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Temple-Inland Inc.
1986 Annual Report



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ABOUT OUR COMPANY

TEMPLE-INLAND IS A HOLDING COMPANY WITH MAJOR INTERESTS IN PAPER, PACKAGING, BUILDING PRODUCTS, MORTGAGE BANKING AND INSURANCE. ■ MAJOR SUBSIDIARIES INCLUDE: INLAND CONTAINER CORPORATION (CONTAINERBOARD AND CORRUGATED PACKAGING); TEMPLE-EASTEX INCORPORATED (BLEACHED PAPERBOARD AND BUILDING MATERIALS); LUMBERMEN'S INVESTMENT CORPORATION (MORTGAGE BANKING, LAND DEVELOPMENT AND REAL ESTATE); GREAT AMERICAN RESERVE INSURANCE COMPANY AND NATIONAL FIDELITY LIFE INSURANCE COMPANY (LIFE AND HEALTH INSURANCE). ■ TEMPLE-INLAND IS A MAJOR LANDOWNER WITH MORE THAN 1.3 MILLION ACRES OF TIMBERLAND IN EAST TEXAS AND LOUISIANA, AND 50% OWNERSHIP OF GEORGIA KRAFT COMPANY, WHICH OWNS OVER ONE MILLION ACRES IN GEORGIA AND ALABAMA. ■ THE COMPANY NOW HAS THE CAPACITY TO PRODUCE ANNUALLY ABOUT 1.8 MILLION TONS OF CONTAINERBOARD AND 540,000 TONS OF PULP AND BLEACHED PAPERBOARD IN ITS NINE MILLS, INCLUDING THREE GEORGIA KRAFT COMPANY MILLS. A LARGE VOLUME OF THE CONTAINERBOARD IS CONVERTED INTO CORRUGATED PACKAGING AT THE COMPANY'S 32 BOX PLANTS. ■ TEMPLE-INLAND ALSO MANUFACTURES A WIDE RANGE OF BUILDING PRODUCTS INCLUDING LUMBER, PLYWOOD, PARTICLEBOARD, GYPSUM WALLBOARD, FIBERBOARD, ORIENTED STRANDBOARD, RIGID FOAM SHEATHING, AND DECORATIVE WALL PANELING. ■ LUMBERMEN'S INVESTMENT CORPORATION SERVICES OVER $3 BILLION OF MORTGAGE LOANS, PRIMARILY RESIDENTIAL. THE COMBINED INSURANCE COMPANIES HAVE APPROXIMATELY $10 BILLION OF INSURANCE IN FORCE AND HAD ABOUT $300 MILLION OF PREMIUM INCOME IN 1986. ■ TEMPLE-INLAND IS BASED IN DIBOLL, TEXAS, AND ITS COMMON STOCK IS TRADED ON THE NEW YORK AND PACIFIC STOCK EXCHANGES UNDER THE TICKER SYMBOL TIN.

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FINANCIAL HIGHLIGHTS

(in millions, except share and per share data)

	1986	1985	Percent Increase (Decrease)
Net Sales	$1,295.8	$1,243.1	4 %
Operating Income	$ 118.2	$ 111.6	6 %
Net Income	$ 80.8	$ 85.1	(5)%
Shareholders' Equity	$ 928.9	$ 863.7	8 %
Earnings Per Share†	$ 2.64	$ 2.80	(6)%
Book Value Per Share†	$ 30.61	$ 28.57	7 %
Dividends Per Share†	$ .58	$ .51	13 %
Average Shares Outstanding (in thousands)	30,566	30,390	1 %

SELECTED BUSINESS SEGMENT DATA

(in millions)

	1986	1985	Percent Increase (Decrease)
Net Sales			
Container and containerboard	$721.7	$684.2	5 %
Pulp and paperboard	$264.9	$256.7	3 %
Building products	$281.5	$268.0	5 %
Operating Income			
Container and containerboard	$ 38.8	$ 49.7	(22)%
Pulp and paperboard	$ 29.4	$ 19.8	48 %
Building products	$ 35.9	$ 22.5	60 %
Financial services*	$ 33.0	$ 25.3	30 %

†Per share amounts have been retroactively adjusted for a five-for-four stock split declared in February, 1987.
*Pre-tax earnings of unconsolidated financial services subsidiaries.

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TO OUR SHAREHOLDERS



CLINTON G. AMES JR.
CHAIRMAN AND CHIEF
EXECUTIVE OFFICER
INLAND CONTAINER
CORPORATION



JOE C. DENMAN JR.
CHAIRMAN, PRESIDENT AND
CHIEF EXECUTIVE OFFICER
TEMPLE-EASTEX INCORPORATED



W. WAYNE MCDONALD
CHAIRMAN AND CHIEF
EXECUTIVE OFFICER
TEMPLE-INLAND
FINANCIAL SERVICES

Dear Shareholder:

1986 was a year of significant growth and development for Temple-Inland. It was also a difficult year.

Operating income increased by 6%, but net income dropped to $2.64 per share from the $2.80 per share earned in the prior year. However, included in net income for 1985 was $.23 per share from the sale of a folding carton business which was not strategically important for continued growth of the Company. Net sales from manufacturing operations were $1.3 billion in 1986, up slightly from 1985.

Temple-Inland's principal product is paper with concentration in two segments of this industry—the manufacture of containerboard used in corrugated boxes and bleached paperboard used in a wide variety of consumer items. We convert a large portion of our containerboard production in our own box plants but sell the bleached paperboard to other converters.

In addition, we produce a wide range of building materials and have a financial services group involved in mortgage banking, insurance, and real estate development.

Our paper segments produced 58% of total operating income in 1986 compared with 62% in 1985. Bleached paperboard earnings were up 48% over 1985, but our larger container and containerboard operation was down 22%.

In our segments of the paper industry, there are many American manufacturers supplying worldwide demand. Therefore, we are affected not only by the domestic economy, but also by the U.S. industry's ability to serve foreign markets.

The strong American dollar in 1984–85 made U.S. products very expensive in foreign markets and caused export demand to diminish greatly. Even though domestic markets continued to grow, overall industry demand dropped, causing an erosion of selling prices. In fact, the selling prices for most of the paper products we

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manufacture, which peaked near the end of 1984, continued to fall well into the second quarter of 1986.

As the American dollar began to weaken, export volumes improved and relative stability of markets was again established. The continued growth in worldwide demand has allowed some price recovery, but at year-end, prices still were below peak levels.

The building products group benefited from the favorable levels of residential construction, and earnings increased 60% over 1985. This was achieved despite adverse economic conditions in Texas, a principal market for the group.

Temple-Inland Financial Services had another record year with earnings increasing 30% to $33 million. Earnings from financial services are becoming a more material portion of total earnings. Insurance was the largest contributor to financial services' earnings in 1986 and will be important in the continued growth of this segment of Temple-Inland.

Our initial comment was that 1986 was a significant year in the growth of Temple-Inland. Virtually all of the Company's manufacturing facilities operate at one speed—full-out. Therefore, unit growth is dependent on new or improved facilities. In 1986, we increased productive capacity of containerboard by 50% to 1.8 million annual tons with the acquisition of a mill in Orange, Texas, from Owens-Illinois, Inc., (O-I), and the start-up of the new Ontario, California, mill.

The O-I acquisition included the Orange mill with an estimated capacity of 400,000 tons of linerboard annually, three corrugated box manufacturing plants, approximately 260,000 acres of timberland in east Texas and Louisiana, and a short-line railroad. The purchase price was $220 million.

This acquisition has unique advantages for us: it gives us needed additional containerboard capacity, and the mill is strategically located within our timberland holdings in east Texas. The purchase of the timberlands gives us over 1.3 million acres in east Texas and Louisiana from which we can supply fiber to the Company's various converting facilities in that region.

Under previous ownership, the Orange mill experienced many operating problems and was a relatively high-cost producer of linerboard. We have already begun to achieve reduction of cost, have improved productivity, and have plans to significantly improve the continuity of operation. We are pleased with the progress to date, but we estimate it will take at least three years to achieve the low-cost structure we expect from our other operations.

The Ontario mill, which uses old corrugated waste as its raw material, actually began operations in late 1985. The effluent system designed for the mill did not work to specification, and a new system was completed late in 1986.

While the new system was being installed, production was somewhat curtailed through most of 1986. We are encouraged by the level of production reached during the fourth quarter, and now expect that the mill may be able to exceed its rated capacity under normal operating conditions.

The building products group completed a new gypsum wallboard plant at Fletcher, Oklahoma, in the third quarter. By year end, this mill had shown that it could operate at designed capacity and produce quality board, a significant achievement in a short period.

This plant allows us to dedicate the production of our existing plant in West Memphis, Arkansas, to southeastern markets while the new plant will serve Texas and Oklahoma. The potential of this new plant will not be fully realized until construction activities in Texas and Oklahoma recover.

The year was also one of significant growth for Temple-Inland Financial Services. It was the first full year in which National Fidelity Life Insurance Company operated as a subsidiary.

In May, Financial Services acquired the annuity business of Voyager Life Insurance Company of Jacksonville, Florida. This company primarily sold its products in Florida and surrounding states to teachers and other educators—the same markets where we have unique strengths in other geographical areas. This acquisition also doubles the Company's annuity base, provides an excellent variable annuity product, and gives us expertise in the sale of variable annuities which, we feel, will be an important product for us in the future.

It is significant that at the end of the year we had 1,500 agents, excluding brokers, selling our insurance products, up 33% from last year. They produced a record volume of business for us in 1986, and we expect another record in 1987.

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Arthur Temple
Chairman of the Board

Three years ago, when Temple-Inland became an independent company, we established certain goals: first, to maintain and improve our position as a low-cost producer of all products and services; second, to maintain the Company's record of profitable growth; and third, to develop a management team which would lead us in the future.

We have not totally achieved those goals. We do feel that with the almost $1 billion spent or committed to upgrade and expand our facilities, we have gone a long way toward improving productivity and containing our costs. New plants in Ontario and Fletcher give us additional low-cost production. A new wood converting facility under construction at Buna, Texas, will give us a high tech sawmill and provide low-cost residue fiber to our paper mills at Evadale and Orange.

Our management team continues to develop from within. Our strategy is to operate Temple-Inland with a small corporate staff and to rely on employees at our subsidiaries to do much of the staff work. It has worked well thus far, and we plan to continue. We wish to thank not only those employees who are involved with Temple-Inland projects, but all of the more than 10,000 men and women who work for our subsidiaries. They have done a tremendous job.

As part of our management development, we are pleased to announce the election of Ben J. Lancashire as President of Inland Container Corporation. Ben joined Inland in 1961 and has served as Executive Vice President since 1977. He has been an able associate with Inland's chief executive officer, C. G. (Jack) Ames, Jr., in leading Inland, and this move has been made in anticipation of Jack Ames' retirement later this year.

In February 1987, Admiral B. R. Inman, USN (Ret.) was elected to the Board of Temple-Inland, bringing the number of directors to 12. He is Chairman, President and Chief Executive Officer of Westmark Systems, Inc. We look forward to his advice and counsel.

