
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2002

Commission File Number 333-18723

MAXXAM GROUP HOLDINGS INC.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

76-0518669

(I.R.S. Employer
Identification Number)

5847 San Felipe, Suite 2600

Houston, Texas

(Address of Principal Executive Offices)

77057

(Zip Code)

Registrant's telephone number, including area code: **(713) 975-7600**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Number of shares of common stock outstanding at November 8, 2001: 1,000

Registrant meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this Form with the reduced disclosure format.

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MAXXAM GROUP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
(In millions of dollars, except share information)

	September 30, 2002	December 31, 2001
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 26.2	\$ 66.0
Marketable securities	52.1	53.6
Receivables:		
Trade	10.5	12.5
Receivables from MAXXAM.	—	8.5
Other	1.7	2.1
Inventories	34.1	51.4
Prepaid expenses and other current assets	17.7	17.5
Total current assets	142.3	211.6
Property, plant and equipment, net of accumulated depreciation of \$109.6 and \$100.1, respectively	220.5	224.9
Timber and timberlands, net of accumulated depletion of \$201.8 and \$193.7, respectively	229.3	235.0
Note receivable from MAXXAM.	191.5	183.1
Deferred financing costs, net	20.8	22.8
Deferred income taxes	22.9	13.4
Restricted cash, marketable securities and other investments	57.4	89.8
Other assets	8.1	6.8
	<u>\$ 892.8</u>	<u>\$ 987.4</u>
Liabilities and Stockholder's Deficit		
Current liabilities:		
Accounts payable	\$ 5.4	\$ 5.7
Accrued interest	12.4	30.5
Accrued compensation and related benefits	11.8	12.4
Deferred income taxes	8.4	6.8
Other accrued liabilities	10.4	8.0
Short-term borrowings and current maturities of long-term debt, excluding \$2.6 and \$2.3, respectively, of repurchased Timber Notes held in the SAR Account	68.1	35.5
Total current liabilities	116.5	98.9
Long-term debt, less current maturities and excluding \$52.8 and \$55.4, respectively, of repurchased Timber Notes held in the SAR Account	855.9	962.7
Deferred income taxes	22.8	19.5
Other noncurrent liabilities	28.8	28.3
Total liabilities	1,024.0	1,109.4
Contingencies (See Note 7)		
Stockholder's deficit:		
Common stock, \$1.00 par value; 3,000 shares authorized; 1,000 shares issued and outstanding	—	—
Additional capital	123.2	123.2
Accumulated deficit	(254.6)	(245.5)
Accumulated other comprehensive income	0.2	0.3
Total stockholder's deficit	(131.2)	(122.0)
	<u>\$ 892.8</u>	<u>\$ 987.4</u>

The accompanying notes are an integral part of these financial statements.

MAXXAM GROUP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

(In millions of dollars)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
	(Unaudited)			
Net sales:				
Lumber and logs	\$ 47.9	\$ 39.5	\$ 142.8	\$ 124.4
Real estate	2.2	2.2	6.5	2.3
Other	3.9	5.3	11.2	18.4
	<u>54.0</u>	<u>47.0</u>	<u>160.5</u>	<u>145.1</u>
Operating expenses:				
Cost of goods sold	32.3	36.9	103.8	119.6
Selling, general and administrative expenses	8.2	5.1	17.9	13.9
Impairment of assets	—	0.7	—	0.7
Depletion and depreciation	7.1	5.5	21.6	15.7
	<u>47.6</u>	<u>48.2</u>	<u>143.3</u>	<u>149.9</u>
Operating income (loss)	6.4	(1.2)	17.2	(4.8)
Other income (expense):				
Equity in earnings of Kaiser	—	23.7	—	43.3
Investment, interest and other income (expense), net	6.5	7.1	22.3	25.5
Interest expense	<u>(18.9)</u>	<u>(20.2)</u>	<u>(57.7)</u>	<u>(56.7)</u>
Income (loss) before income taxes	(6.0)	9.4	(18.2)	7.3
Benefit in lieu of income taxes	<u>1.9</u>	<u>3.2</u>	<u>6.8</u>	<u>12.2</u>
Income (loss) before extraordinary item	(4.1)	12.6	(11.4)	19.5
Extraordinary item:				
Gains on repurchases of debt, net of income tax provisions of \$0.1, \$1.2 and \$2.0, respectively	0.2	—	2.3	3.6
Net income (loss)	<u>\$ (3.9)</u>	<u>\$ 12.6</u>	<u>\$ (9.1)</u>	<u>\$ 23.1</u>

The accompanying notes are an integral part of these financial statements.

MAXXAM GROUP HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(In millions of dollars)

	Nine Months Ended September 30,	
	2002	2001
	(Unaudited)	
Cash flows from operating activities:		
Net income (loss)	\$ (9.1)	\$ 23.1
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:		
Depletion and depreciation	21.6	15.7
Non-cash impairment charge	—	0.7
Extraordinary gains on repurchases of debt, net	(2.3)	(3.6)
Equity in undistributed earnings of Kaiser	—	(43.3)
Amortization of deferred financing costs	2.0	1.8
Net loss (gain) on marketable securities	1.1	(2.7)
Deferral of interest payment on note receivable from MAXXAM.	(0.2)	(18.6)
Increase (decrease) in cash resulting from changes in:		
Receivables	2.6	0.9
Inventories, net of depletion	15.0	(0.9)
Prepaid expenses and other assets	(2.2)	(2.6)
Accounts payable	(0.3)	(0.3)
Accrued interest	(18.1)	(18.8)
Accrued and deferred income taxes	(6.9)	(13.5)
Other liabilities	1.5	5.4
Long-term assets and long-term liabilities	<u>1.6</u>	<u>(2.8)</u>
Net cash provided by (used for) operating activities	<u>6.3</u>	<u>(59.5)</u>
Cash flows from investing activities:		
Net sales (purchases) of marketable securities	2.7	(21.6)
Capital expenditures	(9.0)	(141.6)
Net proceeds from dispositions of property and investments	<u>1.9</u>	<u>—</u>
Net cash used for investing activities	<u>(4.4)</u>	<u>(163.2)</u>
Cash flows from financing activities:		
Proceeds from issuances of long-term debt	—	122.5
Borrowings (repayments) under revolving credit agreements, net	(12.8)	(19.0)
Redemptions, repurchases of and principal payments on long-term debt	(58.0)	(39.7)
Incurrence of deferred financing costs	—	(5.3)
Restricted cash (deposits) withdrawals, net	30.3	18.4
Other	<u>(1.2)</u>	<u>(11.1)</u>
Net cash provided by (used for) financing activities	<u>(41.7)</u>	<u>65.8</u>
Net decrease in cash and cash equivalents	(39.8)	(156.9)
Cash and cash equivalents at beginning of period	<u>66.0</u>	<u>201.7</u>
Cash and cash equivalents at end of period	<u>\$ 26.2</u>	<u>\$ 44.8</u>
Supplemental disclosure of cash flow information:		
Interest paid, net of capitalized interest	\$ 73.8	\$ 73.7
Tax allocation payments to MAXXAM	—	1.3

The accompanying notes are an integral part of these financial statements.

MAXXAM GROUP HOLDINGS INC. AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. General

The information contained in the following notes to the consolidated financial statements is condensed from that which would appear in the annual consolidated financial statements; accordingly, the consolidated financial statements included herein should be reviewed in conjunction with the consolidated financial statements and related notes thereto contained in the Form 10-K. Any capitalized terms used but not defined in these Condensed Notes to Consolidated Financial Statements are defined in the "Glossary of Defined Terms" contained in Appendix A. All references to the "Company" include MAXXAM Group Holdings Inc. and its subsidiary companies unless otherwise noted or the context indicates otherwise. Accounting measurements at interim dates inherently involve greater reliance on estimates than at year end. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the entire year.

The consolidated financial statements included herein are unaudited; however, they include all adjustments of a normal recurring nature which, in the opinion of management, are necessary for a fair presentation of the consolidated financial position of the Company at September 30, 2002, and the consolidated results of operations for the three and nine months ended September 30, 2002 and 2001, and the consolidated cash flows for the nine months ended September 30, 2002 and 2001. The Company is a wholly owned subsidiary of MAXXAM.

