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TEMPLE-INLAND INC.



1988
Annual Report

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About Our Company

Temple-Inland is a holding company with major interests in paper, packaging, building products and financial services.

In 1988, the Company's Temple-Eastex Incorporated subsidiary changed its name to Temple-Inland Forest Products Corporation. The Company's pulp and paperboard and building products groups now market their products under the Temple-Inland name, providing a clearer marketing identity with Temple-Inland Inc. The Company's two other operating groups are Inland Container Corporation, which is our container and containerboard group, and Temple-Inland Financial Services.

In 1988, the Company's container and containerboard group produced 1,836,000 tons of containerboard (linerboard and corrugating medium), ranking it fifth among all containerboard producers in the United States. Corrugated box shipments of 1,502,000 tons ranked the Company third among the more than 800 corrugated producers in the United States.

The pulp and paperboard group's bleached paperboard mill at Evadale, TX is one of the largest specialty mills in the country. In 1988, it produced 491,000 tons of bleached paperboard and 111,000 tons of pulp.

Although Temple-Inland is not a major producer of any single building material, it does produce a wide range of materials including lumber, plywood, particleboard, gypsum wallboard, fiberboard, and rigid foam products.

Temple-Inland is a major landowner with about 1.8 million acres of timberland in east Texas, Louisiana, Georgia, and Alabama.

The Company's financial services group consists mainly of Lumbermen's Investment Corporation, a mortgage banking and real estate development firm based in Austin, TX and Great American Reserve Insurance Company and National Fidelity Life Insurance Company based in Dallas, TX. Temple-Inland is the majority owner of Guaranty Federal Savings Bank, a federally-chartered savings and loan institution based in Dallas.

Temple-Inland is based in Diboll, TX. Its common stock is traded on the New York and Pacific Stock Exchanges under the Ticker Symbol TIN.

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Financial Highlights

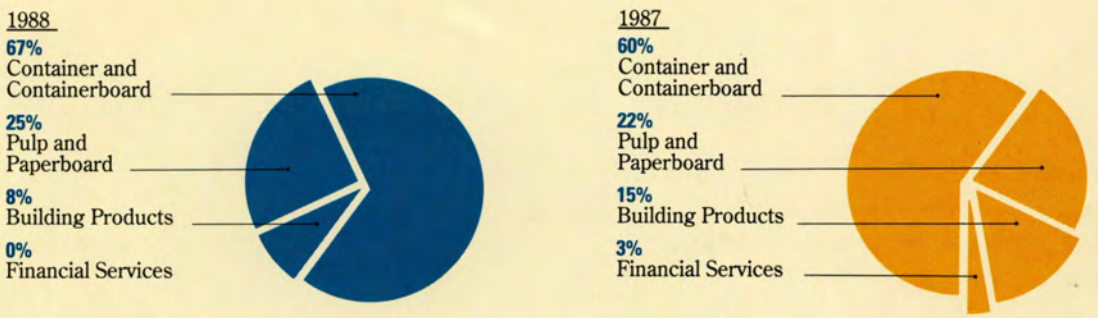
(in millions, except per share data)

	1988	1987	Percent Increase (Decrease)
Manufacturing Net Sales	$1,773.5	$ 1,602.7	11 %
Financial Services Revenues	$ 325.6	$ 336.2	(3)%
Operating Income	$ 304.3	$ 236.5	29 %
Net Income	$ 199.2	$ 141.4	41 %
Earnings Per Share	$ 7.15	$ 4.69	52 %
Dividends Per Share	$ .84	$ .69	22 %
Shareholders' Equity	$1,095.8	$ 927.5	18 %
Book Value Per Share	$ 39.73	$ 33.52	19 %
Average Shares Outstanding	27.8	30.2	(8)%
Common Shares Outstanding at Year End	27.6	27.7	—

Selected Business Segment Data

(in millions)

	1988	1987	Percent Increase (Decrease)
Manufacturing Net Sales			
Container and containerboard	$1,093.1	$ 964.2	13 %
Pulp and paperboard	$ 336.0	$ 292.5	15 %
Building products	$ 312.2	$ 322.8	(3)%
Operating Income			
Container and containerboard	$ 221.3	$ 150.8	47 %
Pulp and paperboard	$ 82.7	$ 53.4	55 %
Building products	$ 24.6	$ 36.5	(33)%
Financial services	$ (5.6)	$ 7.6	—



Combined operating earnings for Temple-Inland Inc. in 1988 and 1987 totaled $304.3 million and $236.5 million respectively. These charts show the percentage contributed by each of the Company's four operating groups.

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To Our Shareholders

The year ended December 31, 1988, marked our fifth anniversary as a publicly owned Company—a period in which we made great strides toward improving our position as a low-cost manufacturer, as well as an aggressive marketer committed to becoming more customer friendly.

In 1988, we continued to concentrate on managing the basics of our businesses to accomplish our strategic goals.

It was a year in which Temple-Inland set records in net sales, operating income, net income, book value per share, return on equity, and return on assets. Strong markets for paper and paper-related products, improved operating margins, and expanded manufacturing capacity contributed to these gains.

Per share earnings rose 52 percent to $7.15. Net manufacturing sales were $1.8 billion, up 11 percent from 1987.

The operating and financial results of our business segments are discussed in greater detail in the operations reports which follow this letter.

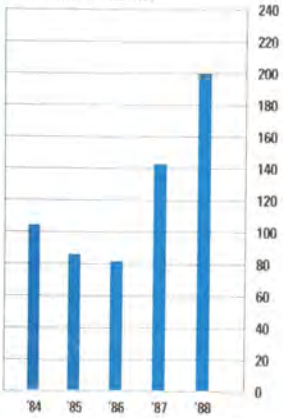
Reflecting our strong earnings and cash flow, the Board of Directors in February of this year raised the quarterly dividend to $.29 per share, a 38 percent increase, and the fifth increase in as many years. Our annual dividend rate is currently $1.16 per share, double that of 1986.

At our first annual meeting held on May 4, 1984, we stated that our future growth would be controlled—that we would expand only where we were convinced the financial rewards justified the risks and the necessary financial investment. We indicated that we did not necessarily want to become the biggest company in the forest products industry, only the most profitable for our shareholders and we believed so strongly in that message that we imprinted it on the cover of our annual report that year. Let us suggest how well we have succeeded over the five-year period:

- Sales have risen 50 percent to $1.8 billion.
- Operating income increased 278 percent to $304.3 million.
- Net income has risen 315 percent to $199.2 million.
- Earnings per share have improved 350 percent to $7.15.
- The annual dividend has increased 110 percent over the five-year period ended December 31, 1988.
- Return on equity now stands at 21 percent.
- And, despite a volatile stock market, TIN's stock price as of December 31, 1988 was 82 percent higher than on December 31, 1983 compared with a 72 percent gain in the Dow Jones Industrial Average.

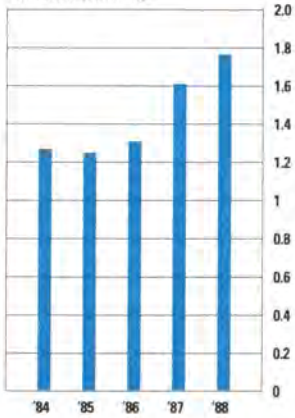
Our financial results alone do not reflect the progress we are making in order to better position our basic businesses for the future.

Temple-Inland
Net Income (millions)

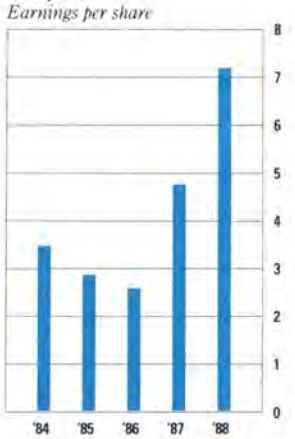


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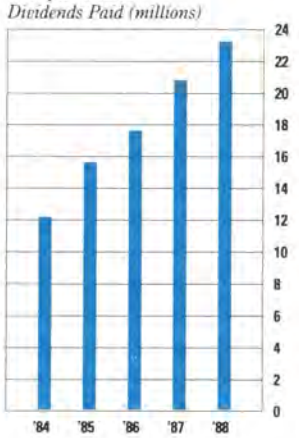
Temple-Inland
Net Sales (billions)



Temple-Inland
Earnings per share



Temple-Inland
Dividends Paid (millions)



Historically, all of our businesses have been cyclical, and we have no reason to believe these trends will not continue. To help offset the cyclical declines, we continue to manage our businesses to outperform our competitors in periods in which weaker conditions exist.

In the corrugated shipping container business, certain companies, including Temple-Inland, manufacture both the outside and inside walls of the container (linerboard) as well as the fluted material which binds and supports the walls (corrugating medium). Together, these products are referred to as containerboard. Most manufacturers of containerboard also maintain box plants, but very few manufacturers have sufficient box plant capacity to utilize fully all of their containerboard production.

When containerboard markets decline, the price of shipping containers generally does not decline at the same rate; therefore, by maintaining a stable group of box customers, the financial results historically have been better than if the Company were solely a manufacturer of containerboard.

We have a strategy directed toward full integration and, therefore, have tried to expand our box plant capacity to utilize all of our containerboard. Due to our recent large incremental containerboard expansions, plus projects currently underway, we will not be able to achieve this level of integration during the next few years and will have some containerboard to sell to others.

Since we already have 32 box plants strategically located, further expansion in converting capacity is not necessarily dependent on geographic additions. In many cases, additional capacity can be gained through technological improvements to existing box plants, and our strategy is to be alert for and to take advantage of those opportunities.

In the Evadale bleached paperboard mill, we have chosen a different strategy. It is a non-integrated mill that can produce paperboard for a wide spectrum of markets, allowing us to shift production to meet the needs of our customers in a variety of industries. Naturally, this creates more production problems than a paper machine dedicated to one particular grade. Thus, our emphasis has been on technological improvements to allow actual production to more closely approach potential capacity. Many of the costs in a paper mill are fixed and the more units that can be manufactured, the lower the fixed cost per unit. Thus, all mills operate 24 hours a day, seven days a week. The record tonnage produced by the Evadale mill in 1988 indicates the progress we have made.

We continue to be somewhat apprehensive about the growth of new residential construction. Therefore, we have been redirecting our building products resources to those products which not only serve the new residential market but can also be used extensively in remodeling and industrial markets, both of which should grow faster than new housing.

In 1988, we converted more of our particleboard capacity to industrial products for use in furniture and cabinets, including the establishment of a new facility which actually overlays and cuts the particleboard sheet to size for some of the customers in this industry.

Our forest resource of almost 1.8 million acres in Texas, Louisiana, Georgia, and Alabama is strategically located to provide a consistent supply of raw material for our building products and paper operations. The future growth opportunity for southern pine lumber should exceed that of lumber from other species. This is based on both the availability of timber to cut as well as its characteristics and location near the consuming markets.

Southern pine is a unique, low-cost lumber product which can be treated with preservatives to allow its use outside the residential structure in decks, patios, etc. Over half of the southern pine lumber produced is now being treated for these markets. In order to capitalize on these growing markets and utilize fully the increased sawtimber from our forests, we have added one new sawmill and are in the process of building a second which should be operational in 1989. Both of these mills will provide us with low-cost timber conversion to lumber products.

By strategically locating these new mills close to our paper mills in east Texas, the residues, primarily chips, from the manufacture of lumber will also serve as low-cost fiber sources for our paper products.

During 1988, our corporate expenditures to modernize and improve basic facilities were about $220 million, and we fully expect to invest a similar amount in 1989.

Because of the cyclical nature of earnings

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Arthur Temple



Clifford J. Grum

from our building products and paper activities, the Company has chosen to be active in certain segments of financial services. These activities include mortgage banking, real estate development, life and limited casualty insurance, and ownership of a savings and loan. They have historically provided a growing and less cyclical earnings stream.

In 1988, the adversity of the Texas economy, as well as the low level of new construction activities, dramatically reduced earnings from our mortgage banking group, and our insurance group was unprofitable as we refocused its activities. However, in 1989, we fully expect to begin to regain the profitability that we have always expected from these operations.

Late in the year, we participated as the majority owner in a FSLIC assisted acquisition of three Texas savings and loan companies by Guaranty Federal Savings Bank, a new federally chartered savings and loan association. We regard this investment as a unique opportunity to establish a viable savings and loan institution in the state of Texas and to add a potentially profitable business to our Financial Services Group.

Joe Denman retired from our Company in October after serving with us for over 37 years. Joe had headed our Texas building products group as well as the bleached paperboard operations. These two units have grown dramatically under his stewardship and currently have annual revenues of nearly $650 million. His talents will certainly be missed, but we will still have his advice and counsel as a director emeritus.

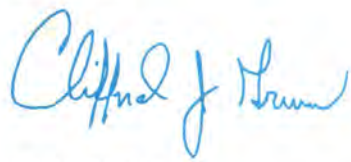
With Joe's retirement, we are pleased to report that David Ashcraft became group vice president of pulp and paperboard, and Harold Maxwell became group vice president of building products.

Jim Shepley, our director emeritus, passed away in November. Jim, in his former position of president of Time Inc., orchestrated the mergers that created our Company, and it was through his support and guidance that our Company grew as a subsidiary of Time Inc. After the spin-off, Jim rejoined Temple-Inland as a director. Both of us had the pleasure of serving under Jim and we will certainly miss him.

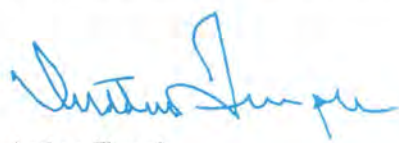
We discussed earlier our determination to not necessarily be the biggest company in the industry, only the most profitable. We fully recognize that to accomplish this goal, we must continue our efforts in the area of quality and service, both of which have been an integral part of the Temple-Inland concept over the five years of our corporate existence and will continue to remain such into the future.

Our record performance for 1988, as well as our overall earnings growth and improvement in returns over the past five years, is the benchmark and a challenge for us to continue our dedicated commitment to our shareholders in the future.

Sincerely,



Clifford J. Grum
President & Chief Executive Officer



Arthur Temple
Chairman of the Board

February 17, 1989

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This new $50 million boiler is an integral part of the overall $190 million Rome, GA improvement program which, when completed, should add 25% to production capacity at the Rome mill.

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Review of Operations

Container & Containerboard

Inland Container is the largest subsidiary of Temple-Inland's four operating groups, having contributed 67 percent of operating profit in 1988.

Group revenues totaled $1.1 billion in 1988, a 13 percent increase over 1987. Operating income increased 47 percent to $221.3 million, a new record.

Inland is the third largest producer of corrugated boxes in the country but still has less than 8 percent of the domestic market. As a vertically integrated Company, most of Inland's revenues are derived from the sale of corrugated shipping boxes. In 1988, some 88 percent of Inland's containerboard production was converted into boxes in the Company's 32 box plants and sold to thousands of customers nationwide and in Puerto Rico.

Inland box shipments reached an all-time high of over 1.5 million tons, a gain of approximately 6 percent over 1987, compared with an industry increase of about 3 percent.

The strength of Inland's box business was widespread and not confined to any one geographic region or market. Demand tracked the U.S. economy, peaking in the second quarter and then leveling off.

The market for containerboard was strong throughout 1988. In fact, the supply of linerboard and corrugating medium became very tight in the first half of the year. Industry inventories grew somewhat in the third quarter and became tight again in the fourth quarter.

Industry containerboard export sales, generally about 10 percent of total industry production, started and finished the year quite strong, ending slightly ahead of 1987 and making 1988 exports the second highest in history. Although we are not major exporters, industry exports do have an impact on us, and we are optimistic that exports in 1989 will continue near current levels.

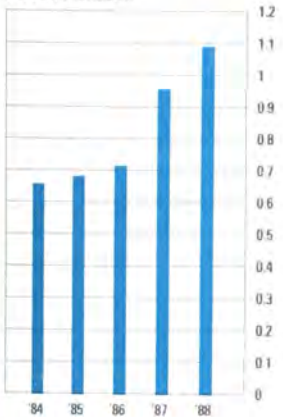
The price of our primary grade of linerboard rose to $410 per ton from $380 during the first quarter of 1988. Since we sell very little linerboard, our earnings did not improve until box prices increased, primarily in the second and third quarters of the year.

Inland's basic strategy is to be a vertically integrated operation. Therefore, to achieve greater box volume, our objective is to also increase the manufacturing capabilities of our containerboard system.

Currently, we believe that the company can achieve greater economic results by modernizing our existing mills rather than building new greenfield mills. In 1988, we continued these improvement programs at both our Rome, GA and Orange, TX linerboard mills and have initiated a similar program at our corrugating medium mill at New Johnsonville, TN.

The Rome linerboard mill, which we acquired in the division of Georgia Kraft Company, is in the middle of a three-year, $190 million improvement program. The biggest single expenditure in this project is a new state-of-the-art recovery boiler which began operations in 1988. Performance testing shows that operating efficiencies are even better than projected. Final modifications to the paper machine will be made in December of 1989, which should allow production to increase approximately 25 percent from

Container & Containerboard
Net Sales (billions)

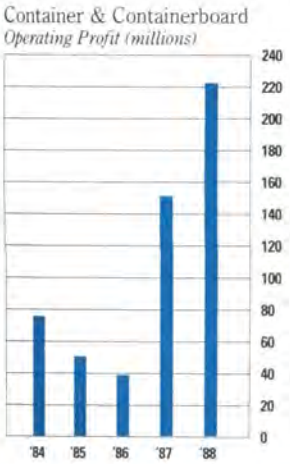


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Customers continue to desire packages with improved graphics compared to traditional boxes. We continue to innovate to be a leader in providing these new containers such as this preprint linerboard for Coors Light Party Ball packages.

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2,000 tons to about 2,500 tons per day.

A major rebuild of one of the two paper machines at the Orange linerboard mill was completed in 1988. This rebuild represents a significant part of a $75 million improvement program at Orange which has resulted in increased production of about 17 percent and has markedly improved the consistency and quality of the linerboard manufactured.

Late in the year, a $20 million improvement program was approved for the New Johnsonville mill. When completed in 1990, daily production is expected to increase about 15 percent, to 675 tons per day. The principal investment will be for the rebuild of the press section and new drives for the paper machine.

The containerboard industry as a whole experienced increased mill downtime in 1988 for machine rebuilds similar to those at Rome and Orange. Most of this work will result in incremental additions to capacity, and there is likely to be temporary pressure on industry supply and demand relationships.

The Company continues to strive toward excellence in quality and service. The use of Statistical Process Control (SPC) is one of the ways Inland is focusing on improving quality. SPC continued to remain a high-priority item at Inland's box plants and mills throughout the year, and our employees are rapidly gaining skills and capability in further improvement and control of manufacturing process variations.

Inland has developed its own approach to implementing SPC with a program specifically designed for our box plants and mills. A dozen plants have spearheaded this approach and their learning experience will be passed on to the rest of our plants in 1989. We have been developing SPC techniques that are applicable specifically to our operations for several years, and are now beginning to see the results in improved performance.

During the year, we continued to emphasize more value-added products, such as enhanced graphics. Focusing on customer service and quality in this area led to further printing improvements, especially with regard to ink viscosity and color match.

Inland completed development of and introduced a family of high-strength liners named "MaxPly." This product addresses a new and expanding market opportunity and is being produced at both the Rome and Ontario, CA mills.

