



PARAGON  
TRADE BRANDS

Annual Report

1994

## Company Profile

Paragon Trade Brands, Inc. is the leading manufacturer of store brand disposable diapers in the United States and Canada. Paragon manufactures a line of premium and economy diapers and training pants. These products are distributed throughout North America, primarily through grocery stores, mass merchandisers, warehouse clubs, toy stores and drug stores

that market the products under their own brand names. Since its inception in 1972, Paragon's success has been driven by a commitment to provide its customers the highest quality products and value-added services at the lowest possible price. As a result, the Company continues to attract new customers and increase its market share.

### Financial Highlights

(in thousands, except percentages and per share amounts)

	1994	1993
Revenue	\$ 578,618	\$ 562,949
Gross profit	108,781	105,336
Gross margin	18.8%	18.7%
Operating income	42,462	49,295
Operating margin	7.3%	8.8%
Earnings before income taxes	40,327	48,384
Net income	24,994	45,928
Net income per share	\$ 2.16	\$ 3.97
Capital expenditures	74,921	53,660

### Balance Sheet Information

	1994	1993
Total assets	\$ 275,392	\$ 244,168
Long-term debt	6,000	—
Equity	195,679	167,074

## To Our Shareholders:

*This past year was one of major challenge. Although we began the year strongly, our 1994 results were significantly affected by competitive pricing and promotional pressures initiated in the second half of the year by the national brands. As a result, we achieved only modest sales growth and lower profits.*

*In spite of this challenging environment, we did achieve many of our operating goals.*

# W

e strengthened our position as the leading store brand supplier in North America and the third largest disposable diaper manufacturer in the world. The expansion of our store brand leadership reflects Paragon's commitment to superior product quality and customer service.

We work closely with our retail trade partners to establish long-term relationships and jointly develop marketing programs to promote product sell-through. During our 23-year history, we have developed a "blue chip" customer list that includes nearly every leading retailer in North America.

A key part of our productivity and profitability program is the upgrading of our manufacturing facilities. This past year we invested \$75 million in our plants. Our facilities are now well

equipped to consistently produce the highest quality store brand diapers at productivity levels significantly above that of our store brand competitors. In addition, 80 percent of our machines have been modified and tested to produce the new Ultra thin diapers. We also doubled our training pant capacity and developed a Supreme diaper in order to compete in this new product segment.

### 1994 in Review

Net sales in 1994 were a record \$578.6 million, up 2.8 percent from \$562.9 million in the previous year. Volume increased 4.7 percent to a record 3.6 billion diapers; however, our average product prices, exclusive of mix effects, decreased approximately 4.5 percent. Net income for the year was \$25.0 million, or \$2.16 per share. This compares with 1993 pro forma net earnings of \$30.3 million, or \$2.61 per share before the one-time benefit for a change in tax law of \$15.6 million, or \$1.36 per share. While our gross profit margin of

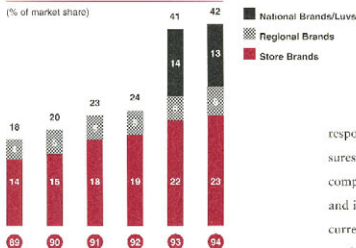
18.8 percent was slightly higher than the prior year, operating income was significantly affected in 1994 by increased promotional expenses. Packaging, sales and marketing expenses also increased to support the thin diaper roll-out. We believe that the positive consumer response to our new thin pad diaper, combined with rising pulp prices, validates our decision to accelerate the introduction of this product line. Today, the thin pad diaper accounts for approximately 50 percent of our total unit volume compared with less than 10 percent six months ago.

### The U.S. Diaper Industry: A Highly Competitive Market

The \$3.7 billion U.S. diaper market reported little growth in 1994, with an estimated 17 billion units sold. The value segment, however, grew one percentage point to 42 percent and store

## Value Segment

(% of market share)



brand share also increased one percentage point to 23 percent. Paragon continues to lead the store brand segment with a 66 percent market share. We expect 1995 to be very challenging because both national brands have reduced prices and increased promotional spending. As a result, we expect our volume to be flat or slightly down during 1995, particularly in the first half of the year as we switch to lower package counts and prices. In addition, we will be affected by significantly higher material costs for fluff pulp, corrugated containers, and plastic. We expect that in 1995 pulp prices may rise as much as 50 percent over their 1994 average. In

response to these market and cost pressures, the Company has undertaken a comprehensive review of its operations and implemented a program to win the current competitive battle and to restore profitability. Our goal is to restore operating profits to 1994 annualized levels by the second half of fiscal 1995.

## Restoring Profitability: Winning the Current Battle

Our strategy for enhancing our competitive position and restoring profitability includes a cost-reduction program as well as pricing and promotional actions. This program will result in a first quarter 1995 pre-tax charge of between \$13 million to \$16 million, excluding any gains for disposal of assets.

Key elements of the cost-reduction program include closure of our highest cost plant, reduction of corporate staff and product refinements to lower raw material costs. In January 1995, we announced

our intent to close the Company's manufacturing facility in La Puente, California, and to allocate production to our remaining four facilities. The plant closure is substantially complete. Our other four plants have the capacity to meet our current and future needs, and we expect no interruption of service to our customers. As we optimize our plant capacity, manufacturing costs will decline, further strengthening our position as the leading low-cost, store brand diaper manufacturer.

Also in January, we streamlined our corporate organization. We eliminated 31 positions, thereby reducing our staff by approximately 20 percent.

The final element of our cost-reduction program focuses on product design optimization. Through more efficient product designs, substitutions of certain materials, and better waste recovery, we hope to realize significant savings in raw material usage and cost.

We believe that our total cost management program will offset the currently projected increases in raw material prices in pulp, corrugated containers, and plastics.

In addition to lowering our costs, we have developed a strategy to limit revenue erosion in this competitive pricing environment. We are planning to reduce our package counts to levels either equal to the national brands or to match lower count, lower-priced competition. We expect to complete these count reductions by mid-1995. We are also working closely with our retail trade customers to develop pricing and promotional strategies that will help them protect and grow their store brand diaper business.

### **Positioning for Growth: Winning the Future**

Our goal in 1995 is to set the stage for continued growth and profitability. We believe that we have developed a sound strategy, which includes growing the base business by helping our customers strengthen their store brand franchises, expanding internationally, and introducing new products.

## Paragon Quality: Preference for Paragon Products

vs. Premium National Brands



vs. Other Store Brands



### Growing the Base Business: Protecting and Enhancing Our Customers' Market Shares

Our first objective is to help our existing customers strengthen their market shares and to acquire new customers by leveraging Paragon's competitive advantages. These include:

- superior product quality and value;
- higher profits for our retail partners;
- superior service and merchandising support;
- low-cost manufacturing.

The value segment represents \$1.2 billion of the diaper market and is still growing as consumers reaffirm their willingness to purchase lower-priced, quality store brands rather than higher-priced national brands. Consumer tests

have demonstrated that Paragon's product performance is preferred twice as much as other store brands, and our product performance is essentially equal to the national brands. By building on superior design and manufacturing technology and helping retailers market their store brand, Paragon will continue to leverage this favorable trend.

Paragon works closely with its retail trade customers to build long-term relationships. In addition to providing our retailers with higher profit margins – 10 to 15 percent compared with 4 to 11 percent offered by the national brands – we consistently focus on providing our customers with superior service. In 1994, our on-time delivery rates increased to 98 percent from 96 percent, and we maintained our order fill rate of 98 percent. Because of our efforts, Paragon is the leading store brand diaper supplier in the United States. We are

From Kroger we received *Outstanding Private Label Supplier*; from Safeway, *The Circle of Excellence Award*; and from HEB, one of the leading food retailers in the Southwest, *Vendor of the Year*.

very proud that our efforts have been recognized this year with

three customer service awards. From Kroger we received *Outstanding Private Label Supplier*; from Safeway, *The Circle of Excellence Award*; and from HEB, one of the leading food retailers in the Southwest, *Vendor of the Year*. We also offer retailers a comprehensive merchandising program. Our very strong base of retail trade partners includes leading companies in each distribution channel. In addition, we continue to add new customers.

#### International Opportunities

We also sell product internationally. To date our focus has been on the Canadian and Mexican markets. In 1994, net sales in Canada accounted for about 5 percent of total revenue. While unit volume was up 3 percent, prices overall were down nearly 10 percent

because of increased price competition and a weaker Canadian dollar. In the fourth quarter, however, we were pleased that volume and profitability in Canada were up substantially over the same quarter in 1993.

While Canadian sales rose in the fourth quarter, sales to Mexico deteriorated significantly. Historically, Paragon has sold diapers to trade customers along the border in the United States who have then exported them to Mexico. New import documentation requirements instituted during the fall of 1994 led to a temporary disruption of our sales destined for Mexico. More importantly, the devaluation of the Mexican peso in December 1994 hurt this segment significantly. Nevertheless, Mexico is an important market for us, as it represents major growth potential.

After evaluation of a number of alternative approaches to this market, we recently announced that we signed a letter of intent to acquire a 49 percent interest in Productos Internacionales Mabesa de C.V., the second largest



diaper manufacturer in Mexico. Further, we plan to jointly develop a new manufacturing facility in northern Mexico to serve export markets. Under the terms of the agreement, we will acquire 49 percent of Mabesa and related companies for \$50 million and a five-year earn out contingent on Mabesa's financial results during the period.

Mabesa was founded in 1977. The company has a strong market share in both national brand and store brand baby diapers, distributing to nearly every major retailer in Mexico and exporting to over 15 countries in Central and South America. The company also markets feminine care and adult incontinence products as well as training pants. The partnership gives Paragon immediate access to the Mexican market and provides a vehicle to serve other high-growth Latin American countries. In addition, with the establishment of our new manufacturing facility, we will

have a low-cost manufacturing base for export to the Pacific Rim and the United States.

As we explore other international opportunities, we will adopt a strategy similar to our approach in Mexico: invest in joint ventures in rapidly developing economies with local partners who bring distribution and marketing capabilities.

### New Product Opportunities

New product opportunities represent the third element of our strategic growth plan. We continue to research and evaluate the \$1.7 billion feminine care category and plan to enter this market. In addition, we are targeting the \$1 billion adult incontinence market. Other product opportunities that will be considered are those that leverage our competencies – low-cost manufacturing technology and established trade customer relationships and distribution channels.

## Investing in Our Future

In 1994 we spent approximately \$75 million to essentially complete our program to modernize our equipment base, including conversion to the thin pad diaper, and to expand capacity. Our 1995 plans call for capital expenditures of approximately \$20 million in the baby diaper business. These expenditures will focus on completion of the thin pad conversion, cost reduction and product quality improvements. After providing for some additional working capital needs, the balance of the Company's cash flow, coupled with borrowed funds, will be used to further the Company's growth strategies.

## Building Shareholder Value

We are driven by our commitment to help retailers build their store brand share and diaper category profits by providing consumers with quality products at competitive prices. Expanding our diaper business within North America and abroad remains our top priority. Further, we believe that in the future we will have opportunities to diversify our revenue

base. Our vision is to build a company that provides:

- consumers: better value than competitive products;
- retailers: better profits than competitive suppliers;
- employees: a desirable place to work;
- suppliers: a good customer;
- communities: a socially responsible organization.

As we realize this vision, the Company will continue to grow both revenue and profits. By managing our businesses professionally and delivering strong growth, we believe that we can provide our shareholders with an attractive return on investment and maximize shareholder value. We have aligned our employee compensation programs to reflect this commitment.

We appreciate the confidence and support that our shareholders, customers, and employees have shown Paragon during this challenging period. We are committed to restoring profitability and growing the Company, and we look forward to communicating to you our progress towards these goals.

Sincerely,



Bobby Abraham

Chairman and Chief Executive Officer

March 7, 1995

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 25, 1994

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-11368

**PARAGON TRADE BRANDS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**91-1554663**  
(I.R.S. employer  
identification no.)

**33325 8th Avenue South**  
**Federal Way, Washington**  
(Address of principal executive offices)

**98003**  
(Zip code)

Registrant's telephone number, including area code: **(206) 815-7000**

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceeding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

As of February 28, 1995, there were 11,827,054 shares of the Registrant's Common Stock outstanding, and the aggregate market value of such stock held by non-affiliates of the Registrant was \$164,100,374 (based on the closing price on the New York Stock Exchange).

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement relating to the Annual Meeting of Shareholders to be held May 9, 1995, are incorporated by reference into Part III of this report.