Liquidity and Cash Resources

Pacific Lumber's 2001 cash flows from operations were adversely affected by operating inefficiencies, lower lumber prices, an inadequate supply of logs and a related slowdown in lumber production. During 2001, comprehensive external and internal reviews were conducted of Pacific Lumber's business operations. These reviews were conducted in an effort to identify ways in which Pacific Lumber could operate on a more efficient and cost effective basis. Based upon the results of these reviews, Pacific Lumber, among other things, closed two of its four sawmills, eliminated certain of its operations, including its soil amendment and concrete block activities, began utilizing more efficient harvesting methods and adopted certain other cost saving measures. Most of these changes were implemented by Pacific Lumber in the last quarter of 2001, or the first quarter of 2002. Pacific Lumber also ended its internal logging operations (which historically performed approximately half of its logging) as of March 31, 2002, and now relies exclusively on contract loggers to conduct these activities. In connection with these changes, the Company recorded an impairment charge to operating costs of \$2.2 million in the fourth quarter of 2001. Further actions may be taken during the next year as a result of Pacific Lumber's continuing evaluation process, and additional writedowns of certain assets may be required.

The \$29.4 million release from the SAR Account discussed in Note 3 improved Pacific Lumber's liquidity. However, Pacific Lumber may require funds available under the Pacific Lumber Credit Agreement and/or additional repayments by MGI of an intercompany loan in order to meet its working capital and capital expenditure requirements for the next year.

Scotia LLC's cash flows from operations are significantly impacted by harvest volumes and SBE prices. On June 19, 2002, the State Board of Equalization adopted the new Harvest Value Schedule for the second half of 2002. The SBE Prices published in this schedule reflect an approximate 16% decline for small redwood logs and no price change for small Douglas fir logs. This decline in SBE Prices will continue to have an adverse impact on Scotia LLC's net sales and liquidity during the fourth quarter of 2002. With respect to the note payment due in January 2003, Scotia LLC expects that it will require funds from the Scotia LLC Line of Credit to pay a portion of the interest due, and that all of the funds used to pay the Scheduled Amortization amount will be provided from the SAR Account. With respect to short-term liquidity, Scotia LLC believes that existing cash available for principal payments from the SAR Account, and funds available under the Scotia LLC Line of Credit, together with cash flows from operations, should provide sufficient funds to meet its working capital, capital expenditures and required debt service obligations through 2003. However, cash flows from operations and funds available under the Scotia LLC Line of Credit may be insufficient to allow Scotia LLC to fulfill its interest and certain other payment obligations in the long-term if SBE Prices do not improve.

With respect to long-term liquidity, although MGI and its subsidiaries expect that their existing cash and cash equivalents, lines of credit and ability to generate cash flows from operations should provide sufficient funds to meet their debt service, working capital and capital expenditure requirements, until such time as Pacific Lumber has adequate cash

flows from operations and/or dividends from Scotia LLC and SBE Prices improve, there can be no assurance that this will be the case.

Comprehensive Income (Loss)

The following table sets forth comprehensive income (loss) (in millions).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Net income (loss)	\$ (3.9)	\$ 12.6	\$ (9.1)	\$ 23.1
Cumulative effect of accounting change	—	—	—	0.6
Unrealized net gains on derivative instruments arising during the period	—	12.4	—	9.9
Less reclassification adjustment for realized net gains on derivative instruments included in net income	—	(0.1)	—	(1.0)
Change in value of available-for-sale investments, net of income tax provision (benefit) of \$0.2, \$0.4, \$(0.1) and \$0.6, respectively	0.2	0.7	(0.1)	0.9
Comprehensive income (loss)	<u>\$ (3.7)</u>	<u>\$ 25.6</u>	<u>\$ (9.2)</u>	<u>\$ 33.5</u>

Investment in Kaiser

The Company's investment in Kaiser consists of a 34.6% equity interest at September 30, 2002. As of December 31, 2001, the Company's investment in Kaiser was accounted for under the equity method. On February 12, 2002, Kaiser filed a voluntary petition under Chapter 11 of the Code. As a result of such filing, the Company began reporting its investment in Kaiser under the cost method with no further recognition of equity in earnings or losses until such time as the shares are disposed of or a plan of reorganization is implemented. See Note 5 for further discussion of the Company's investment in Kaiser.

New Accounting Standards

In June 2001, the FASB issued SFAS No. 143 which addresses accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the related asset retirement costs. The Company is required to adopt SFAS No. 143 beginning on January 1, 2003. In general, SFAS No. 143 requires the recognition of a liability resulting from anticipated asset retirement obligations, offset by an increase in the value of the associated productive asset for such anticipated costs. Over the life of the asset, depreciation expense is to include the ratable expensing of the retirement cost included with the asset value. The statement applies to all legal obligations associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, or development and /or the normal operation of a long-lived asset, except for certain lease obligations. Excluded from this statement are obligations arising solely from a plan to dispose of a long-lived asset and obligations that result from the improper operation of an asset (i.e., certain types of environmental obligations). The Company is continuing its evaluation of SFAS No. 143. However, the Company does not currently expect the adoption of SFAS No. 143 to have a material impact on its future financial statements.

In August 2001, the FASB issued SFAS No. 144 which sets forth new guidance for accounting and reporting for impairment or disposal of long-lived assets. The provisions of SFAS No. 144 were effective for the Company beginning on January 1, 2002. Based on presently available estimates, the new impairment and disposal rules did not result in the recognition of impairment losses in 2002 beyond those reported as of December 31, 2001 (see Note 2). In addition to the new guidance on impairments, SFAS No. 144 broadens the applicability of the provisions of Accounting Principles Board Opinion 30 for the presentation of discontinued operations in the income statement to include a component of an entity (rather than a segment of a business). A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Effective after December 31, 2001, when the Company commits to a plan of sale of a component of an entity, such component will be presented as a discontinued operation if the operations and cash flows of the component will be eliminated from the ongoing operations of the entity and the entity will not have any significant continuing involvement in the operations of the component. Although this provision will not affect the total amount reported for net income, the income statements for prior periods will be reclassified to report the results of operations of the component separately when a component of an entity is reported as a discontinued operation. The Company does not currently expect the adoption of SFAS No. 144 to have a material impact on its financial statements.

In April 2002, the FASB issued SFAS No. 145, which rescinds the previous guidance for debt extinguishments. This statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe applicability under changed conditions. SFAS No. 145 eliminates the requirement that gains and losses from extinguishment of debt be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. However, transactions would not be prohibited from extraordinary item classification if they meet the criteria in APB Opinion 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Applying the provisions of APB 30 will distinguish transactions that are part of an entity's recurring operations from those that are unusual or infrequent or that meet the criteria for classification as an extraordinary item. This statement is effective for the Company's fiscal year beginning January 1, 2003. The Company does not expect the adoption of SFAS No. 145 to have a material impact on its financial statements.

In July 2002, the FASB issued SFAS No. 146. The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. This statement is to be applied prospectively to exit or disposal activities initiated after December 31, 2002.

2. Segment Information

The following table presents unaudited financial information by reportable segment (in millions).

	Forest Products	Real Estate	Corporate and Other	Consolidated Total
Net sales for the three months ended:				
September 30, 2002	\$ 51.8	\$ 2.2	\$ —	\$ 54.0
September 30, 2001	44.8	2.2	—	47.0
Operating income (loss) for the three months ended:				
September 30, 2002	5.7	0.8	(0.1)	6.4
September 30, 2001	(1.9)	0.7	—	(1.2)
Other income (expense), net for the three months ended:				
September 30, 2002	(13.6)	(2.4)	3.6	(12.4)
September 30, 2001	(13.0)	(2.4)	26.0	10.6
Net sales for the nine months ended:				
September 30, 2002	154.0	6.5	—	160.5
September 30, 2001	142.8	2.3	—	145.1
Operating income (loss) for the nine months ended:				
September 30, 2002	15.3	2.4	(0.5)	17.2
September 30, 2001	(5.4)	0.8	(0.2)	(4.8)
Other income (expense), net for the nine months ended:				
September 30, 2002	(38.1)	(7.1)	9.8	(35.4)
September 30, 2001	(36.3)	(2.5)	50.9	12.1
Total assets as of:				
September 30, 2002	547.8	129.4	215.6	892.8
December 31, 2001	610.8	133.7	242.9	987.4

The column entitled "Corporate and Other" includes the results of the parent company and the investment in Kaiser, and also serves to reconcile the total of the reportable segments' amounts to the total in the Company's consolidated financial statements.

