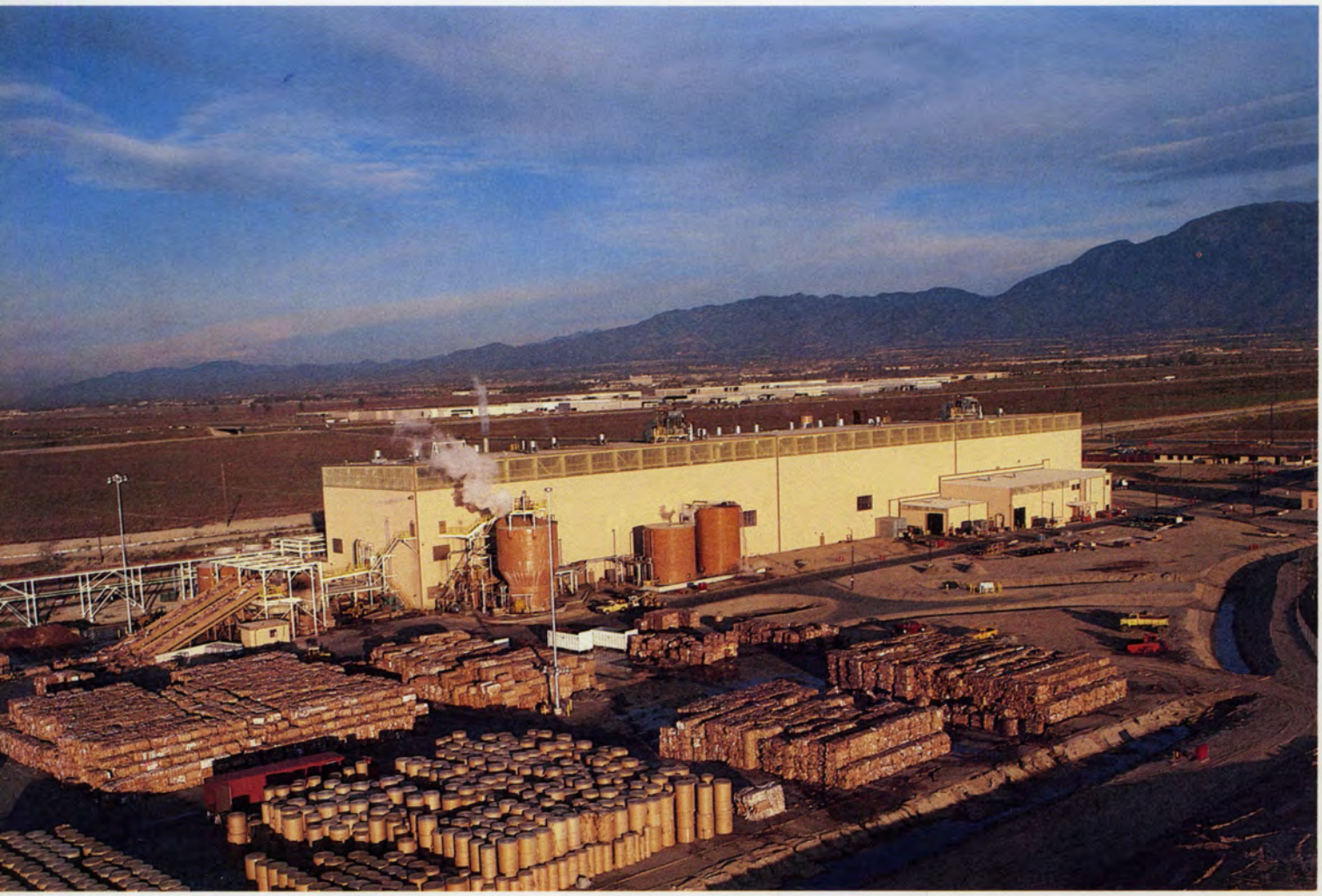
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TEMPLE-INLAND



1985 Annual Report

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Production began in October at our new Ontario, California mill, designed to produce about 175,000 tons of linerboard annually.

Contents

Financial Highlights 1
Company Profile 2
Letter to Shareholders 3
Review of Operations 7
Facilities Map and Listing 22
Financial Review 23
Consolidated Financial Statements 31
Notes to Consolidated Financial Statements 36
Management's Report on Financial Statements and Independent Auditor's Report 42
Directors/Officers 43
Shareholder Information and Dividend Reinvestment Plan . . . . . *Inside Back Cover*

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Financial Highlights
(in millions except per share data)

	1985	1984	Percent Increase (Decrease)
Net Sales	$1,243.1	$1,262.9	(2)%
Operating Income	$ 111.6	$ 162.6	(31)%
Net Income	$ 85.1	$ 102.7	(17)%
Shareholders' Equity	$ 863.7	$ 792.7	9 %
Earnings Per Share	$ 3.50	$ 4.24	(17)%
Book Value Per Share	$ 35.71	$ 32.86	9 %
Dividends Per Share	$ .64	$ .50	28 %

Selected Business Segment Data
(in millions)

		1985	1984	Percent Increase (Decrease)
Net Sales				
	Container and containerboard	$684.2	$665.3	3 %
	Pulp and paperboard	$256.7	$284.5	(10)%
	Building products	$268.0	$295.3	(9)%
Operating Income				
	Container and containerboard	$ 49.7	$ 74.8	(34)%
	Pulp and paperboard	$ 19.8	$ 46.8	(58)%
	Building products	$ 22.5	$ 40.9	(45)%
	Financial services*	$ 25.3	$ 15.2	66 %

*Pre-tax earnings of unconsolidated financial services subsidiaries.

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Our ongoing expansion program will give us a lower cost structure, expanded product lines and additional capacity. A lower cost structure is more important than volume in achieving maximum profitability for our Shareholders.

About Our Company

Temple-Inland is a forest resource company with major interests in paper, packaging, building products, mortgage banking and insurance.

It is a holding company and functions through subsidiaries including Inland Container Corporation, Temple-Eastex Incorporated, Lumbermen's Investment Corporation, and Great American Reserve Insurance Company. In 1985, we added National Fidelity Life Insurance Company to our insurance group.

Forest resources include ownership of 1.1 million acres of timberland in east Texas and 50% ownership of Georgia Kraft Company which owns over one million acres in Georgia and Alabama.

We operate eight paper mills including three owned by Georgia Kraft. A large volume of the paperboard manufactured is converted to finished products by 29 Company-owned box plants. We also manufacture a wide range of building products including lumber, plywood, particleboard, gypsum wallboard, fiberboard, oriented strandboard, rigid foam sheathing, and decorative wall paneling.

The Financial Services Group includes insurance and mortgage banking activities, as well as land development. ■

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To Our Shareholders

Dear Shareholder:

1985 was our second year as an independent company. Despite substantial gains realized by our financial services group, deteriorating conditions in our paper and building products markets caused earnings per share to drop to $3.50, down 17% from last year's level. Revenues totaled $1.24 billion in 1985.

Most of our paper and building products can be categorized as commodity items on a worldwide basis, with no single manufacturer dominating any of these product categories. Traditionally, most U.S. companies have been low-cost producers. Capacity in the U.S. not only provided for domestic needs, but product was exported to meet worldwide demand.

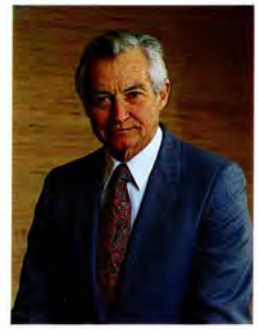
The strengthening of the U.S. dollar over the last four years changed this pattern. As U.S. products became more expensive, foreign producers added to their own capacity. A high level of imports from the U.S. was no longer necessary, particularly of paper products. Therefore, domestic markets were forced to absorb this additional capacity that previously had been exported, resulting in a substantial decline in selling prices. Coupled with slightly rising costs, this decline dramatically reduced profit margins.

Last year's bad news, however, should be the foundation for improved results over the next few years. Demand for our products continues to grow and announced industry capacity increases are limited.

Although our current level of profitability will no doubt improve as markets recover, we are firmly committed to being an even lower-cost producer.

In late October, we began start-up operations of our new linerboard mill in Ontario, California, and it should reach rated capacity during the first quarter of 1986. This state-of-the-art mill with an impressive level of productivity is the largest recycle linerboard mill in the U.S. The mill came on stream on schedule and below budget.

Most of the other six unbleached mills we operate, including those of our 50%-owned affiliate Georgia Kraft Company,



Clinton G. Ames Jr.
Executive Vice President
Temple-Inland Inc.



Joe C. Denman Jr.
Executive Vice President
Temple-Inland Inc.



W. Wayne McDonald
Executive Vice President
Temple-Inland Inc.

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Arthur Temple
Chairman of the Board

have recently completed or have profit improvement programs in process. These programs are designed to allow the mills to reduce their unit cost, and include upgrading of virtually every aspect of their operations.

We also have a major cost-reduction program underway at our bleached paperboard mill in Evadale, Texas. Our new $45 million wood-fired boiler will utilize a convenient lower-cost energy source—wood debris from our forest operations.

Other programs have been instituted to reduce fiber cost and increase productivity. These modifications will also allow us to manufacture a wider variety of products for consumer packaging, increasing our ability to respond to new opportunities.

We own over a million acres of timberlands in Texas, and Georgia Kraft owns another million acres in Georgia and Alabama. To maximize the return on trees grown on our lands, we manufacture lumber and other building products in addition to paper. In order to save freight costs for wood chips and residues, we have located sawmills next to our paper mills.

The number of harvestable trees on our land in Texas will expand dramatically in the next five years; therefore, we will be adding a modern forest converting complex in the Evadale area. Bark and tops of trees will be used for fuel, the prime center portion will be converted to lumber, and the remainder will be chipped for fiber for our paper mill.

In the first quarter, we will complete the modernization and expansion of our oriented strandboard plant (OSB) in Claremont, New Hampshire, and in the third quarter, our new gypsum wallboard plant in Fletcher, Oklahoma is scheduled to come on stream. The OSB plant is ideally located to serve the large northeastern markets, particularly New England, and gypsum product demand continues to create favorable market conditions throughout the South, the region covered by our two gypsum manufacturing facilities.

In Financial Services, pretax earnings of $25 million were up over 50% from last year, and we expect another record year in 1986.

We continue to believe that Financial Services not only provides a stream of more predictable earnings, but also is another growth

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area that does not compete with our traditional businesses for capital. This mix is unique and, to date, very rewarding.

Last year was a significant milestone for this group. With the acquisition of National Fidelity Life Insurance Company of Kansas City and the internal growth of Great American Reserve Insurance Company, insurance operations have become a more meaningful part of this group along with mortgage banking and real estate activities.

Because of the growth of Financial Services, it has become a more significant part of our company. Therefore, more financial information on this group has been provided in this report. We hope you find this data useful.

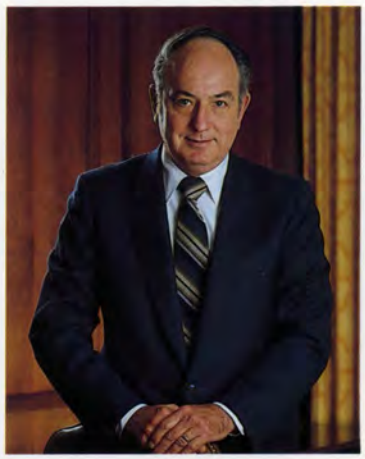
In February of this year Tom Sumner, our treasurer, retired and Richard Warner was elected to take his place. Tom joined our company in 1972, when we acquired AFCO Industries, and has been an integral part of our financial management, holding several positions with our company. We appreciate his faithful service and wish him well in retirement.

Your Board of Directors has increased the quarterly cash dividend to $.18 per share beginning with the dividend payable in March. This is a 12.5% increase from last year's level and is the second consecutive year in which the dividend has been increased.

We continue to believe that one of the best opportunities to serve our shareholders is to reduce our unit cost, increasing the long-term competitive strength of the company. Throughout this report you will read about our expansion and modernization programs, most of which have reduction of cost as their purpose.

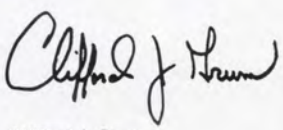
One major element of cost containment achievement has been the productivity of our 10,000 employees without whose efforts our level of profitability in 1985 would not have been possible. Their continued efforts will be the foundation for our future strength.

