sector.

The Company's international operations, conducted primarily in continental Europe and the United Kingdom, are on the FIFO basis of inventory cost accounting. U.S. operations use both FIFO and LIFO. Export sales from the United States to unaffiliated customers are not a material factor in the Company's business.

Identifiable assets are those assets of the Company which are identifiable with the operations in each industry or geographic sector. Corporate assets consist principally of Corporate property, plant and equipment, tax related asset accounts and other non-operating assets. Intersector receivables are eliminated in determining consolidated identifiable assets.

Capital expenditures and depreciation expense by industry sector are set forth below:

(In millions)	1996	1995	1994
Capital expenditures:			
Pressure-sensitive adhesives and materials	\$100.8	\$100.5	\$101.3
Consumer and converted products	79.8	78.7	65.1
Corporate and divested operations	7.0	11.1	13.9
	\$187.6	\$190.3	\$163.3
Depreciation expense:			
Pressure-sensitive adhesives and materials	\$49.4	\$40.9	\$36.7
Consumer and converted products	41.2	42.5	39.8
Corporate and divested operations	9.6	11.9	11.4
	\$100.2	\$95.3	\$87.9

#### NOTE 11. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(In millions, except per common share data)	First Quarter	Second Quarter	Third Quarter <sup>(1)</sup>	Fourth Quarter <sup>(2)</sup>
1996 <sup>(3)</sup>				
Net sales	\$796.6	\$797.7	\$819.3	\$808.9
Gross profit	246.7	248.4	260.5	262.7
Net income	40.0	41.6	46.6	47.7
Net income per common share	.38	.39	.45	.46
1995 <sup>(2)</sup>				
Net sales	\$773.2	\$780.5	\$783.5	\$776.7
Gross profit	244.8	239.0	235.0	238.5
Net income	34.5	35.7	35.8	37.7
Net income per common share	.32	.34	.34	.35
1994				
Net sales	\$667.7	\$718.6	\$733.7	\$736.7
Gross profit	212.5	227.7	232.6	235.0
Net income	25.2	27.9	27.8	28.5
Net income per common share	.22	.25	.25	.26

Per common share amounts for all periods shown have been restated to reflect the December 1996 two-for-one common stock split.

- (1) Net income for the third quarter of 1996 includes income of \$1.4 million, or \$.01 per common share, related to the net gain on divestiture and restructuring charges.
- (2) Net income for the fourth quarter of 1995 includes income of \$1 million, or \$.01 per common share, related to the net gain on divestitures and restructuring charges.
- (3) During the fourth quarter of 1996, certain inventories were reduced, resulting in the liquidation of LIFO inventory. The effect was to reduce cost of products sold by \$1.7 million.

## STATEMENT OF MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS

The consolidated financial statements and accompanying information were prepared by and are the responsibility of management. The statements were prepared in conformity with generally accepted accounting principles and, as such, include amounts that are based on management's best estimates and judgments.

The internal control systems are designed to provide reliable financial information for the preparation of financial statements, to safeguard assets against loss or unauthorized use and to ensure that transactions are executed consistent with Company policies and procedures. Management believes that existing internal accounting control systems are achieving their objectives and that they provide reasonable assurance concerning the accuracy of the financial statements.

Oversight of management's financial reporting and internal accounting control responsibilities is exercised by the Board of Directors, through an audit committee which consists solely of outside directors (see page 58). The Committee meets periodically with financial management, internal auditors and the independent accountants to obtain reasonable assurance that each is meeting its responsibilities and to discuss matters concerning auditing, internal accounting control and financial reporting. The independent accountants and the Company's internal audit department have free access to meet with the Audit Committee without management's presence.



Charles D. Miller  
Chairman and  
Chief Executive Officer



R. Gregory Jenkins  
Senior Vice President, Finance  
and Chief Financial Officer

## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF AVERY DENNISON: We have audited the accompanying consolidated balance sheet of Avery Dennison Corporation and subsidiaries as of December 28, 1996 and December 30, 1995, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 28, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion the financial statements referred to above, which appear on pages 42 through 56 of this Annual Report, present fairly, in all material respects, the consolidated financial position of Avery Dennison Corporation and subsidiaries as of December 28, 1996 and December 30, 1995, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 28, 1996, in conformity with generally accepted accounting principles.