Special Items

In connection with the operational changes described in Note 1, the Company identified machinery and equipment that it no longer needed for its current or future operations and in 2001 committed to a plan for disposal of these assets during 2002. During the third quarter of 2002, machinery and equipment with a carrying value of \$1.2 million was sold, resulting in a loss of \$0.4 million. During the nine months ended September 30, 2002, machinery and equipment with a carrying value of \$2.2 million was sold, resulting in a gain of \$1.0 million.

A \$2.6 million restructuring charge was recorded in the fourth quarter of 2001 reflecting cash termination benefits associated with the separation of approximately 305 employees as part of an involuntary termination plan. As of June 30, 2002, all of the affected employees had left the Company, and the entire amount of the related liability had been paid.

3. Cash, Marketable Securities and Other Investments

Restricted Cash, Marketable Securities and Other Investments

Cash, marketable securities and other investments include the following amounts which are restricted (in millions):

	September 30, 2002	December 31, 2001
Current assets:		
Restricted cash and cash equivalents	\$ 0.1	\$ 35.4
Marketable securities, restricted:		
Amounts held in SAR Account	19.3	17.1
Long-term restricted cash, marketable securities and other investments:		
Amounts held in SAR Account	102.9	137.8
Other amounts restricted under the Timber Notes Indenture	2.6	2.8
Other long-term restricted cash	2.3	2.2
Less: Amounts attributable to Timber Notes held in SAR Account	(50.4)	(53.0)
	<u>57.4</u>	<u>89.8</u>
Total restricted cash, marketable securities and other investments	<u>\$ 76.8</u>	<u>\$ 142.3</u>

On March 5, 2002, Scotia LLC notified the trustee for the Timber Notes that it had met all of the requirements of the SAR Reduction Date, as defined in the Timber Notes Indenture (e.g., certain harvest, THP inventory and Scotia LLC Line of Credit requirements). Accordingly, on March 20, 2002, Scotia LLC released \$29.4 million from the SAR Account and distributed this amount to Pacific Lumber.

Other Investments

Cash, marketable securities and other investments include interests in several limited partnerships which invest in diversified portfolios of common stocks and other equity securities. These investments are not consolidated, but are accounted for under the equity method. The following table shows the Company's investment in these partnerships, including restricted amounts held in the SAR Account (in millions).

	September 30, 2002	December 31, 2001
Restricted	\$ 13.7	\$ 15.7
Unrestricted	9.7	36.5
	<u>\$ 23.4</u>	<u>\$ 52.2</u>

4. Inventories

Inventories consist of the following (in millions):

	September 30, 2002	December 31, 2001
Lumber	\$ 24.2	\$ 29.3
Logs	9.9	22.1
	<u>\$ 34.1</u>	<u>\$ 51.4</u>

Substantially all product inventories are stated at last-in, first-out (LIFO) cost, not in excess of market.

5. Investment in Kaiser

As of November 8, 2002, the Company has 27,938,250 shares of the common stock of Kaiser, of which 18,333,939 shares are pledged as collateral for the MGHI Notes. Kaiser operates in several principal aspects of the aluminum industry—the mining of bauxite into alumina, (the major aluminum-bearing ore), the refining of bauxite into alumina (the intermediate material), the production of primary aluminum and the manufacture of fabricated and semi-fabricated aluminum products. Kaiser’s common stock is publicly traded on the OTC Bulletin Board under the trading symbol “KLUCQ.”

On February 12, 2002, Kaiser filed a voluntary petition for reorganization under Chapter 11 of the Code. The necessity for filing the Cases was attributable to the liquidity and cash flow problems of Kaiser arising in late 2001 and early 2002. Kaiser was facing significant near-term debt maturities at a time of unusually weak aluminum industry business conditions, depressed aluminum prices and a broad economic slowdown that was further exacerbated by the events of September 11, 2001. In addition, Kaiser had become increasingly burdened by the asbestos litigation and growing legacy obligations for retiree medical and pension costs. The confluence of these factors created the prospect of continuing operating losses and negative cash flow, resulting in lower credit ratings and an inability to access the capital markets.

For 2001 and prior years, the Company accounted for its investment in Kaiser using the equity method. As a result of the Cases, the Company began reporting its investment in Kaiser under the cost method with no further recognition of equity in earnings or losses until such time as the shares are disposed of or a plan of reorganization is implemented. No assurances can be given that the Company’s ownership interest in Kaiser will not be significantly diluted or cancelled. When and if Kaiser emerges from the jurisdiction of the Court, the subsequent accounting will be determined based upon the facts and circumstances at the time, including the terms of any plan of reorganization.

On April 12, 2002, Kaiser filed with the Court a motion seeking an order of the Court prohibiting the Company (or MAXXAM), without first seeking Court relief, from making any disposition of its stock of Kaiser, including any sale, transfer, or exchange of such stock or treating any of its Kaiser stock as worthless for federal income tax purposes. Kaiser indicated in its Court filing that it was concerned that such a transaction could have the effect of depriving Kaiser of the ability to utilize the full value of its net operating losses, foreign tax credits and minimum tax credits. On July 22, 2002, the Company agreed with Kaiser that it would not dispose of any of its Kaiser shares prior to a hearing on the April 12, 2002 motion. The Company and Kaiser also agreed that the Company may upon 10 days written notice to Kaiser (a) request the Court to hear the matter at a special hearing or (b) have the matter heard at one of Kaiser’s scheduled monthly bankruptcy hearings.

The market value for the Kaiser Shares based on the price per share quoted at the close of business on November 8, 2002, was \$1.7 million. There can be no assurance that such value would be realized should the Company dispose of the Kaiser Shares. The following tables contain summarized financial information for Kaiser (in millions).

	<u>September 30, 2002</u>	<u>December 31, 2001</u>
Current assets	\$ 594.3	\$ 759.2
Property, plant and equipment, net	1,160.7	1,215.4
Other assets	746.6	769.1
Total assets	<u>\$ 2,501.6</u>	<u>\$ 2,743.7</u>
Liabilities not subject to compromise:		
Current liabilities	\$ 323.4	\$ 803.4
Long-term debt, less current maturities	42.8	700.8
Other liabilities	94.9	1,562.1
Liabilities subject to compromise	2,592.2	—
Minority interests	119.9	118.5
Stockholders’ deficit	(671.6)	(441.1)
Total liabilities and stockholders’ deficit	<u>\$ 2,501.6</u>	<u>\$ 2,743.7</u>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Net sales	\$ 348.0	\$ 430.3	\$ 1,104.9	\$ 1,357.4
Costs and expenses	(413.7)	(466.4)	(1,244.0)	(1,205.7)
Other expenses - net	(12.1)	152.7	(41.7)	53.3
Income (loss) before income taxes and minority interests	(77.8)	116.6	(180.8)	205.0
Benefit (provision) for income taxes	(7.0)	(49.4)	(21.4)	(83.9)
Minority interests	1.4	1.2	4.3	2.8
Net income (loss)	<u>\$ (83.4)</u>	<u>\$ 68.4</u>	<u>\$ (197.9)</u>	<u>\$ 123.9</u>
Equity in earnings (loss) of Kaiser	<u>\$ —</u>	<u>\$ 23.7</u>	<u>\$ —</u>	<u>\$ 43.3</u>

6. Debt

Long-term and short-term debt consists of the following (in millions):

	September 30, 2002	December 31, 2001
12% MGHI Notes due August 1, 2003	\$ 43.2	\$ 88.2
Pacific Lumber Credit Agreement	—	17.7
6.55% Scotia LLC Timber Notes due July 20, 2028	103.2	120.3
7.11% Scotia LLC Timber Notes due July 20, 2028	243.2	243.2
7.71% Scotia LLC Timber Notes due July 20, 2028	463.3	463.3
7.56% Lakepointe Notes due June 8, 2021	120.1	121.7
Scotia LLC Line of Credit	5.5	—
Other	0.9	1.5
	<u>979.4</u>	<u>1,055.9</u>
Less: current maturities	(68.1)	(35.5)
Timber Notes held in SAR Account	(55.4)	(57.7)
	<u>\$ 855.9</u>	<u>\$ 962.7</u>

The amount attributable to the Timber Notes held in the SAR Account of \$50.4 million as of September 30, 2002, reflected in Note 3 above represents the amount paid to acquire \$55.4 million of principal amount of Timber Notes.

During the nine months ended September 30, 2002, the Company repurchased \$45.0 million principal amount of the MGHI Notes, resulting in an extraordinary gain of \$2.3 million (net of tax). Subsequent to September 30, 2002, the Company repurchased \$11.6 million principal amount of the MGHI Notes resulting in a small gain.