This new linerboard is being used to produce a dramatic new high-performance box which provides greater strength and overall cost savings. Box compression strength has been enhanced for those customers who require greater stacking strength in shipping and warehousing their products.

The "Inland Edge" box design received recognition as one of the industry's outstanding packaging designs in 1988. This new package, designed for easy and attractive product displays in stores, is now being used by several major national companies.



Ben J. Lancashire
Group Vice President

Inland has gained a larger position as a supplier to many large national companies. Because of our responsiveness and effectiveness in coordinating large supply contracts with these multi-plant national customers, we are considered a leader in this important marketing approach. As these customers gain market share in their industries, we are growing with them. This is reflected by our gain in market share in 1988.

Box plant productivity gains have been accomplished as a direct result of capital programs for newer, faster, labor-saving equipment. Modernization and expansion programs are underway at Inland's box plants at Crawfordsville, IN and Biglerville, PA and should be completed early in 1989. Both plants will set a new standard in the industry with corrugators capable of running at 1,000 feet per minute.

During 1989, Inland's 33rd box plant, located in Edinburg, TX will begin limited production in the second quarter. A newly-constructed 80,000 square foot building has been purchased and an additional 120,000 square feet is under construction. The facility will serve a variety of industries, including the fruit and vegetable markets in the area, as well as the Maquiladora Manufacturing plants in Mexico. The plant will be fully operational by the end of the year.

The container and containerboard group has grown considerably since 1984. Containerboard

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production has increased 47 percent to 1,836,000 tons from new capacity additions—the Ontario and Orange mills—and from productivity improvements at existing facilities.

Box plant shipments of 1,502,000 tons have increased 41 percent in the last five years, including further expansion into more diversified product lines. In these five years, we have added containerboard capacity faster than box plant consumption, giving us the flexibility to add box plant capacity or continue to sell containerboard on the open market.

Pulp & Paperboard

The Pulp and Paperboard Group consists primarily of a bleached paperboard mill in Evadale, TX. This specialty mill is one of the largest bleached mills in the country and is specifically designed for the production of higher profit margin grades of paperboard including cup, plate, folder, tag and index stock, and bleached linerboard. During 1988, operating profits were a record $82.7 million, a 55 percent gain from 1987. Sales increased 15 percent to $336 million.

For the past few years, the strategy of this group has been to enhance its leadership position in the food service marketplace while increasing its share of specific grades in the printing, office supplies, and packaging markets. The Company's success in 1988 was due to several factors including strong markets, improved quality, increased volume, cost control, and a participative management style.

In the marketplace, the products produced at the Evadale mill are classified as bleached board, bleached bristols, or bleached market pulp. Last year, all of these markets were very strong. In fact, 1988 was probably the best market environment for bleached paperboard manufacturers since the early 1970s. There were a number of reasons for last year's strength.

First, continued growth of the U.S. economy stimulated demand for nondurable consumer goods which often are packaged in bleached paperboard. Demand for bleached paperboard also strengthened as merchandisers upgraded point of sale packaging to enhance product sales.

Also, the weak dollar aided the export of bleached board tonnage, primarily milk carton stock. Although the Evadale mill does not produce this product, the industry's increased production of milk carton was a significant factor in the overall balancing of supply and demand.

Finally, very little capacity came on stream during 1988, so machine operating rates at most bleached board mills rose to meet the increased demand.

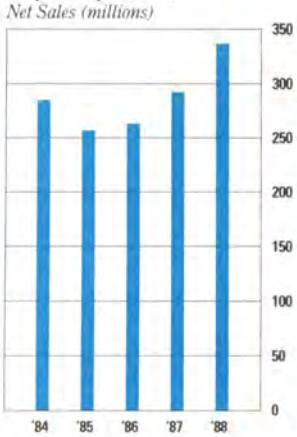


David L. Ashcraft
Group Vice President

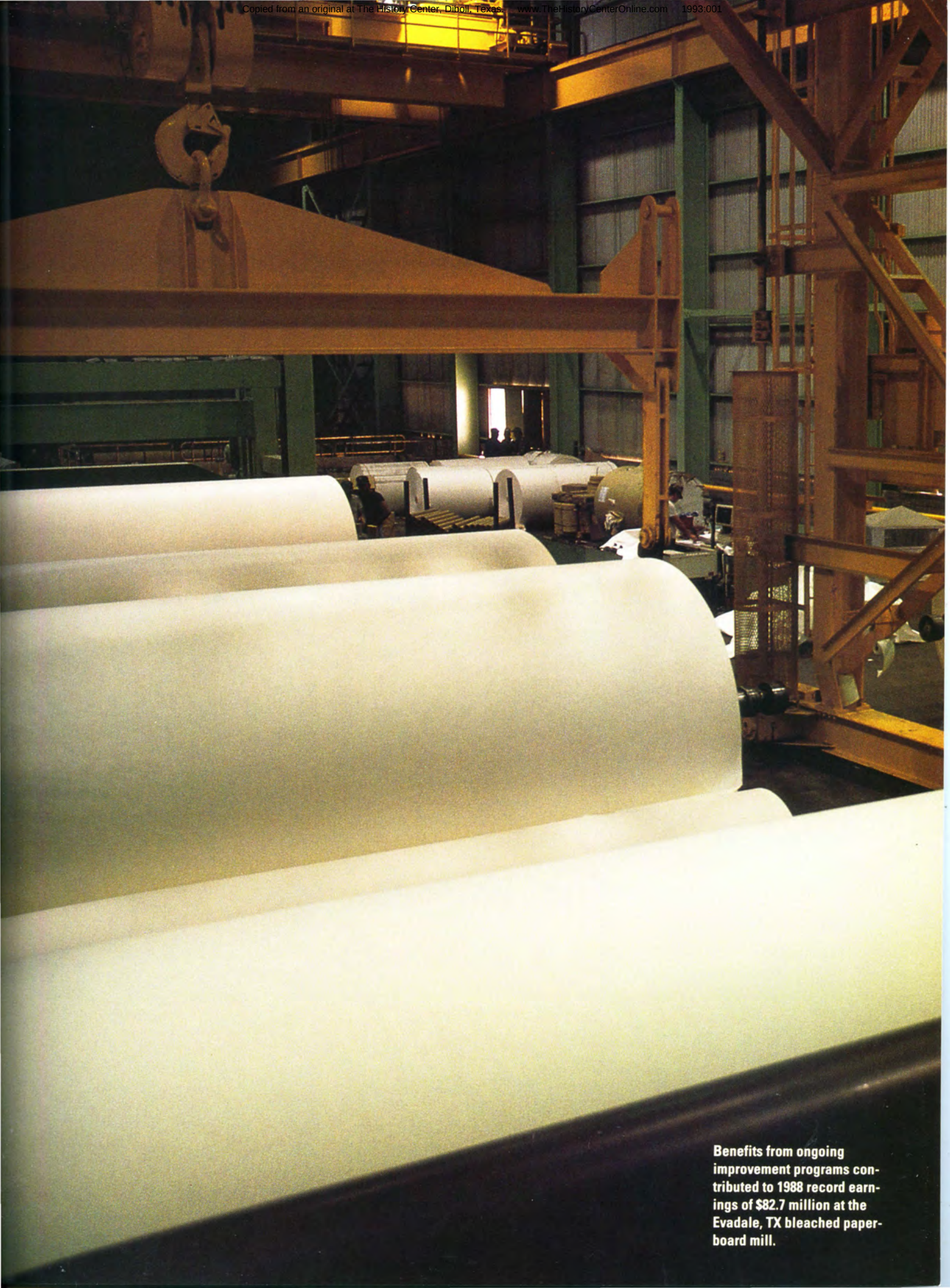
The strong demand for products permitted two major price increases during 1988, one in the spring and one in the fall, restoring paperboard prices to 1984 levels.

Improved quality of the products manufactured at Evadale became evident in 1988 as demand for several premium grades established new records. A program of excellence has been underway for the past several years designed to improve process uniformity and product quality. Capital expenditures have included a new coater and related equipment on one of the mill's paper machines to produce premium coated grades of paper for higher quality phone book covers and paper plates. The rebuild of another machine was designed to produce a uniform

Pulp & Paperboard
Net Sales (millions)



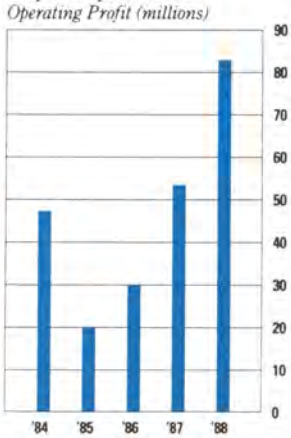
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Benefits from ongoing improvement programs contributed to 1988 record earnings of $82.7 million at the Evadale, TX bleached paperboard mill.

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Pulp & Paperboard
Operating Profit (millions)



heavyweight paperboard. Other expenditures throughout the manufacturing process have been geared toward improved cleanliness, higher strength, higher brightness and reduced density.

Capital spending for quality improvements has emphasized consistent, good production using statistical quality methods. By the end of 1989, most processes within the mill will have been introduced to statistical quality concepts designed to produce a consistent, premium output.

The volume of bleached board produced at Evadale increased again in 1988. Production from the mill's four paper machines has increased 11 percent during the past five years. The increased production during 1988 was the result of faster machine speeds since many of the capital projects designed primarily to improve quality have had the secondary benefit of increasing production rates. Higher production, increased operating efficiencies, and better cost controls have contributed to a reduction in unit manufacturing cost in recent years.

All paper mills basically are two separate systems—a pulping system which takes wood fiber and creates pulp, and a process which converts the pulp into paper. Although most mills are designed with equal capacity, technological changes can cause an imbalance in these capacities. Extension of our shortline railroad to connect the Evadale and Orange mills will give us unique opportunities to level the imbalances at both mills.

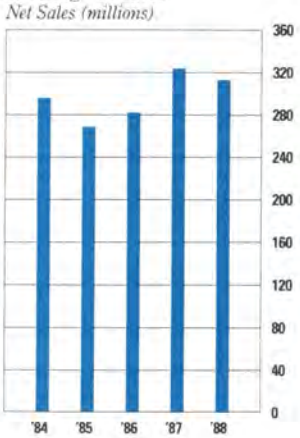
The final element of success during 1988 was the participative management style in place at the mill. A new five-year labor agreement was signed in October 1988. The first year of an intensive supervisory management development program was completed and one level of supervision was effectively removed from the mill. The management philosophy of decisions at the lowest effective level and employee involvement will continue to contribute to the long-term success of the mill. This people-oriented philosophy results in higher efficiencies, higher quality, higher morale and lower costs.

1988 was a record year and the result of several years of preparation. The future looks promising, with industry conditions the most favorable in a decade.

Building Products

Our Building Products group suffered from a weak residential and commercial construction market in 1988. Operating profit was $24.6 million, down 33 percent from 1987. Revenues declined 3 percent to $312.3 million.

Building Products
Net Sales (millions)



Temple-Inland manufactures a wide variety of building products, most of which allow us to utilize our timber more effectively. These include lumber, plywood, particleboard and fiberboard. An exception is gypsum and we entered this business because it is an alternative to wood and can be sold through our existing sales network.

Building material markets have always been very cyclical, but not every product experiences the same level of demand. As a result, our portfolio of products has allowed us to concentrate our efforts on those items with the best market conditions.

Following this strategy, we decided to focus our growth in products which not only benefit from residential construction, but also can be used in remodeling, in repair of existing structures, and in furniture.

Particleboard is an example. Rather than concentrate on commodity grades of particleboard used for subflooring in new construction, we have chosen to produce a higher quality engineered particleboard. We have increased our market penetration for such products as ready-to-assemble furniture, countertops and kitchen cabinets.

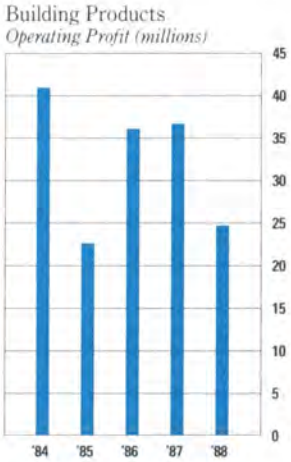
We have taken an additional step to integrate products into our customers' manufacturing process with the addition of a new laminating line which overlays paper and vinyl coatings on a particleboard substrate for furniture and cab-

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Over 50% of Temple-Inland's particleboard now is used in furniture and cabinets. This machine laminates vinyl and paper coatings on particleboard substrate which simulates wood patterns for uses in these markets.

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inets. Experimentation with other building materials, including hardboard and gypsum, in these overlays will continue to expand their potential uses.

Due to broader usages, demand for southern pine lumber is projected to grow much faster than that of other species of wood. In addition, potential environmental restrictions could hamper conversion of fiber in certain other areas of the country.

Because of these factors, and our own harvesting schedules which are generating a great deal more wood that we are capable of converting, we have chosen to expand our lumber production.

The start-up of our Buna, TX sawmill, with an annual production capacity of 120 million board feet, is a major component of our strategic plan. This state-of-the-art sawmill was specifically designed to efficiently convert logs of all diameters to a wide range of lumber sizes. In 1988, we produced 105 million board feet and expect to achieve capacity production in 1989.

The Buna mill is located on the Company's short-line railroad and is just 27 miles from the Orange linerboard mill and 10 miles from the Evadale paperboard mill. Annually, this sawmill generates some 185,000 tons of wood chips which are being economically shipped to our own paper mills.

A similar, slightly smaller mill currently is under construction near DeQuincy, LA. This mill, with a capacity of 100 million board feet of production annually, will improve the efficiency of utilizing our Louisiana timber base as well as supply additional chips to our paper operations. When the DeQuincy mill starts up late in 1989, we will have more than doubled our lumber production capacity since 1986 to 450 million feet.



Harold C. Maxwell
Group Vice President

Current economic conditions do not create a great deal of enthusiasm for new housing construction this year. We continue to invest in programs which will help us produce the highest quality products and in becoming more customer friendly in our distribution. These investments will enhance our ability to be a low-cost, quality producer.

As important as capital expenditures are programs that assist employees to better understand and utilize the new technology in our plants. Training programs designed to improve employees' mechanical skills and management capabilities are going on at all our operations.

As we continue transition from residential construction to more specialized markets, we are providing even greater customer service and product quality. An increased level of employee understanding and response to the customer are the keys to the successful transition to these less cyclical markets.

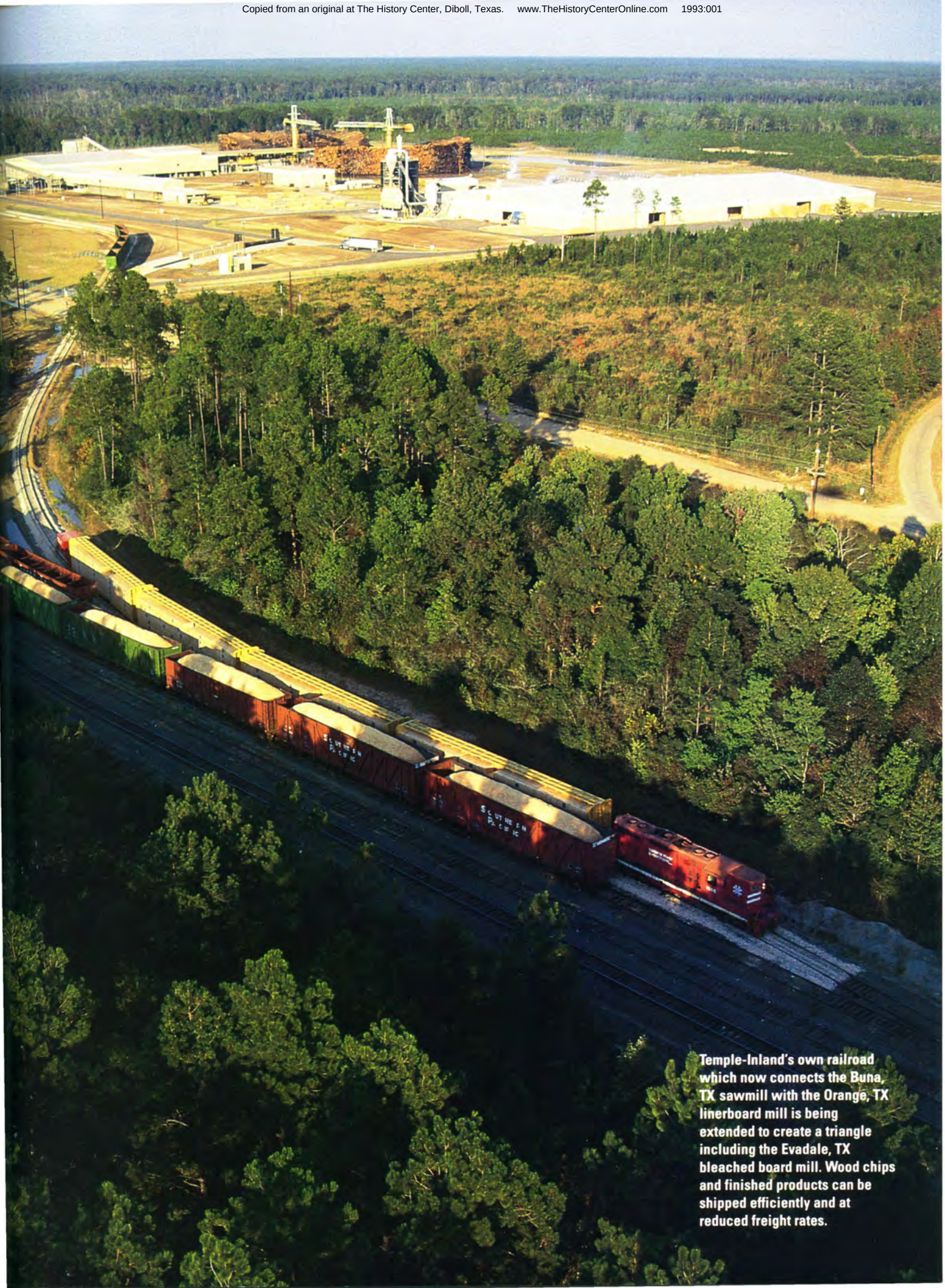
Timber & Timberland

Temple-Inland's most valuable natural resource is its nearly 1.8 million acres of Texas, Louisiana, Georgia, and Alabama timberlands, supplemented by an additional 110,000 acres under long-term lease. The Company's holdings make it the largest corporate landholder in Texas.

The fundamental objective is to manage this resource for maximum present net worth while producing suitable quality fiber for the Company's paper and wood products operations. Sophisticated management techniques utilizing genetically improved growing stock produce a forest that yields up to twice the fiber volume of naturally grown stands.

The lands have been compartmented into naturally common management units averaging about 300 acres each to maximize efficiency. Through the use of Japanese Tea Garden type

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Temple-Inland's own railroad which now connects the Buna, TX sawmill with the Orange, TX linerboard mill is being extended to create a triangle including the Evadale, TX bleached board mill. Wood chips and finished products can be shipped efficiently and at reduced freight rates.

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detail techniques, each compartment and each timber stand within the compartment have a detailed management plan, inventory, and harvest schedule. A staff of over 100 professional foresters supervises planned growth and harvesting of Company-owned fiber.

In 1988, these timberlands, directly and indirectly from residues of lumber and plywood operations, produced 54 percent of Temple-Inland's wood requirements. The combined harvest from Company-owned land totaled 1.4 million cords.