Coopers & Lybrand L.L.P.  
Los Angeles, California  
January 28, 1997

## DIRECTORS AND OFFICERS

## BOARD OF DIRECTORS

Charles D. Miller<sup>1,3,6,7</sup>  
Chairman and  
Chief Executive Officer  
Avery Dennison Corporation

Philip M. Neal<sup>1,3,6,7</sup>  
President and  
Chief Operating Officer  
Avery Dennison Corporation

Sidney R. Petersen<sup>1,2,3</sup>  
Private investor and  
retired Chairman and  
Chief Executive Officer  
Getty Oil Company,  
an international petroleum  
development and production  
company

Frank V. Cahouet<sup>1,3,6</sup>  
Chairman, President and  
Chief Executive Officer  
Mellon Bank Corporation

Richard M. Ferry<sup>2,3,6,7</sup>  
Chairman and  
Chief Executive Officer  
Korn/Ferry International,  
an international executive  
search firm

John C. Argue<sup>1,3,6,7</sup>  
Of Counsel and  
former Senior Partner of  
Argue Pearson Harbison &  
Myers, law firm

Peter W. Mullin<sup>2,3,5,7</sup>  
Chairman and  
Chief Executive Officer  
Mullin Consulting, Inc.,  
an executive compensation, ben-  
efit planning and corporate  
insurance consulting firm

John B. Slaughter<sup>4,7</sup>  
President  
Occidental College

Dwight L. Allison, Jr.<sup>2,3,7</sup>  
Private investor and former  
Chairman, President and  
Chief Executive Officer of  
The Boston Company

Joan T. Bok<sup>2,3,4</sup>  
Chairman of the Board  
New England Electric System,  
a public utility company and  
supplier of electricity

## CORPORATE OFFICERS

Charles D. Miller  
Chairman and  
Chief Executive Officer

Philip M. Neal  
President and  
Chief Operating Officer

R. Gregory Jenkins  
Senior Vice President, Finance  
and Chief Financial Officer

Alan J. Gortcher  
Senior Vice President  
Manufacturing and Technology

Robert G. van  
Schoonenberg  
Senior Vice President,  
General Counsel and Secretary

Wayne H. Smith  
Vice President and Treasurer

Thomas E. Miller  
Vice President and Controller

Diane B. Dixon  
Vice President  
Corporate Communications

Susan B. Garelli  
Vice President  
Human Resources

Paul B. Germeraad  
Vice President and Director  
Corporate Research

Daniel R. O'Bryant  
Vice President  
Operations Audit and  
Business Consulting

Margaret S. Dano  
Vice President  
Manufacturing and Engineering

Johan J. Goemans  
Vice President  
Management Information  
Systems

James L. Fletcher  
Vice President  
Customer Service and Logistics

Gary A. McCue  
Vice President  
Strategic Value Development

- 1 - Member of Compensation and Executive Personnel Committee
- 2 - Member of Audit Committee
- 3 - Member of Finance Committee
- 4 - Member of Ethics and Conflict of Interest Committee
- 5 - Member of Nominating Committee
- 6 - Member of Executive Committee
- 7 - Member of Strategic Planning Committee

## DIVISION OFFICERS

Materials - Americas and Asia Kim A. Caldwell* Senior Group Vice President Materials - Americas and Asia	Dean A. Scarborough Vice President, General Manager Fasson Roll Division (Europe)	Specialty Tape Divisions David W. Scheible Vice President, General Manager Specialty Tape Division (U.S.)	J. Paul May Vice President, General Manager Office Products U.K. and European Business Development
Flavio Lacerda* Group Vice President Latin America	Josef Kagon Vice President, General Manager Fasson Roll Division (Europe) Central Region	Jef Smers Vice President, General Manager Specialty Tape Division (Europe)	Bernard Planche Vice President, General Manager Office Products France
Terence J. Jones Vice President, General Manager Fasson Roll Division (U.S.)	Christian A. Simcic Vice President, General Manager Fasson Roll Division (Europe) Southern Region	Worldwide Office Products Stephanie A. Streeter* Group Vice President Worldwide Office Products	Automotive and Graphic Systems James E. Shaw* Group Vice President Automotive and Graphic Systems
Robert H. Coleman Vice President, General Manager Fasson Films Division	Svend L. Joergensen Vice President Converted Products Europe	Stephen M. Sharp Vice President, General Manager Worldwide Office Automation Products	Heinz Pichler Vice President, General Manager Marking Films Division (Europe)
Graham Lloyd Vice President Ventures and Specialty Businesses	Ronald H. Stone Vice President Global Business Development Converted Products	Jesse Beim Senior Vice President U. S. Office Products	John J. Purcell Vice President, General Manager Automotive Division
Mel S. Freedman Vice President Advanced Concepts and Products	Paul J. Caruso Vice President, General Manager Decorating Technologies Division	Henry C. Reed Vice President, General Manager Organization, Filing and Presentation Products North America	Teddy P. Chung Vice President, General Manager Marking Films Division (U.S.)
Dana G. Devereux Vice President, General Manager Merchant Division North America	David S. Logan Vice President, General Manager Fastener Worldwide	Christopher H. Binkley Vice President Sales and Marketing Office Products North America	Asia Pacific Group Robert D. Fletcher* Group Vice President Asia Pacific
Jennings C. Lambeth Vice President Ventures and International	Mathew S. Mellis Vice President, General Manager Industrial Products Division	Franklyn C. Hathaway Vice President Customer Operations Office Products North America	John N. Anderson Vice President, Fastener Asia
Lawrence C. Mitchell Vice President, General Manager Release Coated Materials	Simon D. Coulson Vice President, General Manager VIP Converted Products North America	Craig L. Donaldson Vice President, General Manager Markers and Adhesives	David L. Gurbach Vice President, Operations Asia Pacific
James A. Shenker Vice President Procurement and Manufacturing Services	Donald R. McKee* Vice President Label Ventures	Brant D. Kline Vice President, General Manager Indexes	Chemical Division H. Paul Barker Vice President, General Manager Chemical Divisions (U.S. and Europe)
Worldwide Tape & Converting and Materials - Europe Geoffrey T. Martin* Senior Group Vice President Worldwide Tape and Converting and Materials - Europe	Robert D. Smith Vice President Corporate Projects	David W. Freeman Vice President, General Manager Office Labels North America	
	James P. Schmitt Vice President International Manufacturing	Joseph A. Michael Vice President Operations Planning	