With respect to the MAXXAM Note which is pledged to secure the MGHI Notes, the Company expects MAXXAM to pay the amount of the MAXXAM Note necessary to retire the MGHI Notes.

At September 30, 2002, \$14.0 million of letters of credit and no borrowings were outstanding under the Pacific Lumber Credit Agreement. Unused availability was limited to \$18.0 million at September 30, 2002. On July 24, 2002, a letter agreement was signed extending the maturity date of the Pacific Lumber Credit Agreement from August 14, 2003, to August 13, 2004. In connection with such extension, the facility commitment amount was reduced from \$50.0 million to \$45.0 million. On October 28, 2002, a new credit agreement was entered into which incorporated these changes and allowed for syndication of the facility.

The Scotia LLC Line of Credit allows Scotia LLC to borrow up to one year's interest on the Timber Notes. On May 31, 2002, the Scotia LLC Line of Credit was extended for an additional year to July 11, 2003. Annually, Scotia LLC will request that the Scotia LLC Line of Credit be extended for a period of not less than 364 days. If not extended, Scotia LLC may draw upon the full amount available. The amount drawn would be repayable in 12 semiannual installments on each note payment date (after the payment of certain other items, including the Aggregate Minimum Principal Amortization Amount, as defined, then due), commencing approximately two and one-half years following the date of the draw. On the note payment date in July 2002, Scotia LLC borrowed \$13.9 million under the Scotia LLC Line of Credit to pay interest on the Timber Notes. At September 30, 2002, Scotia LLC could have borrowed a maximum of \$54.3 million under the Scotia LLC Line of Credit, and there was \$5.5 million outstanding under the Scotia LLC Line of Credit.

7. Contingencies

Regulatory and environmental matters play a significant role in the Company's forest products business, which is subject to a variety of California and federal laws and regulations, as well as the HCP and SYP, dealing with timber harvesting practices, threatened and endangered species and habitat for such species, and air and water quality.

The SYP complies with regulations of the California Board of Forestry and Fire Protection requiring timber companies to project timber growth and harvest on their timberlands over a 100-year planning period and to demonstrate that their projected average annual harvest for any decade within a 100-year planning period will not exceed the average annual harvest level during the last decade of the 100-year planning period. The SYP is effective for 10 years (subject to review after five years) and may be amended by Pacific Lumber, subject to approval by the CDF. Revised SYPs will be prepared every decade that address the harvest level based upon assessment of changes in the resource base and other factors. The HCP and the Permits related to the HCP allow incidental "take" of certain species located on the Company's timberlands which species have been listed as endangered or threatened under the ESA and/or the CESA so long as there is no "jeopardy" to the continued existence of such species. The HCP identifies the measures to be instituted in order to minimize and mitigate the anticipated level of take to the greatest extent practicable. The SYP is also subject to certain of these provisions. The HCP and related Permits have a term of 50 years.

Since the consummation of the Headwaters Agreement in March 1999, there has been a significant amount of work required in connection with the implementation of the Environmental Plans, and this work is expected to continue for several more years. Nevertheless, the rate of approvals of THPs during 2001 improved over that for the prior year, and further improvements had been experienced in 2002 prior to the recent developments in the *EPIC-SYP/Permits lawsuit* described below. Despite the improvements in the THP approval process, other factors such as actions by the North Coast Water Board and pending litigation discussed below may adversely impact the Company's ability to meet its harvesting goals.

In late May 2002, the Company completed its timber cruise, its first since 1986. The results of the timber cruise provided the Company with an estimate of the volume of merchantable timber on the Company's timberlands. The new cruise data reflected a 0.1 million MBF decrease in estimated overall timber volume as compared to the estimated volumes reported as of December 31, 2001 using the 1986 cruise data (adjusted for harvest and estimated growth), with an increase in young growth timber volume almost equal to the decrease in old growth timber volume. This shift in timber volume between classifications decreased the overall timber volume reported in Mbfe by 0.2 million to 2.9 million. The new cruise data indicates that there is significantly less old growth timber available for harvest than estimated as of December 31, 2001, using the 1986 cruise data. This change in mix could potentially result in a decrease in the Company's revenues. However, because there are many variables that affect revenues and profitability, the Company cannot quantify the effect of the above changes on current and future cash flows. The new timber volumes are now being utilized in various aspects of the Company's operations, including estimating volumes on THPs and determining depletion expense.

Under the CWA, the EPA is required to establish TMDLs in water courses that have been declared to be "water quality impaired." The EPA and the North Coast Water Board are in the process of establishing TMDLs for 17 northern California rivers and certain of their tributaries, including nine water courses that flow within the Company's timberlands. The Company expects this process to continue into 2010. In December 1999, the EPA issued a report dealing with TMDLs on two of the nine water courses. The agency indicated that the requirements under the HCP would significantly address the sediment issues that resulted in TMDL requirements for these two water courses. The North Coast Water Board has begun the process of establishing the TMDL requirements applicable to two other water courses on the Company's timberlands. The North Coast Water Board has targeted the fall of 2003 as the completion date of the TMDL process for these four water courses. The final TMDL requirements applicable to the Company's timberlands may require aquatic protection measures that are different from or in addition to those in the HCP or that result from the prescriptions to be developed pursuant to the watershed analysis process provided for in the HCP.

Effective January 1, 2003, a California statute eliminates a waiver previously granted to, among others, timber companies. This waiver had been in effect for a number of years and waived the requirement under California water quality regulations for timber companies to follow certain waste discharge requirements in connection with their timber harvesting and related operations. The new statute provides, however, that regional water boards such as the North Coast Water Board are authorized to renew the waiver. If a regional water board decides not to renew the waiver by January 1, 2003, it may notify a company that the board will require such company to follow certain waste discharge requirements in order to conduct harvesting operations on a THP. The waste discharge requirements may include aquatic protection

measures that are different from or in addition to those provided for in the THP approved by the CDF. Harvesting activities could be delayed and/or adversely affected, as a separate, additional regulatory process would be required for harvesting under THPs.

In August 2002, the North Coast Water Board issued the Company an order requiring reports of waste discharge in connection with the Company's winter operations in the Elk River basin to be conducted under THPs approved by CDF. This order currently impacts an estimated 18,000 Mbfe of timber covered by a number of THPs. This order prohibits sediment discharges caused by Company operations during the winter period in the watershed until the reports are submitted by the Company and a determination is made by the North Coast Water Board regarding what, if any, waste discharge requirements are to be imposed. The Company submitted a report of waste discharge, and on November 7, 2002, the North Coast Water Board approved waste discharge requirements that the Company believes will allow it to operate within this basin during the winter months.

Lawsuits are pending and threatened which seek to prevent the Company from implementing the HCP and/or the SYP, implementing certain of the Company's approved THPs, or carrying out certain other operations.

On January 28, 1997, the *ERF lawsuit* was filed against Pacific Lumber. This action alleges that Pacific Lumber has discharged pollutants into federal waterways, and seeks to enjoin these activities, remediation, civil penalties of up to \$25,000 per day for each violation, and other damages. On June 5, 2002, the Company settled this lawsuit for \$0.5 million.

On December 2, 1997, the *Wrigley lawsuit* was filed. This action alleges, among other things, that the defendants' logging practices have contributed to an increase in flooding and damage to domestic water systems in a portion of the Elk River watershed. On September 20, 2002, an agreement was reached to settle this litigation, and the parties are proceeding to implement that agreement.

On March 31, 1999, the *EPIC-SYP/Permits lawsuit* was filed alleging, among other things, various violations of the CESA and the California Environmental Quality Act, and challenging, among other things, the validity and legality of the SYP and the Permits issued by California. On March 31, 1999, the lawsuit *USWA lawsuit* was filed also challenging the validity and legality of the SYP. The trial judge has issued a stay of the effectiveness of the Permits but has not issued an injunction against harvesting on the Company's lands under THPs that were previously approved consistently with the Permits. The stay does, however, prevent CDF from approving certain new THPs that rely upon the Permits, and unless the stay can be vacated or amended, as the Company has requested, it could force the Company to modify its pending THPs in accordance with alternative Board of Forestry rules that do not depend upon an approved SYP. This procedure could cause reductions in 2003 harvest levels and could have an adverse impact on the Company. A trial date is set for January 20, 2003. The judge has indicated that he expects to rule on this matter no earlier than July 2003. The Company believes that appropriate procedures were followed throughout the public review and approval process concerning the HCP and the SYP, the Company is working with the relevant government agencies to defend these challenges, and does not believe the resolution of these matters should result in a material adverse effect on its financial condition, results of operations or the ability to harvest timber. However, in addition to the potential short-term adverse impacts described above, these matters could have a long-term negative impact if they are decided adversely to the Company.