At the February board meeting, Temple-Inland directors approved a 5-for-4 split of the Company's common stock. It is management's intent, commencing in the second quarter of 1987, to recommend to the Company's Board of Directors that the current quarterly cash dividend rate of $.18 per share be continued, effectively increasing the total quarterly dividend by 25%.

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In this year's annual report, we have further expanded the statistical information in the financial review section. We hope you find this additional information helpful in understanding our Company.

We move into 1987 with much more confidence than when we entered 1986. Our business segments are strong and have a great deal of momentum in the right direction. If the first two months are any indication, we believe 1987 will be highly successful for Temple-Inland and similarly rewarding for you, our shareholders.

Sincerely,

Clifford J. Grum
President & Chief Executive Officer

Arthur Temple
Chairman of the Board

February 20, 1987



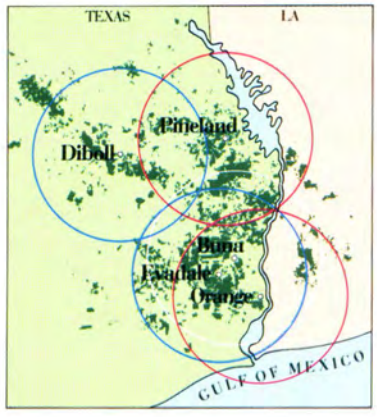
Clifford J. Grum
President & Chief Executive Officer

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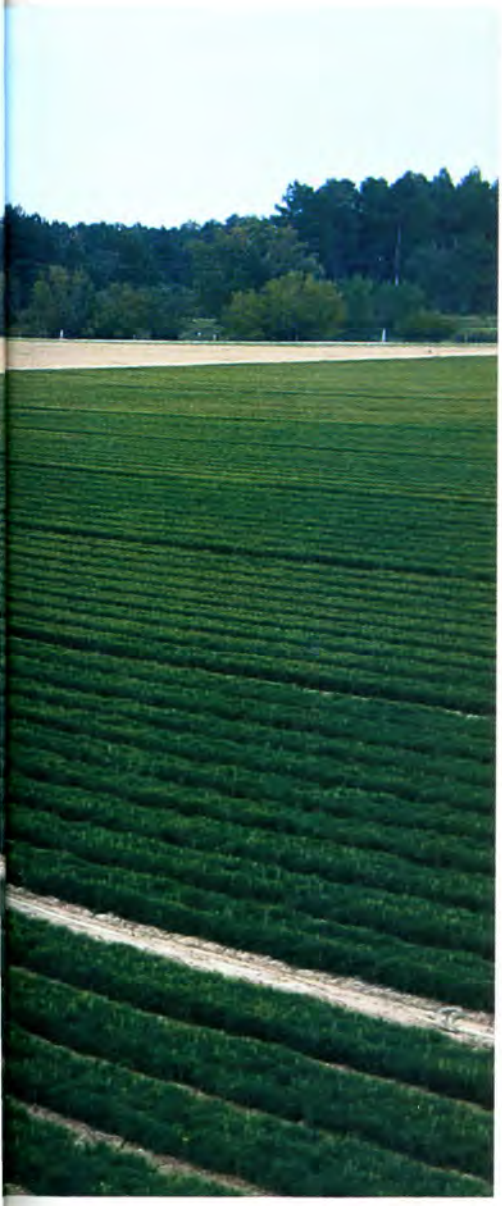


With the purchase of 260,000 acres of land in 1986, over 90 percent of our acreage in East Texas and Louisiana is located within 40 miles of at least one of our converting operations.





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EACH YEAR, OUR NURSERY NEAR NEWTON, TEXAS, PRODUCES ABOUT 25 MILLION SUPERIOR PINE SEEDLINGS WHICH ARE TRANSPLANTED AND WILL PROVIDE OUR TREES OF THE FUTURE.

TIMBERLANDS

Timber is the primary raw material used in our manufacturing operations and, historically, has been a principal source of value for the Company. The major contributor has been the larger trees which can be converted to lumber and plywood rather than smaller ones which are primarily used as fiber in paper products.

In recent years, a combination of lower levels of residential construction, the dramatic increase in the importation of lumber from Canada, and substitution of other panel products for plywood usages have resulted in declining values for larger trees. In fact, the current value of these trees has declined by about one-half from their historical highs. However, we fully expect these values to recover in the next decade.

As tree farmers, we are planting a crop that will not be ready for harvesting for a minimum of 15 years and will only reach optimum value creation at some time between the 30th and the 40th year. Substantial cost is involved in the planting of these trees, as well as the annual payment for land taxes and maintenance with no income for at least 15 years. The decline in value of trees currently being harvested, as well as the impact of the tax reform bill, is discouraging many of the private timber owners from replanting their lands as timber is cut.

Although this will not have an immediate effect on timber supply in this country, we believe it will begin to become a critical factor in about 10 years as timber values will reflect scarcity conditions. Therefore, the long-term objective is to be able to supply internally a larger percentage of our needs by the turn of the century.

In order to preserve as much of the income stream from these trees as possible, we have continued to innovate and improve forestry practices. One major cost over which we have some immediate control is that of hauling logs from the forest to the converting plant. Historically, some of our fee lands were 80 air miles or more from our nearest wood-using facility. We have determined that maximum transportation benefit could be gained by reducing this distance to 40 miles or less, and we are attempting to concentrate most of our land holdings within this radius.

With the acquisition of 260,000 acres from Owens-Illinois, Inc., we now have more than 1.3 million acres of pine and hardwood in east Texas and western Louisiana. The O-I land complements our existing land holdings, and approximately 90% of the combined acreage already fits the 40-mile radius concept.

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During 1986, over 90% of our Texas requirements for sawtimber was supplied from company-owned lands, and approximately 50% of our pine pulpwood needs came from the same source. This fiber came principally from approximately 30,000 acres of natural timber stands which were harvested and will be replanted in plantations.

We currently have about 560,000 acres in fast growing pine plantations designed to utilize each of the acres to its maximum growth potential. The remainder of the land is in natural-growth stands.

We fully expect the company's fiber needs to continue to grow, especially in Texas. Therefore, we are continuing technological improvements to maximize growth per acre. Growth rates in many plantations are twice that which is historically experienced in natural timber stands, and we plan to continue to convert additional acres to plantations each year.

In addition to our Texas and Louisiana woodlands, Georgia Kraft Company, our 50%-owned affiliate, has nearly one million acres in Georgia and Alabama. The average volume of wood on these acres is considerably less than on our Texas and Louisiana land.

Most of the timberland in Georgia and Alabama is held by small landowners. This type of ownership allows Georgia Kraft to purchase approximately 80% of its fiber needs from these timber farmers and rely on company lands for the remaining 20%. Because of the effectiveness of forest management programs that result in higher yields, our long-term objective is to increase the level of company-supplied timber at Georgia Kraft from 20% to 40% without purchases of additional timberlands.

A complete inventory of our acreage is constantly being updated. With modern forestry practices, we fully expect to be able to provide the sawtimber and fiber requirements of our east Texas complexes on somewhat fewer acres than we presently own. Therefore, selective tracts not fitting our strategic requirements will be offered for sale as our inventory of timber grows.

Productive forests designed for maximum fiber growth will also provide other benefits as we continue to be concerned with the multiple uses of land, including strong support of wildlife and woodland recreation. Our biologists work closely with state and national organizations to provide an attractive environment for endangered species and to achieve proper balance in wildlife numbers.



GENETICALLY SUPERIOR PINE TREES, GROWN AT OUR SEED ORCHARDS, PRODUCE MILLIONS OF SEEDS HARVESTED EACH YEAR TO HELP MAINTAIN OUR SUPPLY OF SEEDLINGS.

THE NEEDS OF OUR CUSTOMERS FOR ATTRACTIVE GRAPHICS AND STRUCTURAL IMPROVEMENTS IN THEIR PACKAGING REQUIRE CONTINUAL INVESTMENT IN OUR BOX PLANTS. THREE NEW BOX PLANTS WERE ADDED IN 1986, BRINGING OUR TOTAL TO 32.

CONTAINER AND CONTAINERBOARD

Much of what is grown or manufactured in this country finds its way into a corrugated box sometime during the distribution process. It is the best and most economical way to ship products.

The principal raw material used in the manufacture of corrugated packaging is containerboard—linerboard and corrugating medium. Temple-Inland, through Inland Container Corporation, is a major producer of containerboard and corrugated packaging.

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The corrugated container industry is highly competitive with over 800 companies operating more than 1,400 box plants in this country. No company dominates the market. Inland operates 32 box plants, including one in Puerto Rico, and has about seven percent of the domestic market, making it one of the four largest producers.

1986 saw a continuation of the consolidation within the paper industry. In 1987, the top five manufacturers of containerboard are expected to produce nearly half the total domestic production, up from about one-third just five years ago. Moreover, three of the top five producers in 1987 were not in the top five in 1982.

Inland participated in this consolidation with the purchase of the Orange, Texas, linerboard mill and three corrugated box plants. The linerboard mill added 400,000 annual tons of production and, along with an additional 175,000 annual tons from the new Ontario, California mill, increases Inland's containerboard production by about 50% to approximately 1.8 million tons.

The addition of the Orange and Ontario mills has changed Inland from a company that converted virtually all of its containerboard production into corrugated boxes in its own plants to a net seller of board. The Company has become a factor in the brown paper market and will sell about 400,000 tons of containerboard on the open market in 1987.

The competitive environment in the containerboard and corrugated box market was intense last year. Even though containerboard prices did move up during the second half of the year, improvement in corrugated box prices lagged considerably. Real improvement in box prices was not felt until the final months of 1986. Since corrugated boxes are Inland's principal product, this condition resulted in lower profitability than would normally be expected, given the environment of healthy exports, higher mill operating rates, and lower containerboard industry inventory levels.

Operating earnings for Inland totaled $38.8 million compared with $49.7 million in 1985.

During 1986, productivity improvements were realized in our paper mills with the corrugating medium mills increasing production about 7% due to incremental additions and mix improvement. Furthermore, the three linerboard mills at Georgia Kraft improved productivity while holding costs in line.

Georgia Kraft produces about half of Inland's containerboard supply. A two-year, $185 million program at the Rome, Georgia, mill will help reduce production costs considerably and will expand its capacity by about 25% to about 2,500 tons of linerboard per day. This project should be completed in 1989.

Upgrading productivity and quality at our Orange and Ontario mills is receiving immediate attention. At Ontario, we believe the major operating problems are behind us, and we can now concentrate on improving consistency in production.

STATE-OF-THE-ART TESTING EQUIPMENT AT OUR MARKETING AND TECHNICAL CENTER IN INDIANAPOLIS, INDIANA, SIMULATES VIRTUALLY EVERY ABUSE THAT A CORRUGATED BOX MIGHT RECEIVE IN ITS SHIPPING CYCLE. WE WORK CLOSELY WITH OUR CUSTOMERS IN ASSESSING AND MEETING THEIR PACKAGING NEEDS.