\* Corporate Officer

## CORPORATE INFORMATION

## COUNSEL

Latham & Watkins  
Los Angeles

## INDEPENDENT ACCOUNTANTS

Coopers & Lybrand L.L.P.  
Los Angeles

## TRANSFER AGENT-REGISTRAR

First Chicago Trust Company of New York  
P.O. Box 2500  
Jersey City, NJ 07303-2500  
(800) 756-8200

## ANNUAL MEETING

The Annual Meeting of Shareholders will be held at 1:30 pm, Thursday, April 24, 1997, in the Conference Center of the Avery Dennison Corporate Center, 150 North Orange Grove Boulevard, Pasadena, California.

## DIVIDEND REINVESTMENT PLAN

Shareholders of record may reinvest their cash dividends in additional shares of Avery Dennison common stock at market price.

Shareholders can also invest optional cash payments of up to \$3,000 per month in Avery Dennison common stock at market price.

Avery Dennison investors not yet participating in the plan, as well as brokers and custodians who hold Avery Dennison common stock for clients, may obtain a copy of the plan by writing to First Chicago Trust Company of New York, Attn. Avery Dennison Corporation Dividend Reinvestment Plan, P.O. Box 2598, Jersey City, NJ 07303-2598, (800) 756-8200.

## FORM 10-K

A copy of the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, will be furnished to shareholders and interested investors free of charge upon written request to the Secretary of the Corporation.

## CORPORATE HEADQUARTERS

150 North Orange Grove Boulevard  
Pasadena, California 91103  
(818) 304-2000

## MAILING ADDRESS

P.O. Box 7090  
Pasadena, California 91109-7090  
Fax: (818) 792-7312

## INVESTOR RELATIONS CONTACT

Wayne H. Smith, Vice President and Treasurer  
(818) 304-2000  
investorcom@averydennison.com

## WORLDWIDE WEB SITES

<http://www.averydennison.com>  
<http://www.avery.com> (direct address for Avery-brand office and consumer products)  
<http://www.fasson.com> (direct address for Fasson-brand products)

STOCK AND DIVIDEND DATA<sup>(1)</sup>

Common shares of Avery Dennison are listed on the New York and Pacific stock exchanges. Ticker symbol: AVY.

	1996		1995	
	High	Low	High	Low
Market Price				
First Quarter	28 1/2	23 7/8	20 3/16	16 1/8
Second Quarter	29 1/16	27	21 7/8	19 1/2
Third Quarter	27 3/4	25	21	19 3/8
Fourth Quarter	35 7/8	27 11/16	25 1/16	20 7/16

Prices shown represent closing prices on the NYSE.

	1996	1995
Dividends Per Common Share		
First Quarter	.15	.135
Second Quarter	.15	.135
Third Quarter	.15	.135
Fourth Quarter	.17	.150

Number of shareholders of record as of year end 1996: 10,949

<sup>(1)</sup> Market price and dividend per common share amounts were restated to reflect the December 1996 two-for-one common stock split.

The following products mentioned in this Annual Report are trademarks of Avery Dennison Corporation: Avery, Avcoat, Avery Computer Central, Avery Dennison, BinderPack, Direct Print, Avery Kids, Avery Wizard, Avloy, ClearADvantage, Dry Paint, DualSharp, EXACT, FasClear, Fasson, Mirage, NotePack, PencilPack, PRI-MAX, SmartFolio, and StaySharp.

All other brands and product names are trademarks of their respective companies.