1986 should be a very challenging year. Depressed selling prices are continuing into the first quarter. However, with only limited new industry capacity currently under construction, our markets should begin to recover this year, and our long-term outlook is more promising than at any time in our history. ■

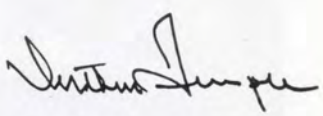


Clifford J. Grum
President & Chief Executive Officer

February 14, 1986



Clifford J. Grum
President & Chief Executive Officer



Arthur Temple
Chairman of the Board

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A forester checks tree growth on one of our 425,000 acres of plantation stands in east Texas.

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Review of Operations
Timber and Timberlands

Temple-Inland is a resource-driven company and that resource is our timber; 1.1 million acres of east Texas timberland and half ownership of a million acres of timberland in Georgia and Alabama.

A fundamental objective of our timberland operations is to manage our woodlands for maximum profitability by growing more trees faster to supply fiber for our paper and wood products operations.

A forest can yield up to twice as much fiber if it is professionally managed. We use the latest forest management techniques to ensure maximum productivity from our timberlands. Computer systems have been installed which inventory tracts of land by location, acreage, timber characteristics and volume, and then rank those tracts for harvesting based on present value of growth rates. In addition, the system analyzes the trees on tracts scheduled for harvest and determines the most profitable use for each tree, either for lumber, plywood or pulp. These computer models have helped produce the best timber recovery factors in our company's history.

In 1985, our lands in Texas provided 90% of the saw-timber requirements for the Temple-Eastex lumber and plywood operations, and 70% of the pine pulpwood requirements of the Evadale paperboard mill. We harvested and replanted approximately 25,000 acres, bringing our plantation total to about 425,000 acres.

At Georgia Kraft Company, about 20% of wood requirements was supplied from company lands, with the remainder purchased from private landowners. About 35,000 acres were harvested and our continuing replanting program has brought the plantation total to 540,000 acres.

As another means of reducing our costs, we began a whole-tree chipping operation in Texas to supply fuel for the new wood-fired boiler at the Evadale paper mill. The material being used is debris from our regular logging operations. Currently, four contractor-operated units are employed which will produce some 250,000 tons of waste fiber annually. This waste material, which was formerly a



▼ *Computer systems have helped to greatly improve yields from our timberlands.*

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Residue from our logging operations is used for fuel for our boilers.

liability that had to be piled and burned as part of our reforestation program, is now an asset. This new system provides a double bonus by supplying a low-priced fuel while reducing the cost of major forest management programs.

In 1985, a southern pine beetle outbreak hit parts of Texas. Before we were able to control last year's infestation on our lands, it affected scattered tracts totaling about 6,000 acres of our timberland. By prompt harvesting of the attacked trees, we were able to salvage about two-thirds of the trees and obtain some value from them. The remainder was used for fuel. The overall impact on the long-term productivity of the forests was slight. However, the cost of destroying the beetle was substantial, especially considering the loss of value of the trees harvested.

Our forest policies are designed to allow tree growing to harmonize with other parts of the forest family. This includes leaving irregular shapes of regeneration areas to maximize "edge effect" so beneficial to wildlife, buffer strips along streams, roadside protection strips, maintenance of hardwood stands on hardwood sites, and strong support of wildlife projects.

In a guide published by the Texas Forestry Association to direct the general public to open timberlands in Texas, we are listed as the largest contributor of acreage. We believe in being good neighbors and in working to prove that industry and the environment can live together in harmony. ■

Container and Containerboard

Our Container and Containerboard segment—Inland Container Corporation—is virtually a totally integrated packaging company which produces containerboard (linerboard and corrugating medium) and converts that paper into corrugated shipping containers which are sold throughout the United States. Virtually all of this segment's revenue is derived from selling these boxes.

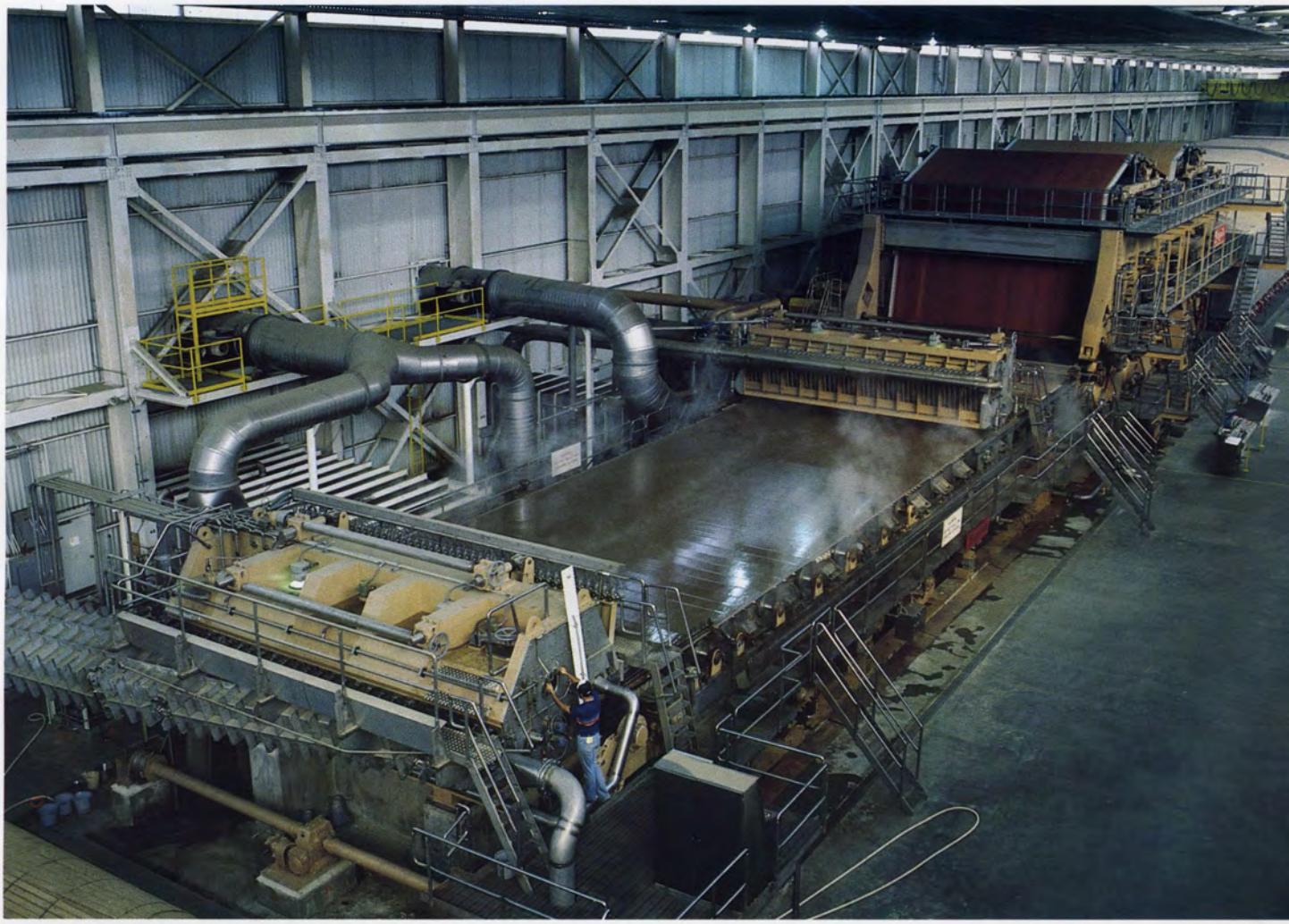
We have approximately 6% of the domestic corrugated box market, making us about the fifth largest producer in the country. The top six companies have about 40% of the domestic box market.

In 1985, Container and Containerboard had operating earnings of $49.7 million, down from $74.8

Container and Containerboard
(dollars in thousands)

	1985	1984	% Change
Sales	$ 684,200	$ 665,300	+3%
Operating Income	$ 49,700	$ 74,800	−34%
Tons Corrugated Boxes Sold	1,147,000	1,063,000	+8%
Tons Mill Production	1,294,000	1,252,000	+3%

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The design of the Ontario mill makes it one of the most productive per man hour in the country.

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We continue to install state-of-the-art box-making equipment, such as this Bobst die cutter at our Chicago plant.

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million in 1984. Still, it was the third best year in Inland's 60-year history.

In anticipation of the additional linerboard from our new mill in Ontario, California, a major effort was aimed at increasing volume through our box plants. Inland's corrugated box shipments increased 8% over 1984, to a record 1,147,000 tons, while industry shipments were down 1.3%.

Our containerboard mills, including half of Georgia Kraft production, produced 1,294,000 tons, up 42,000 tons from last year.

The primary reason for lower earnings in 1985 was the lower selling price of corrugated boxes. Although Inland maintained full production at its paper mills, operating rates for the industry's mills were down, indicating that some competitors took downtime. This condition produced a very volatile market which deteriorated throughout the year.

In 1985, the export of U.S. manufactured linerboard dropped about 15%, or 300,000 tons from 1984. Although Inland has not been a major exporter of board, when industry exports drop, that production backs up into the domestic market, causing inventories to swell and prices to drop.

One of the major reasons we were able to maintain relative profitability was our cost containment programs, both at our mills and throughout our box plant system. Our continuation of upgrading box plants allowed us to increase productivity and move into more higher value-added products.

During 1985, we took structural steps to consolidate our organization and concentrate our activities in the corrugated box market. We sold Eastex Packaging Incorporated and its three folding carton plants; we sold our 40% interest in a company located in the Canary Islands; and we sold our only corrugated sheet plant. All of these assets were sold because they did not fit into Inland's strategy of total integration of mill and converting plants.

New box plants were added in Edison, New Jersey and Ontario, California, bringing the total number of box plants in the system to 29. Demand for corrugated boxes exceeded our existing box plant capacity in these geographic areas.



Our corrugated shipments in 1985 totaled 1,147,000 tons, up 8% from 1984.

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Our mills produced 1,294,000 tons of containerboard in 1985, and our new mill in California will increase this by 15%.

Pulp & Paperboard
(dollars in thousands)

	1985	1984	% Change
Sales	$256,700	$284,500	– 10%
Operating Income	$ 19,800	$ 46,800	– 58%
Tons Sold			
Paperboard	452,000	464,000	– 3%
Pulp	83,000	92,000	– 10%

The new linerboard mill in Ontario began trial production runs in late October and results to date have been encouraging. Using old corrugated boxes as raw material, this mill is designed to produce 175,000 tons of linerboard annually, increasing our total containerboard production by about 15%, to 1.4 million tons.

California continues to be a high growth area for corrugated box demand, and this mill gives us low-cost tonnage to serve this market. We currently have four corrugated box plants in California.

The mill also includes a cogeneration facility which is generating about 37 megawatts of electricity, with half being used by the mill and the remainder sold to an electric utility. The cogeneration plant also is producing the steam requirements for the mill.

With growth in demand for linerboard expected to outpace production growth for the next several years, the output of this mill and the expansion of box production should prove beneficial in future years. ■

Pulp & Paperboard

Our Pulp and Paperboard segment is part of our Temple-Eastex subsidiary and consists of a bleached paperboard mill in Evadale, Texas. This specialty mill is the sixth largest producer of bleached paperboard in the country. With its four paper machines, it is geared toward shorter runs of higher profit-margin grades and has a leading position in four specific market areas: cup stock, plate stock, file folders and bleached linerboard.

1985 was a difficult year for the bleached paperboard industry and the Evadale mill. Pretax income totaled $19.8 million, down from $46.8 million last year.

Production dropped about 5% from 1984, to a total of 535,000 tons. This production was about 13% of the bleached paperboard industry total.

Unlike the containerboard industry where little new capacity came on stream last year, a large amount of new bleached paperboard tonnage reached the market in 1985. More new bleached paperboard capacity is scheduled for completion in 1986.

The bleached paperboard industry faces many of the same

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Using forest residues to fuel this new boiler at our Evadale mill will reduce energy costs substantially.

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The Evadale mill produces paperboard for a wide assortment of products.

Building Products*
(in thousands)

	1985	1984	% Change
Manufactured Products			
Sales	$226,900	$226,600	—
Operating Income	$ 23,500	$ 40,200	−42%
Retail Distribution			
Sales	$ 41,100	$ 68,700	−40%
Operating Income	$ (1,000)	$ 700	−243%

*Excludes those operations of Georgia Kraft which are accounted for by the equity method of accounting.

problems faced by linerboard producers, including stiff competition from domestic producers and reduced export opportunities.