THE ORANGE, TEXAS, LINERBOARD MILL, PURCHASED IN 1986, AND OUR NEW MILL IN ONTARIO, CALIFORNIA, HAVE INCREASED THE COMPANY'S CONTAINERBOARD CAPACITY BY 50 PERCENT.

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NEW PRODUCTS ARE CONTINUALLY BEING DEVELOPED BY OUR BLEACHED PAPERBOARD GROUP. A NEW MARRIAGE OF PAPER AND PLASTIC CREATES A PRODUCT, SHOWN BEING TESTED (RIGHT), WHICH HAS UNIQUE CHARACTERISTICS, ALLOWING THE PRODUCT TO TRAVEL FROM THE FREEZER TO HIGH TEMPERATURE OVENS, OR MICROWAVES, AND THEN TO THE DINNER TABLE (ABOVE).



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As stated in the Letter to Shareholders, the Orange mill was purchased with the knowledge that additional investments would be necessary to bring the mill up to Inland's standards. We are committed to that. This mill offers unique advantages due to its ideal strategic location.

In fact, management had considered constructing a new greenfield linerboard mill in east Texas to take just such advantage of the close proximity to Temple-Inland's timber base and other timber conversion facilities in the area. However, because of the high cost of building a new mill, there was little possibility of achieving a satisfactory financial return on our investment.

We fully believe that the Orange mill, after modifications are completed, offers opportunity for profitable growth and the achievement of satisfactory financial returns.

The acquisition also added three box plants, filling some geographical holes in our box plant system and increasing our box sales by about 15%. The plants have blended well into the Inland system.

Inland is also committed to improving profitability in the box business. Emphasis will continue to be placed on quality and service to customers, and we intend to concentrate on increasing participation in the higher-value-added box business, such as die cuts, specialty packaging and improved graphics. However, our immediate objective is to optimize product mix and to receive adequate prices for products and service.

PULP AND PAPERBOARD

Bleached paperboard is converted into products used every day by millions of people. Paper cups and plates, folding cartons, shopping bags, file folders, and telephone book covers are just a few of the uses our customers have for bleached paperboard.

The Temple-Eastex mill at Evadale, Texas is one of the largest producers of specialty grades of bleached paperboard with an annual rated capacity of 540,000 tons. While this is a small percentage of total industry production, we enjoy a large share of the market for selected products such as cups, coated and uncoated plates, file folders, and bleached linerboard.

The mill has three large fourdrinier machines and one cylinder machine. With four machines in a single mill, we have the flexibility to make a wide range of paperboard grades and weights to serve a broad base of customers. The four machines allow us to capitalize on those opportunities which require making grade changes quickly and efficiently.

As with container and containerboard, prices for bleached paperboard fell in 1985 and continued to drop in 1986 before leveling off. Demand picked up and the chaotic markets began to improve in the second half of the year, allowing some price recovery.

In 1986, continued emphasis was placed on cost containment programs and productivity improvement. As a result, man-hours per ton of production are expected to decrease over 10% in 1987.

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Operating income of $29.4 million was up 48% from 1985 and production totaled 562,000 tons.

With the mill in a good competitive cost position in the industry, increased emphasis is being placed on quality and service to customers. A key element in service is the ability to develop products to meet new needs of customers.

In 1986, we entered the polyethylene coated cup market. Combining this with existing capabilities in waxed cups strengthened our ability to service new customers and increased our growth potential in higher-value-added products.

Another new product of the Evadale mill, currently in the developmental stage, is a synthetic pulp product for use in making food containers able to withstand the range of temperatures from freezer to oven.

This "polymer composite sheet" can be used for dual ovenable formed trays for food packaging. With its temperature resistance and a competitive cost, the new materials system could find additional applications in the business equipment, appliance and even the automotive markets. Actual production will be limited in 1987 as we continue to explore potential markets and consumer acceptance.

With the flexibility to produce custom specialty grades and weights, management will continue to pursue new opportunities in products that offer higher value to customers and to Temple-Inland. And, we will continue to make the investment necessary to improve the mill's competitiveness and cost structure.



NEW COMPUTER-CONTROLLED EQUIPMENT (ABOVE) AT OUR PARTICLEBOARD MILLS HELPS US PRODUCE A SUPERIOR GRADE OF HIGH DENSITY PARTICLEBOARD. IN 1986, OVER 50 PERCENT OF OUR PARTICLEBOARD WAS IN NON-COMMODITY ITEMS SUCH AS THAT USED IN COUNTERTOPS AND KITCHEN CABINETS (RIGHT).

BUILDING PRODUCTS

Temple-Inland manufactures and markets a wide range of building materials. Lumber and plywood are produced by both our Temple-Eastex subsidiary and Georgia Kraft Company, our 50%-owned affiliate. In addition, Temple-Eastex is a manufacturer and marketer of particleboard, gypsum wallboard, oriented strandboard (OSB), rigid foam insulation, hardboard siding, fiberboard sheathing and decorative wall paneling.

While we are not a major national manufacturer of any one of these products, we are a force in certain geographic markets with particular products. Furthermore, the wide diversification helps us avoid some of the cyclical variation in this segment of our business.

Housing starts totaled a robust 1.8 million in 1986, although the geographic distribution of these starts changed somewhat from the recent past. As the southwest felt the effects of the oil "bust," markets in the northeast and southeast improved.

Our building products group had a good year in 1986, earning $35.9 million, up from $22.5 million in 1985. The composition of the earnings changed dramatically in 1986. In 1985, gypsum contributed almost one-third of the total building products earnings, and although this product remained very profitable in 1986, margin levels moderated. At the same time, we had

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considerable profit increase in most every other product line. Fiberboard had a record year and was our single largest contributor to earnings.

Our solid wood group (lumber and plywood) posted sharply improved operating results. A renovation at the Pineland, Texas, stud mill, which was completed during the year, reduced energy consumption and increased lumber recovery, helping production reach record levels.

Georgia Kraft lumber and plywood production increased slightly in 1986 which saw the first full year of operation of the Cottonton, Alabama, sawmill. Earnings from these operations are accounted for as a cost reduction for the fiber used by its paper mills rather than as a separate profit center.

Particleboard markets were strong in 1986, and we were able to benefit from recent capital projects at these operations which allowed us to manufacture a more diverse product mix with state-of-the-art process control.

We are converting more of our production from commodity particleboard, used primarily in new-home construction, to industrial-grade board used in laminating processes in the furniture and cabinet industries. In addition, we are working to further penetrate the mobile home market with Premideck®, a board manufactured using a formaldehyde-free resin.

A major renovation at the Company's oriented strandboard operation at Claremont, New Hampshire, was completed in 1986. This mill was purchased in a bankruptcy proceeding in 1985, and we recognized that major capital improvements would be necessary to produce a quality product at an efficient level of production. The first phase of the capital improvement was completed in late 1986, and we have seen some improvement in the operations already. Problems with fiber supply and environmental restrictions will probably continue to reduce profitability until further enhancements are achieved this year.

Both major fiberboard products—sheathing and siding—are heavily used in residential construction, and they benefited from the strong market in 1986. The record volume levels allowed us to spread our fixed cost in this product over more units.

We continue to develop new products in this group. We expanded our siding products, including a new prefinished siding targeted for the manufactured housing market. The acceptance of these products continues to be very gratifying.

The new $20 million gypsum wallboard plant, which was built adjacent to our gypsum mine in Fletcher, Oklahoma, was completed during the third quarter of 1986, doubling our annual capacity. By year-end, the Fletcher plant was producing at designed capacity.

Unfortunately, our traditional markets for gypsum—Texas and Oklahoma—were particularly depressed in 1986 and continue slow into 1987. Selling prices in the southeast and northeast are considerably higher, allowing us to profitably ship product from Fletcher and our plant in West Memphis, Arkansas. Our objective is to develop a customer base for the Fletcher plant closer to home in order to avoid the high freight charges.



EXCEPTIONAL SMOOTHNESS OF THE PARTICLEBOARD IS NECESSARY TO ALLOW LAMINATING OF VARIOUS MATERIALS. OUR PREMIDECK® PARTICLEBOARD, WHICH USES A FORMALDEHYDE-FREE RESIN, IS BEING ESPECIALLY WELL-RECEIVED BY THE MOBILE HOME INDUSTRY, AS WELL AS BY MANUFACTURERS OF FURNITURE AND CABINETS.

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Capital projects aimed at cost containment and improved process control at all building products operations paid dividends in the form of productivity improvement in 1986 and further improvement can be expected in 1987.

A new wood converting complex is underway at Buna, Texas. Scheduled for completion in 1987, this state-of-the-art sawmill will efficiently convert logs of all diameters and will produce a wide range of lumber sizes to serve the changing needs of the marketplace. The new mill will increase Temple-Eastex's lumber production to approximately 300 million feet annually and will generate 185,000 tons of wood chips annually for the Company's paper operations. Since it is being built on the Company's short-line railroad, those chips will be delivered to the Orange mill at substantial savings on freight.

Housing starts are expected to drop in 1987, especially in multi-family units. To maintain the current level of earnings, continued productivity improvement will be necessary.

FINANCIAL SERVICES

Temple-Inland Financial Services grew significantly in 1986 with earnings increasing from $25.3 million to $33 million. Earnings have more than doubled in just two years, making financial services a much more important contributor to our earnings stream.

Our financial services operations are primarily involved in mortgage banking, real estate development, and insurance.

Insurance

Our insurance activities have shown the most growth in recent years. Great American Reserve Insurance Company (GARCO), based in Dallas, Texas, and National Fidelity Life Insurance Company (NFL), based in Overland Park, Kansas, are our two major insurance operations. Both companies are rated A+ (Excellent) by the A. M. Best Company.

GARCO underwrites life, health, and annuity policies to a broad base of customers. Most agents who sell GARCO products concentrate primarily on writing for GARCO.

National Fidelity Life concentrates its activities in life and annuity policies. NFL continues to be one of the industry leaders in insuring individuals with some medical impairment. While continuing to build this important market, NFL also provides insurance for especially healthy persons at preferred premium rates. NFL sales are generally made through brokerage agents who also sell for other companies.

1986 was an excellent sales year for our insurance operations even though industry sales remained essentially unchanged. New life insurance sold by GARCO and NFL in 1986 exceeded $1.5 billion. Total insurance in force for the two companies now exceeds $9 billion.

Over the years, GARCO has had a unique specialization in the education market, particularly in southwestern states. Considerable emphasis was placed during the year on this market as well as on geographical expansion. In May,



FIBERBOARD OPERATIONS HAD A RECORD YEAR IN 1986. NEW PRODUCTS, SUCH AS THE HARDBOARD SIDING SHOWN ABOVE, CONTRIBUTED TO THAT RECORD.

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GARCO acquired the annuity business of Voyager Life Insurance Company of Jacksonville, Florida. This segment of Voyager's business was largely concentrated in the teacher market in Florida and Georgia. The purchase allowed GARCO to achieve greater penetration in the southeast and brought to the Company a new product, the variable annuity. We are now selling this product in all our markets.