On July 24, 2001, the *Bear Creek lawsuit* was filed. The lawsuit alleges that Pacific Lumber's harvesting and other activities under certain of its approved and proposed THPs will result in discharges of pollutants in violation of the CWA. The plaintiff asserts that the CWA requires the defendants to obtain a permit from the North Coast Water Board before beginning timber harvesting and road construction activities in the Bear Creek watershed, and is seeking to enjoin these activities until such permit has been obtained. The plaintiff also seeks civil penalties of up to \$27,000 per day for the defendant's alleged continued violation of the CWA. The EPA has been joined as a defendant in this case. The Company believes that the requirements under the HCP are adequate to ensure that sediment and pollutants from its harvesting activities will not reach levels harmful to the environment. Furthermore, EPA regulations specifically provide that such activities are not subject to CWA permitting requirements. The Company believes that it has strong legal defenses in this matter; however, there can be no assurance that this lawsuit will not have a material adverse effect on its consolidated financial condition or results of operations.

On April 3, 2002, the Environmental Protection Information Association filed a 60-day notice letter threatening suit against the Company and certain federal agencies under the ESA. The threatened suit would seek to require the federal agencies to consider new information obtained since the approval of the HCP concerning marbled murrelets and

salmon and to require a cessation of certain harvesting operations. No suit has yet been filed. The Company believes that it has strong factual and legal defenses with respect to this matter; however, there can be no assurance that such a suit would not have a material adverse effect on the Company's financial position, results of operations, or liquidity.

While the Company expects environmentally focused objections and lawsuits to continue, it believes that the HCP, the SYP and the Permits should enhance its position in connection with these continuing challenges and, over time, reduce or minimize such challenges.

8. Pension Plan Matters

The assets of the Pacific Lumber-sponsored pension plan, like numerous other companies' plans, are, to a substantial degree, invested in equity trust funds which are managed by a third party. Given the year-to-date performance of the capital markets, it is likely that, barring a material improvement during the remainder of 2002, the Company may be required to reflect an increase in its minimum pension liability in its year-end financial statements as a result of a decline in the value of the assets held by Pacific Lumber's pension plan. Such an increase in the minimum pension liability would be a non-cash adjustment that would be reflected as an increase in pension liability with an offsetting charge to stockholders' deficit (net of income tax) through comprehensive income (rather than net income). The ultimate amount of such additional adjustment cannot be determined until year-end 2002. However, such amount could be material.

9. Other Significant Events

In August 2002, Motel Assets entered into an agreement to acquire for approximately \$53.0 million an interest in a trust which owns a portfolio of sixteen motel properties located in ten different states. Under the agreement, Motel Assets would make a cash payment of \$3.0 million and assume the outstanding principal balance of approximately \$50.0 million on the Motel Notes at the expected closing date in November 2002. The Motel Notes have an interest rate of 7.03% with a May 1, 2018, maturity date. Motel Assets would acquire the properties subject to an existing lease agreement with the current tenant, under which the properties are fully leased through April 2019, and under which all obligations are guaranteed by the parent company of the current tenant. Motel Assets expects to account for the lease as an operating lease. The Motel Notes are secured by the lease, the properties, and an \$11.2 million residual value insurance contract.

In August 2002, Beltway Assets entered into an agreement to acquire an office building located in Houston, Texas, for a purchase price of approximately \$32.0 million. The transaction would be financed with a cash payment of \$2.0 million and proceeds of approximately \$30.0 million from the issuance of the Beltway Notes. At the time of the acquisition, Beltway Assets would simultaneously lease the property back to the seller for a period of 22 years. Beltway Assets expects to account for the lease as an operating lease. The Beltway Notes would be secured by the building, the lease, and an \$11.2 million residual value insurance contract.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following should be read in conjunction with the financial statements in Part I, Item 1 of this Report and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8. "Financial Statements and Supplementary Data" of the Form 10-K. Any capitalized terms used but not defined in this Item are defined in the "Glossary of Defined Terms" contained in Appendix A. Except as otherwise noted, all references to notes represent the Notes to the Condensed Consolidated Financial Statements included in Item 1.

This Quarterly Report on Form 10-Q contains statements which constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements appear in a number of places in this section and in Part II. Item 1. "Legal Proceedings." Such statements can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "estimates," "will," "should," "plans" or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy. Readers are cautioned that any such forward-looking statements are not guarantees of future performance and involve significant risks and uncertainties, and that actual results may vary materially from the forward-looking statements as a result of various factors. These factors include the effectiveness of management's strategies and decisions, general economic and business conditions, developments in technology, new or modified statutory or regulatory requirements, and changing prices and market conditions. This Form 10-Q and the Form 10-K identify other factors that could cause such differences between the forward-looking statements and actual results. No assurance can be given that these are all of the factors that could cause actual results to vary materially from the forward-looking statements.

Results of Operations

This section contains statements which constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. See above for cautionary information with respect to such forward-looking statements.

The Company's wholly owned subsidiary, MGI, and its operating subsidiaries, Pacific Lumber and Britt, are engaged primarily in forest products operations. In addition, the Company added real estate operations to its business with the June 2001 acquisition of Lake Pointe Plaza, an office complex located in Sugar Land, Texas. The Company's forest products business is somewhat seasonal, and its net sales have been historically higher in the months of April through November than in the months of December through March. Management expects that this segment's revenues and cash flows will continue to be somewhat seasonal. Accordingly, the segment's results for any one quarter are not necessarily indicative of results to be expected for the full year. Real estate operations do not have any seasonality elements impacting the quarterly results.

Regulatory and environmental matters play a significant role in the Company's forest products operations. See Item 1. "Business—Forest Products Operations—Regulatory and Environmental Factors" of the Form 10-K and Note 7 to the Condensed Consolidated Financial Statements for a discussion of these matters. Regulatory compliance and related litigation have caused delays in obtaining approvals of THPs and delays in harvesting on THPs once they are approved. This has resulted in a decline in harvest, an increase in the cost of logging operations, and lower net sales.

Since the consummation of the Headwaters Agreement in March 1999, there has been a significant amount of work required in connection with the implementation of the Environmental Plans, and this work is expected to continue for several more years. The rate of approvals of THPs during 2001 improved over that for the prior year, and further improvements have been experienced thus far in 2002. As discussed in Note 7 to the Condensed Consolidated Financial Statements, other factors may adversely impact the Company's abilities to meet its harvesting goals. The North Coast Water Board is requiring the Company to apply certain waste discharge requirements to approved THPs covering winter harvesting operations in the Elk River basin, and beginning in 2003 the North Coast Water Board could require the Company to follow waste discharge requirements before harvesting operations are conducted on THPs in other watersheds. This requirement could cause further delays in harvesting. A stay issued in connection with the *EPIC-SYP/Permits lawsuit* could require the Company to follow an alternative THP approval process, resulting in delays in obtaining approvals of THPs which have already been submitted or are currently being prepared.

Furthermore, there can be no assurance that certain other pending legal, regulatory and environmental matters or future governmental regulations, legislation or judicial or administrative decisions, adverse weather conditions or low SBE prices, will not have a material adverse effect on the Company's financial position, results of operations or liquidity.

See Part II, Item 1. "Legal Proceedings" and Note 7 to the Condensed Consolidated Financial Statements for further information regarding regulatory and legal proceedings affecting the Company's operations.

During 2001, comprehensive external and internal reviews were conducted of Pacific Lumber's business operations. These reviews were conducted in an effort to identify ways in which Pacific Lumber could operate on a more efficient and cost effective basis. Based upon the results of these reviews, Pacific Lumber, among other things, closed two of its four sawmills, eliminated certain of its operations, including its soil amendment and concrete block activities, began utilizing more efficient harvesting methods and adopted certain other cost saving measures. Most of these changes were implemented by Pacific Lumber in the last quarter of 2001, or the first quarter of 2002. Pacific Lumber also ended its internal logging operations (which historically performed approximately half of its logging) as of March 31, 2002, and now relies exclusively on contract loggers to conduct these activities. Further actions may be taken during the next year as a result of Pacific Lumber's continuing its evaluation process, and additional writedowns of certain assets may be required.