Because of this excess capacity, major price improvement during 1986 may be difficult. This environment has reemphasized our need to reduce unit cost. A major step was begun in late 1984 when construction began on the new power boiler and turbine generator which will come on stream early in 1986. This new system will use alternate fuels including wood waste and rice hulls rather than expensive fossil fuels. Energy cost, which until recently was the most rapidly escalating cost element at the mill, will be reduced in 1986 by 20% from 1985.

With four machines, the Evadale mill has the ability to react quickly to changes in the marketplace. Our capital expenditure programs are designed to enable us to take advantage of this flexibility and capitalize on opportunities. ■

Building Products

In 1985, despite housing starts totaling a respectable 1.7 million units, pretax earnings in our building products segment were $22.5 million, down from $40.9 million in 1984.

Temple-Inland building products are produced by Temple-Eastex and by Georgia Kraft. Earnings from Georgia Kraft's wood products group are accounted for as a cost reduction for the fiber used by its paper mills.

Georgia Kraft produces lumber products and plywood. Temple-Eastex building products include lumber, plywood, particleboard, hardboard siding, fiberboard sheathing, oriented strandboard (OSB), rigid foam, gypsum wallboard, and decorative wall paneling. This wide diversification of products helps protect this segment from having even greater cyclical variations.

While we have less than 10% of the market for any of these products nationwide, we are a more important factor in our geographic area.

Our emphasis in 1985 has been on market diversification, adding value to our products, expansion in certain product lines, and continued attention to cost.

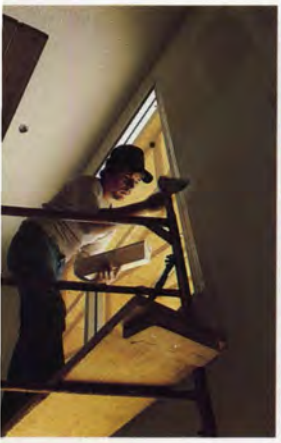
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Improved technology allows us to use logs of any length and diameter throughout our system.

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(Left) Gypsum demand continued strong in 1985. (Right) Quality is important, even in commodity items. The magenta coloring on our studs allows builders to distinguish our product from that of our competitors.

With the exception of gypsum wallboard and fiber products, prices for building products during the past year were disappointing. Excess supply led to low prices for lumber and studs. The supply situation was exacerbated by low-priced Canadian imports coming into the U.S. at record levels. These imports represent about one-third of total U.S. consumption. In addition, the problem was compounded by the southern pine beetle. Timber harvested from our land to eliminate additional beetle damage had only limited value in its conversion to lumber. Both yield per tree and grade of product were affected.

Particleboard underlayment is a commodity item used in residential construction. This product was particularly depressed in 1985, due in part to increased usage of oriented strandboard as a substitute. In recent years, we have developed new particleboard products, primarily for furniture and cabinets. In addition, we pioneered the development of a flooring material for the mobile home industry which utilizes a formaldehyde-free resin. These products which serve less volatile markets accounted for about 25% of our particleboard sales in 1985 and should be over 50% in 1986.

Production of structural panel products—plywood and oriented strandboard—exceeded demand, pushing prices downward. Since growth in demand for many of the commodity items are projected to increase only moderately, we are changing our product mix to increase our capacity for specialty items with improved growth possibilities.

Markets for fiberboard products improved last year and our plant ran at near capacity. New technology is allowing us to produce a much broader line of siding and additional products for roofing systems. The market acceptance of these value-added products has continued to grow.

Although gypsum earnings were down slightly from last year, it remained the largest contributor to building products' earnings. We set new records for unit production and are now receiving the benefits of past cost containment programs.

The market for gypsum products was especially strong in the southeast. When our new gypsum wallboard plant in Fletcher, Okla-

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We're building a new gypsum wallboard plant next to our quarry in Fletcher, Oklahoma.

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▼ *(Top) Our computerized log-sorting ability at Pineland allows us to utilize timber for its highest value and best use. (Bottom) Our range of building products is one of the widest in the industry.*

Financial Services
(in thousands)

	1985	1984	% Change
Operating Income	$ 25,300	$ 15,200	+ 66%
Mortgage Loan Portfolio	$ 2,928,000	$ 2,665,000	+ 10%
New Loan Production	$ 358,000	$ 362,000	– 1%
Insurance in Force	$ 8,796,000	$ 4,162,000	+ 111%
Premium Volume	$ 138,000	$ 84,900	+ 63%

homa comes on stream during the third quarter, we will double our productive capacity and also be more competitive in the market place. Located at our gypsum quarry, the new plant will give us substantial freight-savings in serving the Texas market. We will also be able to allocate more of the production from our existing West Memphis plant to southeastern markets.

The major modernization and expansion program at our OSB plant in Claremont, New Hampshire, hampered our operations at this plant in 1985. Despite these obstacles, the improved market for this product in the New England area allowed us to operate at near break-even. The modernization and expansion will be completed by the end of the first quarter. Results to date indicate that we already produce a better quality product with a lower cost structure.

The recent decline in interest rates will allow housing to be more affordable for many new homeowners, and our upgraded manufacturing operations will allow us to be more competitive in serving this area of opportunity. Virtually all of our operations are in the South, and while housing starts in Texas were down, the region continues to be an area of projected dynamic growth. As a producer with low-cost facilities located near our markets, we should be able to record significant long-term growth. This continued development of higher margin products will add to our growth potential. ■

Financial Services

We began our mortgage banking business in 1954 and its impressive growth through the years provided the capabilities to expand into other areas of financial services. The acquisitions of Great American Reserve Insurance Company (GARCO) in December, 1982, and National Fidelity Life Insurance Company (NFL) in July, 1985, have made Temple Inland Financial Services a significant partner in contribution to earnings along with our manufacturing operations.

To help you better understand Temple Inland Financial Services, we have included expanded financial data on the group in the Financial Review section of this report.

Temple-Inland Financial Services had pre-tax earnings in 1985 of

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We are a "supermarket" for real estate needs. This family could live on land developed by our company, have a house built with our building products, have a loan from our mortgage banking company, and have life, health and casualty insurance from our insurance companies.

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We doubled the size of our career-agent sales force at Great American Reserve Insurance Company in 1985.

$25.3 million, up 66% from $15.2 million in 1984. All divisions within the group—insurance, mortgage banking, and land development—had improved earnings over the prior year.

Lumbermen's Investment Corporation (LIC), our mortgage banking company based in Austin, Texas, has 16 offices in six states. LIC now services over $2.9 billion in mortgage loans, up from about $2.7 billion in 1984.

Mortgage banking pre-tax income for 1985 of $6.6 million was up 22% from $5.4 million in 1984. New residential loan originations of $317 million in 1985 were down from $353 million in 1984. Additionally, $41 million of commercial loans were produced in 1985, up from $9 million in 1984.

Interest rates showed substantial declines in 1985, and the housing market was active. However, loan-servicing portfolio growth was restricted somewhat by increased competition for new loans created by new entrants into this lending field, such as large homebuilders developing their own lending operations, and further movement of commercial banks and saving and loans into mortgage financing.

Our land development and property division, Temple-Inland Properties, engages in every aspect of residential and commercial land development with the exception of actual construction. The division earned $8 million in 1985, up from $5 million in 1984. The high level of earnings in 1985 was achieved partially by the sale of several large commercial tracts, including a 12.8 acre tract in Dallas which produced a gain of approximately $3 million.

One of our premier residential developments, Onion Creek in Austin, is the site of the prestigious Legends of Golf seniors tournament played each year.

On July 1, 1985, we added National Fidelity Life to our insurance operations. NFL is headquartered in Overland Park, Kansas, a suburb of Kansas City, and sells through general agents in 49 states.

During the past 20 years, NFL has emphasized the writing of individual life insurance on medically impaired lives, and this market continues to comprise a large majority of current sales. Today, NFL is recognized by insurance agents as one of the leaders in this field, with unique underwriting and

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product design. In addition to the impaired-lives market, NFL is making inroads in the super-preferred market, a universal life product for the extremely healthy, nonsmoking segment of the population.

Great American Reserve operates in 46 states with both a career sales force and a group of career managing agents who primarily place business through GARCO. The career-agent sales force at GARCO increased by about 100% in 1985, and this should enable the company to continue policy and premium growth in the coming year.

Both of our insurance companies are rated A+ (Excellent) by the A. M. Best Company, and both are well-established companies. NFL was started in 1914 and GARCO celebrated its 50th anniversary in 1984.

1985 was a good year for our life insurance group. Earnings grew impressively, with pre-tax income from NFL and GARCO reaching $15.9 million. These levels were obtained despite costs related to the July acquisition of NFL and its startup as an independent entity, that offset income gains in the second half of the year.

At year-end, the combined insurance assets were $798 million. Insurance in force for the two companies was $8.8 billion. First year life and health premiums in 1985 increased 54% to $41 million. This increase should have a positive effect on income in 1986.

Certain functions of our insurance operations are being centralized to enable us to achieve greater economies of scale. We will begin to benefit from these moves in 1986.

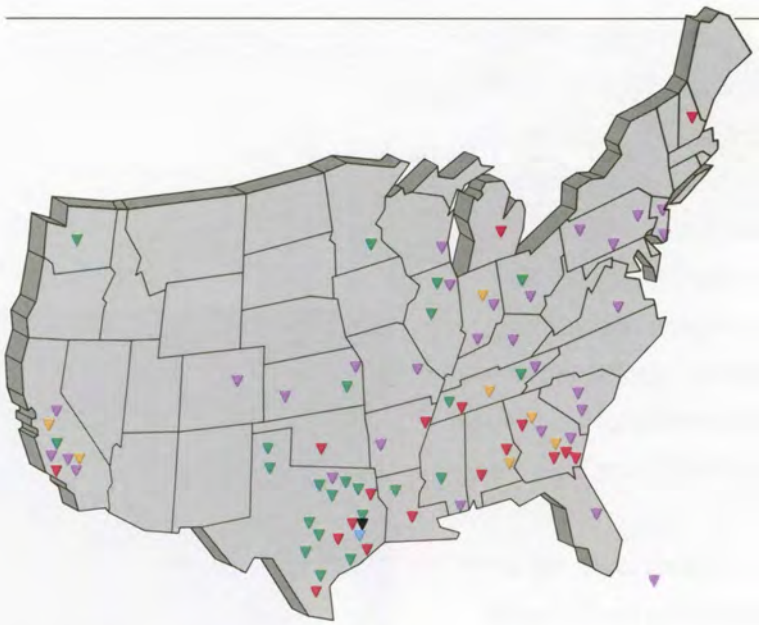
In addition to our life insurance companies, we operate an insurance agency, Timberline Insurance Managers, in Austin and San Antonio, specializing in selected areas of property and casualty insurance. A tightening in the reinsurance markets and a trend by underwriters to be extremely restrictive on underwriting risks they will accept have created a difficult environment for this segment of our business. This marketplace dictates that significantly more time and insurance expertise be devoted to the placement of insurance coverage than has historically been required. ■



▼

The acquisition of National Fidelity Life allowed us to combine certain computer and other operations with Great American Reserve.

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Corporate Headquarters

Diboll, Texas

Bleached Paperboard

Evadale, Texas

Containerboard

Linerboard Mills

Mahrt, Alabama*
Macon, Georgia*
Rome, Georgia*
Ontario, California

Corrugating Medium Mills

New Johnsonville, Tennessee
Newark, California
Newport, Indiana

*—50% owned

Building Products

Fiberboard Operation

Diboll, Texas

Rigid Foam Operation

Diboll, Texas

Particleboard Operations

Diboll, Texas
Monroeville, Alabama
Thomson, Georgia

Gypsum Operations

West Memphis, Arkansas
Fletcher, Oklahoma
(under construction)

Plywood Operations

Pineland, Texas
Madison, Georgia*

Lumber Operations

Diboll, Texas
Pineland, Texas
Greenville, Georgia*
Madison, Georgia*
Mahrt, Alabama*
Rome, Georgia*

Oriented Strandboard Operation

Claremont, New Hampshire

Retail Distribution Operations

Diboll, Texas
Pineland, Texas
Conroe, Texas
Houston, Texas
Harlingen, Texas
Alexandria, Louisiana

AFCO Industries Operations

Alexandria, Louisiana
Holland, Michigan
Memphis, Tennessee

*—50% owned

Packaging

Corrugated Container Operations

Fort Smith, Arkansas
Los Angeles, California
Newark, California
Ontario, California
Santa Fe Springs, California
Denver, Colorado
Orlando, Florida
Macon, Georgia
Rome, Georgia
Chicago, Illinois
Crawfordsville, Indiana
Evansville, Indiana
Garden City, Kansas
Kansas City, Kansas
Louisville, Kentucky
Hattiesburg, Mississippi
St. Louis, Missouri
Edison, New Jersey
Spotswood, New Jersey
Middletown, Ohio
Biglerville, Pennsylvania
Erie, Pennsylvania
Hazleton, Pennsylvania
Vega Alta, Puerto Rico
Lexington, South Carolina
Rock Hill, South Carolina
Elizabethton, Tennessee
Dallas, Texas
Richmond, Virginia

Anderson Box Company

21 warehouses located throughout the country

Rexford Paper Company

Milwaukee, Wisconsin

Financial Services

Mortgage Loan Operations

Austin, Texas
Dallas, Texas
Houston, Texas
Killeen, Texas
Temple, Texas
San Antonio, Texas
Garland, Texas
Downers Grove, Illinois
Gurnee, Illinois
Oklahoma City, Oklahoma
Memphis, Tennessee
Jackson, Mississippi
Knoxville, Tennessee
Minneapolis, Minnesota

Insurance Operations

Amarillo, Texas
Austin, Texas
Columbus, Ohio
Corpus Christi, Texas
Dallas, Texas
Tyler, Texas
Fort Worth, Texas
Houston, Texas
Seattle, Washington
Shreveport, Louisiana
San Antonio, Texas
Lubbock, Texas
Los Angeles, California
Overland Park, Kansas

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Financial Review
Management's Discussion and Analysis
Results of Operations and Financial Condition

Results of operations including information regarding the Company's principal business segments are shown below.