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## PART I

### ITEM 1: BUSINESS

#### GENERAL

Paragon Trade Brands, Inc. (the "Company") is the leading manufacturer of store brand infant disposable diapers in the United States and Canada. The Company, previously a division of Weyerhaeuser Company ("Weyerhaeuser"), became a publicly-held, independent company as a result of a public offering of stock completed on February 2, 1993. The Company acquired substantially all the assets and liabilities of the private label diaper business of Weyerhaeuser (the "Business") in exchange for 10 million shares of stock and \$35 million in cash. The Company manufactures a line of premium-quality diapers known as "Ultra," a line of economy diapers that have fewer features, and a line of training pants. The Company's products are distributed throughout the United States and Canada, primarily through grocery and food stores, mass merchandisers, warehouse clubs, toy stores and drug stores that market the products under their own store brands.

Weyerhaeuser entered the private-label infant disposable diaper market in 1972. Between 1987 and 1990, Weyerhaeuser attempted to develop a branded diaper business based on a new diaper design using new super-absorbent pad technology and advanced materials. In 1990, Weyerhaeuser's branded diaper business was discontinued after Weyerhaeuser determined that the unit-manufacturing costs of the new diaper and the cost of introducing a branded diaper on a national basis would be too high.

After Weyerhaeuser ended its branded diaper development efforts, the Business redesigned its private-label products, narrowed its product line, updated its packaging and implemented a program that involved targeted price reductions and customer-specific marketing support. As part of the general refocusing on its core businesses, Weyerhaeuser decided to divest its interest in the Business by means of the public offering completed on February 2, 1993. The Company was incorporated in Delaware in June 1992 as a wholly owned subsidiary of Weyerhaeuser.

#### PRODUCTS

The Company manufactures three principal product lines: the premium-quality Ultra line, in both thick and thin versions, an economy line ("Economy"), and a training pant diaper line. In fiscal 1994, approximately 83% of the Company's net sales came from sales of Ultra diapers. The new thin version of Ultra diapers accounted for 11% of the Ultra unit volume. Sales of Ultra diapers accounted for approximately 82% and 84% of the Company's net sales in 1993 and 1992, respectively. Sales of Economy diapers represented approximately 11%, 14%, and 15% of the Company's net sales in fiscal years 1994, 1993, and 1992, respectively. Training pant sales represented approximately 6%, 4%, and 1% of the Company's net sales over the same periods.

The Company's Ultra diaper combines wood pulp with super-absorbent polymer ("SAP") in the absorbent inner core. SAP is significantly more absorbent and better able to retain liquids than wood pulp. The Ultra diaper incorporates a number of product features comparable to those introduced by the national branded manufacturers enhancing performance and appearance. Elasticized leg cuffs and inner-leg gathers, along with gender-specific absorbency zones, improve the ability of the Ultra diaper to prevent leakage and retain moisture. The Company now produces both its thick and new thin versions of the Ultra diaper in five different sizes which are designed to fit babies better as they grow and develop. Additionally, the Company continued its agreement with Jim Henson Productions, Inc. pursuant to which the Company reproduces the Muppet Babies® cartoon characters on the "tape landing zone" of its Ultra diapers.

The Economy diaper is designed to satisfy the needs of the more cost-conscious value segment shopper. Its absorbent pad contains wood pulp and SAP. Its features include a "tape landing zone" allowing for easy fitting and re-adjustment after fastening. The Company produces the Economy diaper in three unisex sizes.

The Company's training pant is designed for use by children primarily during their transition from diapers. The Company's training pant utilizes an absorbent core of wood pulp and SAP and a cloth-like nonwoven outer cover. The Company produces its training pant in two gender-specific sizes.

The Company has also developed and shipped a product with a thin pad and soft, cloth-like nonwoven outer cover in response to a supreme diaper product called Huggies Supreme introduced by Kimberly Clark.

## PRODUCT DEVELOPMENT

To enhance the Company's objective of providing its trade customers with premium-quality private-label infant disposable diapers, the Company devotes substantial resources to market research and product design and development to enable it to improve product performance and consumer acceptance. The Company believes that it has the largest product development program of any manufacturer in the infant disposable diaper market, other than the national branded manufacturers. The Company spent approximately \$6.9 million, \$6.0 million and \$6.6 million on research and development in fiscal years 1994, 1993 and 1992, respectively.

The Company is also researching feminine care and adult incontinence products.

## PATENT RIGHTS

Because of the emphasis on product innovations in the infant disposable diaper market, patents and other intellectual property rights are an important competitive factor. The national branded manufacturers have sought to enforce vigorously their patent rights (see "Legal Proceedings"). To protect its competitive position, the Company has acquired or developed an intellectual property portfolio that includes 72 U.S. patents relating to disposable diaper product features and manufacturing processes.

## MAJOR CUSTOMERS AND FOREIGN OPERATIONS

The Company's net sales to its largest trade customer, Wal-Mart Stores, Inc. and Sam's Club, a division of Wal-Mart, represented an aggregate of approximately 15%, 15% and 14% of total net sales in fiscal years 1994, 1993 and 1992, respectively. As is customary in the infant disposable diaper market, the Company does not have long-term contracts with any of its trade customers. The Company estimates that approximately 5%, 6% and 5% of net sales were to trade customers in Canada in fiscal years 1994, 1993 and 1992, respectively.

The Company does not sell its diapers directly in Mexico. However, the Company believes, that in fiscal year 1994 approximately 7% of its diapers were sold to trade customers in the United States and used by consumers in Mexico. For fiscal years 1993 and 1992, the percentage was approximately 9%. These sales are expected to be negligible in 1995 as a result of the recent devaluation of the Mexican peso. Although the Company's principal business strategy is focused on sales in the United States and Canada, the Company intends to pursue opportunities in certain foreign markets through export or the establishment of manufacturing facilities abroad. See the discussion under "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Subsequent Events" for a discussion of the Company's recent announcement regarding a possible joint venture in Mexico.

## RAW MATERIALS

The principal raw material components of the Company's diapers are fluff pulp, SAP, polyethylene backsheet, polypropylene nonwoven liner, adhesive closure tape, hotmelt adhesive, elastic and tissue.

The primary raw material used in the production of infant disposable diapers is fluff pulp, a product made from wood fibers. The Company entered into a fluff pulp supply contract with Weyerhaeuser whereby it agreed to purchase its requirements of bleached chemical fluff pulp through August 31, 1997 at prices as favorable as those Weyerhaeuser charges other U.S. or Canadian diaper customers for similar grade pulp. Several other raw materials are also each purchased from a single supplier. The Company believes that alternative sources of each of these raw materials are readily available.

## COMPETITION

### *National Branded Manufacturers*

The principal bases of competition from the national branded manufacturers are price, product quality, product innovation and customer service. The U.S. infant disposable diaper market is led by the national brands manufactured by Procter & Gamble Company ("Procter & Gamble") and Kimberly-Clark Corporation ("Kimberly-Clark"). The Company estimates that in 1994, the national branded manufacturers accounted for approximately 71% of all U.S. infant disposable diaper sales. The market position of these manufacturers, relative to the Company, varies from one geographic region to another, but due to their substantial financial, technical and marketing resources, each of these companies has the ability to exert significant influence on the infant disposable diaper market.

The market for disposable infant diapers is divided into the premium and value segments. The premium segment accounts for 58% of the unit volume. Both Kimberly-Clark and Procter & Gamble dominate the premium segment; more recently, they also compete in the value segment. The value segment of the industry, which the Company estimates in 1994 accounted for approximately 42% of unit volume, is highly competitive. The Company includes the following products in the value segment: store brands, control labels, Luvs, Drypers Fitti, and all other regional brands.

In total, Procter & Gamble is the dominant manufacturer in the U.S. diaper market with approximately 40% market share. Procter & Gamble manufactures two brands; Pampers, its premium brand with approximately 27% market share and Luvs, its value brand with 13% market share. Luvs was repositioned from a premium brand to a value brand in April 1993. Kimberly-Clark manufactures the number one diaper brand, Huggies, with approximately 31% market share. Kimberly-Clark does not offer a value brand, but supplies some store brand diapers and training pants within the value segment.

Price has become the significant variable in the competitive strategy of the national branded companies in the past two years. Procter & Gamble, in particular, has been very aggressive in reducing prices in the market in pursuit of market share. In April 1993, Procter & Gamble reduced prices on Pampers by 5% and on Luvs by 16%. In November 1994, Procter & Gamble announced another major price reduction; prices were reduced on Pampers by 2.5% and Luvs by 11%. Kimberly-Clark responded with similar pricing actions. All other diaper manufacturers have been forced to reduce their prices to remain competitive.

The Company believes that the national branded manufacturers have lower per unit costs and higher margins than the Company, principally due to their higher volume, their ability to achieve greater automation and manufacturing speed due to fewer variations in product and packaging, and their ability to charge higher prices. In addition, the national branded manufacturers have access to substantially greater financial resources than the Company. As a result, the Company believes that the national branded manufacturers are capable of competing effectively on the basis of price, even in the face of rising raw material prices.

Product quality and innovation have also been a critical basis of competition for the national branded manufacturers. The Company estimates that since 1985 both of the national branded manufacturers have generally introduced a product innovation approximately every 12 months. Kimberly-Clark has been more active than Procter & Gamble in introducing new products in recent years.

In January 1994, Kimberly-Clark introduced Huggies Supremes, a new line of "super premium" or supreme diapers with Velcro closures instead of tapes and a soft nonwoven outer cover, priced at a 20% premium per diaper. Kimberly-Clark was first to market with a disposable training pant product line in 1990 and recently added an inner leg gather feature. Procter & Gamble followed Kimberly-Clark with a training pant product almost five years later. In September 1994, Procter & Gamble introduced a new stretch waist feature on its Pampers brand diaper.



The national branded manufacturers have substantially larger research and development budgets than the Company and are able to develop product innovations more rapidly than the Company and thereby may gain market share at the Company's expense. The national branded manufacturers also aggressively enforce their respective patent rights.

Customer service is another area where the national brands are able to compete. The Company believes that each of the national branded manufacturers has an order-delivery cycle that is significantly shorter than the Company's order-delivery cycle. In addition, the national branded manufacturers devote substantially greater financial resources than the Company to providing trade customers with category expertise, customized promotional campaigns and market support. Finally, the national branded manufacturers have sophisticated electronic data interchange systems that interface directly with their customers' product information systems.

#### *Value Segment*

The Company competes in the value segment of the market with national value brands and store brand products. The value segment is characterized by excess capacity and vigorous price competition. The Company's largest competitor in the value segment is Procter & Gamble with its Luvs brand. The next largest competitor is Drypers Corp., which has announced a consolidation of its three regional brands into one national value brand, Drypers. Mergers involving Drypers Corp. have given it a national manufacturing base. In the store brand portion of the value segment, the Company's largest competitor is Pope & Talbot, Inc., an integrated forest products company that produces and markets wood pulp, consumer tissue and disposable diaper products, and softwood lumber. Kimberly-Clark also produces store brand infant disposable diapers, including training pants.

The Company seeks to compete against other value segment manufacturers by emphasizing research and development and maintaining a leading position among value segment competitors in product quality. Smaller competitors of the Company are sometimes able to introduce new product features more quickly than the Company, in part as a result of having fewer diaper machines to convert to new production processes.

#### **EMPLOYEES**

At December 25, 1994 the Company had approximately 1,575 full-time employees, including 1,410 employees located at its five manufacturing facilities.

In January 1995, the Company announced the closure of its one unionized manufacturing facility located in La Puente, California as part of a restructuring and cost reduction program (see Note 17 of Notes to Financial Statements). The Company has negotiated closure and severance agreements with the Graphic Communications Union, Local 388M.

#### **ENVIRONMENT**

The Company is subject to federal, state, local and foreign laws, regulations and ordinances that (i) govern activities or operations that may have adverse environmental effects, such as discharges to air and water as well as handling and disposal practices for solid and hazardous wastes or (ii) impose liability for the costs of cleaning up, and certain damages resulting from, sites of past spills, disposals or other releases of hazardous substances (together, "Environmental Laws").

The Company uses certain substances and generates certain wastes that are regulated by or may be deemed hazardous under applicable Environmental Laws. The Company believes that it currently conducts its operations, and in the past has conducted its operations, in substantial compliance with applicable Environmental Laws. From time to time, however, the Company's operations have resulted or may result in certain noncompliance with applicable requirements. The Company believes, however, that it will not incur compliance or cleanup costs pursuant to applicable Environmental Laws that would have a material effect on the Company's results of operations or financial condition.



The Company monitors Environmental Laws and regulations, as well as pending legislation, in each of the markets in which its products are sold. A number of states have passed or are considering legislation intended to discourage the use of disposable products, including disposable diapers, or to encourage the use of non-disposable or recyclable products. The Company does not believe that any such laws currently in effect will have a material adverse effect on its results of operations or financial condition.

## ITEM 2: PROPERTIES

As of December 25, 1994, the Company operated five manufacturing facilities, with plants located in the United States at La Puente, California; Macon, Georgia; Harmony, Pennsylvania; and Waco, Texas; and in Canada at Brampton, Ontario. The Company owns all of its manufacturing facilities.