Timber Cruise. In late May 2002, the Company completed its timber cruise, its first since 1986. The results of the timber cruise provided the Company with an estimate of the volume of merchantable timber on the Company's timberlands. The new cruise data reflected a 0.1 million MBF decrease in estimated overall timber volume as compared to the estimated volumes reported as of December 31, 2001 using the 1986 cruise data (adjusted for harvest and estimated growth), with an increase in young growth timber volume almost equal to the decrease in old growth timber volume. This shift in timber volume between classifications decreased the overall timber volume reported in Mbfe by 0.2 million to 2.9 million. The new cruise data indicates that there is significantly less old growth timber available for harvest than estimated as of December 31, 2001, using the 1986 cruise data. This change in mix could potentially result in a decrease in the Company's revenues. However, because there are many variables that affect revenues and profitability, the Company cannot quantify the effect of the above changes on current and future cash flows. The new timber volumes are now being utilized in various aspects of the Company's operations, including estimating volumes on THPs and determining depletion expense.

The Company owns 27,938,250 shares of Kaiser common stock, representing a 34.6% interest in Kaiser on a fully diluted basis as of September 30, 2002. For 2001 and prior years, the Company's investment in Kaiser was accounted for under the equity method. On February 12, 2002, Kaiser filed a voluntary petition for reorganization under Chapter 11 of the Code in the Court. As a result of such filing, the Company began reporting its investment in Kaiser under the cost method with no further recognition of equity in earnings or losses until such time as the shares are disposed of or a plan of reorganization is implemented. See Notes 1 and 5 of the Condensed Consolidated Notes to the Financial Statements for further information, including summarized financial information of Kaiser.

The following table presents selected operational and financial information for the three and nine months ended September 30, 2002 and 2001.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
(In millions of dollars, except shipments and prices)				
Shipments:				
Lumber: ⁽¹⁾				
Redwood upper grades	7.4	3.6	20.9	12.1
Redwood common grades	55.9	41.5	173.5	123.6
Douglas-fir upper grades	1.0	2.0	3.7	6.7
Douglas-fir common grades	7.3	11.4	12.9	44.2
Other	—	1.0	—	3.6
Total lumber	<u>71.6</u>	<u>59.5</u>	<u>211.0</u>	<u>190.2</u>
Wood chips ⁽²⁾	<u>19.2</u>	<u>29.6</u>	<u>51.7</u>	<u>90.2</u>
Average sales price:				
Lumber: ⁽³⁾				
Redwood upper grades	\$ 1,291	\$ 1,739	\$ 1,327	\$ 1,788
Redwood common grades	559	570	546	595
Douglas-fir upper grades	1,456	1,287	1,330	1,341
Douglas-fir common grades	336	357	336	343
Wood chips ⁽⁴⁾	34	64	34	67
Net sales:				
Lumber, net of discount	\$ 44.5	\$ 36.5	\$ 130.6	\$ 119.2
Logs	3.3	3.0	12.2	5.2
Wood chips	0.6	1.9	1.7	6.1
Cogeneration power	2.5	2.0	7.2	9.4
Other	0.9	1.4	2.3	2.9
Total forest products	<u>51.8</u>	<u>44.8</u>	<u>154.0</u>	<u>142.8</u>
Real estate	<u>2.2</u>	<u>2.2</u>	<u>6.5</u>	<u>2.3</u>
Total net sales	<u>\$ 54.0</u>	<u>\$ 47.0</u>	<u>\$ 160.5</u>	<u>\$ 145.1</u>
Operating income (loss)	<u>\$ 6.4</u>	<u>\$ (1.2)</u>	<u>\$ 17.2</u>	<u>\$ (4.8)</u>
Operating cash flow ⁽⁵⁾	<u>\$ 13.5</u>	<u>\$ 5.0</u>	<u>\$ 38.8</u>	<u>\$ 11.6</u>
Income (loss) before income taxes	<u>\$ (6.0)</u>	<u>\$ 9.4</u>	<u>\$ (18.2)</u>	<u>\$ 7.3</u>
Net income (loss) ⁽⁶⁾	<u>\$ (3.9)</u>	<u>\$ 12.6</u>	<u>\$ (9.1)</u>	<u>\$ 23.1</u>

⁽¹⁾ Lumber shipments are expressed in millions of board feet.

⁽²⁾ Wood chip shipments are expressed in thousands of bone dry units of 2,400 pounds.

⁽³⁾ Dollars per thousand board feet.

⁽⁴⁾ Dollars per bone dry unit.

⁽⁵⁾ Operating income before depletion and depreciation, also referred to as "EBITDA."

⁽⁶⁾ 2002 results for the three and nine month periods include an after-tax extraordinary gain of \$0.2 million and \$2.3 million, respectively, on the repurchase of MGHI Notes. 2001 results include after-tax extraordinary gains of \$3.6 million for the nine month period on the repurchase of MGHI Notes.

Net Sales

Net sales increased for the third quarter and first nine months of 2002 as compared to the third quarter and first nine months of 2001, primarily due to increased shipments of redwood common grade lumber. Net sales for the first nine months of 2002 also increased due to additional rental income from the Lake Pointe Plaza office complex acquired in June 2001. Growth in net sales was negatively impacted by a decline in shipments of Douglas-fir lumber and lower average sales prices for redwood lumber.

Operating Income (Loss)

Operating results improved for the three and nine month periods ended September 30, 2002, as compared to the same periods of 2001. The Company was able to increase shipments while lowering cost of sales and operations. The decline in operating expenses primarily reflects the benefits of cost saving measures taken in late 2001 and early 2002.

Selling, general and administrative expenses for the two periods increased, however, primarily as a result of an increase in administrative, litigation and other expenses.

Income (Loss) Before Income Taxes

The Company had losses before income taxes for the third quarter and first nine months of 2002 as compared to income before income taxes for the comparable prior year periods. The decline is primarily because during the 2002 periods, the Company recognized no earnings or losses with respect to its investment in Kaiser, whereas the third quarter and first nine months of 2001 included equity in earnings of Kaiser of \$23.7 million and \$43.3 million, respectively. The decline in income as a result of the decrease in earnings from Kaiser was offset in part by the improvement in operating income discussed above.

Financial Condition and Investing and Financing Activities

This section contains statements which constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. See above for cautionary information with respect to such forward-looking statements.

Note 8 to the Consolidated Financial Statements in the Form 10-K contains additional information concerning the Company’s indebtedness and information concerning certain restrictive debt covenants. “**MGHI Parent**” is used in this section to refer to the Company on a stand-alone basis without its subsidiaries.

The following table summarizes certain data related to financial condition and to investing and financing activities of the Company and its subsidiaries.

	Scotia LLC	Pacific Lumber	MGI and Other	MGHI Parent	Total
	(In millions of dollars)				
<u>Debt and credit facilities (excluding intercompany notes)</u>					
Short-term borrowings and current maturities of long-term debt:					
September 30, 2002	\$ 22.3	\$ 0.3 ⁽¹⁾	\$ 2.3	\$ 43.2 ⁽²⁾	\$ 68.1
December 31, 2001	14.9	17.8	2.8	—	35.5
Long-term debt, excluding current maturities:					
September 30, 2002	\$ 737.6 ⁽²⁾	\$ 0.4	\$ 117.9	\$ — ⁽²⁾	\$ 855.9
December 31, 2001	754.5	0.5	119.5	88.2	962.7
Revolving credit facilities:					
Facility commitment amounts	\$ 59.8	\$ 45.0	\$ 2.5	\$ —	\$ 107.3
September 30, 2002:					
Borrowings	5.5	—	—	—	5.5
Letters of credit	—	14.0	—	—	14.0
Unused and available credit	54.3	18.0	2.5	—	74.8
<u>Cash, cash equivalents, marketable securities and other investments</u>					
September 30, 2002:					
Current amounts restricted for debt service	\$ 19.3	\$ —	\$ 0.1	\$ —	\$ 19.4
Other current amounts	2.0	24.8	31.8	0.3	58.9
	<u>21.3</u>	<u>24.8</u>	<u>31.9</u>	<u>0.3</u>	<u>78.3</u>
Long-term amounts restricted for debt service	55.1	—	—	—	55.1
Other long-term restricted amounts	—	—	2.3	—	2.3
	<u>55.1</u>	<u>—</u>	<u>2.3</u>	<u>—</u>	<u>57.4</u>
	<u>\$ 76.4</u>	<u>\$ 24.8</u>	<u>\$ 34.2</u>	<u>\$ 0.3</u>	<u>\$ 135.7</u>