Business Segments For years ended December 31	1985	1984	1983	1982	1981
			(in millions)		
Net Sales					
Container and containerboard	$ 684.2	$ 665.3	$ 596.9	$ 576.8	$ 595.7
Pulp and paperboard	256.7	284.5	253.2	254.5	261.7
Building products:					
Manufacturing	226.9	226.6	207.5	158.2	151.0
Retail	41.1	68.7	87.6	67.3	59.2
Other activities (1)	34.2	17.8	30.3	39.6	46.5
	$1,243.1	$1,262.9	$1,175.5	$1,096.4	$1,114.1
Income Before Taxes					
Container and containerboard (2)	$ 49.7	$ 74.8	$ 20.8	$ 30.0	$ 58.1
Pulp and paperboard	19.8	46.8	20.0	20.9	45.4
Building products:					
Manufacturing	23.5	40.2	31.0	1.8	0.9
Retail	(1.0)	.7	4.2	2.8	2.0
Other activities (1)	2.5	(3.2)	(2.1)	—	1.2
Operating profit	94.5	159.3	73.9	55.5	107.6
Financial services (3)	25.3	15.2	13.8	11.4	15.2
	119.8	174.5	87.7	66.9	122.8
Corporate expense (4)	(8.1)	(11.9)	(7.2)	—	—
Interest—net	1.2	(4.6)	(4.7)	(1.9)	(1.0)
Other income—net	2.2	1.8	2.9	1.9	—
Gain on sale of property and equipment (5)	12.5	5.8	—	2.5	3.7
	$ 127.6	$ 165.6	$ 78.7	$ 69.4	$ 125.5

(1) Primarily industrial contracting.
(2) Includes $22.1, $21.7, $24.6, $26.0 and $24.6 million of operating income from Georgia Kraft, a 50% owned affiliate of the Company, for the years 1985, 1984, 1983, 1982, and 1981, respectively. These Georgia Kraft income amounts are deducted from cost of sales in the statement of income.
(3) Equity in pre-tax earnings of unconsolidated subsidiaries including an $8.8 million gain on the sale of a building in 1981.
(4) Prior to the formation of Temple-Inland in 1983 there were no material amounts of general corporate expenses.
(5) Includes a $11.3 million pre-tax gain on the sale of the Company's Eastex Packaging subsidiary in 1985.

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Container and Containerboard

Container and Containerboard operations are basically a fully integrated unit which manufactures linerboard and corrugating medium and converts these grades of containerboard into corrugated shipping containers. A significant portion of the linerboard is manufactured by Georgia Kraft Company, a 50% owned affiliate.

During the fourth quarter the Company completed construction of a recycle linerboard mill in Ontario, California, with an estimated annual production of 175,000 tons. Although startup commenced, no significant tonnage was available from this mill in 1985.

The Company converts its containerboard to shipping containers in 29 box plants, including two new box plants added in 1985. One is located in Edison, New Jersey and the other is in Ontario, California.

Tonnage through our box plants increased by about 8%, reaching record levels; however, the gross selling price of boxes deteriorated throughout the year. The average gross selling price at the end of 1985 was down about 11% from the beginning of the year.

Pulp & Paperboard

Pulp & Paperboard produces bleached paperboard at our Evadale, Texas mill and sells production to manufacturers who convert the product into paper cups, plates, shopping bags, file folders, and a wide range of other products. Sales prices moved downward throughout the year, and the overall average net sales price for 1985 was $473 per ton, down 7 percent from 1984.

During the fourth quarter we chose not to sell market pulp at the depressed sales prices and instead took selected down time on our machines. Tonnage in 1985 was 535,000 tons, down from 555,000 tons in 1984.

The wood-fired boiler began operating in January 1986 and should reach designed capacity in the first quarter.

Building Products

This unit manufactures a complete line of building products including lumber, plywood, fiberboard, particleboard, gypsum wallboard, oriented strandboard, rigid foam insulation and decorative wall paneling. The average sales prices for all our major product lines were lower in 1985 than in 1984.

Increased volumes of Canadian lumber and furniture imported into the United States in 1985 contributed substantially to the lower prices for lumber and particleboard.

Fiberboard and gypsum continue to be major contributors to Building Products earnings.

The retail operations continue to suffer. The loss in 1985 is attributable to a lower level of sales, primarily in the Houston area, and the discontinuation of our millwork operation.

The Company has completed the preliminary design and engineering work for a wood resource complex to be located in the Evadale area. This complex, with an annual capacity estimated to be 120 million board feet, will provide a more efficient vehicle for converting our fiber in the southern regions of our timberlands.

A new gypsum plant in Fletcher, Oklahoma, with an estimated annual capacity of 300 million square feet, is scheduled for completion in the third quarter of 1986 and the major expansion of the Claremont, New Hampshire oriented strandboard plant will be completed in March 1986.

Reference is made to the following tables for information on sales volumes and unit sales for the last five years.

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The following table shows the net sales of Temple-Inland Inc.

Net Sales For years ended December 31	1985	1984	1983	1982	1981
			(in millions)		
Container and containerboard	$ 684.2	$ 665.3	$ 596.9	576.8	$ 595.7
Pulp and paperboard					
Paperboard	230.4	250.2	224.1	218.5	222.3
Market pulp	18.6	24.7	21.1	28.0	26.0
Nodular pulp	4.3	6.3	3.5	5.3	9.0
Other	3.4	3.3	4.5	2.7	4.4
Building products					
Pine lumber	26.8	27.7	28.9	22.1	21.1
Fiberboard	50.1	47.4	49.5	40.4	32.4
Particleboard	40.2	49.4	43.5	31.8	39.1
Plywood	22.0	21.2	21.7	19.4	17.9
Gypsum wallboard	34.8	37.5	27.2	14.2	11.6
Decorative wall paneling	13.0	15.6	14.1	13.6	16.1
Rigid foam insulation	15.3	14.3	10.5	6.5	5.2
Oriented strandboard (a)	9.1	1.2	—	—	—
Retail distribution	41.1	68.7	87.6	67.3	59.2
Other	15.6	12.3	12.1	10.2	7.6
Other activities	34.2	17.8	30.3	39.6	46.5
	$1,243.1	$1,262.9	$1,175.5	$1,096.4	$1,114.1

The following table shows the rated annual capacities of the production facilities for, and unit sales of, the principal manufactured products of Temple-Inland Inc.

Unit Sales	Rated annual capacity at 12/31/85	For years ended December 31, 1985	1984	1983	1982	1981
			(in thousands of tons)			
Container and containerboard	(b)	1,248	1,176	1,172	1,128	1,139
Pulp and paperboard						
Paperboard	(c)	452	464	449	417	416
Market pulp	(c)	62	69	72	97	70
Nodular pulp	(c)	21	23	17	20	31
Building products						
			(in millions of board feet)			
Pine lumber (d)	143	135	128	121	101	98
			(in millions of square feet)			
Fiberboard	430	415	385	401	362	289
Particleboard	300	283	284	286	261	271
Plywood (d)	195	164	155	148	149	133
Gypsum wallboard	320	326	300	298	211	174
Decorative wall paneling	87	51	60	54	50	61
Rigid foam insulation	110	73	64	41	25	21
Oriented strandboard (a)	110	68	9	—	—	—

(a) The oriented strandboard plant was acquired in October 1984.

(b) The annual capacity of Inland's box plants and three folding carton plants (which were sold in October 1985) are not given because such annual capacity is a function of the product mix, customer requirements and the type of converting equipment installed and operating at each plant, each of which varies from time to time. The rated annual capacity of Inland's three corrugating medium mills is 455,000 tons per year. The rated annual capacity of Inland's recycle linerboard mill and one-half the annual capacity of Georgia Kraft is 965,000 tons per year.

(c) The annual capacity of the paperboard and pulp mill is 540,000 tons. Such capacity may vary to some degree depending on product mix.

(d) Excludes the Company's 50% interest in pine lumber and plywood produced by Georgia Kraft. Georgia Kraft production in 1985 totaled 278 million feet of pine lumber and 268 million feet of plywood.

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Temple-Inland Financial Services

Temple-Inland entered the financial services business in 1954 as a member of an investment group which formed Lumbermen's Investment Corporation ("LIC"). Temple-Inland acquired virtually 100% of the stock of LIC in 1962. Initially, LIC was a small Texas mortgage bank financing new home construction which would in turn aid the Company's building products sales. The Company found the financial services arena to be a sound business and one in which steady income streams could be built.

Today the Company's Financial Services operations, consisting of mortgage banking, real estate development, and insurance activities, are conducted as Temple-Inland Financial Services ("Financial Services"). The results of these operations are not consolidated with the Company for financial reporting purposes, because such businesses are dissimilar to the Company's other businesses. The following information and discussions of each business segment is provided to offer a more detailed description and explanation of the business activities and operations of Financial Services. Selected segment information is shown below.

Temple-Inland Financial Services Selected Segment Information Years ended December 31		1985	1984 (in thousands)	1983
Income	Mortgage banking	$ 6,622	$ 5,423	$ 7,127
	Land development and income properties	8,116	4,817	6,221
	Agency insurance	937	1,011	1,774
	Life insurance:			
	Income from operations (a)	15,898	9,176	4,112
	Acquisition interest	(9,170)	(7,463)	(7,455)
		6,728	1,713	(3,343)
	Other activities	2,912	2,198	2,050
	Income before taxes	25,315	15,162	13,829
	Taxes on income	8,353	4,687	4,364
	Net income	$ 16,962	$ 10,475	$ 9,465
Assets	Mortgage banking	$ 98,065	$ 99,862	$ 73,906
	Land development and income properties	20,121	19,444	33,179
	Agency insurance	4,729	6,270	6,804
	Life insurance (b)	174,637	90,593	79,333
	Other	9,640	10,643	3,540
	Total assets	$307,192	$226,812	$196,762
Liabilities	Mortgage banking	$ 96,587	$ 96,114	$ 70,881
	Land development and income properties	15,440	12,807	16,158
	Agency insurance	3,752	4,413	4,842
	Life insurance (c)	133,400	67,000	70,000
	Other	1,574	4,801	741
	Total liabilities	$250,753	$185,135	$162,622
Equity	Mortgage banking	$ 1,478	$ 3,748	$ 3,025
	Land development and income properties	4,681	6,637	17,021
	Agency insurance	977	1,857	1,962
	Life insurance	41,237	23,593	9,333
	Other	8,066	5,842	2,799
	Total equity	$ 56,439	$ 41,677	$ 34,140

(a) Equity in the pre-tax earnings of unconsolidated insurance subsidiaries. Such subsidiaries are not consolidated because they are dissimilar to the other businesses of the financial services group.
(b) Investment in unconsolidated insurance subsidiaries.
(c) Represents notes payable incurred in the acquisition of insurance subsidiaries.

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Mortgage Banking

The mortgage banking operations of Financial Services are conducted through Lumbermen's Investment Corporation ("LIC"). Mortgage banking is basically two businesses; the first, arranging financing for purchasers of real estate and the second, the ongoing servicing of these mortgage loans. The mortgage banker plays the role of an intermediary, putting the ultimate borrower and lender together and receiving a fee for his services. The first business may show volume variations from year to year depending on the health of the residential and commercial real estate markets. However, the second major component of the mortgage banking business, servicing the loans, results in a stable income stream.