In 1994, the Company completed construction of a new headquarters building on 5.8 acres of land located in Federal Way, Washington. The new building has 88,000 square feet and provides space for all of the Company's corporate offices, including research facilities. At December 25, 1994, the Company was in the process of moving its offices to the new building and was still leasing headquarters office space from Weyerhaeuser and research facilities in Kent, Washington. The move to the new building was substantially completed in January 1995. In January 1995 the Company announced the closure of the manufacturing facility located in La Puente, California as part of the restructuring and cost reduction program (see Note 17 of Notes to Financial Statements).

The following table summarizes the physical properties that were in use by the Company in its operations at December 25, 1994:

Location	Use	Approximate Size (Sq. Feet)	Owned/Leased	Number of Diaper Machines
Federal Way, Washington	Headquarters	88,000	Owned	--
Federal Way, Washington	Headquarters	27,000	Leased	--
La Puente, California	Manufacturing	227,000	Owned	8
Macon, Georgia	Manufacturing	308,000	Owned	12
Harmony, Pennsylvania	Manufacturing	173,000	Owned	9
Waco, Texas	Manufacturing	151,000	Owned	8
Brampton, Ontario	Manufacturing	76,000	Owned	3
Kent, Washington	Research and Development	44,000	Leased	--

## EXECUTIVE OFFICERS

The following table sets forth certain information regarding the Company's executive officers:

Name	Age	Position
Bobby V. Abraham	53	Chief Executive Officer and Chairman of the Board
David W. Cole	47	President and Chief Operating Officer
Susan Barley	36	Vice President, General Counsel and Secretary
Robert C. Hirschev	36	Acting Chief Financial Officer (effective January 6, 1995)

*Bobby V. Abraham* has been a director and the Chief Executive Officer of the Company since its initial public offering in February 1993, has been Chairman of the Company's Board of Directors since August 1993 and served as the Company's President from its inception until November 1993. Prior to the Company's initial public offering in February 1993, Mr. Abraham had been the President of the Personal Care Products Division of Weyerhaeuser since February 1988. From 1986 until February 1988, Mr. Abraham served as Vice President and General Manager of the Personal Care Products Division of Weyerhaeuser.

*David W. Cole* has been the President and Chief Operating Officer of the Company since his appointment by the Board of Directors on November 1, 1993. Prior to assuming his current responsibilities, Mr. Cole had since February 1993 served as Executive Vice President and Chief Operating Officer. Prior to the Company's initial public offering in February 1993, Mr. Cole had been Vice President and General Manager of the Personal Care Products Division of Weyerhaeuser from May 1990 to November 1993, and Executive Vice President of Sales from 1989 to 1990. Prior to joining Weyerhaeuser in 1989, Mr. Cole served as Director of Field Sales with Cadbury USA, a division of Cadbury Schweppes PLC, and its successor, Hershey Chocolate Company.

*Susan Barley* has been the Vice President, General Counsel and Secretary of the Company since July 1993. Prior to assuming her current responsibilities, Ms. Barley had practiced law with the Perkins Coie law firm since 1983, becoming a partner in 1990.

*Robert C. Hirschey* has been acting Chief Financial Officer since January 6, 1995. Prior to his appointment as acting Chief Financial Officer, Mr. Hirschey was the Company's Director of Business Development. Prior to joining Paragon in February 1994, Mr. Hirschey was the Director of Investment Evaluation and Analysis for Weyerhaeuser since January 1991, and was responsible for the evaluation of Weyerhaeuser's merger and acquisition activities, including capital spending programs. Prior to January 1991, Mr. Hirschey was the Assistant Manager of Investment Evaluation and Analysis for Weyerhaeuser.

### **ITEM 3: LEGAL PROCEEDINGS**

Procter & Gamble Company ("P&G") filed a claim in the District Court for the District of Delaware that the Company's products infringe two of P&G's inner-leg gather patents. The lawsuit seeks injunctive relief, lost profit and royalty damages, treble damages and attorneys' fees and costs. The Company has denied liability under the patents and has counterclaimed for patent infringement and violation of antitrust laws by P&G. Discovery is proceeding, and trial has been set for October 1995. Legal fees and costs for this litigation may be significant. If P&G were to prevail on its claims, award of all or a substantial amount of the damages asserted by P&G could have a material adverse effect on the Company's financial condition and its results of operations. Based on the advice of patent counsel, the Company believes that P&G's claims are invalid.

The Company has also had discussions with Kimberly-Clark concerning the inner-leg gather feature on the Company's products. Kimberly-Clark has offered the Company a license, upon payment of a royalty, for rights under Kimberly-Clark's patents relating to the inner-leg gather feature. The Company has taken the position, based on the advice of its patent counsel, that the patent coverage claimed by Kimberly-Clark is not applicable to the Company's products. The Company has been notified that an additional patent in favor of Kimberly-Clark relating to the inner-leg gather feature may be issued from the U.S. Patent and Trademark Office. The Company is unable to evaluate any potential new patent claims because the patent file and prosecution history will not be available to the public and the Company until such time as the patent may issue.

The Company is also a party to other legal activities generally incidental to its activities. Although the final outcome of any legal proceeding or dispute is subject to a great many variables and cannot be predicted with any degree of certainty, the Company presently believes that any ultimate liability resulting from any legal proceeding or dispute, or all of them combined, will not have a material adverse effect on its financial condition or results of operations.

### **ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to vote of security holders during the fourth quarter of the 1994 fiscal year.

## PART II

### ITEM 5: MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

As of February 28, 1995, there were 303 holders of record of the Company's common stock. The Company has not paid dividends on its common stock. The Board of Directors will determine future dividend policy based upon the Company's results of operation, financial condition, capital requirements and other circumstances. The Company's common stock is listed on the New York Stock Exchange, Inc. The Company's credit facility prohibits the Company from paying cash dividends. See Note 16 of Notes to Financial Statements regarding the quarterly high and low price range of the Company's common stock.

### ITEM 6: SELECTED FINANCIAL DATA (Dollar amounts in millions)

	Fiscal Years				
	1990	1991	1992	1993	1994
<b>Earnings statement data (1)</b>					
Sales, net of discounts and allowances .....	\$ 286.2	\$ 396.3	\$ 484.8	\$ 562.9	\$ 578.6
Gross profit .....	38.3	73.4	84.9	105.3	108.8
Gross margin.....	13.4%	18.5%	17.5%	18.7%	18.8%
Operating profit (loss).....	\$ (4.4)	\$ 33.4	\$ 34.8	\$ 49.3	\$ 42.5
Operating margin .....	-	8.4%	7.2%	8.8%	7.3%
Net earnings (loss) .....	\$ (1.8)	\$ 21.0	\$ 21.1	\$ 45.9 (2)	\$ 25.0
Net margin .....	-	5.3%	4.4%	8.2% (2)	4.3%
<b>Balance sheet data (1)</b>					
Working capital .....	\$ 20.8	\$ 27.6	\$ 31.9	\$ 20.7	\$ 16.5
Total assets.....	\$ 110.4	\$ 122.4	\$ 150.6	\$ 244.2	\$ 275.4
Stockholders' equity .....	-	-	-	\$ 167.1	\$ 195.7
Investment by Weyerhaeuser....	\$ 80.5	\$ 88.8	\$ 108.8	-	-
<b>Other data</b>					
Capital spending.....	\$ 13.2	\$ 15.2	\$ 29.0	\$ 55.4 (3)	\$ 74.9
Depreciation and amortization ...	\$ 12.4	\$ 13.5	\$ 15.6	\$ 22.5	\$ 31.1
Units sold (millions) .....	1,907	2,535	2,993	3,435	3,595

(1) See Note 1 of Notes to Financial Statements.

(2) Reflects the benefit to income of \$15.6 million relating to deferred taxes due to the enactment of the Omnibus Budget Reconciliation Act of 1993 (see Notes 1 and 3 of Notes to Financial Statements). If this tax benefit were excluded, net earnings would be \$30.3 and net margin would be 5.4%.

(3) Includes \$1.7 million for computer software and development.

## **ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Year Ended December 25, 1994 Vs. Year Ended December 26, 1993**

### ***Results of Operations***

Net earnings decreased to \$25.0 million in 1994 from \$45.9 million in 1993. Earnings in 1993, however, were favorably impacted by a \$15.6 million increase in the deferred tax asset as required by SFAS 109, "Accounting for Income Taxes." The increase primarily recognized the amortization of acquired intangibles, including goodwill, as a result of the Omnibus Budget Reconciliation Act of 1993 (see Note 3 of Notes to Financial Statements). After excluding the effect of the tax asset increase, net earnings in 1993 were \$30.3 million and net earnings in 1994 decreased \$5.3 million, or 17.5%, from that level.

The decrease in net earnings was primarily due to lower sales prices (net of favorable mix), an increase in depreciation expense, poor results in Canada and increases in selling, general and administrative expenses. These negative impacts to earnings were partially offset by increased volume and reduced cost of sales due primarily to lower raw material costs.

Net earnings of \$25.0 million in 1994 were 16.7% lower than the pro forma earnings of \$30.0 million reported for 1993, excluding the effect of the change in the tax law discussed above (see Pro Forma Earnings Statement in "Year Ended December 26, 1993 Vs. Year Ended December 27, 1992" below). Pro forma adjustments in 1993 reflect costs in excess of historical charges by Weyerhaeuser and the additional costs of being a public, independent company.

Earnings per share of \$2.16 in 1994 were lower than the \$2.61 per share pro forma earnings in 1993, excluding the effect of the change in the tax law. Total pro forma earnings per share for 1993 were \$3.97 per share, including the \$1.36 per share attributable to the effect of the change in the tax law.

### ***Net Sales***

Net sales were \$578.6 million in 1994, a 2.8% increase from the \$562.9 million reported in 1993. Unit sales increased 4.7% to 3,595 million diapers in 1994 from 3,435 million diapers in 1993. Average sales prices during 1994 decreased approximately 4.5%, (before the effects of a favorable product mix) due to increased discounts and promotional allowances in response to price reductions and promotions by branded and value segment manufacturers. In addition to the decrease in average prices, increased sales and promotional expenses included in selling, general and administrative expense effectively decreased price an additional .9%. The negative trend in prices is expected to continue in 1995. In November 1994, Procter & Gamble announced a price reduction, accompanied by package count reductions, resulting in net price decreases of between 2 - 11%. These price decreases became effective in February 1995 and have been matched by other competitors. These price and package count reductions are expected to negatively impact volume during the first half of 1995 as the Company transitions to the new package counts. The Company expects volume to be flat or decrease slightly in 1995.

Sales to U. S. customers for resale in Mexico, which represented approximately 9% of 1993 volume and 7% of 1994 volume, dropped significantly during the fourth quarter of 1994 and are expected to be negligible in 1995 due to the recent devaluation of the Mexican peso.

Net sales in Canada decreased during 1994 compared to 1993. Volume, which was below 1993 levels through the first three quarters of 1994, improved significantly during the fourth quarter of 1994 and resulted in slightly higher volume for 1994 compared to 1993. Unit prices throughout 1994 were depressed by increased price competition instituted by branded manufacturers early in the year. Results were also negatively impacted by the decline of the Canadian dollar in relation to the U.S. dollar during 1994 compared to 1993 levels.

### ***Cost of Sales***

Cost of sales in 1994 was \$469.8 million, a 2.7% increase from \$457.6 million in 1993. As a percentage of net sales, cost of sales was 81.2% in 1994 compared to 81.3% in 1993. Costs in 1994 were favorably impacted by lower material prices, primarily pulp, cost reduction initiatives and lower labor costs compared to 1993. These favorable impacts were offset by increased depreciation expenses and other costs associated with new product rollouts and capital expenditures during 1994.

Raw material prices, primarily pulp, were favorable during the first three quarters of 1994 compared to the same periods of 1993. These favorable prices, however, changed dramatically during the fourth quarter of 1994 as some material prices, including pulp, polyethylene and corrugated, began to increase compared to 1993 levels. Pulp prices in the fourth quarter of 1994 were approximately 17% higher than in the fourth quarter of 1993 and are expected to continue increasing during 1995.

Overall labor costs decreased in 1994 compared to 1993. Labor efficiency gains were partially offset by downtime and training associated with capital installations as well as the costs of maintaining excess capacity in the fourth quarter of 1994.

Depreciation increased \$8.1 million, reflecting the costs of adding diaper and training pant capacity, pad modernization, and the acceleration of depreciation due to obsolescence of equipment as a result of pad modernization. Depreciation will be higher in 1995 due to the carryover of the capital spending program and the acceleration of depreciation on training pant equipment in anticipation of the introduction of the next-generation product. Depreciation will, however, be offset in part through the benefits of restructuring and cost reduction actions discussed below.