Table and Notes continued on next page

	Scotia LLC	Pacific Lumber	MGI and Other	MGHI Parent	Total
	(In millions of dollars)				
December 31, 2001:					
Current amounts restricted for debt service	\$ 52.4	\$ —	\$ 0.1	\$ —	\$ 52.5
Other current amounts	2.5	2.3	26.6	35.7	67.1
	<u>54.9</u>	<u>2.3</u>	<u>26.7</u>	<u>35.7</u>	<u>119.6</u>
Long-term amounts restricted for debt service	87.6	—	—	—	87.6
Other long-term restricted amounts	—	—	2.2	—	2.2
	<u>87.6</u>	<u>—</u>	<u>2.2</u>	<u>—</u>	<u>89.8</u>
	<u>\$ 142.5</u>	<u>\$ 2.3</u>	<u>\$ 28.9</u>	<u>\$ 35.7</u>	<u>\$ 209.4</u>

Changes in cash and cash equivalents

Capital expenditures:

September 30, 2002	\$ 4.9	\$ 3.8	\$ 0.3	\$ —	\$ 9.0
September 30, 2001	4.2	4.9	132.5 ⁽³⁾	—	141.6

Borrowings (repayments) of debt and credit facilities, net of financing costs:

September 30, 2002	\$ (9.4) ⁽²⁾	\$ (17.8)	\$ (2.2) ⁽³⁾	\$ (41.4) ⁽²⁾	\$ (70.8)
September 30, 2001	(14.2)	(19.2)	117.0	(25.1)	58.5

Dividends and advances received (paid):

September 30, 2002	\$ (29.4) ⁽¹⁾	\$ 29.4 ⁽¹⁾	\$ —	\$ —	\$ —
September 30, 2001	(77.4) ⁽⁴⁾	83.8 ⁽⁴⁾	(23.5)	17.1	—

(1) In March 2002, Scotia LLC released \$29.4 million from the SAR Account and distributed this amount to Pacific Lumber. Pacific Lumber used these funds to repay the borrowings outstanding under the Pacific Lumber Credit Agreement.

(2) The decrease in Scotia LLC's long-term debt between December 31, 2001, and September 30, 2002, was the result of principal payments on the Timber Notes of \$14.8 million during the nine months ended September 30, 2002. The decrease in MGHI Parent's long-term debt and increase in short-term debt was due to repurchases of \$45.0 million principal amount of MGHI Notes, and reclassification of \$43.2 million from long-term to short-term debt. Borrowings (repayments) of debt and credit facilities also includes \$5.5 million outstanding on the Scotia LLC Line of Credit as of September 30, 2002.

(3) Capital expenditures and borrowings for MGI, Lakepointe Assets and Other as of and for the period ended September 30, 2001, reflect the purchase of the Lake Pointe Plaza office complex.

(4) For the nine months ended September 30, 2001, \$77.4 million of dividends were paid by Scotia LLC to Pacific Lumber, \$63.9 million of which was made using proceeds from the sale of Scotia LLC's Owl Creek grove. In addition to the \$77.4 million of dividends from Scotia LLC, Pacific Lumber received \$6.4 million from MGI related to repayment of intercompany debt.

During the nine months ended September 30, 2002, the Company repurchased \$45.0 million principal amount of the MGHI Notes, resulting in an extraordinary gain of \$2.3 million (net of tax). Subsequent to September 30, 2002, the Company repurchased \$11.6 million principal amount of the MGHI Notes, resulting in a small gain. MAXXAM Parent expects to pay MGHI the amount of the Intercompany Note necessary to enable MGHI to satisfy its obligations under the MGHI Notes, which are due August 1, 2003.

MGHI owns 27,938,250 shares of the common stock of Kaiser, representing a 34.6% interest. As a result of the Cases, the value of Kaiser common stock has declined substantially. The market value of the Kaiser shares owned by MGHI based on the price per share quoted at the close of business on November 8, 2002, was \$1.7 million. It is possible that MGHI's interest may be diluted or cancelled as a part of a plan of reorganization.

At September 30, 2002, \$14.0 million of letters of credit and no borrowings were outstanding under the Pacific Lumber Credit Agreement. Unused availability was limited to \$18.0 million at September 30, 2002. On July 24, 2002, a letter agreement was signed extending the maturity date of the Pacific Lumber Credit Agreement from August 14, 2003, to August 13, 2004, subject to certain conditions such as completion of a new credit agreement. In connection with such extension, the facility commitment amount was reduced from \$50.0 million to \$45.0 million. On October 28, 2002, a new credit agreement was entered into which incorporated these changes and allowed for syndication of the facility.

The Scotia LLC Line of Credit allows Scotia LLC to borrow up to one year's interest on the Timber Notes. On May 31, 2002, the Scotia LLC Line of Credit was extended for an additional year to July 11, 2003. Annually, Scotia LLC will request that the Scotia LLC Line of Credit be extended for a period of not less than 364 days. If not extended, Scotia LLC may draw upon the full amount available. The amount drawn would be repayable in 12 semiannual

installments on each note payment date (after the payment of certain other items, including the Aggregate Minimum Principal Amortization Amount, as defined, then due), commencing approximately two and one-half years following the date of the draw. At September 30, 2002, Scotia LLC could have borrowed a maximum of \$54.3 million under the Scotia LLC Line of Credit, and there was \$5.5 million outstanding under the Scotia LLC Line of Credit.

On March 5, 2002, Scotia LLC notified the trustee for the Timber Notes that it had met all of the requirements of the SAR Reduction Date, as defined in the Timber Notes Indenture (e.g., certain harvest, THP inventory and Scotia LLC Line of Credit requirements). Accordingly, on March 20, 2002, Scotia LLC released \$29.4 million from the SAR Account and distributed this amount to Pacific Lumber.

On the note payment date in January 2002, Scotia LLC had \$33.9 million set aside in the note payment account to pay the \$28.4 million of interest due as well as \$5.5 million of principal. Scotia LLC repaid an additional \$6.1 million of principal on the Timber Notes using funds held in the SAR Account, resulting in a total principal payment of \$11.6 million, an amount equal to Scheduled Amortization (as defined in the Timber Notes Indenture).

On the note payment date in July 2002, Scotia LLC had \$15.1 million set aside in the note payment account and borrowed \$13.0 million (net of \$0.9 million for Timber Notes held by Scotia LLC) from the Scotia LLC Line of Credit to pay the \$28.1 million of interest due. Scotia LLC repaid \$3.2 million of principal on the Timber Notes (an amount equal to Scheduled Amortization) using funds held in the SAR Account.

MGHI Parent believes that its existing resources and payments on the MAXXAM Note will be sufficient to fund its debt service and working capital requirements for the next year. With respect to its long-term liquidity, MGHI Parent believes that its existing cash and cash resources, together with payments on the MAXXAM Note, should be sufficient to meet its debt service and working capital requirements, although there can be no assurance that this will be the case. MGHI Parent expects MAXXAM to pay the amount of the MAXXAM Note necessary to retire the MGHI Notes which are due in 2003. The regulatory and environmental matters described under “—Results of Operations” above have adversely affected cash available from subsidiaries, and in turn the amount of distributions to MGHI Parent. Distributions from subsidiaries may continue to be minimal, if any, over the next year.

Due to its highly leveraged condition, MGI is more sensitive than less leveraged companies to factors affecting its operations, including governmental regulation and litigation affecting its timber harvesting practices (see “—Results of Operations” above and Note 7 to the Condensed Consolidated Financial Statements), increased competition from other lumber producers or alternative building products and general economic conditions.

Pacific Lumber’s 2001 cash flows from operations were adversely affected by operating inefficiencies, lower lumber prices, an inadequate supply of logs and a related slowdown in lumber production. During 2001, comprehensive external and internal reviews were conducted of Pacific Lumber’s business operations. These reviews were conducted in an effort to identify ways in which Pacific Lumber could operate on a more efficient and cost effective basis. Based upon the results of these reviews, Pacific Lumber, among other things, closed two of its four sawmills, eliminated certain of its operations, including its soil amendment and concrete block activities, began utilizing more efficient harvesting methods and adopted certain other cost saving measures. Most of these changes were implemented by Pacific Lumber in the last quarter of 2001, or the first quarter of 2002. Pacific Lumber also ended its internal logging operations (which historically performed approximately half of its logging) as of March 31, 2002, and now relies exclusively on contract loggers to conduct these activities. Further actions may be taken during the next year as a result of Pacific Lumber’s continuing evaluation process, and additional writedowns of certain assets may be required.