Similar to Temple-Inland's manufacturing operations, the key to profitability in the insurance business is to be a low-cost producer while providing quality products and service to the policyholder. Since the acquisition of NFL in 1985, we have been centralizing certain operations which benefit from economy of scale, while maintaining decentralization in those areas where that is most beneficial. During the year, we made progress in both cost control and improvement in level of service, and further progress in these areas is our goal for 1987.

The insurance industry is going through a significant transition, and, although change is often disconcerting, we feel it offers new opportunities for Temple-Inland. We are comfortable with the changing environment taking place in the insurance industry and believe it is the foundation for future growth.

Timberline Insurance Managers, Inc., our casualty agency based in Austin, Texas, experienced another year of solid earnings growth and service to customers. The agency plans to continue to grow in both personal lines coverage as well as commercial lines.



Mortgage Banking

Because of the lowest mortgage interest rates in this decade, 1986 was an extremely active year to be a mortgage banker. Lumbermen's Investment Corporation (LIC) was inundated with mortgage business, due more to refinancing activity than to new housing starts.

The volume of new residential loans produced by LIC totaled $572 million, the highest in the history of the Company. In addition, the Company produced $74 million of commercial and industrial loans.

Although there was a high level of mortgage activity and an excellent environment in which to originate loans, this robust business did not translate into the kind of portfolio growth the Company had set for itself. The refinancings created excessive "paid in fulls," making it difficult to have significant net increases in its $3 billion servicing portfolio. The net portfolio growth in 1986 was 7.2%.

The mortgage banking industry is highly competitive and very fragmented. LIC continues to stress productivity and the creation of value over market share. In 1986, LIC continued to make strides in keeping its production costs and portfolio servicing costs among the lowest in the industry. Two new loan production offices were opened during the year and we plan to further expand our base from our current 18 offices.

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IN 1986, MAJOR INNOVATIONS WERE MADE IN OUR INSURANCE PRODUCT LINES FOR THE TEACHER AND EDUCATOR MARKETS. OUR NEW "CAFETERIA" PROGRAM FOR THESE GROUPS WAS LAUNCHED LAST YEAR.

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Real Estate

Although our sales of commercial tracts declined in 1986, our residential lot sales maintained a steady rate, a significant achievement considering the depressed state of the Texas real estate markets. In 1986, we sold 687 lots compared with 639 in 1985.

Our residential subdivisions are concentrated in San Antonio and Austin, Texas. The lots in these subdivisions provide for moderately-priced homes. The fact that we experienced above average sales reflects both the location and the price range of the houses to be constructed on those lots.

In the development of a subdivision, the planning, environmental approvals, and road and sewer construction can often require up to two years before the first lot can be sold. Then, as many as 10 years may elapse before the sale of most residential lots is completed. Because most of our subdivisions are mature, we can offer additional lots for sale with only incremental development costs.

In order to have a future supply of lots, in 1986 we agreed, along with two other partners, to purchase 2,148 acres in San Antonio, Texas. Although we will develop certain portions of this land for residential lot sales, our present plan is to partially develop some of the property into multi-acre tracts suitable for other developers to subdivide. This should allow us to begin realizing a cash return quicker than the normal development period.

Commercial real estate activity declined significantly in 1986, and although we expect some recovery in 1987, it probably will not be as robust as single family lot sales.

New Venture

Temple-Inland Financial Services is entering a new segment of its industry with the announced agreement to purchase Kilgore Federal Savings and Loan in Kilgore, Texas. The acquisition is awaiting regulatory approval. Kilgore Federal is a well-managed financial institution and will add a new dimension to Temple-Inland's real estate and mortgage banking activities.

Corporate Headquarters

Bleached Paperboard Mill

Containerboard Mills

Building Products

Packaging

Financial Services

Corporate Headquarters
Diboll, Texas

Bleached Paperboard Mill
Evadale, Texas

Containerboard Mills
Linerboard
Mahrt, Alabama*
Macon, Georgia*
Rome, Georgia*
Ontario, California
Orange, Texas
Corrugating Medium
New Johnsonville, Tennessee
Newark, California
Newport, Indiana
*50% owned

(ABOVE LEFT) NATIONAL FIDELITY LIFE CONTINUES TO DEVELOP ITS INSURANCE POLICIES FOR THE SUPER-HEALTHY. THESE PEOPLE, EXERCISING IN ONE OF OUR REAL ESTATE SUBDIVISIONS, MAY BENEFIT FROM THE PREFERRED RATES OF THIS PRODUCT.

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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

*50% owned

Plywood Operations
Pineland, Texas
Madison, Georgia*

Lumber Operations
Diboll, Texas
Pineland, Texas
Buna, Texas
(under construction)
Greenville, Georgia*
Madison, Georgia*
Cottonton, 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

Packaging

Corrugated Container Plants
Fort Smith, Arkansas
Los Angeles, California
Newark, California
Ontario, California
Santa Fe Springs, California
Tracy, California
Denver, Colorado
Orlando, Florida
Macon, Georgia
Rome, Georgia
Chicago, Illinois
Crawfordsville, Indiana
Evansville, Indiana
Garden City, Kansas
Kansas City, Kansas
Louisville, Kentucky
Minden, Louisiana
Hattiesburg, Mississippi
St. Louis, Missouri
Minneapolis, Minnesota
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
Round Rock, Texas
Corpus Christi, Texas
Downers Grove, Illinois
Gurnee, Illinois
Oklahoma City, Oklahoma
Knoxville, Tennessee
Memphis, Tennessee
Jackson, Mississippi
Southaven, Mississippi
Eagan, Minnesota
Minneapolis, Minnesota

Insurance Operations
Dallas, Texas
Overland Park, Kansas

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1986 WAS A YEAR OF INVESTMENT IN PEOPLE, NATURAL RESOURCES, AND FACILITIES. DIVIDENDS FROM THESE INVESTMENTS WILL COME TO US IN THE FUTURE.

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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 the year	1986	1985	1984	1983	1982
			(in millions)		
Net Sales					
Container and containerboard	$ 721.7	$ 684.2	$ 665.3	$ 596.9	$ 576.8
Pulp and paperboard	264.9	256.7	284.5	253.2	254.5
Building products:					
Manufacturing	251.0	226.9	226.6	207.5	158.2
Retail	30.5	41.1	68.7	87.6	67.3
Other activities (1)	27.7	34.2	17.8	30.3	39.6
	$ 1,295.8	$ 1,243.1	$ 1,262.9	$ 1,175.5	$ 1,096.4
Income Before Taxes					
Container and containerboard (2)	$ 38.8	$ 49.7	$ 74.8	$ 20.8	$ 30.0
Pulp and paperboard	29.4	19.8	46.8	20.0	20.9
Building products:					
Manufacturing	36.2	23.5	40.2	31.0	1.8
Retail	(.3)	(1.0)	.7	4.2	2.8
Other activities (1)	(5.8)	2.5	(3.2)	(2.1)	—
Operating profit	98.3	94.5	159.3	73.9	55.5
Financial services	33.0	25.3	15.2	13.8	11.4
	131.3	119.8	174.5	87.7	66.9
Corporate expense (3)	(13.1)	(8.1)	(11.9)	(7.2)	—
Interest—Net	(13.0)	1.2	(4.6)	(4.7)	(1.9)
Other income—net	3.6	2.2	1.8	2.9	1.9
Gain on sale of property and equipment (4)	4.5	12.5	5.8	—	2.5
	$ 113.3	$ 127.6	$ 165.6	$ 78.7	$ 69.4

(1) Primarily industrial contracting.
(2) Includes $19.1, $22.1, $21.7, $24.6 and $26.0 million of operating income from Georgia Kraft, a 50% owned affiliate of the Company, for the years 1986, 1985, 1984, 1983 and 1982, respectively. These Georgia Kraft income amounts are deducted from cost of sales in the statement of income.
(3) Prior to the formation of Temple-Inland in 1983 there were no material amounts of general corporate expenses.
(4) 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

The Company's Container and Containerboard operations have historically been operated as 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, a 50 percent owned affiliate. With the acquisition of a kraft linerboard mill in Orange, Texas, from Owens-Illinois, Inc., on July 1, 1986, the Company moved to a position where production of containerboard exceeds converting demand by 400,000 tons which must be sold on the open market.

The table below reflects a 26% increase in board manufactured in 1986, including 206,000 tons produced at the Orange mill.

	1986	1985	1984
Tons Mill Production	1,631,000	1,294,000	1,252,000

The Company began operation of a recycle linerboard mill at Ontario, California, in the fourth quarter of 1985. With the commencement of production of significant tonnage in early 1986, problems were encountered with the effluent control system. Pending a solution to these problems, production was reduced until near the end of the second quarter of 1986. At that time, efforts to achieve full production levels were again commenced. 155,000 tons were produced at this mill during 1986. This facility also includes a cogeneration plant which generates approximately 37 megawatts of electricity, half for use by the mill and half for sale to an electric utility. The cogeneration plant also produces the steam requirement for the mill. Problems with the cogeneration system at the mill added to the disruption of operations during 1986.

The Company converts the majority of its containerboard into shipping containers in 32 box plants, including three box plants located at Tracy, California, Minden, Louisiana, and Minneapolis, Minnesota, which were acquired from Owens-Illinois on July 1, 1986. The Company manufactures a wide range of boxes, from the simplest brown box to intricate die-cut containers which can be printed with many colors and attractive graphics. As a result, average prices per ton of boxes can be significantly affected by product mix.

The Company's average box price for 1986 was down 4% from the 1985 average which had been 2% below 1984 levels. Box prices reached a peak in January 1985 and declined steadily to their lowest level in the second quarter of 1986. Box prices then increased in each of the last three quarters, but still remain well below peak January 1985 levels.

Tonnage through the Company's box plants increased by 10% in 1986 due, in part, to the addition of 85,000 tons from the three box plants acquired from Owens-Illinois. Tonnage increased 8% from 1984 to 1985 due to a major effort aimed at increasing sales volume from the Company's box plants in anticipation of additional linerboard from the Company's new Ontario, California mill. Revenues from increased tonnage were not sufficient to offset lower sales prices in 1986 and 1985, and profits declined in both years from the 1984 record levels.

The table below shows the container and containerboard sales in tons and dollars for each quarter in 1986, 1985 and 1984. The totals presented include not only boxes, but open market domestic and export sales of linerboard, bag paper, and related products. Change in product mix from period to period may result in difficulty in making historical comparisons.

Container & Containerboard	1986	1985	1984
Unit Sales		(in thousands of tons)	
1st Quarter	317	304	291
2nd Quarter	335	312	299
3rd Quarter	399	323	305
4th Quarter	421	309	281
For the year	1,472	1,248	1,176
Net Sales		(in millions)	
1st Quarter	$ 153.8	$ 178.2	$ 160.9
2nd Quarter	163.8	176.1	168.4
3rd Quarter	194.1	169.8	173.1
4th Quarter	210.0	160.1	162.9
For the year	$ 721.7	$ 684.2	$ 665.3

Pulp and Paperboard

The Company's Pulp and Paperboard group produces bleached paperboard at its 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 peaked in late 1984 and declined until the third quarter of 1986, when prices began to move upward to current levels. The average net sales price per ton for 1986 was down 1% from 1985 levels and still is 8% below the 1984 levels.