Plant costs increased due to the cost of outside warehousing and inventory handling needed to support the thin pad rollout, increased property taxes as a result of capital additions, and expenses related to the capital expenditure program. The Company expects to continue using outside warehouses to service certain customers.

### ***Selling, General and Administrative Expense***

Selling, general and administrative expenses ("SG & A") were \$59.5 million in 1994 compared to \$50.0 million for the same period of 1993. As a percentage of net sales, these expenses were 10.3% in 1994 compared to 8.9% for 1993. The increase was primarily attributable to an increase in sales promotion expenses. The increase in sales promotion expense was in response to increased pricing and promotional pressures by branded and value segment competitors, as well as the increased price competition discussed above. Expense for packaging, artwork, professional and legal fees, information systems and business development also increased. The Company anticipates that sales promotion, business development and legal expenses will continue at higher levels in 1995.

### ***Research and Development Expense***

Research and development expenses increased to \$6.9 million in 1994 from \$6.0 million in 1993. The increase was primarily due to product and process development expenditures supporting the thin product rollout, and royalties previously classified as selling, general and administrative expenses.

### ***Other Expense***

Other expenses increased to \$2.1 million in 1994 compared to \$.9 million in 1993. The increase was primarily due to the settlement of employment and contract-related litigation.

**Year Ended December 26, 1993 Vs. Year Ended December 27, 1992**

**Results of Operations**

Net earnings increased to \$45.9 million in 1993 compared with \$21.1 million in 1992. Earnings, however, were favorably impacted by a \$15.6 million increase in the deferred tax asset as required by SFAS 109, "Accounting for Income Taxes." The increase primarily recognized amortization of acquired intangibles, including goodwill, as a result of the Omnibus Budget Reconciliation Act of 1993 (see Note 3 of Notes to Financial Statements). Earnings, excluding the effect of the tax asset increase, were \$30.3 million in 1993 compared to \$21.1 million in 1992, a 43.8% increase.

The improved earnings were partially attributable to higher sales due to volume increases. Earnings were also favorably impacted by a decrease in cost of sales as a percentage of net sales, partially offset by an absolute increase in selling, general and administrative expense.

**PARAGON TRADE BRANDS, INC.**  
**UNAUDITED**  
**PRO FORMA EARNINGS STATEMENTS**  
(Dollar amounts in thousands, except per share data)

	Fifty-Two Weeks Ended	
	December 26, 1993	December 27, 1992
Net sales .....	\$562,949	\$484,776
Cost of sales .....	457,613	399,919
Gross profit .....	105,336	84,857
Selling, general and administrative expense .....	50,450	47,642
Research and development expense .....	6,015	6,627
Operating profit .....	48,871	30,588
Interest expense .....	341	274
Other expense, net .....	623	741
Earnings before income taxes .....	47,907	29,573
Provision for income taxes .....	17,868	11,227
Impact of tax law change (benefit) .....	(15,588)	--
Net earnings - pro forma .....	<u>\$45,627</u>	<u>\$ 18,346</u>
Net earnings per common share .....	\$3.97	\$1.60

Net pro forma earnings increased 64% to \$30.0 million in 1993, after adjusting for the tax asset increase of \$15.6 million as discussed earlier, compared to \$18.3 million in 1992. Pro forma earnings per share increased 63% to \$2.61 per share in 1993, after adjusting for the tax asset increase discussed above, compared to \$1.60 per share in 1992. Pro forma adjustments reflected costs in excess of historical charges by Weyerhaeuser and the additional costs of being an independent public company.

**Net Sales**

Net sales were \$562.9 million in 1993, a 16% increase from the \$484.8 million reported in 1992. Unit sales increased 15%, to 3,435 million diapers in 1993 from 2,993 million diapers in 1992. Revenues increased at a slightly higher rate than volume because of shipments of a higher-priced mix of products, including training pants introduced in the third quarter of 1992, and a slight overall price increase due to shipments of reduced-



count products. These improvements were offset by increased promotional discounts and allowances in response to the 1992 and 1993 price reductions instituted by the national branded manufacturers and diaper-price decreases in the latter part of the year due to diaper-price reductions announced by Procter & Gamble in April 1993.

Net sales in Canada increased significantly in 1993 compared to 1992. The Canadian increase primarily represented an increase in unit volume as price increases in Canada were offset by the devaluation of the Canadian dollar in relationship to the U.S. dollar in 1993.

#### ***Cost of Sales***

Cost of sales in 1993 was \$457.6 million compared to \$399.9 million in 1992, a 14% increase. As a percentage of net sales, cost of sales was 81.3% in 1993 compared to 82.5% in 1992. The lower costs in 1993 were principally caused by lower raw material prices compared to 1992 offset by increased labor, thin pad start-up and depreciation costs. Pulp prices dropped approximately 19% in 1993. Other raw material prices were also at slightly lower levels in 1993 when compared to 1992. The decrease in cost of sales in 1993 also reflected some improvement in costs in the second half of 1993 due to cost reduction and pad modernization efforts.

Manufacturing efficiencies improved in 1993, but were offset by additional labor costs of the training pant operations and thin-pad start-up costs incurred late in 1993. Labor costs increased 8% in 1993 compared to 1992. Depreciation costs increased over \$6 million in 1993 due to additional diaper-making capacity, pad improvement capital and training pant operations added during late 1992 and 1993. Depreciation costs also included the acceleration of depreciation due to obsolescence of equipment as a result of pad modernization.

#### ***Selling, General and Administrative Expense***

Selling, general and administrative expense increased to \$50.0 million in 1993 compared to \$43.5 million in 1992. As a percentage of net sales, however, this expense decreased to 8.9% in 1993 compared to 9.0% in 1992. The increase of \$6.5 million represented the following: additional cost of accruals for performance-based compensation programs such as incentive bonuses and profit sharing; additional costs of being an independent public company; and increased promotional expenses. The promotional expenses were in response to branded pricing and promotional pressures in 1993. These increased expenses were partially offset by savings generated by the termination of the Company's relationship with its largest sales broker in the latter part of 1992. Outside brokerage costs fell dramatically during the first three quarters of 1993, but were partially offset by the additional costs of an internal sales force.

Pro forma selling, general and administrative expense rose to \$50.5 million in 1993 compared to \$47.6 million in 1992. As a percentage of net sales, this expense represented 9.0% in 1993 compared to 9.8% in 1992. Pro forma adjustments reflected costs in excess of historical charges by Weyerhaeuser and the additional costs of being an independent public company.

#### ***Research and Development Expense***

Research and development expense decreased to \$6.0 million in 1993 from \$6.6 million in 1992. This expense was lower due to the discontinuation of an alternative pad technology.

#### ***Liquidity and Capital Resources***

In 1994 net cash flow from earnings and non cash charges to earnings was \$59.8 million compared to net cash flow from earnings and non cash charges to earnings of \$50.6 million in 1993.

During 1994, working capital, exclusive of cash, and short-term borrowings, increased \$4.3 million. The primary driver was a \$9.7 million decrease in accounts payable. The decrease primarily reflected payment during 1994 for fourth quarter 1993 purchases of pulp and capital items.

Cash flow was favorably impacted by decreases in both inventories and receivables. Inventories and prepaids decreased \$1.4 million. Finished good inventories increased during the first half of 1994, reflecting increases to support the downtime associated with capital conversions, including the thin product rollout, but decreased during the second half of the year. Raw material inventories also decreased due to the first quarter use of a special purchase of pulp made in the fourth quarter of 1993. These decreases were partially offset by increases in poly bag inventories due to the rollout of the thin product. Accounts receivable decreased \$1.3 million due to a slight decrease in business activity at the end of 1994 compared to the end of 1993.

Although accrued liabilities decreased by \$1.3 million, cash flow was favorably impacted by a net \$2.7 million as the Company issued stock valued at \$4.0 million to settle certain accrued payroll liabilities. See Notes 1 and 4 of Notes to Financial Statements.

A large portion of the 1993 cash flow was generated by changes in working capital items, primarily payables and accrued liabilities, that reflected a one-time impact of becoming an independent company.

Capital expenditures were \$74.9 million in 1994 compared to \$53.7 million in 1993. Capital expenditures during 1993 and 1994 supported plans to increase diaper and training pant capacity, make pad improvements, improve manufacturing efficiencies, construct corporate headquarters, and expand product lines. Capital plans to support additional capacity, make pad improvements, improve manufacturing efficiencies, and construct a corporate headquarters are substantially complete. The Company expects capital spending to support the baby diaper business to decrease substantially in 1995.

The Company has access to a revolving bank credit facility of \$50 million and an additional CDN \$10 million revolving credit facility in Canada. In addition to the revolving credit facilities, the Company has \$30 million in uncommitted lines of credit with various banks. Borrowings against these lines bear interest at rates that vary with each lending bank's base and LIBOR interest rates. As of the end of 1994, there was \$11.6 million in debt outstanding under the credit facilities and \$2.5 million in debt outstanding under the uncommitted lines of credit. The Company had \$2.7 million in cash and short-term investments at the end of 1994.

As discussed below, the Company has signed a letter of intent to acquire a 49% interest in a disposable diaper producer in Mexico ("MABESA") for \$50 million cash plus additional consideration based on future financial results of MABESA and to jointly develop a new manufacturing facility in Northern Mexico. In addition, the Company anticipates capital spending in the second half of 1995 in connection with its feminine care and adult incontinence business development plans.

The Company anticipates that despite lower diaper capital spending levels in the baby diaper business in 1995, lower operating results during the first half of 1995 could necessitate additional borrowing against these credit facilities. Further, the Company may utilize the credit facilities to finance the purchase of a 49% interest in MABESA and any expenditures for the feminine care and adult incontinence initiatives. The current credit facilities in combination with internally generated funds, are anticipated to be adequate to finance these needs.

#### **Subsequent Events**

On January 24, 1995, the Company announced a restructuring and cost reduction program. The Company closed its diaper manufacturing facility in La Puente, California, and has reduced its corporate staff by approximately 20%. Management expects these and other actions to substantially offset forecasted increases in material prices. The restructuring program will result in first quarter 1995 pre-tax restructuring and other nonrecurring charges of between \$13 and \$16 million, excluding any gains on disposal of assets. Included in these charges will be costs of planned asset dispositions, employee severance, and other related plant closure costs.



On February 23, 1995, the Company announced that it had signed a letter of intent to acquire a 49% interest in MABESA, and to jointly develop a new manufacturing facility in Northern Mexico to serve export markets. Under the terms of the letter of intent, the Company will acquire the 49% interest for \$50 million cash plus additional consideration based on MABESA's future financial results. In addition, the Company will assist in the financing of the Northern Mexico export facility that is expected to be completed in mid-1996. The Company expects to sell some of the assets from the closed diaper manufacturing facility in California as part of the development of the export facility in Northern Mexico. Consummation of the transactions contemplated by the letter of intent is subject to satisfactory completion of due diligence, negotiation of definitive agreements and other customary closing conditions.

#### **Future Realization of Deferred Tax Asset**

The Company implemented SFAS No. 109, "Accounting for Income Taxes," at its inception. SFAS No. 109 requires accounting for income taxes based on the liability method and, accordingly, deferred income taxes are provided to reflect temporary differences between financial and tax reporting. The Company currently has a net deferred tax asset of \$36.8 million. Significant components of net deferred income taxes include temporary differences due to depreciation/amortization (\$13.0 million), goodwill (\$13.0 million) and reserves not currently deductible (\$6.7 million). To realize the full benefit of the deferred tax asset, the Company needs to generate approximately \$22 million in future taxable income taking into consideration carryback periods available. Management believes that the Company will generate sufficient future taxable income to ensure full realization of the deferred tax asset. Based on the nature of the various components of deferred income taxes, the Company expects to realize approximately 75% of the deferred tax asset within 5 years. The remaining 25% is expected to be realized in 6 to 13 years.

#### **New Accounting Standards**

In October 1994, the Financial Accounting Standards Board issued SFAS No. 119, "Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments," to be effective for fiscal years ending after December 15, 1994. The Company does not have significant involvement in derivative based financial instruments.

In November 1992, the Financial Accounting Standards Board issued SFAS No. 112, "Employer's Accounting for Postemployment Benefits," effective for fiscal years beginning after December 15, 1993. The adoption of this statement did not have a significant impact on the Company's financial position or results of operations.