The East Texas and Louisiana lands have been intensely managed for many years. Because of these programs, we are now beginning to achieve more commercial timber and our future harvest levels will reflect this gain.

Acquisition of the Georgia and Alabama timberlands began in the late 1940s and is still ongoing. Many of these lands were formerly farmland that had reverted to forest. The best management technique to reach maximum production often involved the immediate cutting of understocked stands and replanting or reseeding the acreage. Average timber stands are relatively young today and most have not reached commercial size as have our Texas lands.

Genetically engineered pine seedlings are produced in Company seed orchards near Newton, TX and in a co-op orchard arrangement in Georgia. These assure that future seedlings will grow faster and with better form and wood qualities. Disease resistance is also an important inheritable characteristic that can be exploited. All pine seedlings now being planted on our lands originate in these orchards, some from the second generation of improved parents. Last year, over 40 million superior seedlings were transplanted on Company lands.

Lands best suited for growing hardwood are managed for these species. Temple-Inland owns 140,000 acres that remain dedicated to hardwood. The Evadale and Rome mills both use hardwood fiber in their grade mix. This important forest segment plays a significant role in long-term strategy planning.

Timber needs beyond those supplied from Company lands come from other landowners. By providing a reliable market for timber sellers, most of whom are small private owners, Temple-Inland encourages them to make the 30-plus year investment required for timber crops. This supply is essential for future requirements and growth. Residues from area lumber and plywood producers supply the remaining fiber source for the pulp mills. Most of this volume is under long-term contract.

The drought, which affected much of the Northwest and upper Midwest during the summer of 1988 and which drew nationwide media attention with its publicized wildfires, did not seriously impair Temple-Inland. Its effect on timber supply was minimal, and costs remained almost flat for the year.

The Company has adopted a land improvement strategy with the goals of consolidating ownerships into more efficient units, the selling or trading of tracts too valuable for timber production, and the acquisition of properties within 40 miles of production facilities. Progress was evident in 1988, especially in the sale of high-value lands near Atlanta, GA and the continued disposition of inefficient small tracts in Texas and Louisiana. Several land exchanges were completed with public agencies, individuals or other companies, all of which enhanced the timber management prospects of the lands.

But the careful management of timberlands involves more than just the planting, growing, and harvesting of trees. Lands are carefully supervised to guard against environmental degradation, to assure that surrounding lands are not adversely affected by timbering activities, and to benefit the public in a variety of natural history and recreational activities.



Glenn A. Chancellor
Group Vice President

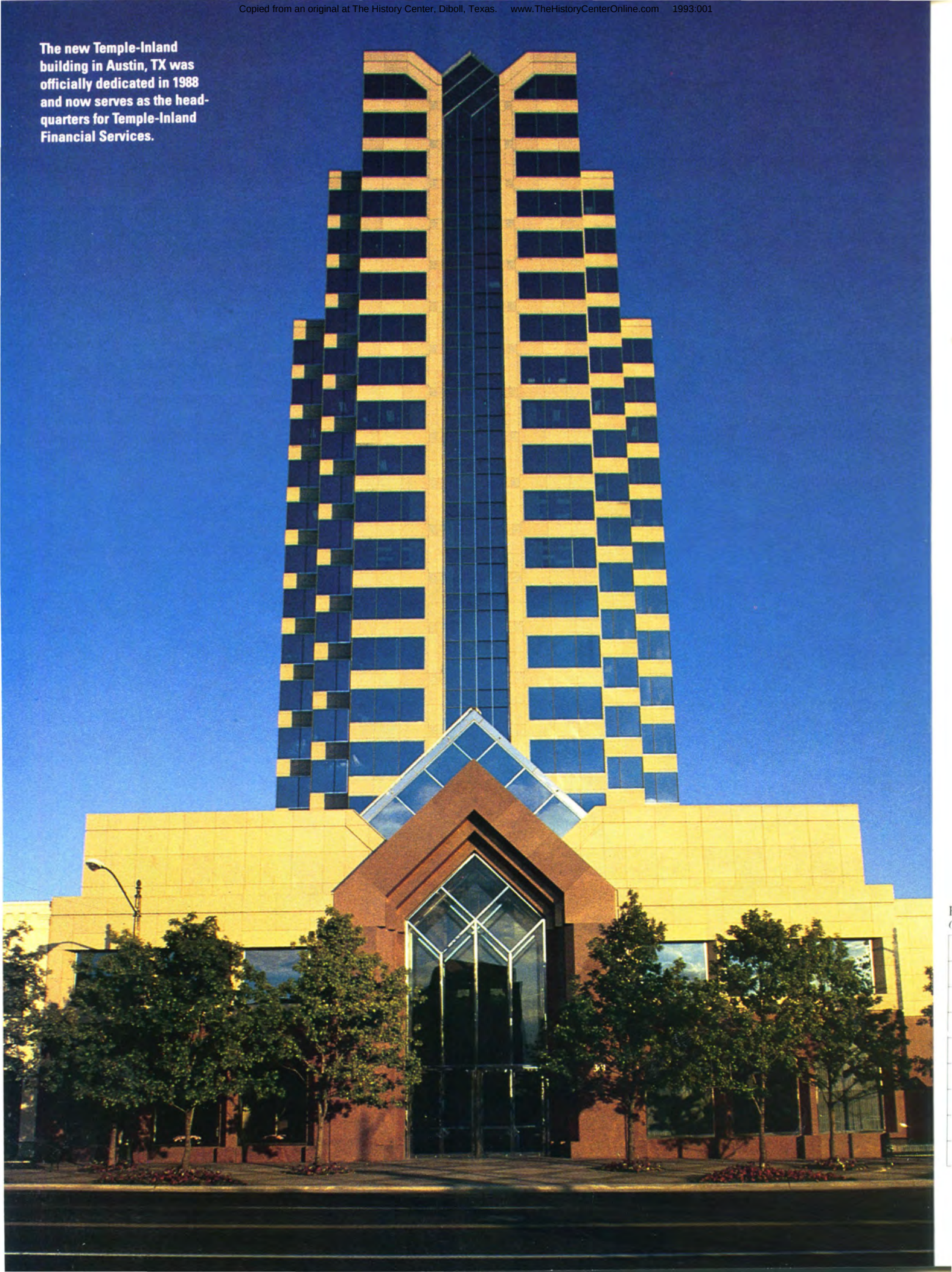
Over 900,000 acres are available for public use either free or through low-cost programs sponsored cooperatively by Temple-Inland and public agencies. Hunting, camping, hiking, and other outdoor recreation are widely practiced on these lands. Environmentally threatened plant and animal species are protected within Company property. Temple-Inland received the 1988 Preservation Award from the Texas Organization For Endangered Species in recognition of Company accomplishments.

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Temple-Inland's forests now provide 55% of the Company's wood fiber needs, and construction of a new sawmill at DeQuincy, LA in 1989 will allow more efficient utilization of our Louisiana forest.

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The new Temple-Inland building in Austin, TX was officially dedicated in 1988 and now serves as the headquarters for Temple-Inland Financial Services.

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Planning ahead, well into the next century, the Company anticipates protection of its forestland acreage with the land improvement strategy as the cornerstone. Timber crops will ultimately increase 25 percent above today's yield with state-of-the-art techniques and growing stock. This increase from one of the world's most efficiently renewable resources can be realized without the need to make a substantial investment in additional acreage.

Financial Services

Temple-Inland Financial Services again encountered difficult markets in 1988, and experienced a decline in earnings that resulted in a loss of $5.6 million for the year.

Financial Services operations are involved primarily in mortgage banking, real estate development, insurance, and savings and loan activities. Mortgage banking activities are transacted through branch offices across the central United States that extend from Texas to Minnesota. Real estate development has been limited to the major metropolitan areas of Texas, while life insurance transacts business nationwide. The group has a wholly-owned savings and loan association, Kilgore Federal Savings & Loan, Kilgore, TX and, in 1988, invested as a majority owner in a federally-assisted acquisition of the assets of three savings and loan associations in Texas.

Depressed operating earnings in life insurance were the result of several factors, including inefficiencies during the early stages of a restructuring designed to consolidate certain administrative functions. During the year, the Company completed the move of one of its companies, National Fidelity Life Insurance ("NFL"), from Overland Park, KS to Dallas, TX. The combination of several functions for NFL and Great American Reserve Insurance Company ("GARCO") allowed a net reduction of personnel of over 50, but resulted in operating inefficiency while both groups were adjusting to the change.

During 1988, the insurance groups continued to eliminate products which were not profitable, including medical coverage through associations and groups, and universal life. The exit process took longer than expected and the claims experience, while those blocks of businesses were running off, was higher than anticipated. The major portion of these problems should now be behind the Company as a result of charges taken in 1988.

Sales results on new products introduced in traditional lines have been building to favorable levels. This provides encouragement that the Company can build a broader, better segmented income stream based on these new products. In addition, combining the two operations at one headquarters should produce efficiencies and enable us to reduce costs.

GARCO has developed a unique position in its marketing of insurance products to educators through public school systems, particularly in the southern United States. These markets, which already comprise 80 percent of the GARCO sales activities, will continue to receive emphasis during the coming year.

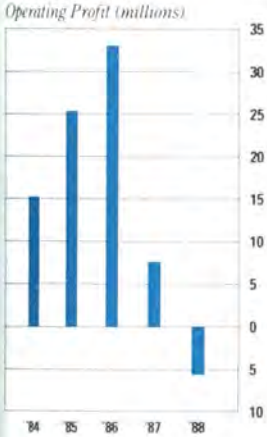
The insurance industry is operating in a period of considerable transition. GARCO and NFL have significantly modified the product mix they offer in order to meet the changing competitive environment and to provide a new avenue for future growth. Both companies continue to be A-plus (excellent) rated by the A. M. Best Company.



W. Wayne McDonald
Executive Vice President and Chief Financial Officer

Timberline Insurance Managers, Temple-Inland's casualty agency, experienced another solid year in earnings and additions to its customer base. This segment continued to report

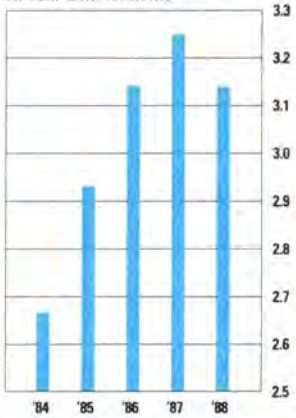
Financial Services
Operating Profit (millions)



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Financial Services

Mortgage Loan Servicing Portfolio At Year End (billions)



earnings at comparable levels to its historical results. Emphasis on shifting the growth of this operation to personal coverage businesses continues along with efforts to develop new commercial accounts.

In mortgage banking, though we do have operations outside Texas, the concentration actually is in the Sunbelt area. In many of the areas where we operate, residential home values have declined dramatically. In a number of cases, current sales prices are at a 50 percent discount from historical pricing levels. These lower values have eliminated the equity that many homeowners had in their houses.

This loss of equity has had two effects. First, it is extremely difficult for homeowners to trade houses, and those who encounter financial difficulty allow their homes to be foreclosed because they have no equity. In addition, the lack of significant population growth and rising interest rates have caused a difficult operating environment, a period of less mortgage generation and higher levels of foreclosure.

Loan originations declined by 62 percent from 1987. Although refinancing activity moderated from prior years, the lower level of housing starts and continued poor resale markets, particularly in Texas and Oklahoma, combined to keep new loan demand at depressed levels. This, along with refinancings, foreclosures, and paid-in-fulls, caused our net servicing portfolio balance to decline in 1988 by 3 percent, the first year in the history of the Company in which portfolio balances have declined.

A high level of foreclosures pushed residential real estate owned (REOs) by the Company to a high of 335 units in the third quarter of 1988 before some improvements occurred. Concentrated efforts in this area resulted in dispositions of property that brought REOs held by the Company to 197 at year end. The cost associated with holding, improving, and maintaining these properties climbed to $9.5 million in 1988, almost double that of 1987.

The mortgage banking group has now completed its efforts to combine activities and restructure operations to provide additional efficiency to the various components of its business. The results of these efforts enabled a reduction of over $1 million in operating costs in 1988.

In 1988, Temple-Inland Financial Services completed its first year of operation of Kilgore Federal Savings & Loan Association. As the year progressed, the Company was able to consolidate many activities with the mortgage banking group, thereby enhancing profitability for this segment.

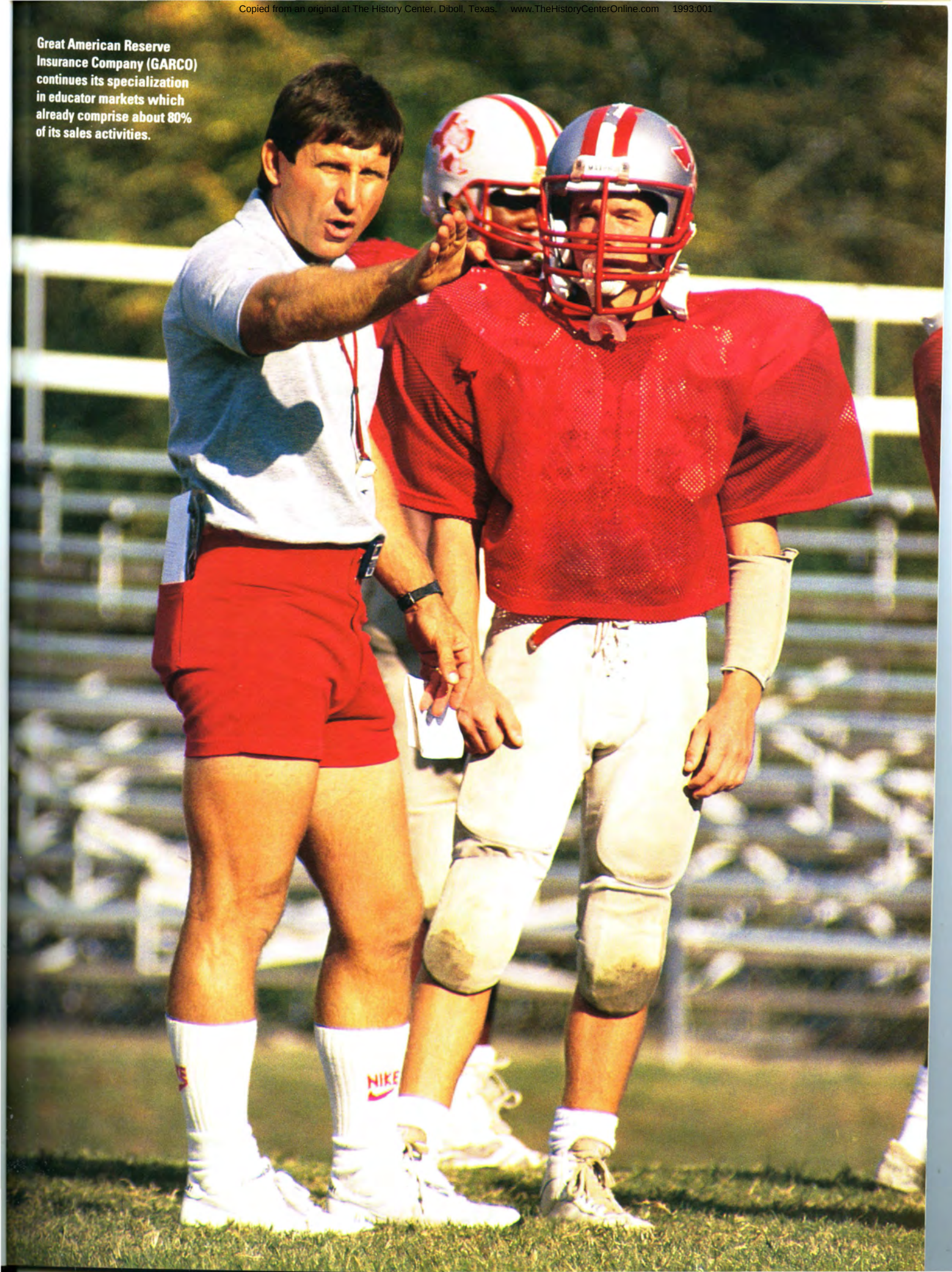
On September 30, Temple-Inland Inc., as the majority investor, participated in the acquisition of Guaranty Federal Savings Bank, headquartered in Dallas. This acquisition was a part of the Federal Savings and Loan Insurance Corporation ("FSLIC") Southwest Plan and covered the assets of three insolvent Texas thrifts, Guaranty Federal Savings and Loan, Dallas; First Federal Savings and Loan Association, Austin; and Delta Savings Association, Alvin. Guaranty Federal has total assets of over $4 billion and operates through 52 branches in Dallas/Fort Worth, Houston, Austin, and the surrounding areas.

Guaranty Federal Savings Bank is expected to provide an excellent opportunity for Temple-Inland to expand its financial services assets and earnings base. The strategy will be to focus on restoring the thrift to a position as a viable consumer lender in its savings and loan markets. The emphasis will be on improving the quality of the operations rather than growth.

The Guaranty Federal Savings Bank acquisition was treated as a non-consolidated investment in 1988, and it is the present intent of the Company to continue such treatment in 1989. Therefore, any earnings generated by the Savings Bank and related tax benefits to Temple-Inland achieved through consolidation of this institution for tax purposes will be treated as a reduction of the investment rather than as additional earnings to the Company. The Company plans to start consolidation of its equity in the earnings in 1990. We are happy to report that in its first quarter of operation, Guaranty Federal Savings Bank earned $3 million and the complete financial statements are available on pages 49 through 56.

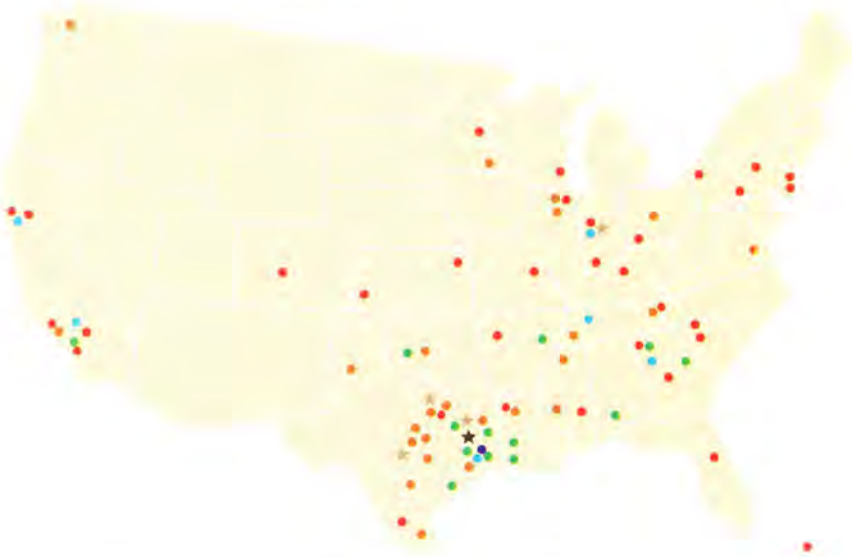
The efforts of all our businesses in financial services are focused on providing a stream of earnings that are less cyclical than the paper and building products earnings of Temple-Inland. Though these earnings were depressed in 1988, accomplishments were made to position this group to be a larger contributor in the future. ■

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Great American Reserve Insurance Company (GARCO) continues its specialization in educator markets which already comprise about 80% of its sales activities.