Tonnage produced in 1986 was 562,000 tons, compared with 534,000 tons in 1985 and 563,000 tons in 1984. Improved market conditions enabled the Company to operate without down time in the fourth quarter of 1986 as compared with the fourth quarter of 1985. As a result of full operations, increased tonnage and lower manufacturing costs, operating profit for the Pulp and Paperboard group rose 48% from 1985. Declining sales prices and reduced production caused profits to decline 58% in 1985 from 1984 levels.

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The table below lists the sales by product for 1986, 1985, and 1984 in tonnage and dollars.

Pulp and Paperboard	1986	1985	1984
Unit Sales		(in thousands of tons)	
Paperboard			
1st Quarter	115	114	119
2nd Quarter	117	113	117
3rd Quarter	110	108	116
4th Quarter	116	117	112
For the year	458	452	464
Pulp			
1st Quarter	25	27	20
2nd Quarter	23	18	21
3rd Quarter	25	21	22
4th Quarter	30	17	29
For the year	103	83	92
Net Sales		(in millions)	
Paperboard			
1st Quarter	$ 56.8	$ 59.6	$ 62.9
2nd Quarter	59.0	60.5	63.7
3rd Quarter	56.2	55.7	65.6
4th Quarter	59.4	54.6	58.0
For the year	$ 231.4	$ 230.4	$ 250.2
Pulp			
1st Quarter	$ 6.0	$ 7.3	$ 6.5
2nd Quarter	6.6	5.1	7.3
3rd Quarter	7.7	5.6	7.7
4th Quarter	10.1	4.9	9.5
For the year	$ 30.4	$ 22.9	$ 31.0
Other			
1st Quarter	$ 1.4	$ 1.3	$ .4
2nd Quarter	1.1	1.0	1.4
3rd Quarter	.4	.7	.7
4th Quarter	.2	.4	.8
For the year	$ 3.1	$ 3.4	$ 3.3

Building Products

The Building Products group manufactures a complete line of building products including lumber, plywood, fiberboard, particleboard, gypsum wallboard, oriented strandboard, rigid foam insulation, and decorative wall paneling. The following tables provide information on sales volume and unit sales for the last three years for each of the building product lines.

Building Products	1986	1985	1984
Unit Sales		(in millions of board feet)	
Pine lumber	156	135	128
		(in millions of square feet)	
Fiberboard	436	415	385
Particleboard	297	283	284
Plywood	203	164	155
Gypsum wallboard	397	326	300
Decorative wall paneling	50	51	60
Rigid foam insulation	78	73	64
Oriented strandboard	67	68	9
Net Sales		(in millions)	
Pine lumber	$ 30.4	$ 26.8	$ 27.7
Fiberboard	56.1	50.1	47.4
Particleboard	50.1	40.2	49.4
Plywood	28.9	22.0	21.2
Gypsum wallboard	36.9	34.8	37.5
Decorative wall paneling	12.7	13.0	15.6
Rigid foam insulation	15.0	15.3	14.3
Oriented strandboard	8.2	9.1	1.2
Retail distribution	30.5	41.1	68.7
Other	12.7	15.6	12.3
For the year	$281.5	$268.0	$295.3

Increased volumes of Canadian lumber imported into the United States in 1986 continued to provide a supply of lumber in excess of domestic demand, even though construction levels improved. The agreed settlement of the Canadian lumber issue and the voluntary 15% charge on timber levied by the Canadian government could increase the cost structure of Canadian producers which may encourage more production from domestic sources.

Manufacturing operating profit increased 54% in 1986 compared with 1985, primarily as a result of increased prices for fiberboard, gypsum and particleboard, and our cost reduction projects. The earnings contribution from particleboard increased in the second half of the year while earnings from gypsum softened. In 1985, lower prices for most of the Company's major building product lines had caused operating profits to decline from 1984.

The expansion of the Company's oriented strandboard plant in Claremont, New Hampshire, was completed in 1986. Production rates improved in the last half of the year although environmental problems forced the Company to operate the plant at less than optimal levels. Efforts to resolve the problems should enable the plant to operate more efficiently in 1987.

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A new gypsum wallboard plant in Fletcher, Oklahoma, became operational in July of 1986. The new plant, with an estimated annual capacity of 350 million square feet, has now completed start-up activities and is operating at rated capacity. This mill, which is located adjacent to the Company's gypsum quarry, enables the Company to ship more economically into the Texas market while diverting production from the Company's West Memphis, Arkansas, wallboard plant to more profitable markets. The Texas and Oklahoma markets continued to decline throughout the year while the eastern, southeastern and northeastern regions continued strong.

The Company began construction activities on a wood resource complex to be located near the town of Buna in east Texas. This complex, with an annual lumber capacity estimated to be 120 million board feet, will provide a more efficient vehicle for converting fiber in the southern region of the Company's timberlands. The plant will be located on the Company's short-line railroad and will enable the Company to deliver chips, a by-product of the lumber manufacturing process but a major raw material source for paper products, to the Orange mill with substantial freight savings.

The retail operations continue to suffer, particularly in the Houston, Texas, market. Personnel cutbacks and cost control efforts enabled the retail operations to operate at a $.3 million loss in 1986 compared with a $1.0 million loss in 1985.

Temple-Inland Financial Services

The Company entered the financial services business in 1954 as a member of an investment group which formed Lumbermen's Investment Corporation (LIC), and later acquired all of the stock of this mortgage banking operation. 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 discussion of each business segment are provided to offer a more detailed description and explanation of the business activities and operations of Financial Services. Selected segment information is shown at right.

Temple-Inland Financial Services
Selected Segment Information

Years ended December 31	1986	1985	1984
		(in thousands)	
Income			
Mortgage banking	$ 6,545	$ 6,622	$ 5,423
Land development and income properties	3,331	8,116	4,817
Agency insurance	1,366	937	1,011
Life insurance:			
Income from operations (a)	31,833	15,898	9,176
Acquisition interest	(11,752)	(9,170)	(7,463)
	20,081	6,728	1,713
Other activities	1,711	2,912	2,198
Income before taxes	33,034	25,315	15,162
Taxes on income	10,339	8,353	4,687
Net income	$ 22,695	$ 16,962	$ 10,475
Assets			
Mortgage banking	$145,318	$98,065	$99,862
Land development and income properties	18,801	20,121	19,444
Agency insurance	5,308	4,729	6,270
Life insurance (b)	185,233	174,637	90,593
Other	4,721	9,640	10,643
Total assets	$359,381	$307,192	$226,812
Liabilities			
Mortgage banking	$142,160	$ 96,587	$ 96,114
Land development and income properties	16,450	15,440	12,807
Agency insurance	4,342	3,752	4,413
Life insurance (c)	134,900	133,400	67,000
Other	1,395	1,574	4,801
Total Liabilities	$299,247	$250,753	$185,135
Equity			
Mortgage banking	$ 3,158	$ 1,478	$ 3,748
Land development and income properties	2,351	4,681	6,637
Agency insurance	966	977	1,857
Life insurance	50,333	41,237	23,593
Other	3,326	8,066	5,842
Total equity	$ 60,134	$ 56,439	$ 41,677

(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 LIC. Mortgage banking is basically two businesses—the first, arranging financing for purchasers of real estate; 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, substantial values are created in that year which 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 normally produces $300 to $500 million in mortgage loans annually. In 1986, the Company produced a total of $572 million in mortgage loans. However, lower interest rates resulted in record run-off (prepayments and refinancings) resulting in only marginal portfolio growth. The Company now services a portfolio of approximately 86,000 loans with a balance of $3.1 billion compared with just less than 81,000 loans in 1985.

One additional source of profit 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.

Typically, a mortgage banker does not have the risk of principal loss on the foreclosure of a mortgage loan, but rather the cost of foreclosing and administering delinquent loans. The Company has two major areas that are of concern on foreclosures: 1) the interest carry of FHA/VA loans in GNMA pools and 2) the interest carry cost and potential loss of principal on real estate owned properties. The economic cost of foreclosures including reserves for potential losses, selling expenses, and interest carry was $3.5 million in 1986, up from $1.5 million in 1985 and $.8 million in 1984. The Company now holds 168 real estate owned properties acquired through foreclosure. The trend appears to have flattened with fourth quarter foreclosure levels dropping below third quarter totals.

On October 30, 1986, the Company announced the execution of a definitive agreement to acquire all of the outstanding common stock of Kilgore Federal Savings & Loan, Kilgore, Texas, for $10 million in cash. The acquisition is expected to be completed in early 1987. This financial institution, with assets of approximately $90 million, will allow Financial Services to expand its mortgage banking operations to additional markets.

A summary of selected financial information for the years 1986, 1985 and 1984 is provided below.

Mortgage Banking Operations Summary

Years ended December 31	1986	1985	1984
		(in thousands)	
Revenues	$32,456	$26,133	$22,752
Income Before Taxes	6,545	6,622	5,423

Mortgage Banking Loan Administration Summary

Years ended December 31	1986	1985	1984
		(in millions)	
Beginning Servicing Portfolio	$ 2,928	$ 2,665	$ 2,449
New Loans:			
Residential	670	317	353
Commercial	80	41	9
	750	358	362
Acquired with National Fidelity	32	133	—
Run-off	(572)	(228)	(146)
Ending Servicing Portfolio	$ 3,138	$ 2,928	$ 2,665
Servicing Portfolio Growth	7.2%	9.9%	8.8%
Run-off Factor	19.5%	8.6%	6.0%

Land Development and Income Properties

This segment of Financial Services, operated as Temple-Inland Properties, consists of 10 active residential subdivisions in Texas with adjoining commercial acreage, one commercial land project 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 builder, 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 to builders the completed lots 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.

Depressed conditions in the Texas real estate markets resulted in a decline in earnings for the real estate development group from 1985 to 1986. Activity, however, continued strong in some of the Company's residential lot sales ventures.

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At year end 1986, the completed inventory of residential lots was 340 and undeveloped acreage was 2,427 compared with 343 lots and 1,644 acres in 1985 and 104 lots and 1,797 acres in 1984. At year end 1986, total commercial acreage in inventory was 36 compared with 40 and 61 in 1985 and 1984, respectively. Only 42 of the residential lots and only one commercial property owned by the Company are located in the currently depressed Houston area.

In 1986, Temple-Inland Properties entered into a joint venture for the development of a 2,148 acre tract in San Antonio, Texas, an area which has remained a strong residential market. The partners in the venture include a builder and a real estate developer. The venture will be developed in phases with a portion of the property to be sold in larger tracts for subdivision by other developers and a portion to be subdivided for moderately priced residential construction and sold by the venture.

Selected financial information related to these activities is shown below.