The mortgage banking operation does not generate significant income in the year in which a loan is created. However, the mortgage banker creates substantial values in that year, which values will result in earnings in subsequent years. The mortgage banker can either sell the right to service the loan for a one-time profit, or service the loan himself and produce future income streams. The Company normally elects to retain the right to service loans.

The Company's loan origination operation covers the middle geographic section of the United States and produces $300 to $500 million in mortgage loans annually. It now services a portfolio of almost 80,000 loans with a balance of $2.9 billion.

One additional profit center for mortgage banking is revenues earned from the usually favorable interest rate spread between long term and short term interest rates. The mortgage banker borrows at short term rates to cover the mortgage loan for the two to three month period between origination and shipment of the loan to the ultimate investor. The mortgage banker earns the spread between his short term borrowing and the long term interest rate actually paid on the loans.

On February 26, 1986 we announced the execution of a letter of intent to acquire all the common stock of Kilgore Federal Savings and Loan (Kilgore, Texas) for $10 million in cash. This financial institution, with assets of about $90 million, will allow us to expand our mortgage banking operations to additional markets.

A summary of selected financial information for the years 1985, 1984, and 1983 is provided below.

Mortgage Banking Operations Summary Years ended December 31	1985	1984	1983
		(in thousands)	
Revenues	$26,133	$22,752	$25,221
Income Before Taxes	$ 6,622	$ 5,423	$ 7,127

Mortgage Banking Loan Administration Summary Years ended December 31	1985	1984	1983
		(in millions)	
Beginning Servicing Portfolio	$ 2,665	$ 2,449	$ 2,072
New Loans:			
Residential	317	353	545
Commercial	41	9	32
	358	362	577
Acquired with National Fidelity	133	—	—
Run-off	(228)	(146)	(200)
Ending Servicing Portfolio	$ 2,928	$ 2,665	$ 2,449
Servicing Portfolio Growth	9.9%	8.8%	18.2%
Run-off Factor	8.6%	6.0%	9.7%

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Land Development and Income Properties

This segment of Financial Services, operated as Temple-Inland Properties, consists of seven active residential subdivisions in Texas with adjoining commercial acreage, two commercial land projects, and several commercial buildings. Typically, the Company takes the position of a financial partner in various joint ventures which are accounted for by the equity method. Temple-Inland Properties generally does not serve as an active constructor, but rather ventures the property with a home builder or land owner who will be the primary constructor.

The typical residential joint venture consists of purchasing raw land, designing a subdivision, developing the subdivision, and selling the completed lots to builders on which they will construct homes.

In any development, the benefits of owning the land can come from several sources including profits on the sale of lots and commercial acreage, or benefits from financing and insuring homes or buildings in the subdivision.

At year end 1985, the completed inventory of residential lots was 343 and undeveloped acreage was 1,644 compared with 104 lots and 1,797 acres in 1984 and 189 lots and 1,700 acres in 1983. At year end 1985, total commercial acreage in inventory was 40 compared with 61 and 79 in 1984 and 1983 respectively.

Selected financial information related to these activities is shown on the right.

Temple-Inland Properties Operations Summary Years ended December 31	1985	1984	1983
		(in thousands)	
Revenues:			
Residential	$ 5,407	$ 9,163	$ 5,291
Commercial	9,058	4,069	7,377
	$14,465	$13,232	$12,668
Income Before Taxes:			
Residential	$ 3,107	$ 3,518	$ 2,812
Commercial	5,009	1,299	3,409
	$ 8,116	$ 4,817	$ 6,221

Shown below is Temple-Inland Properties pro rata share of the assets, liabilities and equity of joint ventures.

Temple-Inland Properties Investment in Joint Ventures As of December 31	1985	1984	1983
		(in thousands)	
Assets	$62,192	$43,871	$39,826
Liabilities (a)	$56,749	$37,439	$31,572
Equity	5,443	6,432	8,254
	$62,192	$43,871	$39,826

(a) Although the Company's pro rata share of joint venture liabilities total $56.7 million, the joint venture partners are in most instances jointly and severally liable for notes payable. The gross balance of these notes was $86.5 million at December 31, 1985.

Agency Insurance

The entrance into the casualty insurance business was a natural extension of the mortgage banking operation. The Agency could write homeowners insurance for mortgagors' borrowing through the mortgage banking group. However, the casualty agency developed the technical expertise and sales force needed to serve a broad spectrum of retail and commercial clients and to place a wide variety of insurance coverages for these clients.

The agency insurance operations also include the placement of significant reinsurance for the Company.

A summary of the revenues and income before taxes for the years 1985, 1984, and 1983 is shown below.

Agency Insurance Operations Summary Years ended December 31	1985	1984	1983
		(in thousands)	
Revenues	$3,502	$3,052	$3,277
Income Before Taxes	$ 937	$1,011	$1,774

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Life Insurance

The life insurance operations of Temple-Inland Financial Services include Great American Reserve Insurance Company ("GARCO"), headquartered in Dallas, Texas, and National Fidelity Life Insurance Company ("NFL"), headquartered in Overland Park, Kansas.

GARCO writes life and health policies. It was largely regional until 1983, but in the last two years has become national in scope.

NFL's primary concentration is the impaired risk, life and health business in both the U.S. and Canada.

Both GARCO and NFL are traditional insurance companies, operating through agents—some of whom represent other companies. The products sold by our insurance company in the life area are changing with a large majority of the new life insurance policies being a variation of the universal life product.

Over 90% of GARCO's and NFL's investment portfolio is invested in fixed income securities, consisting of both marketable bonds, mortgages, and short term securities. The average maturity at the end of the year was approximately 15 years.

From an accounting standpoint, the acquisitions of GARCO and NFL have been accounted for as purchases and the results of operations have been included from the dates of acquisition. The unamortized balance of the excess cost over the fair market value of net assets acquired was $19.6 million, as of December 31, 1985, and is being amortized on a straight line basis over 40 years.

Shown below are condensed consolidated statements of income and balance sheets of the insurance operations for the years 1985, 1984, and 1983, together with a summary of the life insurance in force.

Life Insurance Condensed Consolidated Statements of Income Years ended December 31	1985	1984 (in thousands)	1983
Revenues	$191,814	$115,941	$103,010
Expenses:			
Insurance policy benefits & commissions	145,306	88,188	80,526
Operating and administrative expenses	30,610	18,577	18,372
Total expenses	175,916	106,765	98,898
Income before taxes	15,898	9,176	4,112
Taxes on income	5,405	3,212	871
Net income	$ 10,493	$ 5,964	$ 3,241

Life Insurance Condensed Consolidated Balance Sheets As of December 31	1985	1984 (in thousands)	1983
Assets			
Cash and investments	$657,272	$267,754	$226,112
Deferred acquisition costs	71,901	35,202	33,602
Receivables and other assets	68,891	45,238	32,602
Total assets	$798,064	$348,194	$292,316
Liabilities and Equity			
Future policy benefits	$566,469	$225,107	$195,397
Other liabilities	56,958	32,494	17,586
Equity	174,637	90,593	79,333
Total liabilities and equity	$798,064	$348,194	$292,316

Life Insurance Life Insurance and Annuities in Force As of December 31	1985	1984 (in millions)	1983
Life Insurance	$ 8,800	$ 4,200	$ 3,500
Annuity Reserves	300	100	100

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Additional Comments Regarding Results of Operations and Financial Condition

The Company's financial condition continues to be strong with internally generated funds and the capacity to issue long term debt being sufficient to fund expected capital expenditures, to service existing debt, to pay dividends and to meet normal working capital requirements. The level of spending for capital expenditures is now anticipated to decline in 1986 to $140 million. Major projects will include a forest converting complex in the Evadale, Texas area, together with continued spending for completion of the Fletcher, Oklahoma gypsum wallboard plant.

Interest expense incurred, net of interest income and capitalized interest, is shown below.

	1985	1984 (in thousands)	1983
Interest expense	$(19,619)	$(20,999)	$(10,468)
Interest income	11,523	13,825	4,359
Capitalized interest	9,323	2,620	1,323
Interest (expense) income—net	$ 1,227	$ (4,554)	$ (4,786)

Interest expense for 1983 reflected interest costs on an $80 million loan only from September 15, 1983 (See Note D in Notes to Consolidated Financial Statements). The increase in capitalized interest during 1985 was primarily attributable to the Ontario, California mill and other major construction projects. Most of these projects have been completed and capitalized interest will decline beginning in 1986.

On February 3, 1986, the Company announced the execution of a letter of intent to purchase from Owens-Illinois, Inc. certain assets and properties and is proceeding toward a definitive agreement. The purchase includes a kraft linerboard mill in Orange, Texas, approximately 259,000 acres of timberland in Texas and Louisiana, three corrugated box manufacturing plants, and certain other related properties. The purchase price is expected to be about $228 million. It is anticipated that the transaction will be completed in 1986 and financed with long-term debt.

For information regarding the impact of inflation on the Company, see Note M in Notes to Consolidated Financial Statements.

The following chart provides information on working capital and long-term debt, as well as certain other key financial data and ratios reflecting the financial condition of the Company.

Five Year Selected Financial Data

				Pre Spinoff Data†	
For The Year (in millions)	1985	1984	1983	1982	1981
Net sales	$1,243	$1,263	$1,176	$1,096	$1,114
Net income	85	103	48	39	95
Capital expenditures	184	130	53	77	94
Depreciation, amortization and depletion	66	63	64	59	54
At Year End (in millions)					
Total assets	$1,469	$1,364	$1,209	$1,162	$1,127
Working capital	164	175	136	95	134
Long-term debt	248	251	209	80	82
Shareholders' equity	864	793	701	823	784
Earnings per share	$ 3.50	$ 4.24	$ 1.99	*	*
Average shares outstanding (in thousands)	24,312	24,240	24,225	*	*
Dividends per common share	$ .64	$ .50	*	*	*

†For 1983 and prior years, the table reflects the combined historical amounts of the former subsidiaries of Time Inc. that now form Temple-Inland Inc. Because of the recapitalization of the Company in 1983, the historical operations of the combined companies may not be comparable with the subsequent years in the table. See Note J to Consolidated Financial Statements.

**Earnings per share for 1983 are based upon shares distributed and outstanding as of January 26, 1984 and common stock equivalents. Prior years' earnings per share, average shares outstanding and dividends per common share are not meaningful and are not presented.*

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Consolidated Statements of Income

Temple-Inland Inc. and Subsidiaries For years ended December 31	1985	1984 (in thousands)	1983†
Revenues			
Net sales	$1,243,125	$1,262,904	$1,175,546
Financial services earnings—Note B	25,316	15,163	13,829
	1,268,441	1,278,067	1,189,375
Costs and Expenses			
Cost of sales	1,036,535	992,033	991,756
Selling and administrative	120,295	123,450	117,073
	1,156,830	1,115,483	1,108,829
Operating Income	111,611	162,584	80,546
Interest—net—Note D	1,227	(4,554)	(4,786)
Other—Note L	14,752	7,547	2,919
Income Before Taxes	127,590	165,577	78,679
Taxes on income—Note G	42,500	62,900	30,500
Net Income	$ 85,090	$ 102,677	$ 48,179
Earnings per share—Note A	$ 3.50	$ 4.24	$ 1.99

†For 1983, the table reflects the combined historical amounts of the former subsidiaries of Time Inc. that now form Temple-Inland Inc. Because of the recapitalization of the Company in 1983, the historical operations of the combined companies may not be comparable with the subsequent years in the table. See Note J to Consolidated Financial Statements.

See the notes to the consolidated financial statements.