#### **Inflation**

Inflation has not been a significant factor in the Company's results of operations in recent years due to the modest rate of price increases in the United States and Canada.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO FINANCIAL STATEMENTS AND SCHEDULES

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## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Stockholders of Paragon Trade Brands, Inc.:

We have audited the accompanying consolidated balance sheets of Paragon Trade Brands, Inc., a Delaware Corporation, (Paragon) and Subsidiaries, formerly the Private Label Diaper Business of Weyerhaeuser Company (the Business), as of December 25, 1994 and December 26, 1993, and the related consolidated statements of earnings, changes in stockholders' equity, and cash flows for each of the two years in the period ended December 25, 1994 (see Note 1 of Notes to Financial Statements), and the combined statements of earnings, changes in investment by Weyerhaeuser Company, and cash flows for the year ended December 27, 1992. These financial statements are the responsibility of Paragon's and the Business' management, respectively. 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 audit 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 present fairly, in all material respects, the financial position of Paragon Trade Brands, Inc. and Subsidiaries as of December 25, 1994 and December 26, 1993, and the results of their operations and their cash flows for each of the two years in the period ended December 25, 1994, and the results of operations and cash flows of the Private Label Diaper Business of Weyerhaeuser Company for the year ended December 27, 1992, in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The financial statement schedule listed in the index to the financial statements is the responsibility of Paragon's and the Business' management and is presented for purposes of complying with the Securities and Exchange Commission's rules and is not a part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states, in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

Arthur Andersen LLP

Seattle, Washington

February 3, 1995

(except with respect to the matter discussed in  
Note 18, as to which the date is February 23, 1995)

**PARAGON TRADE BRANDS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(Dollar amounts in thousands)  
(Notes 1)

	December 25, 1994	December 26, 1993
<b>Assets</b>		
Cash and short-term investments.....	\$ 2,684	\$ 8,785
Receivables (Note 5).....	45,154	46,498
Inventories (Note 6).....	34,369	35,571
Current portion of deferred income taxes (Note 3)....	6,930	5,704
Prepaid expenses.....	1,015	1,243
Total current assets.....	90,152	97,801
Property and equipment (Note 7).....	133,956	78,310
Construction in progress.....	18,105	28,841
Patents and trademarks (Note 1).....	1,283	1,739
Deferred income taxes (Note 3).....	29,849	34,742
Other assets.....	2,047	2,735
Total assets.....	<u>\$ 275,392</u>	<u>\$ 244,168</u>
<b>Liabilities and Stockholders' Equity</b>		
Short-term borrowings (Note 9).....	\$ 8,142	\$ -
Checks issued but not cleared (Note 1).....	10,148	10,711
Accounts payable.....	31,389	41,117
Accrued liabilities (Note 8).....	23,932	25,266
Total current liabilities.....	73,611	77,094
Long-term debt (Note 9).....	6,000	-
Other long-term liabilities.....	102	-
Commitments and Contingencies (Notes 12 and 13).....		
Total liabilities.....	79,713	77,094
Stockholders' equity (Note 1):		
Preferred stock: \$.01 par value, authorized 10,000,000 shares, no shares issued.....	-	-
Common stock: \$.01 par value, authorized 25,000,000 shares, 11,623,221 and 11,500,000 shares issued and outstanding in 1994 and 1993, respectively.....	116	115
Capital surplus.....	129,741	125,733
Foreign currency translation adjustment.....	(834)	(436)
Retained earnings (Note 9).....	66,656	41,662
Total stockholders' equity.....	195,679	167,074
Total liabilities and stockholders' equity.....	<u>\$ 275,392</u>	<u>\$ 244,168</u>

See accompanying Notes to Financial Statements.

**PARAGON TRADE BRANDS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED EARNINGS STATEMENTS**  
**AND**  
**PRIVATE LABEL DIAPER BUSINESS OF WEYERHAEUSER COMPANY**  
**COMBINED EARNINGS STATEMENT**  
(Dollar amounts in thousands, except per share data)  
(Note 1)

	Year Ended		
	December 25, 1994	December 26, 1993	December 27, 1992
Sales, net of discounts and allowances .....	\$ 578,618	\$ 562,949	\$ 484,776
Cost of sales, including purchases by the Business of raw materials from Weyerhaeuser Co. totaling \$9,681 and \$88,048 in 1993 and 1992, respectively (Note 11).....	469,837	457,613	399,919
Gross profit .....	108,781	105,336	84,857
Selling, general and administrative expense, including costs allocated to the Business from Weyerhaeuser Co. totaling \$292 and \$3,480 in 1993 and 1992, respectively (Note 11) .....	59,464	50,026	43,472
Research and development expense .....	6,855	6,015	6,627
Operating profit .....	42,462	49,295	34,758
Other expense, net (Note 2) .....	2,135	911	741
Earnings before income taxes .....	40,327	48,384	34,017
Provision for (benefit from) income taxes (Note 3):			
Effect of change in tax law ..	-	(15,588)	-
Other current and deferred taxes.....	15,333	18,044	12,914
	15,333	2,456	12,914
Net earnings.....	\$ 24,994	\$ 45,928	\$ 21,103
Primary earnings per share (Notes 14 and 15) .....	\$ 2.16	N/A	N/A

See accompanying Notes to Financial Statements.

PARAGON TRADE BRANDS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
AND  
PRIVATE LABEL DIAPER BUSINESS OF WEYERHAEUSER COMPANY  
COMBINED STATEMENT OF CHANGES IN INVESTMENT BY WEYERHAEUSER COMPANY  
(Dollar amounts in thousands)  
(Note 1)

	Investment by Weyerhaeuser Company	Common Stock	Capital Surplus	Foreign Currency Translation	Retained Earnings
BALANCE, December 29, 1991	\$ 88,845	\$ -	\$ -	\$ -	\$ -
Net earnings.....	21,103	-	-	-	-
Net return to Weyerhaeuser Co.....	(1,114)	-	-	-	-
BALANCE, December 27, 1992	108,834	-	-	-	-
Net earnings.....	4,266	-	-	-	41,662
Net return to Weyerhaeuser Co.....	(6,188)	-	-	-	-
Acquired net assets of Private Label Diaper Business of Weyerhaeuser Co.....	(106,912)	100	98,883	-	-
Sale of common stock.....	-	15	26,850	-	-
Translation adjustment .....	-	-	-	(436)	-
BALANCE, December 26, 1993	-	115	125,733	(436)	41,662
Net earnings.....	-	-	-	-	24,994
Issue common stock.....	-	1	4,008	-	-
Translation adjustment .....	-	-	-	(398)	-
BALANCE, December 25, 1994	\$ -	\$ 116	\$129,741	\$ (834)	\$ 66,656

See accompanying Notes to Financial Statements.

**PARAGON TRADE BRANDS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**AND**  
**PRIVATE LABEL DIAPER BUSINESS OF WEYERHAEUSER CO.**  
**COMBINED STATEMENT OF CASH FLOWS**  
(Dollar amounts in thousands)  
(Notes 1)

	Year Ended		
	December 25, 1994	December 26, 1993	December 27, 1992
<b>Cash flows from operating activities:</b>			
Net earnings.....	\$ 24,994	\$ 45,928	\$ 21,103
Non-cash charges to earnings:			
Depreciation and amortization.....	31,119	22,510	15,618
Deferred income taxes.....	3,667	(17,831)	(2,656)
Changes in working capital:			
Accounts receivable.....	1,344	(3,422)	(9,806)
Inventories and prepaid expenses.....	1,430	(12,219)	(3,376)
Accounts payable.....	(9,728)	22,503	5,440
Accrued liabilities.....	2,675	10,658	338
Other.....	258	(490)	(516)
Net cash provided by operating activities.....	55,759	67,637	26,145
<b>Cash flows from investing activities:</b>			
Expenditures for property and equipment.....	(74,921)	(53,660)	(29,023)
Acquire net assets - Private Label Diaper Business of Weyerhaeuser Co.....	-	(35,000)	-
Other.....	(518)	(2,204)	(186)
Net cash used by investing activities.....	(75,439)	(90,864)	(29,209)
<b>Cash flows from financing activities:</b>			
Net return to Weyerhaeuser Co.....	-	(6,188)	(1,114)
Deferred taxes credited to investment by Weyerhaeuser Co.....	-	-	243
Net increase in short-term borrowings.....	8,142	-	-
Proceeds from U.S. bank credit facility.....	18,700	43,300	-
Repayments of U.S. bank credit facility.....	(12,700)	(43,300)	-
Sale of common stock (Note 1).....	-	26,865	-
Checks issued but not cleared.....	(563)	11,277	3,987
Net cash provided by financing activities.....	13,579	31,954	3,116
<b>Net increase (decrease) in cash.....</b>	<b>(6,101)</b>	<b>8,727</b>	<b>52</b>
Cash at beginning of period.....	8,785	58	6
Cash at end of period.....	\$ 2,684	\$ 8,785	\$ 58
<b>Cash paid during the year for:</b>			
Interest (net of amounts capitalized).....	\$ 278	\$ 357	\$ -
Income taxes (Notes 1 and 3).....	\$ 16,823	\$ 16,047	\$ 15,570

See accompanying Notes to Financial Statements.

**PARAGON TRADE BRANDS, INC. AND SUBSIDIARIES**  
**AND**  
**PRIVATE LABEL DIAPER BUSINESS OF WEYERHAEUSER CO.**  
**NOTES TO FINANCIAL STATEMENTS**  
(Dollar amounts in thousands, except per share data)

**Note 1: Basis of Presentation and Summary of Significant Accounting and Reporting Policies**

*Basis of Presentation and Related Information*

The consolidated financial statements include the accounts of Paragon Trade Brands, Inc. ("Paragon" or the "Company") and its wholly owned subsidiaries, Paragon Trade Brands (Canada) Inc. and Paragon Trade Brands FSC, Inc. All significant intercompany transactions and accounts are eliminated. The combined financial statements include the accounts of the Private Label Diaper Business (the "Business") of Weyerhaeuser Company ("Weyerhaeuser").

On February 2, 1993, pursuant to an agreement between Weyerhaeuser and Paragon, Weyerhaeuser transferred substantially all the net assets of the Business to Paragon in exchange for 9,999,900 shares of Paragon's \$.01 par value common stock and the payment of \$35,000. The book value of the net assets acquired from Weyerhaeuser in this transaction was \$106,912. As a result, the financial statements reflect the results of Paragon for the fiscal year ended December 25, 1994 and the period from February 2 to December 26, 1993. The results from December 28, 1992 to February 1, 1993 and the fiscal year ended December 27, 1992 reflect the results of the Business.

On February 2, 1993, Paragon issued 1,500,000 shares of its \$.01 par value common stock to Weyerhaeuser in exchange for \$26,865. The entire net proceeds of this issuance were used to reduce the borrowings under the revolving credit facilities described in Note 9.

*Cash and Short-term Investments*

For purposes of cash flow and fair value reporting, short-term investments with original maturities of 90 days or less are considered as cash equivalents. Short-term investments are stated at cost, which approximates fair value. The obligation for outstanding checks is reflected as checks issued, but not cleared.

*Financial Instruments*

The Company occasionally enters into forward contracts to purchase foreign currencies at specific rates on preestablished dates. The purpose of these contracts is to hedge obligations and accounts payable denominated in foreign currencies. Gains and losses on the forward contracts are deferred and offset exchange gains and losses on the transactions hedged. The Company's other off-balance sheet risks are not material.

*Fair Value of Financial Instruments*

The Company estimates that the fair value of its financial instruments approximate their carrying value. As such, no separate disclosure of fair value is made.

*Noncash Transactions*

During the fiscal year ended December 25, 1994, the Company issued 123,221 shares of Common Stock to key management and employees through the Company's Long-Term Incentive Compensation Plan and its Profit Sharing and Savings Plan (see Note 4). The balance sheet effect of issuing these shares of Common Stock was a decrease in accrued liabilities of \$4,009 and an increase in equity by an equal amount without the use of cash.



### *Inventories*

Inventories are stated at the lower of cost or market. Cost includes labor, materials and production overhead. The last-in, first-out ("LIFO") method is used to cost domestic pulp and finished goods inventories. The first-in, first-out ("FIFO") method is used to cost all other inventories. Had the FIFO method been used to cost the domestic pulp and finished goods inventories, the amounts at which they are stated would have been \$2,474 and \$2,421 greater at December 25, 1994 and December 26, 1993, respectively.

### *Property and Equipment*

Paragon's property accounts are maintained on an individual asset basis. Betterments and replacements of major units are capitalized. Maintenance, repairs and minor replacements are expensed. Depreciation is provided on the straight-line method at rates based upon estimated useful lives as follows:

Buildings	20 to 40 years
Building improvements	10 years
Machinery, equipment, furniture and fixtures	3 to 10 years

The cost and related depreciation of property sold or retired is removed from the property and allowance for depreciation accounts and the gain or loss is recorded.