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★ Corporate Headquarters

Subsidiaries Headquarters

● Bleached Paperboard Mill

● Containerboard Mills

● Building Products

● Packaging

● Financial Services

★
Corporate Headquarters
Diboll, Texas

Subsidiaries' Headquarters

Inland Container Corporation
Indianapolis, Indiana

Great American Reserve Insurance Company
Dallas, Texas

Lumbermen's Investment Corporation
Austin, Texas

National Fidelity Life Insurance Company
Dallas, Texas

Temple-Inland Forest Products Corporation
Diboll, Texas

Temple-Inland Financial Services Inc.
Austin, Texas

●
Bleached Paperboard Mill
Evadale, Texas

●
Containerboard Mills

Linerboard
Ontario, California
Rome, Georgia
Orange, Texas

Corrugating Medium
Newark, California
Newport, Indiana
New Johnsonville, Tennessee

●
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

Plywood Operations
Pineland, Texas

Lumber Operations
Rome, Georgia
DeQuincy, Louisiana
(under construction)
Diboll, Texas
Pineland, Texas
Buna, Texas

Retail Distribution Operations
Diboll, Texas
Pineland, Texas
Conroe, Texas
Houston, Texas
Alexandria, Louisiana

●
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
Minneapolis, Minnesota
Hattiesburg, Mississippi
St. Louis, Missouri
Edison, New Jersey
Spotswood, New Jersey
Middletown, Ohio
Biglerville, Pennsylvania
Erie, Pennsylvania
Hazleton, Pennsylvania
Vega Alta, Puerto Rico
Lexington, South Carolina
Rock Hill, South Carolina
Elizabethton, Tennessee
Dallas, Texas
Edinburg, Texas
(under construction)
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
El Paso, Texas
Downers Grove, Illinois
Gurnee, Illinois
Oklahoma City, Oklahoma
Knoxville, Tennessee
Memphis, Tennessee
Jackson, Mississippi
Southaven, Mississippi
Eagan, Minnesota
Minneapolis, Minnesota
Denver, Colorado

Savings & Loan Association
Kilgore, Texas

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Board of Directors

Temple-Inland Inc.

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.

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.

Walter P. Stern (1) (2) (3)
Chairman of
Capital International, Inc.

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

Arthur Temple III (1) (3) (4)
Chairman of the Board and
Chief Executive Officer
Exeter Investment Company

Clinton G. Ames Jr.
Director Emeritus

Joe C. Denman Jr.
Director Emeritus

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

Officers

Temple-Inland Inc.

Clifford J. Grum
President and
Chief Executive Officer

Arthur Temple
Chairman of the Board

W. Wayne McDonald
Executive Vice President and
Chief Financial Officer

Ben J. Lancashire
Group Vice President

Roger D. Ericson
General Counsel and Secretary

M. Richard Warner
Treasurer

David H. Dolben
Vice President

Joseph E. Tomlinson
Assistant Treasurer

James R. Wash
Assistant Secretary

Chester E. Winger
Assistant Treasurer

Inland Container Corporation

Corporate Group

Ben J. Lancashire
Chairman, President and
Chief Executive Officer

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

David J. Harrison
Senior Vice President—
Administration

Joseph M. Areddy
Vice President—
Public Affairs

Steven L. Householder
Vice President and
General Counsel

Joseph E. Tomlinson
Vice President—
Treasurer and Controller

John M. Vaughan
Vice President—
Engineering and Technology

Robert B. White
Vice President—
Management Information Services

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

James W. Emerson
Vice President and
General Manager
Inland-Rome Inc.

Ted A. Owens
Vice President and
General Manager
Inland-Orange Inc.

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 and
General Manager

Temple-Inland Forest Products Corporation

Robert G. Luttrell
Vice President—
Administration and Treasurer

George S. Vorpahl
Vice President and
General Counsel

James R. Wash
Secretary

Jack H. McCuistion
Controller

Building Products Group

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

Kenneth G. Christopher
Vice President—Minerals

Pulp & Paperboard Group

David L. Ashcraft
Group Vice President

Aubrey W. Barlow
Vice President—Sales

W. C. Cole
Vice President—Mill Operations

E. Wayne Carr
Vice President—Administration

Sabine Investment Company of Texas, Inc.

James E. Brasse
President

Temple Associates, Inc.

Joseph C. Foy
Executive Vice President
Construction Group

William B. Fulmer III
Executive Vice President
Universal Electric Construction
Group

The Angelina Free Press, Inc.

Alan O. Miller
President and Publisher

Paul M. Durham
Vice President and Editor

Temple-Inland Financial Services Inc.

W. Wayne McDonald
Chairman, President and
Chief Executive Officer

Lumbermen's Investment Corporation of Texas

Joseph L. O'Connor
President

J. M. Shorter
Senior Vice President—
Chief Financial Officer

Joseph L. Maverick
Senior Vice President—
Commercial Lending

H. J. "Jay" Shands III
Senior Vice President—
Residential Lending—Southwest

Joe Umphries
Senior Vice President—
Residential Lending-Central

Temple-Inland Properties Inc.

Dan Davidson
President

Timberline Insurance Managers, Inc.

Gary H. Cooper
President

Great American Reserve Insurance Company

Wm. P. Tedrow
President and Chief Executive
Officer and Chairman of
National Fidelity Life

John H. Buchanan
Executive Vice President and
Chief Operating Officer

Ronald F. Ruhl
Executive Vice President and
Chief Actuary

Calvin Crider
Executive Vice President—
Marketing

Terrence L. Whitworth
Executive Vice President
and Treasurer
Chief Financial Officer

Karl Sharff
Senior Vice President—
Information Services

National Fidelity Life Insurance Company

Barry J. Grosman
President

Kilgore Federal Savings & Loan

Rex Whitten
Executive Vice President

Investments (Majority-Owned)

Guaranty Federal Savings Bank

Richard M. Jones
Chairman and
Chief Executive Officer

J. Michael Cornwall
President and
Chief Operating Officer

Scott H. Smith
President-GSC Realty Inc.

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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	1988	1987	1986	1985	1984
			(in millions)		
Revenues					
Container and containerboard	$1,093.1	$ 964.2	$ 721.7	$ 684.2	$ 665.3
Pulp and paperboard	336.0	292.5	264.9	256.7	284.5
Building products:					
Manufacturing	278.4	290.7	251.0	226.9	226.6
Retail	33.8	32.1	30.5	41.1	68.7
Other activities (1)	32.2	23.2	27.7	34.2	17.8
Manufacturing Net Sales	1,773.5	1,602.7	1,295.8	1,243.1	1,262.9
Financial services	325.6	336.2	346.3	231.4	152.3
Total Revenues	$2,099.1	$ 1,938.9	$ 1,642.1	$ 1,474.5	$ 1,415.2
Income Before Taxes					
Container and containerboard	$ 221.3	$ 150.8	$ 38.8	$ 49.7	$ 74.8
Pulp and paperboard	82.7	53.4	29.4	19.8	46.8
Building products:					
Manufacturing	24.1	36.8	36.2	23.5	40.2
Retail	.5	(.3)	(.3)	(1.0)	.7
Other activities (1)	1.2	—	(5.8)	2.5	(3.2)
Operating profit	329.8	240.7	98.3	94.5	159.3
Financial services	(5.6)	7.6	33.0	25.3	15.2
	324.2	248.3	131.3	119.8	174.5
Corporate expense	(19.9)	(11.7)	(13.1)	(8.1)	(11.9)
Parent company interest—net	(23.1)	(20.3)	(13.0)	1.2	(4.6)
Other income—net	(.4)	—	3.6	2.2	1.8
Gain on sale of property and equipment (2)	21.0	4.1	4.5	12.5	5.8
	$ 301.8	$ 220.4	$ 113.3	$ 127.6	$ 165.6

(1) Primarily industrial contracting.
(2) Includes gains in 1988 of $12.4 million on the disposition of lands, primarily as a result of the dissolution of Georgia Kraft, and $5.0 million on the sale of the Company's AFCO Industries subsidiary. The 1985 amount includes an $11.3 million gain on the sale of the Company's Eastex Packaging subsidiary.

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Container and Containerboard

The Company's Container and Containerboard operations manufacture linerboard and corrugating medium at six paper mills and convert these grades of containerboard into corrugated shipping containers at 32 box plants. This segment operated at approximately 88 percent integration in 1988. Production of containerboard exceeded internal box plant usage by 228,000 tons in 1988, 354,000 tons in 1987 and 277,000 tons in 1986. Most of the excess board in all years was sold on the open market.

The table below reflects containerboard manufactured at the Company's mills. The significant increase in 1987 resulted from a full year's production from the linerboard mill in Orange, Texas which the Company acquired on July 1, 1986, as well as improved production at the Ontario, California mill. The loss of tonnage in 1988 was due mainly to the sale of the Macon linerboard mill in connection with the dissolution of Georgia Kraft Company.

	1988	1987	1986
Tons Mill Production	1,836,000	1,874,000	1,631,000

At its box plants, 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. Average price per ton of boxes can be significantly impacted by variations in production mix at the various box plant locations.

Container prices began to improve in the second quarter of 1986 and continued throughout 1987 and 1988. Average prices increased 13 percent in 1987 and 9 percent further in 1988.

Box shipments from the Company's converting plants increased by 6 percent in 1988 (in tonnage)and had increased 13 percent in 1987. Revenues from increased box shipments, as well as improved sales prices, pushed profits to record levels in 1988.

The table below shows the container and containerboard sales in tons and dollars. The totals presented include not only boxes sold but open market, domestic and export sales of linerboard, bag paper and related products. Changes in product mix from period to period may make historical comparisons difficult.

Container & Containerboard	1988	1987	1986
Unit Sales		(in thousands of tons)	
1st Quarter	471	454	317
2nd Quarter	470	447	335
3rd Quarter	471	471	399
4th Quarter	455	430	421
For the year	1,867	1,802	1,472
Net Sales		(in millions)	
1st Quarter	$ 264.2	$ 232.8	$ 153.8
2nd Quarter	276.6	235.2	163.8
3rd Quarter	283.2	254.1	194.1
4th Quarter	269.1	242.1	210.0
For the year	$1,093.1	$964.2	$721.7

Pulp and Paperboard

The Company's Pulp and Paperboard group produces bleached paperboard at its mill located in Evadale, Texas. The group sells this production to manufacturers who convert the product into paper cups, plates, shopping bags, file folders and a wide range of other products. Prices for bleached paperboard products began to move upward during the third quarter of 1986, with the average net sales price per ton climbing 8 percent in 1987 and 10 percent in 1988. The product with the most significant price improvement was bleached pulp with prices of this grade improving by about 28 percent each year. Tonnage produced at the mill in 1988 was 602,000 tons compared with 573,000 in 1987 and 562,000 in 1986. Lower unit manufacturing costs, and improved product pricing increased operating income for the Pulp and Paperboard group 55 percent in 1987. This compares to a 82 percent increase in 1987 over the depressed level of earnings in 1986.

The table below lists the quarterly sales by product in tonnage and dollars. Changes in product mix from period to period may make historical comparisons difficult.

Pulp and Paperboard	1988	1987	1986
Unit Sales		(in thousands of tons)	
Paperboard			
1st Quarter	119	123	115
2nd Quarter	122	119	117
3rd Quarter	118	109	110
4th Quarter	118	106	116
For the year	477	457	458
Pulp			
1st Quarter	28	25	25
2nd Quarter	29	25	23
3rd Quarter	33	31	25
4th Quarter	32	31	30
For the year	122	112	103
Net Sales		(in millions)	
Paperboard			
1st Quarter	$ 65.6	$ 64.2	$ 56.8
2nd Quarter	69.2	63.3	59.0
3rd Quarter	68.2	59.1	56.2
4th Quarter	72.3	58.1	59.4
For the year	$275.3	$244.7	$231.4
Pulp			
1st Quarter	$ 11.5	$ 8.8	$ 6.0
2nd Quarter	13.2	8.9	6.6
3rd Quarter	16.0	11.7	7.7
4th Quarter	15.7	13.3	10.1
For the year	$ 56.4	$ 42.7	$ 30.4
Other			
1st Quarter	$ .8	$ .7	$ 1.4
2nd Quarter	1.2	1.5	1.1
3rd Quarter	1.2	1.6	.4
4th Quarter	1.1	1.3	.2
For the year	$ 4.3	$ 5.1	$ 3.1

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Building Products

The Building Products group manufactures a complete line of building products including lumber, plywood, fiberboard, particleboard, gypsum wallboard, and rigid foam insulation. The Company previously produced oriented strandboard at a facility in Claremont, New Hampshire, which temporarily ceased production on July 1, 1988. The Company also previously manufactured decorative wall paneling in a subsidiary which was sold in the first quarter of 1988. The following tables provide information on sales volume and unit sales for each of the building product lines, including those which were eliminated in 1988.

Building Products	1988	1987	1986
Unit Sales		(in millions of board feet)	
Pine lumber	276	174	156
		(in millions of square feet)	
Fiberboard	442	458	436
Particleboard	311	321	297
Plywood	208	212	203
Gypsum wallboard	654	670	397
Decorative wall paneling (1)	14	50	50
Rigid foam insulation	80	71	78
Oriented strandboard (2)	33	80	67
Net Sales		(in millions)	
Pine lumber	$ 60.8	$ 39.5	$ 30.4
Fiberboard	47.1	52.8	56.1
Particleboard	59.3	61.5	50.1
Plywood	28.2	31.1	28.9
Gypsum wallboard	42.2	49.1	36.9
Decorative wall paneling (1)	3.0	12.5	12.7
Rigid foam insulation	17.0	13.5	15.0
Oriented strandboard (2)	3.6	10.0	8.2
Retail distribution	33.8	32.1	30.5
Other	17.2	20.7	12.7
For the year	$312.2	$322.8	$281.5

(1) The Company's decorative wall paneling operation was sold during the first quarter of 1988.
(2) The Company's oriented strandboard operations suspended production at the end of June 1988.

Building product markets generally declined throughout 1988, reflecting the similar trend in the level of construction.

The average sales price for lumber was down 3 percent in 1988 compared with a 17 percent increase in 1987.

Particleboard markets in 1988 showed some strength, particularly in the industrial grades, but prices and demand softened as the year progressed. Prices were slightly below 1987 levels which had been 14 percent above 1986 levels. Almost two thirds of the Company's total particleboard production is now sold to manufacturers who use the products in nonresidential application (i.e. the manufacture of furniture and cabinets) compared with 51 percent of the total production for nonresidential uses in 1987.

Pricing and demand for gypsum wallboard and fiberboard products began the year at depressed levels, with gypsum stabilizing at low levels and fiberboard markets continuing to deteriorate. The general weakness of these markets, coupled with the softening seen in lumber and particleboard products, caused manufacturing profit to decline to $24.1 million in 1988 compared with $36.8 million in 1987 and $36.2 million in 1986.

The Company's wood resource complex at Buna, Texas, which began operations in the fourth quarter of 1987, produced near its estimated annual lumber capacity of 120 million board feet. This mill provides a more efficient vehicle for converting fiber in the southern regions of the Company's timberlands, while at the same time supplying chips, a major by-product of the lumber manufacturing process, to the Company's Orange, Texas linerboard mill.

A total of 819,000 tons of internally-produced chips were supplied to the Company's paper mills in 1988.

During 1988, construction began on expansion of the Company's shortline railroad which already linked the mill at Buna and the Company's Orange linerboard mill, to include the Company's Evadale mill. Completion of the line in the second half of 1989 should provide additional freight savings on the shipment of chips, and black and green liquors between the two paper mills, and finished products to other rail connections.

In 1988 the Company began construction of a new sawmill facility near DeQuincy, LA. The mill, with a design production capacity of 100 million board feet annually, will enable better utilization of Company timber holdings in Louisiana as well as supplying additional chips to the Company's paper mills. It is scheduled for startup late in 1989.

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Temple-Inland Financial Services

The Company's Financial Services operations, which began as a mortgage banking operation in 1954, consist today of mortgage banking, real estate development and insurance activities, as well as the Kilgore Savings and Loan operation. The results of these operations are for the first time fully consolidated for financial reporting purposes with the Company's other businesses.

Difficult times continued in the financial markets, particularly in Texas. The declining earnings' trends which began in 1987 continued and operating results were lower in most of the major segments in 1988. 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 information is set out below.

Temple-Inland Financial Services
Selected Segment Information

Years ended December 31	1988	1987	1986
		(in thousands)	
Income			
Mortgage banking	$ (1,485)	$ 4,428	$ 6,545
Land development and income properties	(1,040)	(1,695)	3,331
Agency insurance	1,499	1,543	1,366
Life insurance:			
Income from operations	5,447	13,867	31,803
Acquisition interest	(11,429)	(11,635)	(11,752)
	(5,982)	2,232	20,051
Other activities	1,385	1,113	1,741
Income before taxes	(5,623)	7,621	33,034
Taxes on income	(1,760)	2,722	10,339
Net income	$ (3,863)	$ 4,899	$ 22,695
Assets			
Mortgage banking	$ 72,487	$ 98,144	$ 145,318
Land development and income properties	52,544	20,976	18,801
Agency insurance	5,092	9,548	5,308
Life insurance	1,172,454	1,102,571	1,050,417
Other	152,900	107,062	26,185
Total assets	$1,455,477	$1,338,301	$1,246,029
Liabilities			
Mortgage banking	$ 66,363	$ 90,617	$ 142,160
Land development and income properties	50,693	21,852	16,450
Agency insurance	4,079	8,540	4,342
Life insurance	1,003,120	924,486	866,610
Life insurance (acquisition debt)	122,900	127,900	134,900
Other	147,154	99,873	21,433
Total liabilities	$1,394,309	$1,273,268	$1,185,895
Equity			
Mortgage banking	$ 6,124	$ 7,527	$ 3,158
Land development and income properties	1,851	(876)	2,351
Agency insurance	1,013	1,008	966
Life insurance	46,434	50,185	48,907
Other	5,748	7,189	4,752
Total equity	$ 61,170	$ 65,033	$ 60,134

Mortgage Banking

The mortgage banking operations of Financial Services are conducted through Lumbermen's Investment Corporation of Texas. Mortgage banking is basically two businesses: the first, arranging the financing for purchasers of real estate; and the second, the servicing of these mortgage loans.

The Company's loan origination operations cover the middle geographic section of the United States and prior to 1986 had produced $300 to $500 million in mortgages annually. The volume of mortgages may vary from year to year depending on the health of the residential and commercial real estate markets. Originations in mortgage loans had reached an all-time high of $651 million in 1986 due in part to heavy refinancing activity. In 1987 they declined to $524 million primarily because refinancing activity subsided somewhat due to increasing interest rates. In 1988, weakness in residential markets, as well as continuing increases in interest rates, produced only $216 million in originations and for the first time in 22 years the Company's loan servicing portfolio declined.

The cost of originating a mortgage loan normally exceeds the fees charged. The Company's profit on a loan is earned by servicing the loan. The servicing portfolio now totals approximately 84,000 loans with a balance of $3.1 billion compared with 86,700 loans with a balance of $3.2 billion in 1987 and 86,000 loans with a balance of $3.1 billion in 1986.