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Consolidated Balance Sheets

Temple-Inland Inc. and Subsidiaries As of December 31	1985	1984
	(in thousands)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 82,490	$ 75,468
Other short-term investments	—	6,616
Receivables, less allowances of $4,134,000 in 1985 and $5,290,000 in 1984	122,957	126,163
Refundable federal income taxes—Note G	8,946	—
Inventories—at lower of cost or market:		
Work in process and finished goods	42,639	48,263
Raw materials	52,649	60,598
	95,288	108,861
Prepaid expenses	19,000	23,235
Total Current Assets	328,681	340,343
Investments—Note B		
Financial services subsidiaries	56,439	41,677
Other unconsolidated subsidiaries	8,280	7,886
Other investments	8,382	6,179
Total Investments	73,101	55,742
Property and Equipment—Note D		
Buildings	151,436	134,927
Machinery and equipment	913,400	768,972
Less allowances for depreciation and amortization	(490,926)	(448,051)
	573,910	455,848
Construction in progress	61,607	77,791
Construction funds held by trustee	16,059	35,794
	651,576	569,433
Timber and timberlands—less depletion	97,704	94,658
Georgia Kraft Company—Note B	294,639	277,953
Land	15,470	15,037
Total Property and Equipment	1,059,389	957,081
Other Assets	8,170	10,556
TOTAL ASSETS	$1,469,341	$1,363,722

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	1985	1984
	(in thousands)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	$ 87,722	$ 89,565
Due to Georgia Kraft Company	64,423	62,370
Employee compensation and benefits	9,461	10,207
Current portion of long-term debt	3,373	3,684
Total Current Liabilities	164,979	165,826
Long-Term Debt—Note D	247,555	251,113
Deferred Investment Tax Credits—Note G	40,975	31,738
Deferred Federal Income Taxes—Note G	132,415	109,539
Other Liabilities	19,712	12,842
Shareholders' Equity		
Common stock—par value $1 per share: authorized 100,000,000 shares; issued 24,184,526 shares in 1985 and 24,135,805 shares in 1984, including shares held in the treasury—Note J	24,184	24,136
Additional paid-in capital	327,979	326,997
Retained earnings	511,586	441,962
	863,749	793,095
Cost of shares held in the treasury: 1,326 shares in 1985; 14,213 shares in 1984	(44)	(431)
	863,705	792,664
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,469,341	$1,363,722

See the notes to the consolidated financial statements.
Certain amounts have been reclassified to conform with current year's classifications.

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Consolidated Statements of Shareholders' Equity

Temple-Inland Inc. and Subsidiaries	Common Stock	Additional Paid-in Capital	Invested Capital (in thousands)	Retained Earnings	Treasury Stock
Balance at January 1, 1983	$ —	$ —	$349,707	$473,104	$ —
Net income	—	—	—	48,179	—
Dividends paid to Time Inc.—Note J	—	—	—	(169,937)	—
Other	—	—	(83)	—	—
Balance at December 31, 1983	—	—	349,624	351,346	—
Distribution of Temple-Inland shares—January 26, 1984	24,074	325,550	(349,624)	—	—
Net income	—	—	—	102,677	—
Dividends paid on Common Stock—$.50 per share	—	—	—	(12,061)	—
Stock issued for stock option and restricted stock plans	62	1,447	—	—	—
Stock reacquired for treasury—14,213 shares at cost	—	—	—	—	(431)
Balance at December 31, 1984	24,136	326,997	—	441,962	(431)
Net income	—	—	—	85,090	—
Dividends paid on Common Stock—$.64 per share	—	—	—	(15,466)	—
Stock issued for stock option and restricted stock plans	48	982	—	—	—
Stock reacquired for treasury—7,781 shares at cost	—	—	—	—	(278)
Stock reissued from treasury—20,668 shares at cost	—	—	—	—	665
Balance at December 31, 1985	$24,184	$327,979	$ —	$511,586	$ (44)

See the notes to the consolidated financial statements.

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Consolidated Statements of Changes in Financial Position

Temple-Inland Inc. and Subsidiaries For years ended December 31	1985	1984 (in thousands)	1983
Working Capital Sources			
Net income	$ 85,090	$102,677	$ 48,179
Items not affecting working capital:			
Depreciation, amortization and depletion	66,445	63,093	63,838
Amortization of intangibles	208	140	515
Deferred taxes and deferred tax credits	30,915	12,284	15,525
Unremitted earnings of affiliated companies	(20,971)	(21,528)	(16,457)
Total from Operations	161,687	156,666	111,600
Disposition of property and equipment	12,182	4,400	4,545
Decrease (increase) in construction funds held by trustees	19,735	(32,274)	9,818
Issuance of long-term debt	—	51,981	149,474
Change in other assets and liabilities	9,048	3,147	9,458
Issuance of common stock	1,695	1,509	—
Other	1,401	5,886	234
Total Working Capital Sources	205,748	191,315	285,129
Working Capital Uses			
Capital expenditures	183,688	129,765	53,006
Dividends paid to shareholders	15,466	12,061	—
Additional investment in affiliated companies	13,573	1,261	—
Dividends to Time Inc.	—	—	169,937
Purchases of treasury stock	278	431	—
Reduction of long-term debt	3,558	9,372	21,165
Total Working Capital Uses	216,563	152,890	244,108
Increase (Decrease) in Working Capital	$ (10,815)	$ 38,425	$ 41,021
Changes in Working Capital			
Cash and short-term investments	$ 406	$ 18,132	$ 61,855
Receivables	5,740	4,737	(5,185)
Inventories	(13,573)	10,325	(2,306)
Prepaid expenses	(4,235)	15,837	1,509
Accounts payable and accrued expenses	2,589	(8,629)	(8,145)
Due to Georgia Kraft Company	(2,053)	(2,512)	(14,560)
Current portion of long-term debt	311	535	7,853
Net Change in Working Capital	$ (10,815)	$ 38,425	$ 41,021

See the notes to the consolidated financial statements.
Certain amounts have been reclassified to conform with current year's classifications.

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Notes To The Consolidated Financial Statements

Note A—Summary of Significant Accounting Policies

Basis of Consolidation

The consolidated financial statements include the accounts of Temple-Inland Inc. (the "Company") and its subsidiaries (except unconsolidated mortgage banking, insurance and real estate development subsidiaries). Unconsolidated subsidiaries and companies 20% to 50% owned are reflected in the financial statements on the equity basis. All material intercompany amounts and transactions have been eliminated.

The Company was formerly a wholly-owned subsidiary of Time Inc. ("Time")—See note J.

Inventories

Inventories are stated at the lower of cost or market.

Cost of inventories amounting to $47.5 million in 1985 and $56.8 million in 1984 was determined by the last-in, first-out method (LIFO). The cost of the remaining inventories of $47.8 million in 1985 and $52.1 in 1984 was determined principally by the first-in, first-out method (FIFO).

If the FIFO method of accounting had been applied to those inventories which were costed on the LIFO method, inventories would have been $14.6 and $19.6 million higher than reported at December 31, 1985 and 1984, respectively.

Property and Equipment

Property and equipment are stated at cost less allowances for accumulated depreciation and depletion. Depreciation is generally provided on the straight-line method based on estimated useful lives of the assets.

Certain properties are being depreciated based on operating hours because they depreciate primarily through use rather than merely through elapsed time.

Timberlands, including long-term timber harvesting rights, are stated at cost, less accumulated cost of timber harvested. The portion of the cost of timberlands attributed to standing timber is charged against income as timber is cut, at rates determined annually, based on the relationship of unamortized timber costs to the estimated volume of recoverable timber. The costs of seedlings and reforestation of timberlands are capitalized.

Start-up costs incurred in connection with major new manufacturing facilities are capitalized as part of the cost of the asset and are amortized over a five year period.

Earnings Per Share

Earnings per share for 1985 and 1984 are based upon the weighted average number of shares outstanding, including common stock equivalents, during the period. Earnings per share for 1983 are based upon the number of shares distributed and outstanding on January 26, 1984, including common stock equivalents. The weighted average shares outstanding was 24,312,000 in 1985, 24,240,000 in 1984 and 24,225,000 in 1983.

Note B—Investments in Affiliated Companies

The Company's 50% investment in Georgia Kraft Company ("Georgia Kraft") is classified as property and equipment since that company's underlying net assets are primarily mill operating properties, and timberlands which are the principal sources of the Company's linerboard raw material requirements. Likewise, equity in operating income of Georgia Kraft is recorded as a reduction of cost of sales and its share of related income taxes is included in taxes on income. The Company's investment exceeded its equity in Georgia Kraft's net assets by $103.0 million at December 31, 1985.

Under a long-term board purchase contract, the Company and the other joint venturer are each obligated to purchase the output of one-half of the production time of Georgia Kraft. Such purchases are at prices which provide Georgia Kraft with a recovery of all costs and expenses, including depreciation claimed for tax purposes but excluding federal income taxes, plus a stated amount per ton. Additionally, the payments must provide adequate funds to meet all obligations and to pay current installments of funded indebtedness.

The Company's purchases of Georgia Kraft output were $181.3 million in 1985, $168.7 million in 1984 and $164.9 million in 1983.

Summary financial information for Georgia Kraft Company is as follows:

	1985	1984	1983
		(in thousands)	
Total revenues	$557,033	$539,746	$516,877
Income before taxes	46,474	45,225	51,007
Net income	31,764	30,737	32,213
Current assets	137,169	147,565	173,255
Noncurrent assets	522,590	487,454	452,350
Current liabilities	58,665	59,914	54,897
Noncurrent liabilities	217,768	223,543	249,883

The Company's financial services operations are conducted as Temple-Inland Financial Services and include mortgage banking, real estate development and insurance activities. Refer to "Selected Segment Information" on page 26, "Condensed Consolidated Statements of Income" and "Condensed Consolidated Balance Sheets" on page 29 for summarized financial information for these wholly-owned unconsolidated subsidiaries.

Effective July 1, 1985 the Company, through Temple-Inland Financial Services, acquired all of the outstanding shares of National Fidelity Life Insurance Company for $82 million in a transaction accounted for as a purchase. Information regarding the pro forma effect of the acquisition on the Company for periods prior to the acquisition date would not be materially different from the historical amounts as reported.

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The Company's share in the net income of all unconsolidated subsidiaries and 20-50% owned affiliates amounted to $33.2 million, $25.8 million and $27.3 million for the years ended December 31, 1985, 1984 and 1983, respectively. Dividends received from such subsidiaries and affiliates amounted to $12.2 million, $4.3 million and $10.9 million for the years ended December 31, 1985, 1984 and 1983, respectively.

The Company's share of undistributed earnings of companies 20-50% owned, included in retained income was $116.7 million and $101.2 million at December 31, 1985 and 1984, respectively.

Note C—Leases

Total rental expense was $8.7 million, $7.8 million and $7.1 million for the years ended December 31, 1985, 1984 and 1983, respectively.

The future minimum rental commitments, as of December 31, 1985, under non-cancellable operating leases were as follows: 1986—$5.1 million; 1987—$4.5 million; 1988—$3.5 million; 1989—$2.5 million; and 1990—$1.1 million.

Note D—Long-Term Debt

Long-term debt consists of the following:

	1985	1984
	(in thousands)	
Bank Revolving Credit Agreement	$ 80,000	$ 80,000
8.25% Promissory Notes to Time due 1986	50,000	50,000
Revenue Bonds due 2014—Average interest rate during 1985 was 5.39%	45,000	45,000
9% Tax Exempt Pollution Control Bonds due 2012	9,400	9,400
7.9% Promissory Notes due through 1994	12,840	14,400
6% Revenue Bonds due 2001-2007	10,000	10,000
Revenue Bonds due 2007—Effective interest rate during 1985 was 7.73%	9,300	9,300
Revenue Bonds due 2008—Effective interest rate during 1985 was 7.52%	8,900	8,900
9.5% Subordinated Debentures through 1995	6,300	7,000
Revenue Bonds due 2009—Average interest rate during 1985 was 5.34%	5,200	5,200
Other revenue bonds due through 2007, weighted average interest rate of 6.6%	5,714	6,356
Other indebtedness due through 2000, weighted average interest rate of 11.2% and 10.9% as of December 31, 1985 and 1984, respectively	4,901	5,557
	$247,555	$251,113

On September 15, 1983, in connection with the restructuring of capitalization, the Company borrowed $80 million under a bank revolving credit agreement with interest at a rate which, at the option of the Company, may be based on various market rates including prime. During 1985, the average interest rate was 8.55%. Credit agreements provide for borrowings of up to $130 million on a revolving basis, repayable in full on September 15, 1989. At December 31, 1985 the unused portion of the credit line was $50 million.

On January 13, 1986, the 8.25% Promissory Notes to Time were paid in full using funds borrowed under a new bank revolving credit agreement. The agreement provides for borrowings of $50 million on a revolving basis, with interest rates determined by market factors at the time of renewal. In addition, an interest rate swap was executed, thereby fixing the effective interest rate at an estimated 8.74% for 1986.

At December 31, 1985, consolidated net current assets were approximately $114 million in excess of the minimum requirements under the most restrictive provisions of the Company's loan agreements and approximately $237 million of consolidated retained income was unrestricted as to the payment of dividends. At December 31, 1985, property and equipment of approximately $35 million was subject to liens in connection with $34 million of debt.