### *Patents and Trademarks*

Purchased patents and trademarks are amortized on a straight-line basis over a five- to ten-year life. Amortization expense for each of the three fiscal years ended December 25, 1994, December 26, 1993 and December 27, 1992, was \$456, \$456 and \$549, respectively. Accumulated amortization was \$3,890 and \$3,434 at December 25, 1994 and December 26, 1993, respectively.

### *Significant Sales*

The following table presents the percentage of net sales distributed through one broker and the percentage of net sales to an individual customer whose sales represent in excess of 10% of net sales.

	Year Ended		
	December 25, 1994	December 26, 1993	December 27, 1992
Net sales to:			
Broker .....	-	-	30%
Customer.....	15%	15%	14%

### *Income Taxes*

Paragon implemented Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," giving effect to the accounting treatment prescribed by SFAS No. 109 from its inception. SFAS No. 109 requires accounting for income taxes based on the liability method and, accordingly, deferred income taxes are provided to reflect temporary differences between financial and tax reporting. Deferred tax assets and liabilities are measured based on enacted tax laws and rates without anticipation of future changes. Effects on deferred taxes of enacted changes in tax laws are recognized in income for financial statement purposes in the period of enactment. The effect of the change in the tax laws from enactment of the Omnibus Budget Reconciliation Act of 1993 was a benefit to income of \$15,588 in the 1993 consolidated statement of earnings.

For the period December 28, 1992 to February 1, 1993 and the fiscal year ended December 27, 1992, federal and state income taxes related to the U.S. operations of the Business were included in the consolidated tax returns of Weyerhaeuser. For foreign income tax purposes during the same period, the Canadian operations of the Business were included in the tax returns of Weyerhaeuser Canada Ltd. Income taxes in the accompanying

financial statements were computed assuming that the Business was a stand-alone entity. Cash paid for income taxes as shown in the accompanying statements of cash flows for the fiscal years ended December 25, 1994 and December 26, 1993 represents actual taxes paid by Paragon. For the fiscal year ended December 27, 1992, the amount shown represents the current portion of the Business' income tax provision reflected in the Investment by Weyerhaeuser.

As of December 25, 1994, there were no undistributed earnings of the Company's Canadian subsidiary. Under existing law, undistributed earnings are not subject to U.S. tax until distributed as dividends. Any future earnings are intended to be indefinitely reinvested in Canadian operations. Furthermore, any taxes that are paid to the Canadian Government on future earnings may be used, in whole or in part, as credits against the U.S. tax on any dividends distributed from such earnings.

Deferred foreign income tax benefits for the fiscal year ended December 27, 1992 were utilized by Weyerhaeuser Canada Ltd. and are therefore included in Investment by Weyerhaeuser as of December 27, 1992.

Liabilities for workers' compensation claims that were incurred prior to the transfer of the Business' assets and liabilities by Weyerhaeuser to Paragon (see above) will be paid by Weyerhaeuser. Therefore, the liability for these claims, and the related deferred tax benefit, is reflected in Investment by Weyerhaeuser.

Income taxes have been provided for all items included in the consolidated and combined earnings statements, regardless of the period when such items will be deductible for tax purposes. The principal temporary differences between financial and tax reporting arise from tax-basis goodwill, depreciation and reserves not currently deductible.

#### *Investment by Weyerhaeuser*

Investment by Weyerhaeuser represents the net, non-interest-bearing assets invested in the Business by Weyerhaeuser.

#### *Foreign Currency*

Non-U.S. assets and liabilities are translated into U.S. dollars using period-end exchange rates. Revenues and expenses are translated at average rates during the period. The net translation gains and losses charged to Investment by Weyerhaeuser for the period December 28, 1992 to February 1, 1993 and the fiscal year ended December 27, 1992 are not material to the financial statements presented.

#### *Pension and Profit Sharing Plans*

With the exception of assuming sponsorship for the pension plan of one plant, Paragon no longer participates in Weyerhaeuser's pension plans. Pension obligations for Paragon's employees through February 1, 1993 were retained by Weyerhaeuser. Effective February 2, 1993, Paragon adopted both a defined contribution profit sharing plan and a 401(k) savings plan covering most of its employees. On October 1, 1993, the two plans were merged, amended and restated into one plan, the Paragon Trade Brands, Inc. Profit Sharing and Savings Plan. The plan provides for both employer-matching contributions based on voluntary salary deferrals of employees and discretionary employer contributions. Plan participants are fully vested after five years of service. Contributions to the plan are based on various levels of employee participation. Plan expense for the fiscal year ended December 25, 1994 and the period February 2, 1993 to December 26, 1993 was \$1,785 and \$2,884, respectively.

For the period December 28, 1992 to February 1, 1993 and the fiscal year ended December 27, 1992, the Business, under Weyerhaeuser, participated in pension plans covering most of its employees. The U.S. plan covering salaried employees provided pension benefits based on the employees' highest monthly earnings for five consecutive years during the final ten years before retirement. Plans covering hourly employees generally provided benefits of stated amounts for each year of service. The Business received an allocated charge from Weyerhaeuser for its share of pension costs for those employees who participated in Weyerhaeuser's pension plans. Contributions by Weyerhaeuser to its U.S. plans were based on funding standards established by the Employee Retirement Income Security Act of 1974 ("ERISA").

### Postretirement Benefits Other Than Pensions

Paragon does not provide postretirement healthcare or life insurance benefits to employees. As such, implementation of SFAS No. 106, "Employer's Accounting for Postretirement Benefits Other Than Pensions," has not had a significant impact on Paragon's financial position or results of operations.

The cash payments made by the Business, and expense recorded, for postretirement benefits other than pensions was \$268 in 1992.

### Postemployment Benefits

In November 1992, the Financial Accounting Standards Board issued SFAS No. 112, "Employer's Accounting for Postemployment Benefits," effective for fiscal years beginning after December 15, 1993. This new standard requires that Paragon follow an accrual method of accounting for benefits payable to former or inactive employees after employment, but prior to retirement. The Company does not provide significant benefits of this nature. As such, the impact of SFAS No. 112 has not had a significant impact on Paragon's financial position or results of operations.

### Note 2: Other Expense, Net

No individual income or expense item is significant in relationship to net earnings.

### Note 3: Income Taxes

Provisions for (benefits from) income taxes include the following:

	December 25, 1994	December 26, 1993	December 27, 1992
Effect of change in tax law .....	\$ -	\$ (15,588)	\$ -
Other current and deferred taxes:			
Federal:			
Current .....	\$ 9,722	\$ 16,380	\$ 13,124
Deferred .....	3,227	(1,890)	(2,268)
	<u>12,949</u>	<u>14,490</u>	<u>10,856</u>
State:			
Current .....	2,552	3,269	2,446
Deferred .....	680	(353)	(229)
	<u>3,232</u>	<u>2,916</u>	<u>2,217</u>
Foreign:			
Current .....	(608)	638	-
Deferred .....	(240)	-	(159)
	<u>(848)</u>	<u>638</u>	<u>(159)</u>
	<u>\$ 15,333</u>	<u>\$ 2,456</u>	<u>\$ 12,914</u>

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

	December 25, 1994	December 26, 1993	December 27, 1992
Expected provision at the statutory rate.....	\$ 14,114	\$ 16,934	\$ 11,566
Effect of change in tax law.....	-	(15,588)	-
State income taxes, net of federal tax benefit.....	2,101	1,895	1,385
Research and experimental credit.....	(210)	(300)	(75)
All other, net.....	(872)	(485)	38
	<u>\$ 15,333</u>	<u>\$ 2,456</u>	<u>\$ 12,914</u>

Net deferred tax assets at December 25, 1994 and December 26, 1993 were \$36,779 and \$40,446, respectively. The amounts recorded primarily reflect the following: (1) the tax effects of a step up in the tax basis of the assets of Paragon as a result of the February 2, 1993 transfer to Paragon of substantially all the assets and liabilities of the Business and (2) an increase in the deferred tax asset due to the enactment of the Omnibus Budget Reconciliation Act of 1993, which replaced the prior law for amortization of intangibles, including goodwill. Net deferred income taxes are attributable to the following temporary differences:

	December 25, 1994	December 26, 1993
Depreciation/amortization.....	\$ 12,984	\$ 17,853
Goodwill.....	13,060	14,059
Reserves not currently deductible.....	6,709	5,606
Package design costs.....	1,922	1,271
Land.....	1,638	1,650
All other, net.....	1,044	600
Valuation allowance.....	(558)	(593)
Net deferred asset.....	<u>\$ 36,779</u>	<u>\$ 40,446</u>

#### Note 4: Pension, Long-Term Incentive and Profit Sharing Plans, including 401(K)

With the exception of assuming the sponsorship of a defined benefit retirement plan for hourly employees at its California plant, Paragon no longer participates in Weyerhaeuser's pension plans. As a result of union negotiations, the Company froze benefit accruals under this sponsored plan, effective August 19, 1994. The cessation of benefit accruals does not affect Paragon's obligation to fund benefits that have already accrued. Plan contributions will be made to fund obligations and meet minimum funding requirements established by ERISA. Prior to freezing benefit accruals, a participant's vested percentage was 100% upon the completion of five years of vesting service. As currently amended to cease benefit accruals, the plan provides that every person employed on the date the plan terminates, and who was a participant in the plan on the date accruals ceased, will be 100% vested in his/her accrued amount. The Company expects to terminate the plan in fiscal year 1995 (see Note 17). The actuarial cost method used in determining pension expense for the plan is the projected unit credit method. Net pension expense for the fiscal years ended December 25, 1994 and December 26, 1993 was \$240 and \$199, respectively.

An interest rate of 8.0% was assumed with respect to both the rate of return on plan assets and the discount rate for determining the net present value of the projected benefit obligation for the 1994 plan year. An interest rate of 7.5% was assumed for 1993. The actuarial present value of the vested and nonvested accumulated plan benefits exceeded the fair value of plan assets by \$725 and \$557 at December 25, 1994 and December 26, 1993, respectively.

In lieu of the defined benefit plan, hourly employees at the California plant are now participating in a union multi-employer defined contribution plan which requires a set dollar monthly contribution per covered employee. Contributions to the plan totaled \$24 for the fiscal year ended December 25, 1994.

For the period December 28, 1992 to February 1, 1993 and the fiscal year ended December 27, 1992, the Business participated in Weyerhaeuser pension plans and recognized as its net pension cost amounts allocated to it by Weyerhaeuser. The assets of Weyerhaeuser's pension plans were included in a master trust and not segregated or otherwise restricted for benefits of the Business, with the exception of the sponsored plan described above. The annual pension expense allocated to the Business was approximately \$34 and \$531 for the period December 28, 1992 to February 1, 1993 and the fiscal year ended December 27, 1992, respectively.

The Company's Long-Term Incentive Compensation Plan ("LTIC Plan") is administered by the Compensation Committee of the Board of Directors and is designed to link management rewards with the long-term interests of Paragon's stockholders. Currently, long-term incentives are provided through grants of stock options and restricted stock. Stock options granted to key management and directors are granted at amounts that approximate market value at the date of grant and, as such, there is no compensation expense related to such grants reflected in the Company's earnings statement. The Company also encouraged the acquisition of common stock at a discount in lieu of all or a portion of the cash bonuses of key management employees paid in 1994 for services in 1993. Compensation expense is recorded with respect to the discounted amount. The stock purchased is non-transferable for two years. During the fiscal year ended December 25, 1994, there were 48,615 shares of common stock issued under the LTIC Plan as restricted and bonus shares.

With regard to stock options granted to key management and directors during the fiscal year ended December 25, 1994 and the period February 2, 1993 to December 26, 1993, the following is provided:

	<u>December 25, 1994</u>	<u>December 26, 1993</u>
During the period:		
Options granted .....	171,940	401,500
Options exercised .....	-	-
Options canceled .....	2,670	-
At end of period:		
Options outstanding .....	570,770	401,500
Options exercisable.....	114,875	-
Average price per share:		
Options granted .....	\$ 30.88	\$ 20.12
Options outstanding .....	\$ 23.34	\$ 20.12
Options exercisable.....	\$ 20.39	\$ -

To further encourage the ownership of Common Stock by all employees, the Company maintains a Profit Sharing and Savings Plan that offers both profit sharing and 401(k) features. The Company's 1993 profit sharing contribution made during the fiscal year ended December 25, 1994 consisted of 57,415 shares of Common Stock. The Company's 401(k) contributions made during the fiscal year ended December 25, 1994 consisted of both cash and 17,191 shares of Common Stock.