Temple-Inland Properties Operations Summary Years ended December 31	1986	1985	1984
		(in thousands)	
Revenues:			
Residential	$ 5,438	$ 5,407	$ 9,163
Commercial	4,219	9,058	4,069
	$ 9,657	$ 14,465	$ 13,232
Income Before Taxes:			
Residential	$ 1,308	$ 3,107	$ 3,518
Commercial	2,023	5,009	1,299
	$ 3,331	$ 8,116	$ 4,817

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	1986	1985	1984
		(in thousands)	
Assets	$ 80,211	$ 62,192	$ 43,871
Liabilities (a)	$ 75,146	$ 56,749	$ 37,439
Equity	5,065	5,443	6,432
	$ 80,211	$ 62,192	$ 43,871

(a) Although the Company's pro rata share of joint venture liabilities total $75 million, the joint venture partners are in most instances jointly and severally liable for notes payable. The gross balance of these notes was $130 million at December 31, 1986. Where a venture partner is jointly and severally liable for notes payable, the partner also has rights against the other partners' interest in joint venture assets if payments above the normal partnership percentage are required.

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. The casualty agency also 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 1986, 1985, and 1984 is shown below.

Agency Insurance Operations Summary Years ended December 31	1986	1985	1984
		(in thousands)	
Revenues	$ 3,952	$ 3,502	$ 3,052
Income Before Taxes	1,366	937	1,011

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, annuity and health policies. It was largely regional until 1983, but in the last three years has become more national in scope.

NFL's primary concentration is life insurance for the impaired risk, life and the super preferred (extremely healthy) clientele in both the U.S. and Canada.

GARCO and NFL sell insurance products through career agents and brokers—some of whom represent other companies. The products sold by these insurance companies in the life area are changing with a large majority of the new life insurance policies being the universal life product.

GARCO enjoys a substantial expertise and increasing presence in the market focusing on sales to school teachers and administrators. In May 1986, GARCO acquired the annuity business of Voyager Life Insurance Company. The Voyager acquisition added a variable annuity line of business to the existing GARCO product mix, as well as providing a base for reaching the southeastern teachers' market.

Over 85% of GARCO's and NFL's investment portfolio is invested in fixed income securities, consisting of marketable bonds, mortgages and short-term securities. The average maturity of the long-term investments at the end of the year was approximately 14 years.

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From an accounting standpoint, the acquisitions of GARCO, NFL, and Voyager 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 $27.5 million as of December 31, 1986, and is being amortized on a straight line basis over 40 years.

During 1986, GARCO and NFL completed the combination of their data processing systems as a part of the consolidation and cost savings anticipated with the purchase of NFL in 1985.

Shown below are condensed consolidated statements of income and balance sheets of the insurance operations for the years 1986, 1985, and 1984, together with a summary of the life insurance in force.

Life Insurance
Condensed Consolidated Statements of Income

Years ended December 31	1986	1985	1984
		(in thousands)	
Revenues	$ 299,306	$ 191,814	$ 115,941
Expenses:			
Insurance policy benefits & commissions	239,451	155,030	89,787
Operating and administrative expenses	28,022	20,886	16,978
Total expenses	267,473	175,916	106,765
Income before taxes	31,833	15,898	9,176
Taxes on income	10,187	5,405	3,212
Net income	$ 21,646	$ 10,493	$ 5,964

Life Insurance
Condensed Consolidated Balance Sheets

As of December 31	1986	1985	1984
		(in thousands)	
Assets			
Cash and investments	$ 848,685	$ 657,272	$ 267,754
Deferred acquisition costs	79,969	71,901	35,202
Receivables and other assets	119,653	68,891	45,238
Total assets	$1,048,307	$ 798,064	$ 348,194
Liabilities and Equity			
Future policy benefits	$ 766,178	$ 566,469	$ 225,107
Other liabilities	96,896	56,958	32,494
Equity	185,233	174,637	90,593
Total liabilities and equity	$1,048,307	$ 798,064	$ 348,194

Life Insurance
Life Insurance and Annuities in Force

As of December 31	1986	1985	1984
		(in millions)	
Life Insurance	$ 9,700	$ 8,800	$ 4,200
Annuity Reserves	445	300	100

Additional Comments Regarding Results of Operations and Financial Condition

The Company's financial condition continues to be strong. Internally generated funds and the capacity to issue long-term debt are sufficient to fund expected capital expenditures, to service existing debt, to pay dividends, and to meet normal working capital requirements. The level of capital expenditures is now anticipated to be in the range of $120 million in 1987. Major projects for 1987 will include a wood resource complex near Buna, Texas, together with a modernization program at the Orange, Texas, linerboard mill.

A summary of capital expenditures is shown below.

Capital Expenditures	1986	1985	1984
		(in millions)	
Container and containerboard	$ 42.8	$102.0	$ 68.0
Pulp and paperboard	27.5	42.9	35.4
Building products	23.9	29.7	17.4
Timber and timberlands	8.0	7.2	6.7
Other activities	.4	1.9	2.3
Total	$102.6	$183.7	$129.8

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

Interest—Net	1986	1985	1984
		(in thousands)	
Interest expense	$(22,972)	$(19,619)	$(20,999)
Interest income	6,895	11,523	13,825
Capitalized interest	3,079	9,323	2,620
Interest (expense) income—net	$(12,998)	$ 1,227	$(4,554)

The increase in capitalized interest during 1985 was primarily attributable to the Ontario, California mill and other major construction projects. In 1986 these projects became operational and interest was no longer capitalized. In addition, interest expense increased due to the Company's borrowing $70 million

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on July 1, 1986, and an additional $70 million on September 30, 1986, to fund a portion of the purchase price paid for assets acquired from Owens-Illinois.

The purchase from Owens-Illinois included a kraft linerboard mill in Orange, Texas, approximately 260,000 acres of timberland in Texas and Louisiana, three corrugated box manufacturing plants, a short-line railroad, and certain other related properties. The purchase price, after adjustments, was approximately $220 million, of which $140 million was financed with long-term debt and the balance was paid with cash from operations.

The Company's liquidity was and will continue to be affected by the Tax Reform Act of 1986 (the Act). The effect in 1986 was to reduce cash flow compared with previous years due to repeal of investment tax credits. The Company expects an overall decrease in future cash flow from operations as a net result of the combination of lower tax rates, repeal of investment tax credit, increase in capital gains rates, and other provisions of the Act.

Because the Company accounts for investment tax credits using the deferred method, the 1986 year end balance of deferred investment tax credits will be amortized as a reduction of income tax expense over the estimated useful lives of the related assets.

The Company is affected by changes in the purchasing power of the dollar, particularly during periods of high inflation. The Company's reported operating results reflect much of the impact of inflation because the LIFO method is used to determine the cost of certain inventories. By using this method, the cost of goods sold reported in the financial statements approximates current costs and thus reduces the distortion in reported income due to increasing costs. In addition, because the Company has acquired a significant percentage of its properties during the last five years, a large part of the inflationary effect has been recognized in the provision for depreciation charged against earnings. Due to the competitive pricing of products sold by the Company, there is no assurance that increased costs of production can be recovered.

The following table provides selected data for the periods indicated.

Five Year Selected Financial Data

				Pre-Spinoff Data†	
For the Year	**1986**	1985	1984	1983	1982
			(in millions)		
Net sales	**$1,296**	$1,243	$1,263	$1,176	$1,096
Net income	**81**	85	103	48	39
Capital expenditures	**103**	184	130	53	77
Depreciation, amortization and depletion	**79**	66	63	64	59
Earnings per share°	**2.64**	2.80	3.39	1.59	*
Dividends per common share°	**.58**	.51	.40	*	*
Average shares outstanding (in thousands)°	**30,566**	30,390	30,300	30,281	*
At Year End			(in millions)		
Total assets	**$1,701**	$1,469	$1,364	$1,209	$1,162
Working capital	**131**	164	175	136	95
Long-term debt	**366**	248	251	209	80
Shareholders' equity	**929**	864	793	701	823

†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.

°Amounts have been retroactively adjusted for a five-for-four stock split declared in February, 1987.

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Consolidated Statements of Income

Temple-Inland Inc. and Subsidiaries
For the year

	1986	1985	1984
		(in thousands)	
Revenues			
Net sales	$1,295,807	$1,243,125	$1,262,904
Financial services earnings—Note B	33,034	25,316	15,163
	1,328,841	1,268,441	1,278,067
Costs and Expenses			
Cost of sales	1,090,821	1,036,535	992,033
Selling and administrative	119,852	120,295	123,450
	1,210,673	1,156,830	1,115,483
Operating Income	118,168	111,611	162,584
Interest—net—Note D	(12,998)	1,227	(4,554)
Other—Note L	8,133	14,752	7,547
Income Before Taxes	113,303	127,590	165,577
Taxes on income—Note C	32,500	42,500	62,900
Net Income	$ 80,803	$ 85,090	$ 102,677
Earnings per share—Notes A and M	$ 2.64	$ 2.80	$ 3.39

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Consolidated Balance Sheets

Temple-Inland Inc. and Subsidiaries
At year end

	1986	1985
	(in thousands)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 50,987	$ 82,490
Receivables, less allowances of $3,904,000 in 1986 and $4,134,000 in 1985	151,287	122,957
Refundable federal income taxes—Note G	—	8,946
Inventories:		
Work in process and finished goods	43,333	42,639
Raw materials	72,908	52,649
	116,241	95,288
Prepaid expenses	12,789	19,000
Total Current Assets	331,304	328,681
Investments—Note B		
Financial services subsidiaries	60,134	56,439
Other unconsolidated subsidiaries	8,908	8,280
Other investments	6,951	8,382
Total Investments	75,993	73,101
Property and Equipment—Note D		
Buildings	182,088	151,436
Machinery and equipment	1,078,090	913,400
Less allowances for depreciation and amortization	(560,877)	(490,926)
	699,301	573,910
Construction in progress	42,581	61,607
Construction funds held by trustee	178	16,059
	742,060	651,576
Timber and timberlands—less depletion	214,919	97,704
Georgia Kraft Company—Note B	309,231	294,639
Land	18,346	15,470
Total Property and Equipment	1,284,556	1,059,389
Other Assets	8,769	8,170
TOTAL ASSETS	$1,700,622	$1,469,341

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	1986	1985
	(in thousands)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	$ 117,728	$ 87,722
Due to Georgia Kraft Company	66,589	64,423
Employee compensation and benefits	12,267	9,461
Current portion of long-term debt	3,320	3,373
Total Current Liabilities	199,904	164,979
Long-Term Debt—Note D	365,513	247,555
Deferred Investment Tax Credits—Note G	36,607	40,975
Deferred Federal Income Taxes—Note G	150,093	132,415
Other Liabilities	19,641	19,712
Shareholders' Equity		
Common stock—par value $1 per share: authorized 100,000,000 shares; issued 30,348,030 shares in 1986 and 30,230,657 shares in 1985, including shares held in the treasury—Notes A and M	30,348	24,184
Additional paid-in capital—Note M	323,643	327,979
Retained earnings	574,928	511,586
	928,919	863,749
Cost of shares held in the treasury: 1,201 shares in 1986; 1,657 shares in 1985	(55)	(44)
	928,864	863,705
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,700,622	$1,469,341