Another source of profit for the mortgage banker is the revenue generated from a favorable interest rate spread between long-term mortgage rates and short-term interest rates paid by the mortgage banker to finance the mortgage loans during the 2 to 3 month period between origination and shipment of loans to the ultimate investor. In rising interest rate markets, these spreads are reduced and can even result in negative margins. Earnings on the spreads declined to $3.1 million in 1988 compared with $5.2 million in 1987 and $6.0 million in 1986.

Historically, the mortgage banker was not considered to have the risk of principal loss on the foreclosure of a mortgage loan, only the cost of foreclosing and administering the delinquent loans. The average administrative cost and pass-through interest associated with handling foreclosure is now about $2,000. Additionally, the Company now has the risk of principal loss and overhead costs associated with certain VA foreclosed loans. The Veterans Administration which guaranteed a minimum of the top 25 percent of the amount financed on the loan, would pay the guarantee to the investor and purchase the property at foreclosure for its own inventory. With real estate values in some areas, particularly in Texas, declining to levels below 75 percent of the loan value, the Veterans Administration ceased bidding at foreclosure and simply paid the amount of its guarantee. Additional losses due to further declines in real estate values, fix-up and sales expenses, and interest carry became the responsibility of the mortgage banker. Costs associated with foreclosure including the foreclosure cost, economic losses, management and sales expenses and interest carry were $9.1 million in 1988, up from $5.1 million in 1987 and $3.5 million in 1986.

The Company now holds 197 residential real estate owned (REO) properties acquired through foreclosure which is down from the peak of 335 REO's in the summer of 1988 and from 294 at the end of 1987. At the end of 1986 there were 168 properties.

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A summary of selected financial information for the years 1988, 1987 and 1986 is provided below.

Mortgage Banking Operations Summary Years ended December 31	1988	1987	1986
		(in thousands)	
Revenues	$24,023	$29,736	$32,882
Income Before Taxes	(1,485)	4,428	6,545

Mortgage Banking Loan Administration Summary Years ended December 31	1988	1987	1986
		(in millions)	
Beginning Servicing Portfolio	$ 3,246	$ 3,138	$ 2,928
New Loans:			
Residential	217	567	670
Commercial	15	50	80
	232	617	750
Acquired with National Fidelity	—	—	32
Run-off	(342)	(509)	(572)
Ending Servicing Portfolio	$ 3,136	$ 3,246	$ 3,138
Servicing Portfolio Growth	(3.4)%	3.4%	7.2%
Run-off Factor	10.5%	16.2%	19.5%

In 1988, the Company completed its first full year of operation of Kilgore Federal Savings and Loan, which was acquired by the Company on December 31, 1987, for approximately $10 million. A summary of the revenues and income before taxes for Kilgore Federal Savings and Loan for the year 1988 is shown below.

Kilgore Federal Savings and Loan Operations Summary Year ended December 31	1988
	(in thousands)
Revenues	$9,664
Income Before Taxes	1,343

On September 30, 1988 the Company and two other investors acquired the assets of three savings and loan associations with assets of approximately $4.2 billion from the Federal Savings and Loan Insurance Corporation under the "Southwest Plan." These assets were consolidated into a new savings and loan corporation, Guaranty Federal Savings Bank, whose principal operations are within the metropolitan regions of Dallas, Houston, and Austin, Texas.

The Company invested $75 million for its majority interest and is scheduled to invest another $50 million for preferred stock during the next two years.

The Company accounts for this investment under the cost method for financial accounting but will consolidate the bank's results for federal income taxes. Therefore, any profits generated or income tax benefits achieved as a result of the investment will not be included in consolidated income but will reduce the Company's investment in the bank. During the fourth quarter of 1988, the Company reduced its investment by $17 million and expects further reductions in 1989.

Land Development and Income Properties

This segment of Financial Services consists of ten active residential subdivisions in Texas, adjoining commercial acreage to those subdivisions, one commercial land project in Dallas, Texas, and several commercial buildings. The continued depressed Texas economy resulted in soft real estate markets and further declining profitability.

Temple-Inland Properties has typically taken the position of a financial partner in various joint ventures with home builders or land owners who are responsible for development. These ventures are accounted for by the equity method. Residential construction sagged in most of this group's markets in 1988. Lots sold in 1988 totaled 90 compared with 131 sold in 1987 and 675 in 1986. At year end 1988, the completed residential lot inventory was 946, over 2,700 undeveloped acres, and 45 unsold commercial acres.

Selected financial information related to these activities is shown below.

Temple-Inland Properties Operations Summary Years ended December 31	1988	1987	1986
		(in thousands)	
Revenues:			
Residential	$ 2,143	$ 1,176	$ 5,438
Commercial	4,666	3,528	4,219
	$ 6,809	$ 4,704	$ 9,657
Income Before Taxes:			
Residential	$ (526)	$(1,327)	$ 1,308
Commercial	(514)	(368)	2,023
	$(1,040)	$(1,695)	$ 3,331

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

Temple-Inland Properties Investment in Joint Ventures As of December 31	1988	1987	1986
		(in thousands)	
Assets	$65,309	$83,228	$80,211
Liabilities (a)	$65,206	$80,657	$75,146
Equity	103	2,571	5,065
	$65,309	$83,228	$80,211

(a) Although the Company's pro rata share of joint venture liabilities total $65.2 million, the joint venture partners are in most instances jointly and severally liable for notes payable. The gross balance of these notes was $128.3 million at December 31, 1988. 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 one segment in Temple-Inland Financial Services which continued to perform at levels comparable to prior years is the agency insurance business. This business is operated as a general agency providing insurance sales to homeowners as well as technical expertise and advice to a broad spectrum of retail and commercial clients. The agency insurance operation also provides the placement of significant reinsurance for the Company.

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A summary of the revenues and income before taxes for the years 1988, 1987 and 1986 is shown below.

Agency Insurance
Operations Summary

Years ended December 31	1988	1987	1986
		(in thousands)	
Revenues	$4,064	$4,069	$3,952
Income before taxes	1,499	1,543	1,366

Life Insurance

The life insurance operations of Temple-Inland Financial Services include Great American Reserve Insurance Company ("GARCO"), and National Fidelity Life Insurance Company ("NFL"), both headquartered in Dallas, Texas. GARCO writes life, annuity and health policies on a national scope. NFL's primary concentration is life insurance through the brokerage market with a selected specialization in impaired risk. Both GARCO and NFL sell insurance products through career agents and brokers, some of whom represent other companies. GARCO enjoys a substantial expertise and increasing presence in the market focusing on sales to school teachers and administrators.

Both GARCO and NFL maintain an investment portfolio to back up the reserves established for policy claims. Over 87 percent of GARCO's and NFL's investment portfolios 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 16 years. Profits of $.6 million were realized in 1988 from gains in this investment portfolio compared to $15.4 million in 1987 and $18.6 million in 1986.

In 1988, the Company completed the relocation of NFL headquarters from Overland Park, Kansas, to the GARCO office building in Dallas, Texas. The cost associated with that move, as well as inefficiencies of establishing new personnel in key positions, had a negative impact on 1988 earnings.

During 1988, adverse claims, particularly in the discontinued health insurance segments of the Company's business were $3.1 million higher than anticipated. Also in 1988, the Company foreclosed 17 commercial properties. The charge to earnings from foreclosures and the write-down of the properties was approximately $3 million in 1988.

Shown below are condensed, consolidated statements of income and balance sheets of the insurance operations.

Life Insurance
Condensed Consolidated Statements of Income

Years ended December 31	1988	1987	1986
		(in thousands)	
Revenues	$ 284,533	$ 296,806	$ 299,276
Expenses:			
Insurance policy benefits & commissions	245,925	244,891	229,191
Operating and administrative expenses	33,210	38,048	38,282
	279,135	282,939	267,473
Income before taxes	5,398	13,867	31,803
Taxes on income	2,124	5,529	10,173
Net income	$ 3,274	$ 8,338	$ 21,630

Life Insurance
Condensed Consolidated Balance Sheets

As of December 31	1988	1987	1986
		(in thousands)	
Assets			
Cash and investments	$ 986,056	$ 908,139	$ 848,685
Deferred acquisition costs	73,950	75,365	79,969
Other assets	114,691	121,149	119,653
Total assets	$1,174,697	$1,104,653	$1,048,307
Liabilities and Equity			
Future policy benefits	$ 917,817	$ 831,347	$ 766,178
Other liabilities	82,950	95,874	96,896
Equity	173,930	177,432	185,233
Total liabilities and equity	$1,174,697	$1,104,653	$1,048,307

Life Insurance
Life Insurance and Annuities in Force

As of December 31	1988	1987	1986
		(in millions)	
Life insurance	$ 7,738	$ 8,172	$ 9,700
Annuity reserves	579	508	445

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, to repurchase shares of stock under authorized repurchase programs, and to meet normal working capital requirements.

The level of capital expenditures is now anticipated to be in the $250 million range in 1989. Major projects for 1989 will include construction of a new sawmill at DeQuincy, Louisiana, modernization at the Rome, Georgia linerboard mill, construction of a new box plant facility at Edinburg, Texas, and major improvements to existing manufacturing facilities. A summary of the capital expenditures is shown below.

Capital Expenditures	1988	1987	1986
		(in millions)	
Container and containerboard	$155.9	$ 68.2	$ 42.8
Pulp and paperboard	24.7	22.1	27.5
Building products	16.0	38.1	23.9
Timber and timberlands	20.7	8.9	8.0
Other activities	1.9	1.3	.7
Manufacturing group	$219.2	$138.6	$102.9

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Net interest expense incurred for the Parent Company is shown below.

Parent Company Interest—Net	1988	1987	1986
		(in thousands)	
Interest expense	$33,737	$27,808	$22,972
Interest income	(1,100)	(3,346)	(6,895)
Capitalized interest	(9,529)	(4,203)	(3,079)
Interest expense—net	$23,108	$20,259	$12,998

The level of capital expenditures was up in 1988 resulting in increased capitalized interest. In addition, interest expense increased in 1987 and 1988 due to the increased borrowings to fund share repurchase activity and an investment in a savings and loan venture in Dallas, Texas.

See Note F of Notes to Consolidated Financial Statements for a discussion of the future impact of new accounting rules for income taxes.

The following table provides selected data for the periods indicated.

Five Year Selected Financial Data

For the Year	1988	1987	1986	1985	1984
			(in millions)		
Manufacturing net sales	$ 1,774	$ 1,603	$ 1,296	$ 1,243	$ 1,263
Financial services revenues	326	336	346	231	152
Net income	199	141	81	85	103
Capital expenditures:					
Manufacturing	219	139	103	184	130
Financial services	5	1	3	3	2
Depreciation and depletion:					
Manufacturing	112	94	79	66	63
Financial services	3	3	2	2	1
Earnings per share	7.15	4.69	2.64	2.80	3.39
Dividends per common share	.84	.69	.58	.51	.40
Average shares outstanding (in thousands)	27,848	30,162	30,566	30,390	30,300
Common shares outstanding at year end (in thousands)	27,583	27,669	30,347	30,229	30,152
At Year End					
			(in millions)		
Total assets	$ 3,370	$ 3,072	$ 2,889	$ 2,357	$ 1,820
Long-term debt:					
Parent company	417	416	366	248	251
Financial services	25	30	25	14	13
Ratio of total debt to total capitalization—parent company	29%	31%	28%	23%	24%
Shareholders' equity	1,096	927	929	864	793

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Summarized Statements of Cash Flows
Parent Company (Temple-Inland Inc.)

For the year	1988	1987	1986
		(in thousands)	
Cash Provided by (Used for) Operations			
Net income	$ 199,180	$ 141,408	$ 80,803
Adjustments to reconcile net income to net cash			
Depreciation and depletion	112,059	94,126	79,296
Deferred taxes and deferred tax credits	11,350	9,449	12,220
Unremitted earnings of affiliated companies	3,259	(5,661)	(27,251)
Receivables	(17,671)	(19,554)	(19,574)
Inventories	(7,041)	(12,446)	(20,616)
Prepaid expenses	7,203	(7,259)	6,202
Accounts payable and accrued expenses	(27,081)	10,521	35,058
Other assets and liabilities	(10,751)	(11,377)	(1,057)
Other	174	1,289	816
Transfer of Georgia Kraft	—	47,093	—
	270,681	247,589	145,897
Cash Provided by (Used for) Investments			
Capital expenditures	(219,180)	(138,621)	(102,953)
Purchase of assets from Owens-Illinois, Inc.	—	—	(204,775)
Sale of property and equipment, net	25,755	4,441	2,200
Investments in affiliated companies	(16,841)	(2,270)	10,000
Investment in Guaranty Federal Savings Bank	(57,988)	—	—
	(268,254)	(136,450)	(295,528)
Cash Provided by (Used for) Financing			
Additions to long-term debt	75,057	70,248	194,490
Payments of long-term debt	(73,625)	(70,904)	(76,532)
Current portion of long-term debt	24,266	231	(53)
Construction funds held by trustees	(312)	178	15,881
Issuance of common stock for stock plans	3,734	11,140	3,052
Purchase of stock for treasury	(11,501)	(133,312)	(1,235)
Cash dividends paid to shareholders	(23,116)	(20,615)	(17,461)
	(5,497)	(143,034)	118,142
Net Increase (Decrease) in Cash	(3,070)	(31,895)	(31,489)
Cash at beginning of year	19,236	51,131	82,620
Cash at end of year	$ 16,166	$ 19,236	$ 51,131

See the notes to the Parent Company summarized financial statements.

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Summarized Balance Sheets
Parent Company (Temple-Inland Inc.)

At year end	1988	1987
	(in thousands)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 16,166	$ 19,236
Receivables, less allowances of $4,989,000 in 1988 and $5,443,000 in 1987	181,970	176,899
Refundable federal income taxes	12,600	—
Inventories:		
Work in process and finished goods	49,248	49,588
Raw materials	108,495	101,113
	157,743	150,701
Prepaid expenses	14,601	21,805
Total Current Assets	383,080	368,641
Investments—Note A		
Financial services group	67,196	69,461
Guaranty Federal Savings Bank	57,988	—
Total Investments	125,184	69,461
Property and Equipment—Note C		
Buildings	246,190	214,918
Machinery and equipment	1,570,379	1,459,428
Less allowances for depreciation and amortization	(873,002)	(791,545)
	943,567	882,801
Construction in progress	114,186	70,127
Construction funds held by trustee	5,155	4,843
	1,062,908	957,771
Timber and timberlands—less depletion	351,657	364,870
Land	24,729	20,262
Total Property and Equipment	1,439,294	1,342,903
Other Assets	34,486	22,188
TOTAL ASSETS	$1,982,044	$1,803,193

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	1988	1987
	(in thousands)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts payable and accrued expenses	$ 169,408	$ 192,547
Employee compensation and benefits	16,280	20,222
Current portion of long-term debt	28,341	4,075
Total Current Liabilities	214,029	216,844
Long-Term Debt	417,498	416,066
Deferred Investment Tax Credits	25,388	32,301
Deferred Federal Income Taxes	216,155	197,891
Other Liabilities	13,192	12,606
Shareholders' Equity	1,095,782	927,485
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,982,044	$1,803,193

See the notes to the Parent Company summarized financial statements.

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Summarized Statements of Income
Parent Company (Temple-Inland Inc.)

For the year	1988	1987	1986
		(in thousands)	
Revenues			
Net sales	$1,773,460	$1,602,694	$1,295,807
Financial services earnings—Note A	(5,623)	7,621	33,034
	1,767,837	1,610,315	1,328,841
Costs and Expenses			
Cost of sales	1,313,691	1,237,003	1,090,821
Selling and administrative	149,840	136,779	119,852
	1,463,531	1,373,782	1,210,673
Operating Income	304,306	236,533	118,168
Interest—net—Note C	(23,108)	(20,259)	(12,998)
Other	20,582	4,134	8,133
Income Before Taxes	301,780	220,408	113,303
Taxes on income	102,600	79,000	32,500
Net Income	$ 199,180	$ 141,408	$ 80,803

See the notes to the Parent Company summarized financial statements.

Notes to the Parent Company (Temple-Inland Inc.) Summarized Financial Statements

Note A—Summary of Significant Accounting Policies

Basis of Presentation

The Parent Company (Temple-Inland Inc.) summarized financial statements include the accounts of Temple-Inland Inc. (the "Company") and its manufacturing subsidiaries. The Financial Services subsidiaries including mortgage banking, real estate development and insurance subsidiaries and the 20 percent to 50 percent owned companies are reflected in the financial statements on the equity basis. Refer to pages 36 through 39 for the Temple-Inland Financial Services summarized financial statements. All material intercompany amounts and transactions have been eliminated. These financial statements should be read in conjunction with the Temple-Inland Inc. consolidated financial statements.

Inventories

Inventories are stated at the lower of cost or market.

Cost of inventories amounting to $56.7 million in 1988 and $62.1 million in 1987 was determined by the last-in, first-out method (LIFO). The cost of the remaining inventories of $101.0 million in 1988 and $88.6 million in 1987 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 $25.9 and $22.9 million higher than reported at year end 1988 and 1987, respectively.

Property and Equipment

Property and equipment are stated at cost less allowances for accumulated depreciation and depletion. Depreciation is generally provided on the straight-line method based on estimated useful lives of the assets. Certain properties are being depreciated based on operating hours because they depreciate primarily through use rather than merely through elapsed time.

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

Note B—Leases

Total rental expense was $12.3 million, $10.3 million and $9.6 million for the years 1988, 1987 and 1986, respectively.

The future minimum rental commitments, as of year end 1988, under non-cancellable operating leases were as follows:

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1989—$7.6 million; 1990—$5.6 million; 1991—$4.1 million; 1992—$2.4 million; and 1993—$1.5 million.

In addition, the future minimum commitments, as of year end 1988, for contracts to lease or manage land to grow and harvest timber through the year 2027 are as follows: 1989—$2.0 million; 1990—$2.0 million; 1991—$2.0 million; 1992—$2.1 million; and 1993—$2.1 million.

Note C—Long-Term Debt

Long-term debt consists of the following:

	1988	1987
	(in thousands)	
Bank Loans—Weighted average interest rate was 8.16% and 7.64% during 1988 and 1987, respectively	$235,000	$205,000
8.375% Notes Payable due 1996	70,000	70,000
Revenue Bonds due 2014—Average interest rate was 5.64% and 5.86% during 1988 and 1987, respectively	34,500	34,500
12.5% Note Payable due 1989	—	25,000
8% Revenue Bonds due through 2009	11,665	11,665
Other Revenue Bonds due through 2015, weighted average interest rate of 7.55% and 7.76% as of year end 1988 and 1987, respectively	48,965	49,776
Other indebtedness due through 2000, weighted average interest rate of 8.86% and 8.79% as of year end 1988 and 1987, respectively	17,368	20,125
	$417,498	$416,066

At December 31, 1988, $80 million of bank loans were in the form of unsecured notes or drafts growing out of transactions involving the domestic shipment of goods, drawn on unsecured Banker's Acceptance lines with various banks. These borrowings, as well as $155 million of loans in the form of unsecured open advance notes drawn on various banks, are supported by a long-term revolving credit agreement and accordingly are classified as long-term debt. Under the agreement, borrowings of up to $250 million, repayable in January 1990, are available to the Company at floating rates of interest.

To offset a portion of the floating rate characteristic of the bank borrowings, the Company negotiated three interest rate conversion agreements for an aggregate amount of $90 million. Under these agreements, the Company is required to pay interest at fixed rates averaging 8.29 percent. 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: $70 million in 1989 and $20 million in 1990.