**Note 5: Receivables**

Receivables consist of the following:

	December 25, 1994	December 26, 1993
Accounts receivable - trade .....	\$ 46,349	\$ 49,698
Other receivables .....	4,690	2,157
	<u>51,039</u>	<u>51,855</u>
Less: Allowance for doubtful accounts .....	(5,885)	(5,357)
Net receivables	<u>\$ 45,154</u>	<u>\$ 46,498</u>

**Note 6: Inventories**

Inventories consist of the following:

	December 25, 1994	December 26, 1993
LIFO:		
Raw materials - pulp .....	\$ 205	\$ 4,428
Finished goods .....	12,236	13,757
FIFO:		
Raw materials - other .....	8,772	6,270
Materials and supplies .....	<u>18,986</u>	<u>15,592</u>
	40,199	40,047
Reserve for excess and obsolete items .....	(5,830)	(4,476)
Net Inventories	<u>\$ 34,369</u>	<u>\$ 35,571</u>

**Note 7: Property and Equipment**

Property and equipment, at cost, are as follows:

	December 25, 1994	December 26, 1993
Land .....	\$ 3,954	\$ 2,758
Buildings and improvements .....	37,917	27,561
Machinery and equipment .....	<u>201,813</u>	<u>142,432</u>
	243,684	172,751
Less: Allowance for depreciation .....	(109,728)	(94,441)
Net property and equipment	<u>\$ 133,956</u>	<u>\$ 78,310</u>

**Note 8: Accrued Liabilities**

Accrued liabilities are as follows:

	December 25, 1994	December 26, 1993
Payroll - wages and salaries, incentive awards, retirement, vacation and severance pay .....	\$ 11,513	\$ 12,537
Coupons outstanding .....	3,930	2,543
Income taxes payable - current .....	175	2,078
Other .....	<u>8,314</u>	<u>8,108</u>
Total	<u>\$ 23,932</u>	<u>\$ 25,266</u>



#### **Note 9: Bank Credit Facilities**

Paragon has a two-year agreement with a group of lenders that provides a \$50,000 revolving credit facility, subject to certain financial and other covenants, including a prohibition against payment of cash dividends. At December 25, 1994, the Company had borrowings of \$6,000 under this facility. These borrowings are reflected as long-term debt in the accompanying balance sheet. An additional Cdn \$10,000 credit facility, guaranteed by Paragon, is available to Paragon Trade Brands (Canada) Inc. with terms reflecting those of the U.S. credit facility, except that its duration is one year. At December 25, 1994, the Company had borrowings under the Canadian credit facility of \$5,642. These borrowings are reflected as short-term in the accompanying balance sheet. There were no borrowings against the credit facilities at December 26, 1993.

Borrowings under the revolving bank credit facilities bear interest at either (1) the Alternative Base Rate, or (2) the reserve-adjusted LIBOR (as determined by the agent bank), plus .5% per annum, at Paragon's option. The "Alternative Base Rate" will mean the highest of (a) the agent bank's prime rate, (b) the weekly average of the 90-day Federal Reserve reported certificate of deposit rate, as adjusted for reserves and assessments, plus 1% per annum and (c) the Federal Funds effective rate, plus .5% per annum. A commitment fee of .35% and .25% is payable quarterly on the unused portion of the U.S. and Canadian facilities, respectively.

In addition to the revolving credit facilities, the Company has \$30,000 in uncommitted lines of credit with various banks. Borrowings against these lines bear interest at rates that vary in a range of 35 to 50 basis points over LIBOR. At December 25, 1994, the Company had borrowings of \$2,500 against these uncommitted lines. These borrowings are reflected as short-term in the accompanying balance sheet.

The Company has determined that the carrying amount of borrowings under the credit facilities and credit lines described above approximates fair value. This is based on the frequent updating of the market based interest rates charged on these borrowings.

For the fiscal years ended December 25, 1994 and December 26, 1993, interest expense, net of amounts capitalized, was \$685 and \$692, respectively. Capitalized interest for the fiscal year ended December 25, 1994, totaled \$539. No interest was capitalized for the fiscal year ended December 26, 1993. Interest expense includes interest on borrowings, bank commitment fees, and amortization of deferred financing costs.

#### **Note 10: Financial Instruments - Foreign Currency Forward Contracts**

The Company has entered into forward contracts to hedge certain foreign currency denominated purchase commitments for periods consistent with the terms of the underlying transactions. While the forward contracts affect the Company's results of operations, they do so only in connection with the underlying transactions. Gains and losses on these contracts are deferred and offset exchange gains and losses on the transactions hedged. At December 25, 1994, the Company had \$5,982 in forward contracts outstanding with maturities of less than one year.

Based on year-end exchange rates and the various maturity dates of the foreign currency forward contracts, the Company estimates the aggregate contract value to be representative of the fair value of these financial instruments at December 25, 1994.

#### **Note 11: Related-Party Transactions**

##### *Cash Management Account*

For the period December 28, 1992 to February 1, 1993 and the fiscal year ended December 27, 1992, Weyerhaeuser managed a centralized cash account for disbursements made by the Business. The obligation for outstanding checks is reflected as checks issued but not cleared; it was Weyerhaeuser's policy to fund these checks when they cleared the bank. Weyerhaeuser also managed the collection of the accounts receivable of the Business, and cash collections were deposited in a Weyerhaeuser account. No interest charge or credit was made by Weyerhaeuser to the Business.

## Purchases

For the period December 28, 1992 to February 1, 1993 and the fiscal year ended December 27, 1992, the Business purchased materials used in the production and packaging process from Weyerhaeuser at prices approximating market value. These purchases included the following:

	February 1, 1993	December 27, 1992
Pulp.....	\$ 8,591	\$ 78,739
Corrugated shipping containers and other..	1,090	9,309
	<u>\$ 9,681</u>	<u>\$ 88,048</u>

## Allocated Charges

Weyerhaeuser incurred and allocated certain direct and indirect expenses for the benefit and support of the Business for the period December 28, 1992 to February 1, 1993 and the fiscal year ended December 27, 1992. These services included treasury, legal, finance, accounting, insurance, occupancy and other administrative costs. Management believes that these expenses were allocated on a reasonable basis. The total of these expenses included in selling, general and administrative expense in the accompanying consolidated and combined earnings statements amounted to \$292 and \$3,480 for the fiscal years ended December 26, 1993 and December 27, 1992, respectively.

Pursuant to the transaction described in Note 1, Weyerhaeuser and Paragon entered into a corporate services agreement under which Weyerhaeuser continues to provide, for the compensation set forth in the agreement, certain of the services referred to above. The agreement became effective as of the closing date of the transaction described in Note 1 for a stated initial term, the length of which depends on the type of services provided. The agreement may be terminated, in whole or in part, by Paragon at any time. The cost of such services for the period February 2, 1993 to December 26, 1993 and the fiscal year ended December 25, 1994 were not significant in relation to total selling, general and administrative expense.

## Investment by Weyerhaeuser

The following is an analysis of the investment by Weyerhaeuser:

	December 26, 1993	December 27, 1992
Cash collected by Weyerhaeuser from the Business' operations.....	\$ (57,275)	\$ (474,469)
Cash provided by Weyerhaeuser to fund the Business' operations.....	38,826	331,423
Purchases of raw materials from Weyerhaeuser.....	9,681	88,048
Costs allocated to the Business by Weyerhaeuser.....	292	3,480
Research and development expense incurred by Weyerhaeuser and charged to the Business.....	77	6,627
Income taxes (see Note 1).....	(497)	15,327
Assets purchased for or transferred to the Business by Weyerhaeuser.....	2,708	29,209
Proceeds from sales of property and equipment.....	-	(759)
Net return to Weyerhaeuser .....	(6,188)	(1,114)
Net earnings.....	4,266	21,103
Net assets of the Business acquired by Paragon .....	(106,912)	-
Net change in investment by Weyerhaeuser.....	(108,834)	19,989
Investment by Weyerhaeuser at beginning of period .....	108,834	88,845
Investment by Weyerhaeuser at end of period.....	<u>\$ -</u>	<u>\$ 108,834</u>
Average balance during the period .....	<u>\$ 9,542</u>	<u>\$ 97,188</u>



## Other Activities

For the period December 28, 1992 to February 1, 1993 and the fiscal year ended December 27, 1992, the Business, as described in Note 1, was conducted by the Personal Care Products Division of Weyerhaeuser ("PCP"). The financial statements of the Business do not include information relating to other businesses conducted by PCP, including the adult incontinent products and branded disposable diaper businesses of Weyerhaeuser. In management's opinion, the combined financial statements of the Business reflect the Business' share of the revenues and costs and of the assets and liabilities attributable to the activities in which it was engaged during the periods presented.

## Note 12: Legal Proceedings

Procter & Gamble Company ("P&G") filed a claim in the District Court for the District of Delaware that the Company's products infringe two of P&G's inner-leg gather patents. The lawsuit seeks injunctive relief, lost profit and royalty damages, treble damages and attorneys' fees and costs. The Company has denied liability under the patents and has counterclaimed for patent infringement and violation of antitrust laws by P&G. Discovery is proceeding, and trial has been set for October 1995. If P&G were to prevail on its claims, award of all or a substantial amount of the damages asserted by P&G could have a material adverse effect on the Company's financial condition and its results of operations. Based on the advice of patent counsel, the Company believes that P&G's claims are invalid.

The Company has also had discussions with Kimberly-Clark concerning the inner-leg gather feature on the Company's products. Kimberly-Clark has offered the Company a license, upon payment of a royalty, for rights under Kimberly-Clark's patents relating to the inner-leg gather feature. The Company has taken the position, based on the advice of its patent counsel, that the patent coverage claimed by Kimberly-Clark is not applicable to the Company's products. The Company has been notified that an additional patent in favor of Kimberly-Clark relating to the inner-leg gather feature may be issued from the U.S. Patent and Trademark Office. The Company is unable to evaluate any potential new patent claims because the patent file and prosecution history will not be available to the public and the Company until such time as the patent may issue.

The Company is also a party to other legal activities generally incidental to its activities. Although the final outcome of any legal proceeding or dispute is subject to a great many variables and cannot be predicted with any degree of certainty, the Company presently believes that any ultimate liability resulting from any legal proceeding or dispute, or all of them combined, will not have a material adverse effect on its financial condition or results of operations.

## Note 13: Commitments

Paragon has operating lease agreements for certain facilities that expire during the three years 1995 through 1997. Future minimum lease payments required under these noncancelable operating leases are:

1995.....	\$ 274
1996.....	\$ 43
1997.....	\$ 11

Rental expense for facilities and equipment, excluding allocated floor space charges from Weyerhaeuser (see Note 11), was \$3,070, \$1,922 and \$178 for each of the three fiscal years in the period ended December 25, 1994, respectively.

The Company has commitments to pay royalties for certain product features. Future minimum royalty payments required under these royalty agreements are:

1995.....	\$ 600
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Commitments for capital expenditures as of December 25, 1994 are:

1995.....	\$ 5,712
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Other Company commitments include purchase commitments for raw materials from Weyerhaeuser and other third-party vendors at prevailing market rates.

#### *Purchase Commitments*

Paragon entered into a wood pulp supply contract with Weyerhaeuser under which Paragon will purchase its requirements of bleached chemical wood pulp through 1997 at prices as favorable as those Weyerhaeuser charges other U.S. or Canadian diaper customers for a similar grade pulp. Either party may elect, on specified notice, to reduce the quantity of pulp purchased under the contract to no less than 80% of Paragon's requirements.

#### **Note 14: Net Earnings Per Common Share**

Net earnings per common share (1993 is on a pro forma basis - see Note 15) are based on the average number of common and common equivalent shares outstanding. For the fiscal year ended December 26, 1993, it assumes that the shares were issued and outstanding for the entire year.

<b>Primary</b>	<b>December 25, 1994</b>	<b>December 26, 1993 (Unaudited)</b>
Net earnings (1993 on a pro forma basis - Note 15) .....	\$ 24,994	\$ 45,627
Average common and common equivalent shares outstanding (000's)....	11,594	11,500
Net earnings per common share (1993 on a pro forma basis - Note 15) .....	\$ 2.16	\$ 3.97
<b>Fully Diluted</b>		
Net earnings (1993 on a pro forma basis - Note 15) .....	\$ 24,994	\$ 45,627
Average common and common equivalent shares outstanding (000's)....	11,689	11,573
Net earnings per common share fully diluted (1993 on a pro forma basis - Note 15) .....	\$ 2.14	\$ 3.94

This calculation is submitted in accordance with Regulation S-K item 601(b)(11), although not required by footnote 2 to paragraph 14 of APB Opinion No. 15, because it results in dilution of less than 3%.