Aggregate maturities of long-term debt during the next five years are as follows: 1986—$2,986,000; 1987—$3,412,000; 1988—$3,426,000; 1989—$133,508,000; 1990—$3,519,000.

For an analysis of net interest expense incurred, see page 30.

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Note E—Stock Option and Purchase Plans

On October 6, 1983, the Company established a stock option plan for key employees. The plan provides for the granting of incentive stock options and/or non-qualified stock options, and permits the grant of stock appreciation rights with all or part of any options so granted.

Under earlier Time stock option plans, employees of the Company had been granted options to purchase Time common stock. All such options outstanding as of January 11, 1984 were converted into options to purchase 439,589 shares of the Company's common stock at prices ranging from $9.29 to $20.77 per share, averaging $16.57 per share.

Options for 472,012 and 425,591 shares were exercisable at December 31, 1985 and 1984, respectively. An additional 751,289 and 898,436 shares of the Company's common stock were available for grants at December 31, 1985 and 1984, respectively.

A summary of activity under the option plans is presented below:

	Common Stock	
	Number of Shares	Price Range Per Share
Outstanding at January 11, 1984	439,589	$ 9-$21
Granted	174,100	$31-$36
Exercised	(13,998)	$12-$21
Forfeited	(12,125)	$31
Outstanding at December 31, 1984	587,566	$ 9-$36
Granted	155,420	$38
Exercised	(51,009)	$12-$31
Forfeited	(8,273)	$31-$38
Outstanding at December 31, 1985	683,704	$ 9-$38

Additionally, an Incentive Stock Plan provides for a maximum of 250,000 shares of common stock to be reserved for awards at the discretion of the Board of Directors. At December 31, 1985, grants of 65,085 shares of common stock were outstanding at an average price of $32.61 per share.

The Company has a Payroll-Based Employee Stock Ownership Plan and Savings and Stock Purchase Plans which permit participating employees to invest in the Company's common stock and other funds.

Compensation expense associated with stock option and award plans totaled $1.6, $2.2 and $6.0 million in 1985, 1984 and 1983, respectively.

Subsequent to December 31, 1985, the Company granted options to purchase 124,475 shares of the Company's common stock at a price of $47.62 per share and granted 16,425 shares of common stock under the incentive stock plan.

Note F—Pension Plans and Other Post-Retirement Benefits

The Company and its subsidiaries have several pension plans covering substantially all employees. Total pension expense was $8.7 million in 1985, $8.6 million in 1984 and $9.9 million in 1983, which includes amortization of past service cost over periods ranging from 10 to 30 years. The Company's policy is to fund amounts as are necessary on an actuarial basis to provide assets sufficient to meet the benefits to be paid to plan members in accordance with the requirements of ERISA.

In 1984 various Temple-Inland pension plans were amended to increase benefits for active and retired employees. Additionally, in 1984 the actuarial interest assumption for various pension plans was increased from 5½% to 7¾%. The combination of the amendments and the change in the actuarial assumption decreased 1985 and 1984 expense by approximately $1 million.

Accumulated benefit information as estimated by consulting actuaries, and net assets for the Company's retirement plans as of January 1, 1985 and January 1, 1984, assuming a rate of return of 8%, were as follows:

	1985	1984
	(in thousands)	
Actuarial present value of accumulated plan benefits:		
Vested	$102,163	$ 94,748
Non-vested	9,010	10,855
Total accumulated plan benefits obligation	$111,173	$105,603
Net assets available for benefits	$160,100	$142,447

In addition to providing pension benefits, the Company and its subsidiaries provide certain health care and life insurance benefits for retired employees. Substantially all of the Company's employees may become eligible for those benefits if they reach retirement age while working for the Company. The Company recognizes the cost of providing the benefits by expensing the insurance premiums as incurred. These costs totaled approximately $.9 million and $.7 million in 1985 and 1984, respectively.

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Note G—Taxes on Income

Taxes on income consisted of the following:

	1985 Current	1985 Deferred	1984 Current	1984 Deferred	1983 Current	1983 Deferred
	(in thousands)					
Federal	$(1,254)	$26,029	$26,945	$25,839	$10,477	$20,449
Investment tax credit deferred	—	13,685	—	7,366	—	(1,773)
State and local	4,040	—	2,750	—	1,347	—
	$2,786	$39,714	$29,695	$33,205	$11,824	$18,676

The provision for deferred income taxes reflects timing differences between financial and tax reporting related to the following items:

	1985	1984	1983
	(in thousands)		
Depreciation	$19,786	$11,966	$13,035
Investment tax credits	13,685	7,366	(1,773)
Contribution to employee benefit trust	(1,075)	7,820	—
Capitalized interest	4,098	1,135	388
Other—net	3,220	4,918	7,026
	$39,714	$33,205	$18,676

The differences between the consolidated effective income tax rate and the federal statutory income tax rate of 46% include the following:

	1985	1984	1983
	(in thousands)		
Taxes on income at statutory rate	$58,691	$76,165	$36,192
Investment tax credits	(7,903)	(6,185)	(5,528)
Tax benefit of capital gains	(8,368)	(8,541)	(7,565)
All other	80	1,461	(3,021)
Approximate separate tax return expense	42,500	62,900	20,078
Allocation of taxes from Time's consolidated group including charges in 1983 for prior years' taxes	—	—	10,422
	$42,500	$62,900	$30,500

At December 31, 1985, the Company was eligible for income tax refunds of $8.9 million, primarily from a carryback of investment tax credits.

The Company's share of Georgia Kraft's tax related items included above for 1985, 1984 and 1983 were: investment tax credits of $1.6 million, $1.9 million and $.9 million; and the tax benefit of capital gains of $1.4 million, $1.4 million and $1.4 million, respectively.

Investment tax credits are deferred and amortized as a reduction of income tax expense over the estimated useful lives of the related assets except for Georgia Kraft which records such credits as reductions in current income tax expense on a flow-through basis.

The Company's equity in the earnings of 20-50% owned affiliates is reinvested; accordingly, no provision for income taxes is made on the undistributed earnings.

Note H—Business Segment Information

Refer to "Business Segments" on page 23 for information relating to the Company's principal segments of business for the three years ended December 31, 1985.

Additional business segment information is presented below.

For years ended December 31	1985	1984	1983
	(in millions)		
Identifiable Assets			
Container and containerboard (1)	$ 741.1	$ 666.7	$ 589.5
Pulp and paperboard	257.0	254.1	233.5
Building products	172.3	155.5	153.8
Timber and timberlands	104.0	101.5	106.6
Other activities	9.1	8.7	6.1
Total	1,283.5	1,186.5	1,089.5
Equity method investments	72.4	55.0	52.3
Corporate (2)	113.4	122.2	66.8
Total	$1,469.3	$1,363.7	$1,208.6
Depreciation, Amortization and Depletion			
Container and containerboard	$ 21.0	$ 20.1	$ 20.7
Pulp and paperboard	28.4	27.0	25.6
Building products	13.5	12.2	14.0
Timber and timberlands	3.0	3.2	2.9
Other activities	.5	.6	.6
Total	$ 66.4	$ 63.1	$ 63.8
Capital Expenditures			
Container and containerboard	$ 102.0	$ 68.0	$ 25.1
Pulp and paperboard	42.9	35.4	14.4
Building products	29.7	17.4	7.1
Timber and timberlands	7.2	6.7	6.2
Other activities	1.9	2.3	0.2
Total	$ 183.7	$ 129.8	$ 53.0

(1) Includes the Company's 50% investment in Georgia Kraft Company.
(2) Principally cash and construction funds held by trustees.

Note I—Commitments and Contingencies

There are pending against the Company and its subsidiaries lawsuits and claims arising in the regular course of business.

In the opinion of management, recoveries, if any, by plaintiffs or claimants that may result from the foregoing litigation and claims will not be material in relation to the consolidated financial position of the Company and its subsidiaries.

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Note J—Related Party Transactions

Temple-Eastex and Inland were formerly wholly-owned subsidiaries of Time. On December 7, 1983, the shareholders of Time approved the distribution of 90% of the Company's outstanding common stock to shareholders of record on January 11, 1984. On January 26, 1984, 24,073,518 shares of common stock were distributed to shareholders. In that connection, the capitalization of Temple-Inland was restructured on September 15, 1983 with a dividend of $169.9 million being paid to Time. Due to this transaction, outstanding debt and interest expense were substantially increased. Previously, most long-term debt requirements were funded by Time.

For the periods prior to 1984, transactions between the Company and Time have been presented in the following manner:

Time charged certain net expenses incurred by it on behalf of the Company on the basis of actual cost. Management believes the methodology of determining these charges is reasonable and that the charges approximate the costs (except interest and taxes) which would have been incurred if the Company had operated as an unaffiliated entity.

Prior to September 15, 1983 advances to and from Time were non-interest bearing and fluctuated on a daily basis. The average balance receivable from Time during 1983 was approximately $17.4 million.

In 1983 and prior years, the Company was included in the consolidated federal tax returns filed by Time and the Company's tax liability was allocated by Time.

The Company is required to remove Time, on or before September 1, 1987, as the guarantor on indebtedness totaling $10.4 million due through 2012.

Note K—Subsequent Event

On February 3, 1986, the Company announced the execution of a letter of intent to purchase from Owens-Illinois, Inc. certain assets and properties and is proceeding toward a definitive agreement. The purchase includes a kraft linerboard mill in Orange, Texas, approximately 259,000 acres of timberland in Texas and Louisiana, three corrugated box manufacturing plants, and certain other related properties. The purchase price is expected to be about $228 million. It is anticipated that the transaction will be financed with long-term debt and will be completed in 1986.

Note L—Summary of Quarterly Results of Operations (Unaudited)

Selected quarterly financial results for the years ended December 31, 1985 and 1984 are summarized below:

	Three Months Ended			
	March 31	June 30	Sept 30	Dec 31
	(in millions except per share amounts)			
1985				
Net Sales	$313.5	$326.5	$310.9	$292.2
Gross Profit	60.5	62.0	45.7	38.4
Net Income	21.7	24.2	17.5	21.7*
Earnings Per Share	.89	1.00	.72	.89
1984				
Net Sales	$313.5	$329.4	$323.9	$296.1
Gross Profit	59.9	73.4	72.2	65.4
Net Income	20.8	28.8	27.4	25.7
Earnings Per Share	.86	1.18	1.14	1.06

*Includes a $7.1 million after-tax ($11.3 pre-tax) gain on the sale of the Company's Eastex Packaging subsidiary.

Note M—Supplemental Information on the Effects of Changing Prices (Unaudited)

Basis of Supplemental Data

The Financial Accounting Standards Board requires disclosure of supplementary financial information adjusted for the estimated effect of inflation as measured by the concept of current cost accounting. Traditionally, financial statements have been reported under the historical cost method of accounting which reflects amounts in dollars of varying purchasing power.

Adjustments to restate costs for the effects of changes in specific prices represent the historical amounts of production and manufacturing costs, and depreciation, amortization and depletion adjusted to reflect current cost at the date of sale and the average current cost depreciation of property and equipment restated to reflect current cost, respectively. Current cost was computed using appropriate external cost indices, appraisals and direct pricing methods. The current cost of timber and timberlands and related depletion was based on estimated reforestation costs and forest management expenditures required to bring a newly harvested area to the existing maturity of present timberland holdings. The depreciation, amortization, depletion and inventory accounting methods used to develop this supplementary financial information are the same as the methods used by the Company in its primary financial statements.

Income Taxes

No adjustments to, or allocations of, the amount of income tax expense in the primary financial statements were made in the computation of the supplemental information. Present tax laws do not allow for higher cost adjustments for the effects of inflation.

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Purchasing Power Gain from Holding Net Monetary Liabilities During the Year

When prices are increasing, the holding of monetary assets (e.g., cash and receivables) results in a loss of general purchasing power. Similarly, monetary liabilities are associated with a gain of general purchasing power. The amount has been calculated based on the Company's average net monetary liabilities for the year multiplied by the change in the Consumer Price Index ("CPI") for the year. Such amounts do not represent funds available for distribution to shareholders.

Increases in Specific Prices of Inventories, Plant and Equipment Held During the Year

Under current cost accounting, increases in specific prices of inventories, plant and equipment held during the year are not included in income from continuing operations but are presented separately. The current cost increase is adjusted by the effect of general inflation measured by applying the annual rate of change in the CPI to the average current cost balances of inventories and plant and equipment.