At year end 1988, property and equipment of approximately $25.5 million was subject to liens in connection with $27.6 million of debt.

Aggregate maturities of the Parent Company's long-term debt during the next five years are as follows (in millions): 1989—$28.3; 1990—$238.4; 1991—$3.1; 1992—$3.6; 1993—$2.5. 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, see page 30.

Note D—Georgia Kraft Company Dissolution

During 1987, the Company announced and completed the division of assets of its 50 percent owned affiliate Georgia Kraft Company ("Georgia Kraft"). The division of Georgia Kraft has been reflected in the Company's consolidated balance sheet as of January 2, 1988. Prior to the dissolution, the Company's equity in operating income of Georgia Kraft was recorded as a reduction of cost of sales and its share of related income taxes was included in taxes on income.

Purchases from Georgia Kraft were $149.0 million in 1987 and $163.3 million in 1986. For 1987, Georgia Kraft had total revenues of $511.0 million, and its net income, which included an after-tax gain of $67.3 million on the sale of the Macon assets, totalled $87.1 million. For 1986, Georgia Kraft had total revenues of $557.4 million and net income of $27.6 million.

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Summarized Statements of Cash Flows
Temple-Inland Financial Services Group

For the year	1988	1987	1986
		(in thousands)	
Cash Provided by (Used for) Operations			
Net income	$ (3,863)	$ 4,899	$ 22,695
Adjustments to reconcile net income to net cash:			
Depreciation	3,230	2,669	2,328
Deferred taxes and tax credits	2,217	2,541	1,075
Receivables and accrued investment income	(11,337)	(8,205)	(10,004)
Future policy benefit reserves	86,504	65,173	199,281
Deferred policy acquisition costs	(3,343)	(3,669)	(17,445)
Cost of insurance acquired	4,758	8,273	7,185
Real estate held for development and sale	2,474	(6,978)	(3,069)
Realized investment gains	(3,909)	(15,392)	(18,579)
Receivable from mortgage insurers	12,824	4,284	(14,582)
Loan inventory	(12,670)	61,511	(24,776)
Accounts payable and accrued expenses	2,564	(8,681)	(441)
Amortization of discounts on investments	(1,153)	(1,713)	8,565
Other	1,228	(1,170)	(6,718)
	79,524	103,542	145,515
Cash Provided by (Used for) Investments			
Purchase of investments	(768,280)	(349,555)	(350,766)
Sale or maturity of investments	695,470	275,456	205,974
Short-term investments	(5,268)	18,894	(9,706)
Capital expenditures	(4,852)	(612)	(3,120)
Sale of property and equipment, net	117	—	—
Purchase of Kilgore Savings and Loan	—	(9,995)	—
Policy loans	3,022	10,883	(5,661)
	(79,791)	(54,929)	(163,279)
Cash Provided by (Used for) Financing			
Net increase in deposits	35,867	—	—
Additions to long-term debt	5,249	33,445	70,707
Payments of long-term debt	(31,119)	(88,727)	(24,047)
Dividends	—	—	(9,000)
Sale of preferred stock	—	2,270	(10,000)
	9,997	(53,012)	27,660
Net Increase (Decrease) in Cash	9,730	(4,399)	9,896
Cash at beginning of year	9,351	13,750	3,854
Cash at end of year	$ 19,081	$ 9,351	$ 13,750

See the notes to the Temple-Inland Financial Services Group summarized financial statements.

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Summarized Balance Sheets
Temple-Inland Financial Services Group

At year end	1988	1987
	(in thousands)	
ASSETS		
Cash	$ 19,081	$ 9,351
Investments—Note D	1,069,095	994,577
Receivables, net of reserve of $4,392 in 1988 and $3,187 in 1987	57,853	59,511
Accrued Investment Income	17,669	17,947
Loan Inventory	42,528	29,858
Real Estate Held for Sale	65,082	36,460
Income-Producing Properties—net of allowances of $2,541 in 1988 and $2,246 in 1987	11,325	8,543
Property and Equipment—net of accumulated depreciation of $9,706 in 1988 and $8,007 in 1987	17,429	18,782
Deferred Policy Acquisition Costs	47,888	44,545
Cost of Insurance Acquired	26,062	30,820
Excess of cost over net assets acquired	26,030	26,762
Separate Account Assets	30,528	32,275
Other Assets	24,907	28,870
TOTAL ASSETS	$1,455,477	$1,338,301
LIABILITIES		
Future Policy Benefit Reserves	$ 917,871	$ 831,367
Policy and Contract Claims	10,204	12,134
Policyholders' Funds	6,243	6,994
Short-Term Borrowings—Note C	207,119	202,325
Long-Term Debt—Note C	24,656	29,961
Deferred Federal Income Taxes	31,248	31,354
Deposits	114,740	78,873
Liabilities Related to Separate Accounts	30,528	32,275
Other Liabilities	51,698	47,985
TOTAL LIABILITIES	1,394,307	1,273,268
SHAREHOLDER'S EQUITY	61,170	65,033
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	$1,455,477	$1,338,301

See the notes to the Temple-Inland Financial Services Group summarized financial statements.

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Summarized Statements of Income
Temple-Inland Financial Services Group

For the year	1988	1987	1986
		(in thousands)	
Revenues			
Premiums	$ 189,454	$ 191,539	$ 195,807
Other	136,118	144,660	150,466
	325,572	336,199	346,273
Costs and Expenses			
Operating costs	316,879	313,360	298,331
Interest expense	14,316	15,218	14,908
	331,195	328,578	313,239
Income (Loss) Before Taxes	(5,623)	7,621	33,034
Taxes on income	(1,760)	2,722	10,339
Net Income (Loss)	(3,863)	$ 4,899	$ 22,695

See the notes to the Temple-Inland Financial Services Group summarized financial statements.

Notes to the Temple-Inland Financial Services Group Summarized Financial Statements

Note A—Summary of Significant Accounting Policies

Basis of Presentation

The Temple-Inland Financial Services Group summarized financial statements include the mortgage banking, Kilgore Federal Savings and Loan, real estate development and insurance activities. All material intercompany amounts and transactions have been eliminated. These financial statements should be read in conjunction with the Temple-Inland Inc. consolidated financial statements.

Investments

Bonds, notes, redeemable preferred stocks and mortgage loans on real estate are carried at amortized cost (which approximates market), other preferred and common stocks at quoted market values, real estate loans at unpaid balance adjusted for amortization of discounts and policy loans at the respective unpaid balances.

Realized gains or losses from the sale of investments and any related Federal income taxes are included in the determination of net income. The "specific identification" method is used to determine cost of investments sold.

Recognition of Premium Income

Insurance premiums include assumptions for expected issuance and maintenance expenses, benefit reserve requirements and profit. Individual life, annuity and individual health premiums are recognized as revenue over the premium-paying period of the policies; group life and group health premiums are earned pro-rata over the terms of the policies. Universal life insurance premiums are recognized as premium income when received. Profits on universal life insurance are recognized in proportion to anticipated margins, as adjusted for actual experience.

Deferred Policy Acquisition Costs

Certain costs of acquiring new insurance policies have been deferred. Such costs include commissions, certain expenses of policy issuance and underwriting and other costs which vary with and are primarily related to the production of new business. These deferred policy acquisition costs are being amortized over the revenue producing period of the related policies using assumptions consistent with those used in computing future policy benefit reserves. Such charges to expense total $12 million, $17 million and $24 million in 1988, 1987 and 1986, respectively.

Future Policy Benefit Reserves

Life insurance future policy benefit reserves have been calculated using a net-level method based on reasonable assumptions for investment yields, mortality and withdrawals which contemplate the risk of adverse deviation. Universal life insurance future policy benefit reserves are carried at accumulated contract values. Future policy benefit reserves for annuities, other than structured settlements, are generally carried at accumulated values. Structured settlement annuities future policy benefit reserves are calculated based on the present value of estimated payments under terms of the contract.

In late 1987, the Financial Accounting Standards Board issued its Statement of Financial Accounting Standards No. 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments," effective for fiscal years beginning after December 15, 1988. The Company intends to adopt the new standards for its year ending December 31, 1989 and believes it will have little impact on financial position and results of operations.

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Real Estate Held for Development and Sale

Real estate held for sale and development is carried at the lower of cost or market. Interest on indebtedness, property taxes, improvements and other development costs are capitalized during the development phase.

Reinsurance

Total future policy benefit reserves are shown after deduction for reinsurance ceded to other companies on a coinsurance and yearly renewable term basis. Contingent liabilities exist with respect to this reinsurance in the event that these reinsurance companies should be unable to meet their contractual obligations.

Note B—Leases

Total rental expense was $1.6 million, $2.4 million and $2.8 million for the years 1988, 1987 and 1986, respectively.

The future minimum rental commitments, as of year end 1988, under non-cancellable operating leases were as follows: 1989—$.8 million; 1990—$.6 million; 1991—$.5 million; 1992—$.4 million; and 1993—$.3 million.

Note C—Short-Term Borrowings and Long-Term Debt

Short-term borrowing consists of the following:

	1988	1987
	(in thousands)	
Short-term borrowings:		
Secured	$205,748	$193,625
Unsecured	1,371	8,700
	$207,119	$202,325

Long-term debt consists of the following:

	1988	1987
	(in thousands)	
Long-term debt (at varying interest rates which approximate prime):		
Notes payable to banks	$ 12,412	$ 8,502
Other indebtedness	12,244	21,459
	$ 24,656	$ 29,961

To offset a portion of the floating rate characteristic of the bank borrowings, the Financial Services Group negotiated an interest rate conversion agreement for an aggregate amount of $70 million. Under this agreement, the Group is required to pay interest at a fixed rate of 10.2% annually. In return, the Group receives interest payments on an equal balance calculated at the 90-day Libor rate. This agreement expires in 1990.

Aggregate maturities of the Group's long-term debt during the next five years are as follows (in millions): 1989—$7.0; 1990—$12.6; 1991—$.2; 1992—$.2; 1993—$.2.

Note D—Investments and Net Investment Income:

Investments consist of the following:

	1988	1987
	(in thousands)	
Investments:		
Fixed maturities	$ 669,912	$578,872
Equity securities	34,072	31,572
Real estate loans	221,754	266,168
Short-term investments	74,447	46,033
Policy loans	68,910	71,932
	$1,069,095	$994,577

The following schedule summarized the components of net investment income:

	1988	1987	1986
		(in thousands)	
Investment income from:			
Fixed maturities	$60,742	$56,544	$50,665
Equity securities	1,027	1,238	900
Mortgage loans	19,839	23,544	25,034
Investment real estate	1,912	533	690
Short-term investments	2,330	1,063	1,329
Policy loans	4,110	4,501	4,741
	89,960	87,423	83,359
Investment expenses	(2,887)	(1,778)	(1,243)
Net investment income	$87,073	$85,645	$82,116

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Consolidated Statements of Cash Flows
Temple-Inland Inc. and Subsidiaries

For the year	1988	1987	1986
		(in thousands)	
Cash Provided by (Used for) Operations			
Net income	$ 199,180	$ 141,408	$ 80,803
Adjustments to reconcile net income to net cash:			
Depreciation and depletion	115,289	96,795	81,624
Deferred taxes and tax credits	13,567	11,990	13,295
Future policy benefit reserves	86,504	65,173	199,281
Receivables	(16,184)	(23,475)	(44,160)
Inventories	(19,711)	49,065	(45,392)
Accounts payable	(24,517)	1,840	34,617
Other	(20,764)	8,335	(37,656)
	333,364	351,131	282,412
Cash Provided by (Used for) Investments			
Capital expenditures	(224,032)	(149,228)	(310,848)
Sale of property and equipment, net	25,872	4,441	2,200
Investment in Guaranty Federal Savings Bank	(57,988)	—	—
Purchase of investments	(768,280)	(349,555)	(350,766)
Sale or maturity of investments	695,470	275,456	205,974
Other	(2,246)	29,777	(15,367)
	(331,204)	(189,109)	(468,807)
Cash Provided by (Used for) Financing			
Additions to debt	80,306	103,693	265,197
Payments of debt	(104,744)	(159,631)	(100,579)
Issuance of common stock for stock plans	3,734	11,140	3,052
Purchase of stock for treasury	(11,501)	(133,312)	(1,235)
Cash dividends paid to shareholders	(23,116)	(20,615)	(17,461)
Net increase in deposits	35,867	—	—
Other	23,954	409	15,828
	4,500	(198,316)	164,802
Net increase (decrease) in cash	6,660	(36,294)	(21,593)
Cash at beginning of year	28,587	64,881	86,474
Cash at end of year	$ 35,247	$ 28,587	$ 64,881

See the notes to the consolidated financial statements.

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Consolidated Statements of Shareholders' Equity
Temple-Inland Inc. and Subsidiaries

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock
	(in thousands)			
Balance at January 1, 1986	$ 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 plans—32,914 shares reissued from treasury at cost	94	1,734	—	1,224
Stock reacquired for treasury—32,458 shares at cost	—	—	—	(1,235)
Balance at January 3, 1987	$ 24,278	$ 329,713	$ 574,928	$ (55)
Net income	—	—	141,408	—
Dividends paid on common stock—$.69 per share	—	—	(20,615)	—
Stock issued for stock plans—42,906 shares reissued from treasury at cost	254	8,542	—	2,542
Stock reacquired for treasury—2,987,464 shares at cost	—	—	—	(133,312)
Effect of five-for-four stock split	6,083	(6,083)	—	—
Stock split—cash for fractional shares	—	(198)	—	—
Balance at January 2, 1988	$ 30,615	$ 331,974	$ 695,721	$ (130,825)
Net income	—	—	199,180	—
Dividends paid on common stock—$.84 per share	—	—	(23,116)	—
Stock issued for stock plans—87,640 shares reissued from treasury at cost	69	(543)	—	4,208
Stock reacquired for treasury—242,647 shares at cost	—	—	—	(11,501)
Balance at December 31, 1988	$ 30,684	$ 331,431	$ 871,785	$ (138,118)

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Consolidating Balance Sheets
Temple-Inland Inc. and Subsidiaries

At year end 1988	Parent Company	Financial Services	Consolidated
		(in thousands)	
ASSETS			
Cash	$ 16,166	$ 19,081	$ 35,247
Investments:			
Fixed maturities	—	669,912	669,912
Real estate loans	—	221,754	221,754
Other	—	177,429	177,429
Receivables	194,570	75,522	270,092
Inventories	157,743	—	157,743
Loan inventory	—	42,528	42,528
Property and equipment	1,439,294	17,429	1,456,723
Deferred acquisition costs	—	47,888	47,888
Investment in affiliates	125,184	—	57,988
Other assets	49,087	183,934	233,021
Total Assets	$1,982,044	$ 1,455,477	$ 3,370,325
LIABILITIES			
Future policy benefit reserves	$ —	$ 917,871	$ 917,871
Long-term debt	417,498	24,656	442,154
Deferred investment tax credits	25,388	—	25,388
Deferred federal income taxes	216,155	31,248	247,403
Short-term borrowings	—	207,119	207,119
Deposits	—	114,740	114,740
Other liabilities	227,221	98,673	319,868
Total Liabilities	$ 886,262	$ 1,394,307	$ 2,274,543
SHAREHOLDERS' EQUITY			
Preferred stock—par value $1 per share: authorized 25,000,000 shares; none issued			—
Common stock—par value $1 per share: authorized 100,000,000 shares; issued 30,684,070 shares including shares held in the treasury			30,684
Additional paid-in capital			331,431
Retained earnings			871,785
			1,233,900
Cost of shares held in the treasury: 3,100,765 shares			(138,118)
Total Shareholders' Equity			1,095,782
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY			$3,370,325

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Consolidating Balance Sheets
Temple-Inland Inc. and Subsidiaries

At year end 1987	Parent Company	Financial Services	Consolidated
		(in thousands)	
ASSETS			
Cash	$ 19,236	$ 9,351	$ 28,587
Investments:			
Fixed maturities	—	578,872	578,872
Real estate loans	—	266,168	266,168
Other	—	149,537	149,537
Receivables	176,899	77,458	254,357
Inventories	150,701	—	150,701
Loan inventory	—	29,858	29,858
Property and equipment	1,342,903	18,782	1,361,685
Deferred acquisition costs	—	44,545	44,545
Other assets	43,993	163,730	207,723
Investment in affiliates	69,461	—	—
Total Assets	$1,803,193	$ 1,338,301	$ 3,072,033
LIABILITIES			
Future policy benefit reserves	$ —	$ 831,367	$ 831,367
Long-term debt	416,066	29,961	446,027
Deferred investment tax credits	32,301	—	32,301
Deferred federal income taxes	197,891	31,354	229,245
Short-term borrowings	—	202,325	202,325
Deposits	—	78,873	78,873
Other liabilities	229,450	99,388	324,410
Total Liabilities	$ 875,708	$ 1,273,268	$ 2,144,548
SHAREHOLDERS' EQUITY			
Preferred stock—par value $1 per share: authorized 25,000,000 shares; none issued			—
Common stock—par value $1 per share: authorized 100,000,000 shares; issued 30,614,830 shares including shares held in the treasury			30,615
Additional paid-in capital			331,974
Retained earnings			695,721
			1,058,310
Cost of shares held in the treasury: 2,945,758 shares			(130,825)
Total Shareholders' Equity			927,485
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY			$ 3,072,033

See the notes to the consolidated financial statements.

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Consolidated Statements of Income
Temple-Inland Inc. and Subsidiaries

For the year	1988	1987	1986
		(in thousands)	
Revenues			
Manufacturing net sales	$1,773,460	$1,602,694	$1,295,807
Financial services revenues	325,572	336,199	346,273
	2,099,032	1,938,893	1,642,080
Costs and Expenses			
Manufacturing costs and expenses	1,463,531	1,373,782	1,210,673
Financial services expenses	316,879	313,360	298,331
Financial services interest	14,316	15,218	14,908
	1,794,726	1,702,360	1,523,912
Operating Income	304,306	236,533	118,168
Parent Company Interest—net	(23,108)	(20,259)	(12,998)
Other	20,582	4,134	8,133
Income before taxes	301,780	220,408	113,303
Taxes on income—Note F	102,600	79,000	32,500
Net Income	$ 199,180	$ 141,408	$ 80,803
Earnings Per Share—Note A	$ 7.15	$ 4.69	$ 2.64

See the notes to the consolidated financial statements.

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 all subsidiaries in which the Company has more than a 50 percent equity ownership, except the Company's investment in the Guaranty Federal Savings Bank. See Note K on page 47. All material intercompany amounts and transactions have been eliminated.

Included as an integral part of the consolidated financial statements are separate summarized financial statements and notes for the Company's primary business groups as well as the significant accounting policies unique to each group.

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 27,848,000 in 1988, 30,162,000 in 1987 and 30,566,000 in 1986.

Statements of Cash Flow

In 1988, the Company adopted FASB Statement No. 95, "Statement of Cash Flows." Accordingly, the Company has replaced the Statements of Changes in Financial Position with the Statements of Cash Flow for 1988, 1987 and 1986. The replacement had no effect on the results of operations as previously reported. For purposes of these Statements, the Company has defined cash and cash equivalents as consisting of cash and short-term investments.