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Consolidated Statements of Shareholders' Equity

Temple-Inland Inc. and Subsidiaries	Common Stock	Additional Paid-in Capital	Invested Capital	Retained Earnings	Treasury Stock
			(in thousands)		
Balance at January 1, 1984	$ —	$ —	$349,624	$351,346	$ —
Distribution of Temple-Inland shares—January 26, 1984—Note J	24,074	325,550	(349,624)	—	—
Net income	—	—	—	102,677	—
Dividends paid on Common Stock—$.40 per share	—	—	—	(12,061)	—
Stock issued for stock option and restricted stock plans	62	1,447	—	—	—
Stock reacquired for treasury—17,766 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—$.51 per share	—	—	—	(15,466)	—
Stock issued for stock option and restricted stock plans	48	982	—	—	—
Stock reacquired for treasury—9,726 shares at cost	—	—	—	—	(278)
Stock reissued from treasury—25,835 shares at cost	—	—	—	—	665
Balance at December 31, 1985	$24,184	$327,979	$ —	$511,586	$ (44)
Net income	—	—	—	80,803	—
Dividends paid on Common Stock—$.58 per share	—	—	—	(17,461)	—
Stock issued for stock option and restricted stock plans	94	1,734	—	—	—
Stock reacquired for treasury—32,458 shares at cost	—	—	—	—	(1,235)
Stock reissued from treasury—32,914 shares at cost	—	—	—	—	1,224
Effect of five-for-four stock split—Note M	6,070	(6,070)	—	—	—
Balance at January 3, 1987	$30,348	$323,643	$ —	$574,928	$ (55)

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 the year	1986	1985	1984
		(in thousands)	
Working Capital Sources			
Net income	$ 80,803	$ 85,090	$102,677
Items not affecting working capital:			
Depreciation, amortization and depletion	79,111	66,445	63,093
Amortization of intangibles	208	208	140
Deferred taxes and deferred tax credits	12,112	30,915	12,284
Unremitted earnings of affiliated companies	(27,333)	(20,971)	(21,528)
Total From Operations	144,901	161,687	156,666
Disposition of property and equipment	2,189	12,182	4,400
Decrease (increase) in construction funds held by trustees	15,881	19,735	(32,274)
Issuance of long-term debt	194,490	—	51,981
Change in other assets and liabilities	(878)	9,048	3,147
Issuance of common stock	3,052	1,695	1,509
Other	712	1,401	5,886
Total Working Capital Sources	360,347	205,748	191,315
Working Capital Uses			
Capital expenditures	102,646	183,688	129,765
Purchase of non-current assets from Owens-Illinois, Inc.	204,775	—	—
Dividends paid to shareholders	17,461	15,466	12,061
Investments in affiliated companies	(10,000)	13,573	1,261
Purchases of treasury stock	1,235	278	431
Reduction of long-term debt	76,532	3,558	9,372
Total Working Capital Uses	392,649	216,563	152,890
Increase (Decrease) in Working Capital	$ (32,302)	$ (10,815)	$ 38,425
Changes in Working Capital			
Cash and short-term investments	$ (31,503)	$ 406	$ 18,132
Receivables	19,384	5,740	4,737
Inventories	20,953	(13,573)	10,325
Prepaid expenses	(6,211)	(4,235)	15,837
Accounts payable and accrued expenses	(32,812)	2,589	(8,629)
Due to Georgia Kraft Company	(2,166)	(2,053)	(2,512)
Current portion of long-term debt	53	311	535
Net Change in Working Capital	$ (32,302)	$ (10,815)	$ 38,425

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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 investment 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.

Change to Fiscal Year

In 1986, the Company changed its annual accounting period from a calendar year to a fiscal year ending on the Saturday nearest December 31. Accordingly, the 1986 accounting year ended on January 3, 1987. The change did not have a material effect on the Company's 1986 financial statements. The unconsolidated Financial Services group and Georgia Kraft Company remained on a calendar year.

Inventories

Inventories are stated at the lower of cost or market.

Cost of inventories amounting to $54.2 million in 1986 and $47.5 million in 1985 was determined by the last-in, first-out method (LIFO). The cost of the remaining inventories of $62.0 million in 1986 and $47.8 in 1985 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 $16.8 and $14.6 million higher than reported at year end 1986 and 1985, 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 the 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 are based upon the weighted average number of shares outstanding, including common stock equivalents, during the period. The weighted average shares outstanding was 30,566,000 in 1986, 30,390,000 in 1985, and 30,300,000 in 1984—See Note M.

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 a major source 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 $103.8 million at year end 1986.

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 $163.3 million in 1986, $181.3 million in 1985 and $168.7 million in 1984.

Summary financial information for Georgia Kraft Company is as follows:

	1986	1985	1984
		(in thousands)	
Total revenues	$557,428	$557,033	$539,746
Income before taxes	41,842	46,474	45,225
Net income	27,577	31,764	30,737
Current assets	142,862	137,169	147,565
Noncurrent assets	554,115	522,590	487,454
Current liabilities	64,522	58,665	59,914
Noncurrent liabilities	221,551	217,768	223,543

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.

The Company's share in the net income of all unconsolidated subsidiaries and 20-50% owned affiliates amounted to $36.4 million, $33.2 million and $25.8 million for the years 1986, 1985 and 1984, respectively. Dividends received from such subsidiaries and affiliates amounted to $19.1 million, $12.2 million and $4.3 million for the years 1986, 1985 and 1984, respectively.

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The Company's share of undistributed earnings of companies 20-50% owned, included in retained income was $129.9 million and $116.7 million at year end 1986 and 1985, respectively.

Note C—Leases

Total rental expense was $9.6 million, $8.7 million and $7.8 million for the years 1986, 1985, and 1984, respectively.

The future minimum rental commitments, as of year end 1986, under non-cancellable operating leases were as follows: 1987—$6.5 million; 1988—$5.1 million; 1989—$4.1 million; 1990—$2.6 million; and 1991—$1.7 million.

Note D—Long-Term Debt

Long-term debt consists of the following:

	1986	1985
	(in thousands)	
Bank Loans—Weighted average interest rate during 1986 was 7.97%	$200,000	$ 80,000
8.375% Notes Payable due 1996	70,000	—
8.25% Promissory Notes to Time due 1986	—	50,000
Revenue Bonds due 2014—Average interest rate during 1986 was 4.93%	34,800	45,000
9% Tax Exempt Pollution Control Bonds due 2012	9,400	9,400
7.9% Promissory Notes due through 1994	11,280	12,840
6% Revenue Bonds due 2001-2007	—	10,000
Revenue Bonds due 2007—Effective interest rate during 1986 was 8.58%	9,300	9,300
Revenue Bonds due 2008—Effective interest rate during 1986 was 7.94%	8,900	8,900
9.5% Subordinated Debentures through 1995	5,600	6,300
Revenue Bonds due 2009—Average interest rate during 1986 was 5.03%	5,200	5,200
Other revenue bonds due through 2007, weighted average interest rate of 6.66% and 6.61% as of December 31, 1986 and 1985, respectively	5,024	5,714
Other indebtedness due through 2000, weighted average interest rate of 9.61% and 11.23% as of December 31, 1986 and 1985, respectively	6,009	4,901
	$365,513	$247,555

At January 3, 1987, the Company's $200 million bank loans were in the form of drafts growing out of transactions involving the domestic shipment of goods and drawn on unsecured Banker's Acceptance lines with various banks. These borrowings are additionally supported by long-term revolving credit agreements and are classified accordingly as long-term debt.

Under one agreement, the Company may borrow up to $80 million, repayable in September 1989, with interest at a rate which, at the option of the Company, may be based on various floating rates. Under a second agreement, borrowings of up to $120 million, repayable in January 1988, are available to the Company at similar floating rates of interest.

To offset a portion of the floating rate characteristic of the Company's bank borrowings, the Company negotiated four interest rate conversion agreements for an aggregate amount of $120 million. Under these agreements, the Company is required to pay interest at fixed rates averaging 8.09%. In return, the Company will receive interest payments on the same declining principal balances calculated at the 30 day commercial paper rate. These agreements expire as follows: $30 million in 1988, $70 million in 1989 and $20 million in 1990.

In December of 1986, the Company purchased government securities sufficient to legally defease the $10.0 million 6% Revenue Bonds due 2001-1007. The cost of such securities was $8.3 million and resulted in a pre-tax gain of approximately $1.5 million.

At year end 1986, consolidated net current assets were approximately $81 million in excess of the minimum requirements under the most restrictive provisions of the Company's loan agreements and approximately $305 million of consolidated retained income was unrestricted as to the payment of dividends. At year end 1986, property and equipment of approximately $27 million was subject to liens in connection with $25 million of debt.

Aggregate maturities of long-term debt during the next five years are as follows: 1987—$3,320,000; 1988—$123,310,000; 1989—$83,380,000; 1990—$3,442,000; 1991—$3,138,000. It is the Company's current intention to extend maturities by refinancing and renewing the long-term revolving credit agreements upon maturity.

For an analysis of net interest expense incurred, see page 29.

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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 549,486 shares of the Company's common stock at prices ranging from $7.43 to $16.62 per share, averaging $13.26 per share.

Options for 556,511, 590,015 and 531,989 shares were exercisable at year end 1986, 1985 and 1984, respectively. An additional 427,332, 939,111 and 1,123,045 shares of the Company's common stock were available for grants at year end 1986, 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	549,486	$ 7-$17
Granted	217,625	$25-$29
Exercised	(17,498)	$10-$17
Forfeited	(15,156)	$25
Outstanding at December 31, 1984	734,457	$ 7-$29
Granted	194,275	$30
Exercised	(63,761)	$10-$25
Forfeited	(10,341)	$25-$30
Outstanding at December 31, 1985	854,630	$ 7-$30
Granted	519,638	$38-$45
Exercised	(139,568)	$ 7-$30
Forfeited	(7,859)	$25-$38
Outstanding at January 3, 1987	1,226,841	$ 8-$45

Additionally, an Incentive Stock Plan provides for a maximum of 312,500 shares of common stock to be reserved for awards at the discretion of the Board of Directors. At year end 1986, grants of 95,231 shares of common stock were outstanding at an average price of $28.56 per share. Subsequent to January 3, 1987, the Company granted 30,218 shares of the Company's common stock at a price of $56.30 per share under the incentive stock plan.

The Company has 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 $2.4, $1.6 and $2.2 million in 1986, 1985 and 1984, respectively.

Note F—Pension Plans and Other Post-Retirement Benefits

The Company and its subsidiaries have several pension plans covering substantially all employees. Plans covering salaried and non-union hourly employees provide benefits based on compensation and years of service, while union hourly plans are based on negotiated benefits and years of service. 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 1986, the Company elected early adoption of FASB Statement No. 87, "Employer's Accounting for Pensions." The effect of this adoption was to reduce 1986 pension cost by approximately $11 million. Pension expense and related information for the years 1985 and 1984 have not been retroactively restated.