Statement of Income Adjusted for Changing Prices

Year ended December 31, 1985		(in millions)
Income from operations, as reported in the statement of income		$ 85
Adjustments to restate costs for the effect of specific prices (current cost):		
Depreciation, amortization and depletion	$ 34	
Cost of products sold	—	(34)
Income from operations adjusted for specific prices		$ 51
Purchasing power gain from holding net monetary liabilities during the year		$ 14
Increase in specific prices (current cost) of inventories, property, plant and equipment and timber and timberlands held during the year*		$ 51
Less effect of increase in general price level		67
Increase in specific prices (under) increase in the general price level		$ (16)

** At December 31, 1985, current cost of inventory was $102 million and current cost of property, plant and equipment, net of accumulated depreciation, was $1,756 million.*

Five-Year Comparison of Selected Supplemental Financial Data Adjusted for Effects of Changing Prices
(stated in average 1985 dollars)
(unaudited)

	1985	1984	1983	1982	1981
	(dollars in millions except per share amounts)				
Net Sales	$1,243	$1,308	$1,269	$1,222	$1,318
Current cost information:					
Income from operations	51	70	7	(1)	67
Earnings per share	2.10	2.90	.27	—	—
Net assets at year-end	1,600	1,600	1,500	1,700	1,700
Increase in specific prices (current cost) of inventories, property, plant and equipment and timber and timberlands over (under) the increase in the general price level	(16)	(36)	(15)	29	29
Other inflation-adjusted information:					
Purchasing power gain on net monetary items	14	14	11	10	23
Cash dividend declared per share	.64	.52	—	—	—
Market price per share at year-end	42.97	38.43	34.77	—	—
Average Consumer Price Index	322.2	311.1	298.4	289.1	272.4

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Report of Management

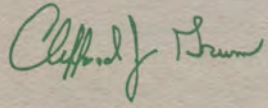
Management Report on Financial Statements

Management has prepared and is responsible for the Company's financial statements, including the notes thereto. They have been prepared in accordance with generally accepted accounting principles and necessarily include amounts based on judgments and estimates by management. All financial information in this annual report is consistent with that in the financial statements.

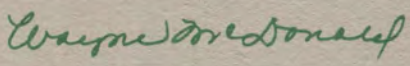
The Company maintains internal accounting control systems and related policies and procedures designed to provide reasonable assurance that assets are safeguarded, that transactions are executed in accordance with management's authorization and properly recorded, and that accounting records may be relied upon for the preparation of financial statements and other financial information. The design, monitoring, and revision of internal accounting control systems involve, among other things, management's judgment with respect to the relative cost and expected benefits of specific control measures. The Company also maintains an internal auditing function which evaluates and formally reports on the adequacy and effectiveness of internal accounting controls, policies and procedures.

The Company's financial statements have been examined by Ernst & Whinney, independent auditors, who have expressed their opinion with respect to the fairness of the presentation of the statements.

The Audit Committee of the Board of Directors, composed solely of outside directors, meets with the independent auditors and internal auditors to evaluate the effectiveness of the work performed by them in discharging their respective responsibilities and to assure their independent and free access to the Committee.



Clifford J. Grum
President & Chief Executive Officer



Wayne McDonald
Executive Vice President &
Chief Financial Officer

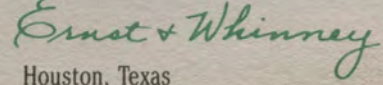
Independent Auditors' Report

Report of Ernst & Whinney, Independent Auditors

To the Board of Directors and Shareholders of Temple-Inland Inc.:

We have examined the consolidated balance sheets of Temple-Inland Inc. and subsidiaries as of December 31, 1985 and 1984, and the related consolidated statements of income, shareholders' equity and changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of Georgia Kraft Company and Great American Reserve Insurance Company, used as a basis for recording Temple-Inland Inc.'s investment in and equity in net income of those corporations, were examined by other auditors whose reports were furnished to us. Our opinion expressed herein, insofar as it relates to the amounts of investment in and income included for Georgia Kraft Company and Great American Reserve Insurance Company, is based solely on the reports of the other auditors.

In our opinion, based upon our examinations and the reports of the other auditors, the financial statements referred to above present fairly the consolidated financial position of Temple-Inland Inc. and subsidiaries at December 31, 1985 and 1984, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.



Houston, Texas
February 14, 1986

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Temple-Inland Inc. Board of Directors

Clinton G. Ames Jr. (3)
Executive Vice President of Temple-Inland Inc.

James F. Beré (1) (2)
Chairman & Chief Executive Officer of Borg-Warner Corp.

Robert Cizik (2) (4)
Chairman, President & Chief Executive Officer of Cooper Industries, Inc.

Joe C. Denman Jr. (3)
Executive Vice President of Temple-Inland Inc.

Henry C. Goodrich (2) (3) (4)
Former Chairman, Sonat Inc.

Clifford J. Grum (3)
President & Chief Executive Officer of Temple-Inland Inc.

W. Wayne McDonald (3)
Executive Vice President & Chief Financial Officer of Temple-Inland Inc.

James R. Shepley (1) (3) (4)
Vice Chairman of the Board of Pullman-Peabody Inc.

Walter P. Stern (1) (2) (3)
Vice Chairman of the Board of Capital Research Company

Arthur Temple (3)
Chairman of the Board of Temple-Inland Inc.

Arthur Temple III (1) (4)
Chairman of the Board and Chief Executive Officer of Exeter Investment Company

(1) Audit Committee
(2) Compensation Committee
(3) Executive Committee
(4) Nominating Committee

Temple-Inland Inc. Officers

Clifford J. Grum
President & Chief Executive Officer

Arthur Temple
Chairman of the Board

Clinton G. Ames Jr.
Executive Vice President

Joe C. Denman Jr.
Executive Vice President

W. Wayne McDonald
Executive Vice President & Chief Financial Officer

Roger D. Ericson
General Counsel and Secretary

M. Richard Warner
Treasurer

Joseph E. Tomlinson
Assistant Treasurer

James R. Wash
Assistant Secretary

Chester E. Winger
Assistant Treasurer

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Officers

Inland Container Corporation

▸ Corporate Group

Clinton G. Ames Jr.
President and Chief Executive Officer

Ben J. Lancashire
Executive Vice President

E. Barney Ciotti
Senior Vice President and President, Anderson Box Co.

Joseph M. Areddy
Vice President—Public Affairs

David J. Harrison
Vice President—Employee Relations and Staff Services

Joseph E. Tomlinson
Vice President, Treasurer and Controller

John M. Vaughan
Vice President—Engineering and Technology

Robert B. White
Vice President—Management Information Services

Steven L. Householder
General Counsel

Donald W. Armstrong Jr.
Assistant Vice President—Human Resources Planning and Development

Frank F. Hirschman
Assistant Vice President and Assistant Secretary

Patricia A. Foley
Assistant Secretary

▸ Containerboard Division

Winfred E. Babin
Group Vice President

Fredrick G. Fly
Vice President—Sales and Administration

Donald O. Parish
Vice President—Mill Operations

▸ Container Division

William A. Long
Group Vice President

James E. Cory
Senior Vice President—Sales and Marketing

Roger B. Morse
Senior Vice President—Plant Operations

James E. Bauer
Vice President—National Accounts

Robert W. Hosford
Vice President—Manufacturing Services

James R. Adams
Vice President—Area Manager

Charles R. Bachman Jr.
Vice President—Area Manager

James M. Givens Jr.
Vice President—National Accounts Executive

Samuel E. MacNulty
Vice President—National Accounts Executive

C. Raymond Pope
Vice President—Regional Sales Manager

J. Larry Tignor
Vice President—Area Manager

Joseph E. Turk
Vice President—Area Manager

Charles L. Wilson
Vice President—Marketing

Robert N. Wood
Vice President—National Accounts Executive

▸ Anderson Box Company

James R. McConnell
Vice President and General Manager

Temple-Inland Financial Services

W. Wayne McDonald
Chairman and Chief Executive Officer

▸ Lumbermen's Investment Corporation

Joseph L. O'Connor
President

J. M. Shorter
Senior Vice President

Joseph L. Maverick
Senior Vice President—Commercial Lending

Steve Hudnall
Senior Vice President—Temple-Inland Properties

▸ Timberline Insurance Managers, Inc.

J. P. Greve
President

▸ Great American Reserve Insurance Company

Thomas C. Hardy
President and Chief Executive Officer and Chairman of National Fidelity Life

Edward H. Keckeisen
Executive Vice President and Chief Operating Officer

John O. Rollwage
Executive Vice President—Administration

Robert L. Sanders
Executive Vice President—Sales and Marketing

Terrence L. Whitworth
Executive Vice President and Chief Financial Officer

William R. Floyd
Executive Vice President—Operations

▸ National Fidelity Life Insurance Company

Jerry W. Fickes
President and Chief Executive Officer

Robert G. Butterworth
Senior Vice President—Marketing Director

Charles R. Duffy Jr.
Senior Vice President—Operations

James N. Kotsonis
Senior Vice President—Actuary

Temple-Eastex Incorporated

▸ Corporate Group

Joe C. Denman Jr.
Chairman, President and Chief Executive Officer

Robert G. Luttrell
Vice President—Administration and Treasurer

George S. Vorpahl
Vice President and General Counsel

James R. Wash
Secretary

Jack H. McCuistion
Controller

James J. Nelson
Assistant Secretary and Assistant Treasurer

▸ Building Products Division

Harold C. Maxwell
Group Vice President

Joe K. Sample
Vice President—Marketing

Jack C. Sweeny
Vice President—Operations

▸ Forests Division

Glenn A. Chancellor
Group Vice President

▸ Pulp and Paperboard Division

David L. Ashcraft
Group Vice President

Russell E. Chase Jr.
Senior Vice President—Marketing

Aubrey W. Barlow
Vice President—Sales

Carl B. Fickenscher
Vice President—Administration

Robert W. Kent
Vice President—Mill Operations

E. Wayne Carr
Controller

▸ AFCO Industries, Inc.

Robert G. Molloy
President and Chief Executive Officer

▸ Sabine Investment Company of Texas, Inc.

Horace G. Stubblefield Jr.
President

▸ Temple Associates, Inc.

Kenneth D. Robirds
President and Chief Executive Officer

▸ The Angelina Free Press, Inc.

Paul M. Durham
Vice President, Editor and General Manager

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Shareholder Information

Transfer Agent and Registrar
RepublicBank Dallas, N.A.
P.O. Box 2964
Dallas, Texas 75221

Independent Auditors
Ernst & Whinney
Houston, Texas

Annual Meeting
The annual meeting of shareholders of Temple-Inland Inc. will be held at our corporate headquarters, 303 South Temple Drive, Diboll, Texas on Friday, May 2, 1986 at 10:00 a.m. local time.

Stock Listing
Temple-Inland Inc. Common Stock is listed on the New York and Pacific Stock Exchanges. Ticker Symbol: TIN

Common Stock Price Range and Dividend Information—1985 and 1984

1985	Price Range		
Quarter	High	Low	Dividends
First	$39½	$32¼	$ .16
Second	37	31¾	.16
Third	40⅜	33⅞	.16
Fourth	44½	35½	.16
Year	44½	31¾	.64

1984	Price Range		
Quarter	High	Low	Dividends
First	$37¾	$25⅜	$.125
Second	33⅜	25¾	.125
Third	35¼	25½	.125
Fourth	37¾	29⅝	.125
Year	37¾	25⅜	.50

At their January, 1986 meeting, the directors of Temple-Inland Inc. voted to increase the regular quarterly dividend rate on Common Stock from 16 cents to 18 cents per share.

Number of Shareholders
As of December 31, 1985, there were 11,441 shareholders of record of the Company's common stock.

Form 10-K
A copy of Temple-Inland Inc.'s annual report on Form 10-K as filed with the Securities and Exchange Commission will be sent without charge upon written request to the Company's Shareholder Relations Department.

Mailing Address
Temple-Inland Inc.
Drawer N
Diboll, Texas 75941

Telephone Number
(409) 829-1313

Dividend Reinvestment Plan

The Company offers its shareholders a convenient and economical way to increase their investment in our Common Stock through the purchase of additional shares with quarterly dividends and optional cash payments. Under the Temple-Inland Inc. Dividend Reinvestment Plan administered by RepublicBank Dallas, N.A., Temple-Inland pays the brokerage fees and service charges, and the shareholder receives the benefit of larger quantity purchases and optional free custodial services. For more information on the Plan, contact RepublicBank Dallas, N.A., Dividend Reinvestment Department, P.O. Box 2964, Dallas, Texas 75221.

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Temple-Inland Inc.
Drawer N
Diboll, Texas 75941