Note B—Investments in Affiliated Companies

In 1988, the Company adopted FASB Statement No. 94, "Consolidation of All Majority-owned Subsidiaries." Accordingly, the wholly-owned subsidiaries of the Company have been consolidated in the accompanying financial statements, which have been restated for 1987 and 1986. These subsidiaries consist primarily of those in the Temple-Inland Financial Services Group. Before adopting Statement 94, the Company accounted for these subsidiaries using the equity method of accounting. The change in accounting policy had no effect on shareholders' equity or net income. Concurrent with this change, the Company has adopted an unclassified balance sheet.

As a result of adopting Statement 94, the Company included in its results of operations for 1988, 1987 and 1986, respectively, revenues of $326 million, $336 million and $346 million, and expenses of $331 million, $329 million and $313 million, and in its financial position for 1988 and 1987, respectively, assets and liabilities of $1.4 and $1.3 billion, from these subsidiaries net of intercompany amounts.

Note C—Long-Term Debt

See pages 35 and 39 for a description of the Company's long-term debt.

Aggregate maturities of long-term debt during the next five years are as follows (in millions): 1989—$35.3; 1990—

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$251.0; 1991—$3.3; 1992—$3.8; 1993—$2.7. It is the Company's current intention to extend maturities by refinancing and renewing the long-term revolving credit agreements upon maturity.

Note D—Stock Option and Purchase Plans

The Company has established stock option plans for key employees and directors. The plans provide for the granting of incentive stock options and/or non-qualified stock options, and permit the grant of stock appreciation rights with all or part of any options so granted.

Options for 540,598, 550,011 and 556,511 shares were exercisable at year end 1988, 1987 and 1986, respectively. An additional 1,526,564, 342,449 and 427,586 shares of the Company's common stock were available for grants at year end 1988, 1987 and 1986, respectively.

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

	Common Stock	
	Number of Shares	Price Range Per Share
Outstanding at January 1, 1986	854,501	$ 7-$30
Granted	519,529	$38-$45
Exercised	(139,539)	$ 7-$30
Forfeited	(7,857)	$25-$38
Outstanding at January 3, 1987	1,226,634	$ 8-$45
Granted	97,294	$44-$64
Exercised	(286,273)	$ 8-$38
Forfeited	(12,157)	$25-$45
Outstanding at January 2, 1988	1,025,498	$ 8-$64
Granted	81,390	$43-$50
Exercised	(156,253)	$ 8-$45
Forfeited	(65,505)	$25-$45
Outstanding at December 31, 1988	885,130	$10-$64

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 1988, awards of 66,475 shares of common stock were outstanding at an average price of $45.74 per share.

The Company has Savings and Stock Purchase Plans which permit participating employees to invest in the Company's common stock and other funds.

On February 3, 1989, options to purchase 137,326 shares of stock at a price of $55.75 per share were granted and 10,706 shares were awarded under the Incentive Stock Plan.

Note E—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.

A summary of the components of net pension cost in 1988, 1987 and 1986 follows:

	1988	1987	1986
		(in millions)	
Charges (Credits)			
Service cost—benefits earned during the period	$ 8.4	$ 6.1	$ 5.9
Interest cost on projected benefit obligation	17.8	13.6	12.4
Actual return on plan assets	(27.7)	(7.7)	(21.7)
Net amortization and deferral	1.0	(14.6)	.7
Special termination benefit cost	—	—	.6
Net Pension Credit	$ (.5)	$ (2.6)	$ (2.1)

The actuarial computations for the years 1988, 1987 and 1986 assumed a discount rate on benefit obligations of 9 percent, an expected long-term rate of return on plan assets of 9 percent and annual salary/benefit increases of 5 percent to 6 percent over the average remaining service lives of employees covered by the plans.

The status of employee pension benefit plans at year end 1988 and 1987 is summarized below:

	1988	1987
	(in millions)	
Actuarial present value of benefit obligations:		
Vested benefits	$ 160.9	$ 117.8
Nonvested benefits	18.8	13.2
Accumulated benefit obligation	$ 179.7	$ 131.0
Projected benefit obligation for service rendered to date	$ (224.4)	$ (169.2)
Plan assets at fair value, primarily fixed income securities	269.6	210.4
Plan assets in excess of projected benefit obligation	45.2	41.2
Prior service cost not yet recognized in net periodic pension cost	.5	.2
Unrecognized net loss from past experience different from that assumed	13.7	10.0
Unrecognized net asset at beginning of period, less amortization to date	(53.8)	(50.7)
Net pension asset included in the balance sheet	$ 5.6	$ .7

The assets of the plans at December 31, 1988 include 190,500 shares of common stock of the Company having a market value of $9.1 million at that date.

The Company's share of the fair market value of assets (approximately $38 million) transferred from the Georgia Kraft pension plans exceeded the assumed projected benefit obligation by approximately $7 million.

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 employed by the Company. The Company recognizes the cost of providing the benefits by expensing the insurance premiums as incurred. These costs totaled approximately $1.5, $1.2 and $1.1 million in 1988, 1987 and 1986, respectively.

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Note F—Taxes on Income

Taxes on income consisted of the following:

	Current	Deferred
	(in thousands)	
1988		
Federal	**$66,512**	**$33,185**
Investment tax credit deferred	**—**	**(6,635)**
State and other	**11,798**	**(2,260)**
	$78,310	**$24,290**
1987		
Federal	$ 59,269	$ 17,315
Investment tax credit deferred	—	(3,744)
State and other	6,440	(280)
	$ 65,709	$ 13,291
1986		
Federal	$ 16,417	$ 15,762
Investment tax credit deferred	—	(1,795)
State and other	2,116	—
	$ 18,533	$ 13,967

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

	1988	1987	1986
		(in thousands)	
Depreciation	$17,580	$11,318	$18,291
Investment tax credits	(6,635)	(3,744)	(1,795)
Pension expense	2,410	3,248	2,382
Contribution to employee benefit trust	—	—	(6,745)
Other employee benefit plans	4,233	82	(595)
Capitalized interest	591	1,683	1,503
Insurance operations	(1,401)	2,561	4,459
Exchange sales	2,200	(1,014)	(1,973)
Other—net	5,312	(843)	(1,560)
	$24,290	$13,291	$13,967

The differences between the consolidated effective income tax rate and the federal statutory income tax rates include the following:

	1988	1987	1986
		(in thousands)	
Taxes on income at statutory rate	$102,605	$88,163	$52,120
Investment tax credits	(6,522)	(6,643)	(7,544)
Tax benefit of capital gains	—	(2,901)	(7,635)
Insurance operations taxed at special rates	288	(18)	(4,442)
All other	6,229	399	1
	$102,600	$79,000	$32,500

Total income tax payments of $76 million, $58 million and $5 million were made during 1988, 1987 and 1986, respectively.

Investment tax credits were deferred and are being amortized as a reduction of income tax expense over the estimated useful lives of the related assets.

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

In December 1987, the Financial Accounting Standards Board issued Statement No. 96, "Accounting for Income Taxes." Under the guidelines, companies are required to adopt the liability method for computing deferred income taxes no later than 1990. The Company presently expects to adopt the Statement in 1990 and does not expect to restate any periods. The adoption of the new guidelines is not expected to have an adverse impact on the Company's financial position.

Consolidated tax benefits resulting from the Company's investment in Guaranty Federal Savings Bank are accounted for using the cost recovery method—see Note K. These benefits totaled approximately $17 million in 1988.

Note G—Business Segment Information

Refer to "Business Segments" on page 24 for information relating to Net Sales and Income Before Taxes and page 30 for information relating to Capital Expenditures for the Company's principal segments of business for the three years 1988, 1987 and 1986.

Additional business segment information is presented below.

For the year	1988	1987	1986
		(in millions)	
Identifiable Assets			
Container and containerboard	**$ 967.9**	$ 841.7	$ 901.5
Pulp and paperboard	**245.6**	252.0	255.3
Building products	**187.1**	209.4	183.2
Timber and timberlands	**377.8**	376.7	220.7
Corporate	**89.7**	26.5	54.7
Other activities	**46.7**	27.4	27.9
	1,914.8	1,733.7	1,643.3
Financial services	**1,455.5**	1,338.3	1246.0
Total	**$3,370.3**	$ 3072.0	$2,889.3
Depreciation, Amortization and Depletion			
Container and containerboard	**$ 52.1**	$ 34.9	$ 30.0
Pulp and paperboard	**28.8**	30.0	29.7
Building products	**18.8**	16.9	14.4
Timber and timberlands	**10.9**	11.2	3.9
Other activities	**1.5**	1.1	1.3
	112.1	94.1	79.3
Financial services	**3.2**	2.7	2.3
Total	**$ 115.3**	$ 96.8	$ 81.6

Note H—Shareholder Rights Plan

On February 3, 1989, the Board of Directors of the Company adopted a Shareholder Rights Plan in which one preferred stock purchase right ("the Right") was declared as a dividend for each common share outstanding as of February 20, 1989. Each right entitles shareholders to purchase, under certain conditions, one one-hundredth of a share of newly issued Series A Junior Participating Preferred Stock of the Company at an exercise price of $200. The Rights will be exercisable only if a person or group acquires beneficial ownership of 20 percent or more of the common shares or commences a tender or exchange offer upon consummation of which such person or group would beneficially own 25 percent or more of the common shares. The Company will generally be entitled to redeem the Rights of $.01 per Right at any time until the 10th business day following public announcement that a 20 percent position has been acquired. The Rights will expire on February 20, 1999.

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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—Summary of Quarterly Results of Operations (Unaudited)

Selected quarterly financial results for the years 1988 and 1987 are summarized below:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in millions except per share amounts)			
1988				
Manufacturing Net Sales	**$425.7**	**$448.5**	**$454.6**	**$444.7**
Financial Services Revenues	**84.8**	**76.2**	**83.8**	**80.8**
Manufacturing Gross Profit	**105.5**	**118.5**	**121.3**	**114.5**
Financial Services Income (Loss) Before Taxes	**1.5**	**(1.5)**	**(1.8)**	**(3.8)**
Net Income	**45.6**	**53.1**	**53.0**	**47.5**
Earnings Per Share	**1.63**	**1.91**	**1.90**	**1.71**
1987				
Manufacturing Net Sales	$390.6	$395.1	$419.1	$397.9
Financial Services Revenues	84.6	83.3	85.5	82.8
Manufacturing Gross Profit	83.1	88.3	94.4	99.9
Financial Services Income (Loss) Before Taxes	8.4	4.3	2.7	(7.8)
Net Income	33.7	35.8	38.2	33.7
Earnings Per Share	1.09	1.17	1.24	1.19

Note K—Guaranty Federal Savings Bank Acquisition

During September 1988, the Company, with minority investors, acquired the assets and business of three savings and loans located in Texas. The acquisition by the Company of a majority interest was made from the Federal Savings and Loan Insurance Corporation ("FSLIC") under their Southwest Plan. The initial capital contribution made by the Company was $75 million. The Company is obligated, subject to continued performance of certain obligations by FSLIC, to make additional capital contributions of approximately $25 million each on January 15, 1990 and January 15, 1991.

The Company has the right under certain conditions to "put" its interest in the acquired thrifts to the minority owners of the savings and loan and thereby limit its exposure to the write-off of its investment rather than the continuing obligation to operate the thrift.

Due to the many uncertainties surrounding operation and control of assets acquired under the FSLIC Southwest Plan, the Company, initially, will not consolidate the savings and loan and will account for its investment under the cost method adjusted for any recovery. Under this method, the recovery resulting from the consolidated tax benefits arising from the non-taxable FSLIC payments are credited to the Company's investment. Such benefits totaled approximately $17 million in 1988. The Company plans to fully consolidate the savings and loan when the uncertainty surrounding operation of assets acquired under the FSLIC's Southwest Plan and the Company's future business plans for the savings and loan are resolved. The Company anticipates it would be in position by the end of 1989 to determine its future course of action concerning this investment and would include the savings and loan in its December 30, 1989 consolidated balance sheet and fully consolidate the savings and loan in its financial statements beginning in 1990.

Complete financial statements for Guaranty Federal Savings Bank are included on pages 49 through 56.

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Report of Management

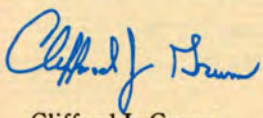
Management Report on Financial Statements

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

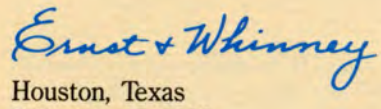
Report of Independent Auditors

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

We have audited the accompanying consolidated balance sheets of Temple-Inland Inc. and subsidiaries as of December 31, 1988 and January 2, 1988, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1988. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Great American Reserve Insurance Company, a consolidated subsidiary, which statements reflect total assets constituting 35 percent in 1988 and 36 percent in 1987, and total revenues constituting 13 percent in 1988, 14 percent in 1987 and 17 percent in 1986 of the related consolidated totals, or the 1987 and 1986 financial statements of Georgia Kraft Company, used as a basis for recording the Company's equity in net income of that corporation. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for Great American Reserve Insurance Company and Georgia Kraft Company, is based solely on the reports of the other auditors.

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

In our opinion, based upon our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Temple-Inland Inc. and subsidiaries at December 31, 1988 and January 2, 1988, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1988, in conformity with generally accepted accounting principles.



Houston, Texas
February 17, 1989

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Statements of Operations and Changes in Retained Earnings
Guaranty Federal Savings Bank

	Three Months Ended December 31, 1988
	(in thousands)
Interest income	
Interest on real estate loans	$ 38,509
Interest on other loans, net	2,877
Interest and dividends on investments	2,952
Interest on FSLIC notes receivable	24,519
FSLIC yield maintenance on covered assets	28,501
Total Interest Income	97,358
Interest expense	
Interest on deposits	65,300
Interest on borrowings	13,341
Total Interest Expense	78,641
Net Interest Income	18,717
Provision for possible loan losses	—
Net Interest Income after Provision for Possible Loan Losses	18,717
Other income	
Other FSLIC assistance:	
Reimbursement from FSLIC	11,169
Equity in earnings (loss) of subsidiaries, net	(3,846)
Fee for early repayment of FHLB advances	(5,008)
Earnings from real estate operations	757
Other	2,012
Total Other Income	5,084
Other expenses	
Employee compensation and benefits	5,628
Occupancy	1,914
Amortization of cost in excess of net assets acquired	5,460
Parent tax benefits shared with FSLIC	1,800
Other	6,186
Total Other Expenses	20,988
Income Before Provision for Federal Income Taxes	2,813
Federal income taxes	—
Net Income	$ 2,813
Retained earnings at September 30, 1988	—
Retained earnings at December 31, 1988	$ 2,813

See notes to financial statements.

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Statement of Financial Condition
Guaranty Federal Savings Bank

	December 31, 1988	September 30, 1988
	(in thousands)	
ASSETS		
Cash (including interest bearing deposits of $32,036,000 and $169,889,000)	$ 46,200	$ 214,063
Investment securities (market value approximates carrying value)	78,764	77,241
Loans receivable	1,972,253	1,960,833
Accrued interest receivable	64,347	58,809
Investments in real estate	338,202	333,738
Advances to and investments in subsidiaries	241,908	240,549
Premises and equipment	32,581	33,074
Other assets	7,812	15,344
Receivables from the Federal Savings and Loan Insurance Corporation	1,232,908	1,170,514
Cost in excess of net assets acquired	111,186	116,646
	$ 4,126,161	$ 4,220,811
LIABILITIES AND STOCKHOLDER'S EQUITY		
Liabilities		
Deposits	$ 3,219,246	$ 3,621,009
Federal Home Loan Bank advances	584,327	309,160
Securities sold under agreements to repurchase	200,803	164,004
Advance payments by borrowers for taxes and insurance	6,532	15,385
Accounts payable and other liabilities	37,440	36,253
	4,048,348	4,145,811
Stockholder's Equity		
Preferred stock, no par value, 2,000,000 shares authorized, none issued	—	—
Common stock, par value $.01 per share, 2,000,000 shares authorized, 800,000 shares issued and outstanding	8	8
Common stock purchase warrants	—	—
Additional paid-in capital	74,992	74,992
Retained earnings	2,813	—
	77,813	75,000
CONTINGENCIES		
	$ 4,126,161	$ 4,220,811

See notes to financial statements.

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Statement of Cash Flows
Guaranty Federal Savings Bank

	Three Months Ended December 31, 1988
	(in thousands)
Operating Activities	
Net income	$ 2,813
Adjustments to reconcile net income to net cash used by operating activities:	
Provision for depreciation and amortization	763
Amortization of purchase accounting adjustments	(7,776)
Amortization of cost in excess of net assets acquired	5,460
Increase in interest receivable	(5,538)
Increase in interest payable	2,330
Increase in receivables from FSLIC	(62,394)
Other, net	4,144
Net Cash Used by Operating Activities	(60,198)
Investing Activities	
Principal collected on loans	51,507
Loans originated or acquired	(65,367)
Net Cash Used by Investing Activities	(13,860)
Financing Activities	
Net decrease in demand deposits, NOW accounts, and savings accounts	(44,876)
Proceeds from sales of certificates of deposit	120,090
Payments for maturing certificates of deposit	(472,046)
Net increase in FHLB advances	275,081
Net increase in securities sold under agreements to repurchase	36,799
Net decrease in advance payments by borrowers for taxes and insurance	(8,853)
Net Cash Used by Financing Activities	(93,805)
Decrease in Cash	(167,863)
Cash at beginning of period	214,063
Cash at End of Period	$ 46,200

See notes to financial statements.

Notes to Financial Statements

Guaranty Federal Savings Bank
December 31, 1988 and September 30, 1988

Note A—Significant Accounting Policies

Basis of Presentation

The financial statements include only the accounts of Guaranty Federal Savings Bank (the "Bank"), a majority-owned subsidiary of Temple-Inland Inc. For the reasons discussed in Note C the Bank's subsidiaries have not been consolidated. Instead, the Bank's investments in subsidiaries are accounted for by the equity method. Bank interest income on advances to subsidiaries and Bank subsidiary interest expense on advances payable to the Bank have been eliminated in the determination of equity in earnings (loss) of subsidiaries.

Cash Equivalents

The Bank considers time deposits with original maturities of three months or less, transit clearing items and federal funds sold to be cash equivalents.

Investment Securities

Investment securities are carried at cost, adjusted for amortization of premiums and accretion of discounts by a method which approximates the interest method over the estimated life of the securities. The specific identification method is used in determining gains or losses on sales of securities. Investment securities are not adjusted to market as it is management's intention to hold them to maturity.

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Loans Receivable and Accrued Interest Receivable

Interest on loans receivable is credited to income as earned. Mortgage loan discounts are amortized to income using the interest method over the estimated life of the related loans adjusted for prepayments. Unearned discounts on consumer loans are amortized to earnings over the life of the loan using the interest method.

A provision for possible losses on noncovered loans is charged to operations based on management's evaluation of the estimated losses in the Bank's portfolio. Such evaluation includes a review of loans on which full collectibility may not be reasonably assured and considers the estimated value of the underlying collateral and other factors which, in management's judgement, deserve recognition under existing economic conditions.

Investments in Real Estate

Real estate investments are carried at cost. Costs relating to the development and improvement of real estate investments and certain holding period costs are capitalized.

Premises and Equipment

Premises and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets ranging from 3 to 40 years. Maintenance and repairs are charged to expense and renewals and replacements are capitalized.