A summary of the components of net pension cost in 1986 follows:

	1986
Charges (credits)	(in millions)
Service cost—benefits earned during the period	$ 5.9
Interest cost on projected benefit obligation	12.4
Actual return on plan assets	(21.7)
Net amortization and deferral	.7
Special termination benefit cost	.6
Net Pension Credit	$(2.1)

Total pension expense was $8.7 million in 1985 and $8.6 million in 1984, which amounts include amortization of past service cost over periods ranging from 10 to 30 years.

The actuarial computations for the year 1986 assumed a discount rate on benefit obligations of 9%, an expected long-term rate of return on plan assets of 9% and annual salary/benefit increases of 5% to 6% over the average remaining service lives of employees covered by the plans.

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The status of employee pension benefit plans at year end 1986 is summarized below:

	1986
	(in millions)
Actuarial present value of benefit obligations:	
Vested benefits	$ 105.8
Nonvested benefits	12.0
Accumulated benefit obligation	$ 117.8
Projected benefit obligation for service rendered to date	$(154.2)
Plan assets at fair value, primarily fixed income securities	207.4
Plan assets in excess of projected benefit obligation	53.2
Unrecognized net gain from past experience different from that assumed	(2.1)
Unrecognized net asset at January 1, 1986, less amortization to date	(55.2)
Net pension liability included in the balance sheet	$ (4.1)

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 millions)	
Actuarial present value of accumulated plan benefits:		
Vested	$102.2	$ 94.7
Non-vested	9.0	10.9
Total accumulated plan benefits obligation	$111.2	$105.6
Net assets available for benefits	$160.1	$142.4

The assets of the plans at December 31, 1986, include 190,500 shares of common stock of the Company having a market value of $8.7 million at that date.

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 $1.1, $.9 and $.7 million in 1986, 1985, and 1984, respectively.

Note G—Taxes on Income

Taxes on income consisted of the following:

	Current	Deferred
	(in thousands)	
1986		
Federal	$16,417	$15,762
Investment tax credit deferred	—	(1,795)
State and other	2,116	—
	$18,533	$13,967
1985		
Federal	$(1,568)	$26,029
Investment tax credit deferred	—	13,685
State and other	4,354	—
	$ 2,786	$39,714
1984		
Federal	$26,945	$25,839
Investment tax credit deferred	—	7,366
State and other	2,750	—
	$29,695	$33,205

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

	1986	1985	1984
		(in thousands)	
Depreciation	$18,291	$19,786	$11,966
Investment tax credits	(1,795)	13,685	7,366
Contribution to employee benefit trust	(6,745)	(1,075)	7,820
Capitalized interest	1,503	4,098	1,135
Insurance operations	4,459	4,905	3,211
Other—net	(1,746)	(1,685)	1,707
	$13,967	$39,714	$33,205

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

	1986	1985	1984
		(in thousands)	
Taxes on income at statutory rate	$52,120	$58,691	$76,165
Investment tax credits	(7,544)	(7,903)	(6,185)
Tax benefit of capital gains	(7,635)	(8,368)	(8,541)
Insurance operations taxed at special rates	(4,442)	(1,704)	(1,002)
All other	1	1,784	2,463
	$32,500	$42,500	$62,900

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 1986, 1985, and 1984 were: investment tax credits of $.8 million, $1.6 million and $1.9 million; and the tax benefit of capital gains of $1.9 million, $2.1 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 Net Sales and Income Before Taxes and page 29 for information relating to Capital Expenditures for the Company's principal segments of business for the three years 1986, 1985 and 1984.

Additional business segment information is presented below.

For the year	1986	1985	1984
		(in millions)	
Identifiable Assets			
Container and containerboard (1)	$ 901.5	$ 741.1	$ 666.7
Pulp and paperboard	255.3	257.0	254.1
Building products	183.2	172.3	155.5
Timber and timberlands	220.7	104.0	101.5
Other activities	9.8	9.1	8.7
Total	1,570.5	1,283.5	1,186.5
Equity method investments	75.4	72.4	55.0
Corporate (2)	54.7	113.4	122.2
Total	$1,700.6	$1,469.3	$1,363.7
Depreciation, Amortization and Depletion			
Container and containerboard	$ 30.0	$ 21.0	$ 20.1
Pulp and paperboard	29.7	28.4	27.0
Building products	14.4	13.5	12.2
Timber and timberlands	3.9	3.0	3.2
Other activities	1.1	.5	.6
Total	$ 79.1	$ 66.4	$ 63.1

(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.

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. During 1986, Time sold its 10% share of the Company's outstanding common stock in a public offering. The Company is required to remove Time, on or before September 1, 1987, as the guarantor on indebtedness totaling $9.4 million due through 2012.

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Note K—Acquisitions

On July 1, 1986, the Company purchased from Owens-Illinois, Inc. (O-I) for approximately $105 million, a linerboard mill in Orange, Texas, three box plants in Tracy, California, Minden, Louisiana, and Minneapolis, Minnesota, and all of the outstanding capital stock of a short-line railroad which serves the Orange, Texas, linerboard mill. Also, on September 30, 1986, the Company finalized the purchase of approximately 260,000 acres of timberlands located in Texas and Louisiana, and certain mineral interests owned or leased by O-I in Texas and Louisiana for $115 million.

On May 15, 1986, the Company, through Temple-Inland Financial Services, acquired all of the annuity business of Voyager Life Insurance Company (Voyager) for approximately $10 million. The business acquired primarily consists of a variable annuity product line with three separate accounts and a general account which, in total, approximated $145 million of assets at December 31, 1985.

Effective July 1, 1985, the Company, through Temple-Inland Financial Services, acquired all of the outstanding shares of National Fidelity Life Insurance Company (NFL) for $82 million.

These acquisitions have been accounted for as purchases and the results of operations have been included from the dates of acquisition. Pro forma results of the Company's operations, assuming the O-I acquisition had occurred at the beginning of 1985, are shown in the following table.

For the year	1986	1985
	(in millions, except per share data) (unaudited)	
O-I Acquisition (pro forma results)		
Net sales	$1,397	$1,424
Net income	77	62
Earnings per share	2.52	2.04

The pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what would have occurred had the acquisition been made at the beginning of 1985 or of results which may occur in the future.

Information regarding the pro forma effect of the NFL and Voyager acquisitions on the Company, for periods prior to the acquisition date, would not be materially different from the historical amounts as reported.

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

Selected quarterly financial results for the years 1986 and 1985 are summarized below:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in millions except per share amounts)			
1986				
Net Sales	$292.7	$313.5	$333.8	$355.8
Gross Profit	34.4	49.7	54.2	66.7
Net Income	13.6	19.3	20.1	27.8
Earnings Per Share	.45	.63	.66	.90
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	.71	.80	.58	.71

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

Note M—Subsequent Event

On February 6, 1987, the Company announced a five-for-four stock split in the form of a stock dividend on its common shares. The new shares will be issued on March 31, 1987, to holders of record on March 16, 1987. At year end 1986, the Company had 24,278,424 shares outstanding on an historical basis, or 30,348,030 shares on a split basis.

Information in the consolidated financial statements as to the number of shares and per share amounts have been adjusted to reflect the stock split on a retroactive basis.

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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 January 3, 1987 and December 31, 1985, and the related consolidated statements of income, shareholders' equity and changes in financial position for each of the three years in the period ended January 3, 1987. 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 January 3, 1987 and December 31, 1985, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended January 3, 1987, in conformity with generally accepted accounting principles consistently applied during the period except for the change, with which we concur, in the method of determining pension cost as described in Note F to the consolidated financial statements.

Ernst & Whinney
Houston, Texas
February 20, 1987

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Temple-Inland Inc. Board of Directors

Clinton G. Ames Jr. (3)
Chairman and Chief Executive Officer
Inland Container Corporation

James F. Beré (1) (2)
Chairman of the Board
Borg-Warner Corporation

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

Joe C. Denman Jr. (3)
Chairman, President and
Chief Executive Officer
Temple-Eastex Incorporated

Henry C. Goodrich (2) (3) (4)
President
Richgood Corporation

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

Bobby R. Inman (1) (4)
Chairman and Chief Executive Officer
Westmark Systems, Inc.

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

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Vice Chairman of the Board
Pullman-Peabody, Inc.

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

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

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

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

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

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Officers

Inland Container Corporation

Corporate Group

Clinton G. Ames Jr.
Chairman and Chief Executive Officer

Ben J. Lancashire
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. Vaughn
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

Frederick G. Fly
Vice President—Sales and Administration

Donald O. Parish
Vice President—West Coast

Container Division

William A. Long
Group Vice President

James E. Bauer
Senior Vice President—National Accounts

James E. Cory
Senior Vice President—Sales and Marketing

Roger B. Morse
Senior Vice President—Plant Operations

Joseph E. Turk
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

Charles L. Wilson
Vice President—Area Manager

Robert N. Wood
Vice President—National Accounts Executive

Anderson Box Company

James R. McConnell
Vice President—General Manager

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

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 & Paperboard Division

David L. Ashcraft
Group Vice President

Russell E. Chase Jr.
Senior Vice President—Marketing

Aubrey W. Barlow
Vice President—Sales

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.

William B. Fulmer III
Executive Vice President

Richard J. Oates
Executive Vice President

The Angelina Free Press, Inc.

Paul M. Durham
Vice President, Editor 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—Commerical Lending

Dennis W. Berry
Senior Vice President
Regional Manager—Lending

Joseph Inderbitzen
Senior Vice President
Regional Manager—Lending

Steve Hudnall
Senior Vice President and Manager
Temple-Inland Properties

Timberline Insurance Managers, Inc.

Gary H. Cooper
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

Jerome H. Gray
Senior Vice President—Finance

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Shareholder Information

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

Independent Accountants
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 1, 1987 at 9:00 a.m. local time.

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

Number of Shareholders
As of December 31, 1986, there were 10,367 shareholders of record of the Company's common stock.

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.

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

Common Stock Prices and Dividend Information

	Actual Price Range			Adjusted* Price Range		
	High	Low	Dividends	High	Low	Dividends
1986						
First Quarter	**$55¾**	**$42**	**$.18**	**$44⅜**	**$33⅜**	**$.14**
Second Quarter	**53¼**	**47½**	**.18**	**42⅜**	**38**	**.14**
Third Quarter	**59⅛**	**44¾**	**.18**	**47⅓**	**35⅘**	**.15**
Fourth Quarter	**58¾**	**52¼**	**.18**	**47**	**41⅘**	**.15**
Year	**50⅛**	**42**	**.72**	**47⅓**	**33⅜**	**.58**
1985						
First Quarter	$39½	$32¼	$.16	$31⅗	$25⅕	$.12
Second Quarter	37	31¾	.16	29⅗	25⅗	.13
Third Quarter	40⅜	33⅞	.16	32⅕	27 1/10	.13
Fourth Quarter	44½	35½	.16	35⅗	28⅗	.13
Year	44½	31¾	.64	35⅗	25⅗	.51

*Amounts have been retroactively adjusted for a five-for-four stock split declared in February 1987.

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Drawer N
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