**Note 15: Unaudited Pro Forma Consolidated Earnings Statement**

	Fiscal Year 1993		
	Historical	Adjustments	Pro Forma
		(Unaudited)	
Sales, net of discounts and allowances .....	\$ 562,949	\$ -	\$ 562,949
Cost of sales .....	457,613	-	457,613
Gross profit .....	105,336	-	105,336
Selling, general and administrative expense .....	50,026	108 (1)	50,450
		316 (2)	
Research and development expense .....	6,015	-	6,015
Operating profit .....	49,295	(424)	48,871
Interest expense .....	288	53 (3)	341
Other expense, net.....	623	-	623
Earnings before income taxes .....	48,384	(477)	47,907
Provision for (benefit from) income taxes:			
Effect of change in tax law .....	(15,588)	-	(15,588)
Other current and deferred taxes.	18,044	(176) (4)	17,868
	2,456	(176)	2,280
Net earnings.....	\$ 45,928	\$ (301)	\$ 45,627
Net earnings per common share (5) .			\$ 3.97

- (1) To reflect expected insurance and other costs to Paragon in excess of the historical charges by Weyerhaeuser to the Business for the period December 28, 1992 to February 1, 1993.
- (2) To reflect the expected costs of corporate, administrative and public financial reporting activities not previously undertaken by the Business and the costs of implementing Paragon's employee retirement benefits program for the period December 28, 1992 to February 1, 1993.
- (3) To reflect (i) amortization of deferred financing costs related to the bank credit facility, (ii) interest expense, at an assumed rate equal to the average LIBOR rate for the relevant period plus 1.75%, (iii) commitment fees of .5% per annum on the unused portion of the bank credit facility, and (iv) interest income at an assumed rate equal to the average LIBOR rate for the period.
- (4) To provide for the federal and state tax effects of the pro forma adjustments described in footnotes (1), (2) and (3) above.
- (5) Net earnings per common share are computed assuming 11,500,000 shares of common stock are outstanding for the entire period presented.

**Note 16: Quarterly Results of Operations (Unaudited)****Fiscal Year Ended December 25, 1994**

	First	Second	Third	Fourth
Net sales.....	\$ 143,216	\$ 146,030	\$ 149,368	\$ 140,004
Gross profit.....	29,920	29,445	29,568	19,848
Net earnings .....	7,882	7,548	7,707	1,857
Net earnings per share of common stock	\$ .68	\$ .65	\$ .66	\$ .16
Price Range:				
High.....	\$ 36.38	\$ 34.13	\$ 30.13	\$ 28.25
Low .....	\$ 28.38	\$ 27.25	\$ 21.88	\$ 11.63

**Fiscal Year Ended December 26, 1993**

	First	Second	Third	Fourth
Net sales.....	\$ 141,864	\$ 138,452	\$ 144,855	\$ 137,778
Gross profit.....	25,004	25,420	29,871	25,041
Net earnings .....	7,530	6,625	24,632	7,141
Net pro forma earnings (Note 15).....	7,229	6,625	24,632 <sup>(1)</sup>	7,141
Net pro forma earnings per share of common stock (Note 15).....	\$ .63	\$ .58	\$ 2.14	\$ .62
Price Range:				
High.....	\$ 29.75	\$ 31.00	\$ 24.00	\$ 31.38
Low .....	\$ 20.50	\$ 15.00	\$ 16.25	\$ 23.25

**Note 17: Subsequent Event - Plant Closure and Workforce Reduction**

On January 24, 1995, the Company announced a restructuring and cost reduction program. The Company is closing its diaper manufacturing facility in La Puente, California and has reduced its corporate staff by approximately 20%. The restructuring program will result in a first quarter 1995 pre-tax restructuring and other non-recurring charges of between \$13,000 and \$16,000, excluding any gains on disposal of assets. Included in the charge will be costs of planned asset dispositions, employee severance, and other related plant-closure costs.

**Note 18: Subsequent Event - Investment in Mexican Diaper Manufacturer**

On February 23, 1995, the Company announced that it had signed a letter of intent to acquire a 49% interest in a disposable diaper producer in Mexico (MABESA), and to jointly develop a new manufacturing facility in Northern Mexico to serve export markets. Under the terms of the letter of intent, the Company will acquire the 49% interest for \$50,000 cash plus additional consideration based on future financial results of MABESA. In addition, the Company will assist in the financing of the Northern Mexico export facility.

<sup>1</sup> Reflects the benefit to income of \$15,588 relating to deferred taxes due to enactment of the Omnibus Budget Reconciliation Act of 1993 (see Notes 1 and 3)

# SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

## PARAGON TRADE BRANDS, INC. AND SUBSIDIARIES AND

## PRIVATE LABEL DIAPER BUSINESS OF WEYERHAEUSER COMPANY

For the three years in the period ended December 25, 1994

(Dollar amounts in thousands)

Description	Balance at Beginning of Period	Charged to Earnings	Deductions from Reserve	Balance at End of Period
Reserve deducted from related assets:				
Doubtful accounts - accounts receivable				
1994.....	\$ 5,357	\$ 3,067	\$ (2,539)	\$ 5,885
1993.....	\$ 3,334	\$ 2,677	\$ (654)	\$ 5,357
1992.....	\$ 1,592	\$ 2,187	\$ (445)	\$ 3,334
Excess and obsolete items - inventories				
1994.....	\$ 4,476	\$ 5,602	\$ (4,248)	\$ 5,830
1993.....	\$ 2,997	\$ 5,567	\$ (4,088)	\$ 4,476
1992.....	\$ 2,561	\$ 4,465	\$ (4,029)	\$ 2,997

**ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON  
ACCOUNTING AND FINANCIAL DISCLOSURE**

None

**PART III**

**ITEM 10: DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

The information as to the Company's directors appearing under the caption "Election of Directors and Director Information" in the Proxy Statement relating to the Annual Meeting of Stockholders to be held May 9, 1995 is incorporated by reference into this Report. The information as to the Company's executive officers is included in Part I hereof under the caption "Executive Officers" in reliance upon General Instruction G to Form 10-K and Instruction 3 to Item 401(b) of Regulation S-K.

**ITEM 11: EXECUTIVE COMPENSATION**

The information set forth under the caption "Director Compensation" in the Proxy Statement relating to the Annual Meeting of Stockholders to be held May 9, 1995, and the information under the caption "Executive Compensation" in such Proxy Statement relating to executive officers' compensation is incorporated by reference into this Report.

**ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The information set forth under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement relating to the Annual Meeting of Stockholders to be held on May 9, 1995 is incorporated by reference into this Report.

**ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Not applicable.

**PART IV**

**ITEM 14: EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K**

a. Financial Statements and Financial Statement Schedules

Report of Independent Public Accountants

Consolidated Balance Sheets as of December 25, 1994 and December 26, 1993

Consolidated and Combined Earnings Statements for the three years in the period ended December 25, 1994

Consolidated Statements of Changes in Stockholders' Equity and Combined Statement of Changes in Investment by Weyerhaeuser Company for the three years in the period ended December 25, 1994

Consolidated and Combined Statements of Cash Flows for the three years in the period ended December 25, 1994

Notes to Financial Statements

Schedule II: Valuation and Qualifying Accounts

b. Reports on Form 8-K

Report on Form 8-K dated December 14, 1994

c. Exhibits

<u>Exhibit</u>	<u>Description</u>
3.1	Certificate of Incorporation of Paragon Trade Brands, Inc.
3.2	By-Laws of Paragon Trade Brands, Inc., as amended through September 1, 1993 <sup>1</sup>
4.1	Certificate of Incorporation of Paragon Trade Brands, Inc. (see Exhibit 3.1).
10.1	Asset Transfer Agreement, dated as of January 26, 1993, by and between Weyerhaeuser and Paragon <sup>1</sup>
10.2	Intellectual Property Agreement, dated as of February 2, 1993, between Weyerhaeuser and Paragon <sup>1</sup>
10.3	License, dated as of February 2, 1993, between Weyerhaeuser and Paragon <sup>1</sup>
10.4	Sublicense, dated as of February 2, 1993, between Weyerhaeuser and Paragon <sup>1</sup>
10.5	Technology Agreement, dated as of October 15, 1987, by and between Weyerhaeuser and Johnson and Johnson, as amended <sup>1</sup>
10.6	Critical Supply Agreement, dated as of February 2, 1993, between Weyerhaeuser and Paragon <sup>1</sup>
10.7	Agreement of Lease, dated as of May 12, 1988, by and between Weyerhaeuser and Corporate Property Investors, Greenriver Corporate Park <sup>1</sup>
10.8*	Stock Option Plan for Non-Employee Directors <sup>1</sup>
10.9*	Annual Incentive Compensation Plan <sup>1</sup>
10.10*	1993 Long-Term Incentive Compensation Plan <sup>1</sup>
10.11*	Paragon Profit Sharing and Savings Plan <sup>1</sup>
10.12*	Employment Agreement, dated as of February 2, 1993, between Paragon and Bobby V. Abraham <sup>1</sup>
10.13*	Employment Agreement, dated as of February 2, 1993, between Paragon and David W. Cole <sup>1</sup>
10.14*	1995 Incentive Compensation Plan
10.15	Amended and Restated Credit Agreement, dated as of November 5, 1993 <sup>1</sup>
10.16	Revolving Canadian Credit Facility and Parent Guarantee <sup>2</sup>
10.17	Amendment No. 1 to Amended and Restated Credit Agreement, dated as of November 1, 1994
10.18	Indemnification Agreements, dated as of February 2, 1993, between Weyerhaeuser and Bobby V. Abraham and Gary M. Amts <sup>1</sup>
10.19	Rights Agreement dated December 14, 1994 between Paragon Trade Brands, Inc. and Chemical Bank, as Rights Agent <sup>3</sup>
10.20	Letter of Intent, dated as of February 23, 1995 between Paragon Trade Brands, Inc. and Lic. Gilberto Marin Quintero <sup>4</sup>
11.	Computation of Per Share Earnings (see Note 14 of Notes to Financial Statements)
21.1	Subsidiaries of the Company
23.1	Consent of Arthur Andersen LLP

\*Management contract or compensatory plan or arrangement.

<sup>1</sup>Incorporated by reference from Paragon Trade Brands, Inc.'s Annual Report on Form 10-K for the fiscal year ended December 26, 1993.

<sup>2</sup>Incorporated by reference from Paragon Trade Brands, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 26, 1994.

<sup>3</sup>Incorporated by reference from Paragon Trade Brands, Inc.'s Current Report on Form 8-K, dated as of December 14, 1994.

<sup>4</sup>Incorporated by reference from Paragon Trade Brands, Inc.'s Current Report on Form 8-K, dated as of February 23, 1995.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 15th day of March, 1995.

PARAGON TRADE BRANDS, INC.

By: /s/ BOBBY V. ABRAHAM  
Bobby V. Abraham  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on this 15th day of March, 1995.

/s/ BOBBY V. ABRAHAM  
Bobby V. Abraham  
Chairman and Chief Executive Officer

/s/ ROBERT C. HIRSCHY  
Robert C. Hirschey  
Acting Chief Financial Officer  
(Principal Financial Officer)

/s/ GARY M. ARNTS  
Gary M. Arnts  
Vice President and Controller  
(Principal Accounting Officer)

/s/ THOMAS B. BOKLUND  
Thomas B. Boklund  
Director

/s/ GENE D. HOFFMAN  
Gene D. Hoffman  
Director

/s/ WILLIAM I. SABEL  
William I. Savel  
Director

/s/ ROBERT L. SCHUYLER  
Robert L. Schuyler  
Director



# Directors, Officers and Corporate Information

## Board of Directors

Bobby V. Abraham  
Chairman and Chief Executive Officer  
Paragon Trade Brands, Inc.

Thomas B. Boklund  
Director  
Chief Executive Officer  
Oregon Steel Mills

Gene D. Hoffman  
Director  
President and Chief Executive Officer  
Corporate Strategies International

William I. Savel  
Director  
President and Chief Executive Officer  
Alta Dena Dairy

Robert L. Schuyler  
Director  
President  
Nisqually Partners

## Officers

Bobby V. Abraham  
Chairman and Chief Executive Officer

David W. Cole  
President and Chief Operating Officer

Robert C. Hirschey  
Acting Chief Financial Officer

Susan Barley  
Vice President, General Counsel and Secretary

## Shareholder Information

Corporate Headquarters  
Paragon Trade Brands, Inc.  
33325 8th Avenue South  
Federal Way, Washington 98003  
Phone: 206-815-7000

## Annual Meeting of Shareholders

The Annual Meeting of Shareholders will be held at 8:00 a.m., Tuesday, May 9, 1995 at the Company's Corporate Headquarters in Federal Way, Washington.

Detailed information regarding the meeting is contained in the Notice of Annual Meeting and Proxy Statement to be sent to each shareholder of record as of the close of business on March 17, 1995.

## Transfer Agent

Chemical Bank  
P.O. Box 24935  
Church Street Station  
New York, New York 10249  
800-647-4273

## Stock Listing

Paragon Trade Brands, Inc. Common Stock is traded on the New York Stock Exchange under the symbol PTB.

Paragon Trade Brands  
33325 8th Avenue South  
Federal Way  
Washington 98003