Loan Fees

Loan origination fees net of direct origination and acquisition costs are capitalized and amortized using the interest method as an adjustment of the yield of the related loans.

Cost in Excess of Net Assets Acquired

Cost in excess of net assets acquired results from the acquisition of the net assets discussed in Note B and is amortized to expense primarily over a period not to exceed the estimated life of the long term interest bearing assets acquired using the interest method.

Note B—Acquisition

The Bank was capitalized on September 30, 1988, with $75,000,000 in cash and a commitment by its parent to purchase an aggregate of approximately $50,000,000 of the Bank's preferred stock during January 1990 and 1991. Concurrently, the Federal Savings and Loan Insurance Corporation (the "FSLIC"), as Receiver for Guaranty Federal Savings and Loan Association of Texas, First Federal Savings and Loan Association of Austin, Texas, and Delta Savings Association of Texas, (the "closed associations"), transferred to the Bank substantially all of the closed associations' assets, deposits and secured liabilities. The transferred assets include an aggregate of $1,094,488,000 in notes receivable from the FSLIC contributed to the closed associations during the period of receivership. The Bank issued to the FSLIC warrants to purchase 20 percent of the Bank's common stock at $.01 per share exercisable during a period of ten years from the date of acquisition. This acquisition has been accounted for as a purchase and, accordingly, the assets acquired and liabilities assumed were recorded at their estimated fair values considering certain financial assistance to be provided by the FSLIC. These estimates of fair value are subject to change when final information concerning asset and liability valuation is obtained.

Note C—FSLIC Assistance

In connection with the acquisition, the Bank entered into an assistance agreement with FSLIC (the "assistance agreement") whereby, for a period of ten years from the date of acquisition, FSLIC will provide substantial financial assistance for and exert significant influences over a substantial portion of the Bank's assets. Such assets ("Covered Assets") are generally all assets except cash, marketable securities, performing one to four family mortgage loans, assets of subsidiaries and certain premises and equipment. While assets of subsidiaries are not Covered Assets, the Bank's advances to and investments in its subsidiaries are Covered Assets and for purposes of determining FSLIC assistance are to be accounted for using the equity method of accounting.

Financial assistance includes guaranteed yields and loss coverage on Covered Assets, certain expense reimbursements and indemnification from certain claims and litigation. A substantial portion of gains on sales of Covered Assets are allocated to FSLIC. The Bank must obtain FSLIC approval for substantially all matters relating to claims or litigation, and the maintenance and/or disposition of Covered Assets and assets of subsidiaries. The Bank will reduce FSLIC assistance for 25 percent of the income tax benefits recognized by the Bank's parent from the inclusion of the Bank's operations in the parent's consolidated income tax returns.

Guaranteed yields are based upon Texas Cost of Funds, as defined, plus certain margins ranging from 2.40 percent to 1.70 percent. FSLIC assistance is reduced by actual yields and increased by actual losses realized on Covered Assets. Equity in subsidiaries' net earnings or losses are considered either actual yields or actual losses under terms of the assistance agreement. As a means of currently funding a portion of the tax benefit arrangement with FSLIC, the Bank has agreed to reduce guaranteed yields by 0.10 percent.

Indemnities in excess of $10 million, interest payments on FSLIC notes receivable, guaranteed yields and actual losses are payable quarterly. At FSLIC's option, all other FSLIC financial assistance may be paid either quarterly or at the end of the term of the assistance agreement. Amounts not paid quarterly earn interest at the guaranteed yield rate.

The amounts receivable under the FSLIC assistance agreement have a significant impact on the Bank's statement of financial condition and future operations. There continues to be uncertainty concerning FSLIC's continuing ability and ultimately, the federal government's plan to deal with the savings and loan industry. Future resolution of this uncertainty could impact the financial condition and operations of the Bank.

Note D—Investment Securities

Investment securities consist of (in thousands):

	December 31, 1988	September 30, 1988
U.S. Government securities	$22,548	$22,546
Corporate bonds	11,399	11,388
Federal Home Loan Bank stock	29,774	28,127
Other securities	15,043	15,180
	$78,764	$77,241

Investment securities aggregating $17,808,000 and $18,000,000 are Covered Assets under the FSLIC assistance agreement at December 31 and September 30, 1988, respectively.

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Note E—Investments in Real Estate

Investments in real estate consist of (in thousands):

	December 31, 1988	September 30, 1988
Real estate acquired in settlement of loans:		
Commercial	$127,921	$127,517
1-4 family	60,059	59,837
Land and lots	37,138	36,923
Multi-family and other	96,806	93,822
	321,924	318,099
Other real estate:		
Land and lots under development	10,175	10,385
Multi-family	6,103	5,254
	16,278	15,639
	$338,202	$333,738

Investments in real estate are Covered Assets under the FSLIC assistance agreement at December 31 and September 30, 1988, respectively.

Note F—Loans Receivable

Loans receivable consist of (in thousands):

	December 31, 1988	September 30, 1988
1-4 family loans	$ 768,961	$ 770,937
Commercial loans (principally real estate loans)	636,590	649,271
Construction loans	391,873	395,785
Mortgage backed securities	353,846	346,865
Property improvement loans	47,813	44,534
Loans on savings accounts	14,484	14,440
Consumer and other loans	72,026	68,247
	2,285,593	2,290,079
Less:		
Participations sold	151,474	156,402
Loans in process	94,254	102,561
Unearned discount	2,449	1,934
Purchase discount	65,163	68,349
	$1,972,253	$1,960,833

Mortgage backed securities consist of Federal Home Loan Mortgage Corporation participation certificates and Government National Mortgage Association and Federal National Mortgage Association pass-through securities. At December 31, 1988 the market value of mortgage backed securities approximated $320,000,000.

The Bank services approximately $441,972,000 and $435,000,000 of loans for the benefit of others at December 31 and September 30, 1988, respectively.

Loans receivable aggregating approximately $1,001,612,000 and $1,025,000,000 are Covered Assets under the FSLIC assistance agreement. These totals include loans receivable from subsidiaries aggregating $59,164,000 and $61,016,000 at December 31 and September 30, 1988, respectively.

Note G—Accrued Interest Receivable

Accrued interest receivable consists of (in thousands):

	December 31, 1988	September 30, 1988
Investment securities	$ 1,907	$ 948
1-4 family loans	7,528	5,687
Other loans	54,912	52,174
	$64,347	$58,809

Accrued interest receivable of $43,091,000 and $58,809,000 is a Covered Asset under the FSLIC assistance agreement at December 31 and September 30, 1988, respectively.

Note H—Advances to and Investments in Subsidiaries

Summarized combined financial information of subsidiaries follows (in thousands):

	December 31, 1988	September 30, 1988
Assets		
Cash	$ 17,670	$ 17,448
Loans and accrued interest receivable, less allowances for possible losses of $15,550,000 and $18,266,000	16,388	14,776
Investments in real estate	415,717	411,806
Premises, equipment and other	23,349	27,710
	$473,124	$471,740
Liabilities and Equity (Deficit)		
Accrued interest and other liabilities	$ 41,849	$ 42,336
Notes payable to the Bank, real estate mortgaged as collateral	59,164	61,016
Notes payable to others, real estate mortgaged as collateral	130,203	127,839
Advances payable to the Bank	586,440	565,211
Equity (deficit)	(344,532)	(324,662)
	$473,124	$471,740
Investments in real estate within the subsidiaries consist of:		
Commercial	$106,686	$110,648
Land and lots under development	494,946	491,796
Residential home building	4,573	4,473
Multi-family	97,474	97,709
Allowance for possible losses	(287,962)	(292,820)
	$415,717	$411,806

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	Three Months Ended December 31, 1988
	(in thousands)
Revenues	$ 9,440
Costs and expenses:	
Interest expense related to notes payable to others	3,315
Interest expense related to advances payable to the Bank	16,024
Interest on secured notes payable to the Bank	1,543
Other operating expenses	8,428
Bank's equity in loss before elimination of interest expense on advances payable to the Bank	(19,870)
Interest expense on advances payable to the Bank	16,024
Bank's equity in loss, net	$ (3,846)

The Bank's advances to and investment in subsidiary is a Covered Asset and consists of the following (in thousands):

	December 31, 1988	September 30, 1988
Advances payable to the Bank	$ 586,440	$ 565,211
Equity (deficit)	(344,532)	(324,662)
	$ 241,908	$ 240,549

Note I—Premises and Equipment

Premises and equipment consists of (in thousands):

	December 31, 1988	September 30, 1988
Land	$ 7,022	$ 7,022
Buildings	20,459	20,319
Furniture, fixtures and equipment	4,480	4,360
Other	1,383	1,373
	33,344	33,074
Less accumulated depreciation and amortization	763	—
	$32,581	$33,074

Certain branch and home office locations are operated from premises leased by the closed associations. The Bank is currently leasing such premises and related leasehold improvements and equipment from the FSLIC at market rates. Rent expense totaled $380,000 for the three months ended December 31, 1988.

Through September 30, 1989, the Bank may under certain conditions, convert owned facilities into Covered Assets under the FSLIC assistance agreement.

Note J—Receivables from the FSLIC

Receivables from FSLIC consist of (in thousands):

	December 31, 1988	September 30, 1988
Initial notes receivable (including accrued interest of $14,780,000 at December 31, 1988) for excess of liabilities assumed over assets acquired, based upon June 30, 1988 amounts, interest due quarterly at the Texas Cost of Funds plus .40 percent, due September 30, 1998	$ 724,926	$ 710,146
Notes receivable (including accrued interest receivable of $9,740,000 at December 31, 1988) from sale of certain assets, interest due quarterly at the Texas Cost of Funds plus 2.30 percent, due March 30, 1989, renewable at the option of FSLIC through September 30, 1989	394,082	384,342
Estimated additional amounts receivable due for excess of liabilities assumed over assets acquired based upon September 30, 1988 amounts, interest initially due quarterly, initially at Texas Cost of Funds plus 2.40 percent, due no later than September 30, 1998	76,026	76,026
Estimated assistance receivable due quarterly, primarily for guaranteed yields and actual losses on Covered Assets	34,196	—
Estimated other assistance payments receivable, due either quarterly or at the expiration of the assistance agreement, interest (if any) payable quarterly initially at the Texas Cost of Funds plus 2.40 percent, due no later than September 30, 1998	3,678	—
	$1,232,908	$1,170,514

The Texas Cost of Funds applicable for the period ended December 31, 1988 was 8.02 percent. This is based on the most recently reported data by the Federal Home Loan Bank which was actually for the quarter ended September 30, 1988.

The final determination of the principal balance of the receivable for excess of liabilities assumed over assets acquired based upon the September 30, 1988 amounts is to be determined by FSLIC based upon its audit of the closed associations' financial statements as of September 30, 1988. Such audit has not been completed. In addition, the estimated amounts of the assistance payments receivable are subject to review by the FSLIC. Bank management does not believe that the final determination of the amount of such receivables from FSLIC will be materially different from that estimated.

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Note K—Cost in Excess of Net Assets Acquired

Costs in excess of net assets acquired consist of (in thousands):

	December 31, 1988	September 30, 1988
Amounts recoverable from FSLIC under terms of the assistance agreement, net	$ 59,283	$ 62,209
Amounts to be charged to expense primarily over a period not to exceed the estimated life of the long term interest bearing assets acquired, net	51,903	54,437
	$111,186	$116,646

Amounts recoverable from FSLIC under terms of the assistance agreement relate to cost in excess of net assets acquired created primarily by purchase discounts on one to four family mortgage loans and mortgage backed securities.

Amortization during the three months ended December 31, 1988 was $5,460,000, of which $2,926,000 is to be recovered from FSLIC.

Note L—Deposits

Deposits consist of (in thousands):

	Weighted Average Contractual Interest Rate	December 31, 1988	September 30, 1988
Certificate accounts	8.85%	$2,578,489	$2,930,445
Statement savings	5.28%	57,241	59,924
Demand accounts including money market accounts	5.95%	554,010	596,203
		3,189,740	3,586,572
Purchase discount		29,506	34,437
		$3,219,246	$3,621,009

Certificate accounts at December 31, 1988, mature annually as follows (in thousands):

1989	$1,722,564
1990	361,574
1991	145,352
1992	127,658
1993	145,191
Thereafter	76,150
	$2,578,489

Interest expense on deposits consists of (in thousands):

	Three Months Ended December 31, 1988
Certificate accounts	$56,178
Statement savings	741
Interest bearing demand accounts	8,381
	$65,300

The weighted average cost of deposits for the three months ended December 31, 1988 was 7.70 percent.

The Bank assumed agreements expiring in 1991 and 1992 to exchange fixed rate interest payments for variable market-indexed interest payments on notional principal amounts of $50,000,000. The weighted average fixed payment rate was 8.7 percent and 8.7 percent, and the weighted average variable payment rate, based on three month LIBOR, was 9.0 percent and 8.5 percent at December 31 and September 30, 1988, respectively. Purchase premiums of $1,025,000 and $1,115,000 relate to these agreements at December 31, and September 30, 1988, respectively.

Note M—Federal Home Loan Bank Advances

At December 31, 1988, Federal Home Loan Bank of Dallas ("FHLB") advances are collateralized primarily by the pledge of $474,452,000 of first mortgage loans on real estate, $96,886,000 of mortgage backed securities, $1,012,502,000 of FSLIC notes receivable, and all of the stock of the FHLB owned by the Bank. Interest rates at December 31 and September 30, 1988 on advances range from 8.46 percent to 10.04 percent and 7.70 percent to 12.55 percent and have a weighted average rate of 9.35 percent and 9.64 percent, respectively. Under the terms of the assistance agreement, the Bank will be reimbursed for $5,008,000 of the fee for early repayment of certain FHLB advances affected within a certain period from the effective date of the acquisition.

The advances at December 31, 1988 mature annually as follows (in thousands):

1989	$498,318
1990	10,000
1991	20,000
1992	—
1993	10,000
Thereafter	50,000
	588,318
Less purchase premium	3,991
	$584,327

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Note N—Securities Sold Under Agreements to Repurchase

At December 31 and September 30, 1988, securities sold under agreements to repurchase mature through February 1989 and October, 1988, respectively. In connection therewith, mortgage backed securities and U.S. Government agency bonds with a carrying value of approximately $218,868,000 and $178,226,000 and a market value of approximately $217,212,000 and $170,850,000, respectively, are reported as being held by the dealers or transfer agents. The dealers may have sold, loaned, or otherwise disposed of such securities to other parties in the normal course of their operations and have agreed to resell to the Bank substantially identical securities at the maturities of the agreements.

Note O—Income Taxes

The Bank will be included in the consolidated income tax returns filed by its parent. Under an agreement with its parent the Bank receives no benefit for tax losses and provides an income tax provision on its taxable income after taking into effect any tax loss carryforwards. FSLIC assistance is not taxable for income tax purposes. See Note C for information regarding the tax sharing agreement with FSLIC.

The provision for Federal income taxes differs from that computed at the statutory corporate tax rate as follows:

	Three Months Ended December 31, 1988
	(in thousands)
Tax at statutory rate	$ 956
Non-taxable FSLIC assistance income allocable to the Bank	(956)
Federal income taxes	$ —

Estimated federal income tax operating loss carryforwards at December 31, 1988 for federal income tax purposes approximate $550,000,000, and if not utilized, expire in 1989 through 2002. Utilization of the income tax operating loss carryforwards are subject to income tax law regulations that limit their utilization to future taxable income of the Bank.

Note P—Regulatory Matters

The Federal Home Loan Bank Board granted the Bank several forbearances from regulatory requirements including reduced regulatory capital and liquidity requirements. The Bank's regulatory capital requirement is reduced to 1.25 percent of total liabilities, increasing annually to 5.0 percent of total liabilities by 1998 after which the requirement shall be the fully phased in capital amount. The Bank's regulatory capital requirement at December 31, 1988, after consideration of forbearances, was approximately $50,600,000. Also, in connection with the Bank's capital maintenance agreement with FSLIC, the Bank may not pay dividends on its common stock in excess of fifty percent of its accumulated net income. These agreements and other forbearances, such as those relating to limits on investments in service corporations and loans to one borrower, expire at various dates throughout the ten year period of the FSLIC assistance agreement.

Note Q—Contingencies

The FSLIC has agreed to indemnify the Bank for amounts incurred in connection with the satisfaction and defense of litigation and claims relating to the closed associations and for challenges to the acquisition. Additionally, any such approved expenses incurred at the Bank's subsidiaries are reimbursable from FSLIC to the extent FSLIC provides yield maintenance or actual loss coverage on the Bank's investments in subsidiaries.

Note R—Market Value of Covered Assets (Unaudited)

As discussed in Note C, certain assets acquired by the Bank are considered Covered Assets and, as such, were transferred to the Bank at the closed associations, book values before valuation allowances. For these assets, FSLIC assures the ultimate recovery of their book value.

Of total assets, approximately $1.23 billion and $1.17 billion are receivables due from FSLIC and approximately $1.64 billion and $1.70 billion are considered Covered Assets under the FSLIC assistance agreement, at December 31, and September 30, 1988, respectively. Without FSLIC assistance, Bank management estimates that the value of Covered Assets would be approximately $321 million and $350 million less than their carrying value at December 31 and September 30, 1988, respectively.

Report of Independent Auditors

To the Board of Directors
Guaranty Federal Savings Bank

We have audited the accompanying statements of financial condition of Guaranty Federal Savings Bank (the "Bank"), a majority-owned subsidiary of Temple-Inland Inc. as of December 31, 1988 and September 30, 1988, and the related statements of operations and changes in retained earnings and cash flows for the three month period ended December 31, 1988. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Guaranty Federal Savings Bank at December 31, 1988 and September 30, 1988, and the results of its operations and its cash flows for the three month period ended December 31, 1988 in conformity with generally accepted accounting principles.

For the next several years, the Bank's future operations are dependent upon the receipt of significant amounts of financial assistance from the Federal Savings and Loan Insurance Corporation (FSLIC). As described in Notes C and J, this assistance is represented by an agreement which provides for guaranteed yields and loss coverage on a substantial portion of the Bank's assets, certain expense reimbursements, indemnification from certain claims and litigation and by receivables from FSLIC. The uncertainties surrounding the FSLIC assistance program for the troubled savings and loan industry are well publicized. An unfavorable resolution of these uncertainties would have a significant impact on the financial statements and operations of the Bank.

Ernst & Whinney

Austin, Texas
February 8, 1989

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Shareholder Information

Transfer Agent and Registrar
NCNB Texas National Bank
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 5, 1989 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.

Common Stock Prices and Dividend Information

	Price Range		Dividends
	High	**Low**	
1988			
First Quarter	**$50**	**$40¼**	**$.21**
Second Quarter	**54⅞**	**43½**	**.21**
Third Quarter	**56½**	**49¼**	**.21**
Fourth Quarter	**53⅜**	**44½**	**.21**
Year	**56½**	**40¼**	**.84**
1987			
First Quarter	$66⅘	$45⅓	$.15
Second Quarter	68½	55⅞	.18
Third Quarter	68	56⅝	.18
Fourth Quarter	68½	35⅛	.18
Year	68½	35⅛	.69

Number of Shareholders
As of December 31, 1988, there were 10,676 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 NCNB Texas National Bank, 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 NCNB Texas National Bank, 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

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Temple-Inland Inc.
1988 Annual Report

Drawer N
Diboll, Texas 75941