The \$29.4 million release from the SAR Account discussed above improved Pacific Lumber’s liquidity during the nine months ended September 30, 2002. However, Pacific Lumber’s cash flows from operations may be adversely affected by the availability of logs. See “Results of Operations” above as well as Note 7 to the Condensed Consolidated Financial Statements for further discussion on the regulatory and environmental factors affecting harvest levels and the results of the timber cruise completed in 2002. Pacific Lumber may require funds available under the Pacific Lumber Credit Agreement and/or additional repayments by MGI of an intercompany loan in order to meet its working capital and capital expenditure requirements for the next year.

Scotia LLC’s cash flows from operations are significantly impacted by harvest volumes and SBE prices. On June 19, 2002, the State Board of Equalization adopted the new Harvest Value Schedule for the second half of 2002. The SBE Prices published in this schedule reflect an approximate 16% decline for small redwood logs and no price change for small Douglas fir logs. This decline in SBE Prices will continue to have an adverse impact on Scotia LLC’s net sales

and liquidity during the fourth quarter of 2002. With respect to the note payment due in January 2003, Scotia LLC expects that it will require funds from the Scotia LLC Line of Credit to pay a portion of the interest due, and that all of the funds used to pay the Scheduled Amortization amount will be provided from the SAR Account. With respect to short-term liquidity, Scotia LLC believes that existing cash available for principal payments from the SAR Account, and funds available under the Scotia LLC Line of Credit, together with cash flows from operations, should provide sufficient funds to meet its working capital, capital expenditures and required debt service obligations through 2003. However, cash flows from operations and funds available under the Scotia LLC Line of Credit may be insufficient to allow Scotia LLC to fulfill its interest and certain other payment obligations in the long-term if SBE Prices do not improve. In addition, cash flows from operations may continue to be adversely affected if harvest levels decline as a result of the factors discussed in “—Results of Operations” above and Note 7 to the Condensed Consolidated Financial Statements.

With respect to long-term liquidity, although MGI and its subsidiaries expect that their existing cash and cash equivalents, lines of credit and ability to generate cash flows from operations should provide sufficient funds to meet their debt service, working capital and capital expenditure requirements, until such time as Pacific Lumber has adequate cash flows from operations and/or dividends from Scotia LLC and SBE Prices improve, there can be no assurance that this will be the case. Cash flows from operations in the long-term may continue to be adversely affected by the same factors discussed above which are affecting short-term cash flows from operations.

In August 2002, Motel Assets entered into an agreement to acquire for approximately \$53.0 million an interest in a trust which owns a portfolio of sixteen motel properties located in ten different states. Under the agreement, Motel Assets would make a cash payment of \$3.0 million and assume the outstanding principal balance of approximately \$50.0 million on the Motel Notes at the expected closing date in November 2002. The Motel Notes have an interest rate of 7.03% with a May 1, 2018, maturity date. Motel Assets would acquire the properties subject to an existing lease agreement with the current tenant, under which the properties are fully leased through April 2019, and under which all obligations are guaranteed by the parent company of the current tenant. Motel Assets expects to account for the lease as an operating lease. The Motel Notes are secured by the lease, the properties, and an \$11.2 million residual value insurance contract.

In August 2002, Beltway Assets entered into an agreement to acquire an office building located in Houston, Texas, for a purchase price of approximately \$32.0 million. The transaction would be financed with a cash payment of \$2.0 million and proceeds of approximately \$30.0 million from the issuance of the Beltway Notes. At the time of the acquisition, Beltway Assets would simultaneously lease the property back to the seller for a period of 22 years. Beltway Assets expects to account for the lease as an operating lease. The Beltway Notes would be secured by the building, the lease, and an \$11.2 million residual value insurance contract.

Critical Accounting Policies

In the second quarter of 2002, the Company completed its timber cruise which resulted in new and updated timber volume information (see also Note 7 to the Condensed Consolidated Financial Statements). Accordingly, the Company revised its estimated depletion rates beginning April 1, 2002. There was relatively no impact on depletion expense for the nine months ended September 30, 2002, as a result of using the updated timber volume information.

See Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies” of the Form 10-K for additional discussion of the Company’s critical accounting policies.

New Accounting Pronouncements

See Note 1 to the Condensed Consolidated Financial Statements for a discussion of new accounting pronouncements and their potential impact on the Company.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

This item is not applicable for the Company and its subsidiaries.

ITEM 4. DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, the Company has investments in certain unconsolidated entities. As the Company does not control or manage these entities, its disclosure controls and procedures with respect to such entities are necessarily substantially more limited than those it maintains with respect to its consolidated subsidiaries.

Within 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect the internal controls subsequent to the date the Company completed its evaluation.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth in Note 7 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q is incorporated herein by reference.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a. Exhibits:

4.1 Credit Agreement dated October 28, 2002 among Pacific Lumber, Bank of America, N.A., as Administrative Agent and L/C Issuer, and the Lenders from time to time party thereto

b. Reports on Form 8-K:

On August 13, 2002, the Company filed a current report on Form 8-K dated August 13, 2002, related to the Certification of the Chief Executive and Chief Financial Officers pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

On October 4, 2002, the Company filed a current report on Form 8-K dated October 1, 2002, related to the *EPIC-SYP/Permits lawsuit*.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, who have signed this report on behalf of the Registrant and as the principal financial and accounting officers of the Registrant, respectively.

MAXXAM GROUP HOLDINGS INC.

Date: November 13, 2002

By: /S/ PAUL N. SCHWARTZ
Paul N. Schwartz
Vice President, Chief Financial Officer and Director
(Principal Financial Officer)

Date: November 13, 2002

By: /S/ ELIZABETH D. BRUMLEY
Elizabeth D. Brumley
Controller
(Principal Accounting Officer)

CERTIFICATIONS

I, Charles E. Hurwitz, certify that:

1. I have reviewed this quarterly report on Form 10-Q of MAXXAM Group Holdings Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

By: /S/ CHARLES E. HURWITZ

Charles E. Hurwitz
Chairman of the Board, President and
Chief Executive Officer

I, Paul N. Schwartz, certify that:

1. I have reviewed this quarterly report on Form 10-Q of MAXXAM Group Holdings Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

By: /S/ PAUL N. SCHWARTZ
Paul N. Schwartz
Vice President, Chief Financial Officer and Director
(Principal Financial Officer)

Glossary of Defined Terms

Bear Creek lawsuit: An action entitled *Environmental Protection Information Association v. Pacific Lumber, Scotia Pacific Company LLC* (No. C01-2821), filed July 24, 2001, in the U.S. District Court in the Northern District of California

Beltway Assets: Beltway Assets LLC, a limited liability company, which is an indirect wholly owned subsidiary of the Company

Beltway Notes: Beltway Assets' 6.31% notes due in November, 2024

Britt: Britt Lumber Co., Inc., a wholly owned subsidiary of MGI

Cases: The Chapter 11 proceedings of Kaiser, KACC and 15 of KACC's subsidiaries

CDF: California Department of Forestry and Fire Protection

CESA: California Endangered Species Act

Code: The United States Bankruptcy Code

Company: MAXXAM Group Holdings Inc., a wholly owned subsidiary of MAXXAM

Court: The United States Bankruptcy Court for the District of Delaware

CWA: Federal Clean Water Act

Environmental Plans: The HCP and the SYP

EPA: Environmental Protection Agency

EPIC-SYP/Permits lawsuit: An action entitled *Environmental Protection Information Association, Sierra Club v. California Department of Forestry and Fire Protection, California Department of Fish and Game, The Pacific Lumber Company, Scotia Pacific Company LLC, Salmon Creek Corporation, et al.* (No. 99CS00639) filed March 31, 1999 in the Superior Court of Sacramento County (Order Granting Change of Venue was filed on May 27, 1999, and assigned Case No. CV990452 in Humboldt County Superior Court)

ERF lawsuit: An action entitled *Ecological Rights Foundation, Mateel Environmental v. Pacific Lumber* (No. 97-0292) which was filed in the U.S. District Court in the Northern District of California on January 28, 1997

ESA: The federal Endangered Species Act

FASB: Financial Accounting Standards Board

Form 10-K: The Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission for the fiscal year ended December 31, 2001

Harvest Value Schedule: A schedule setting forth the SBE Prices published bi-annually by the California Board of Equalization for purposes of computing yield taxes on timber sales

HCP: The habitat conservation plan covering multiple species approved on March 1, 1999, in connection with the consummation of the Headwaters Agreement

Headwaters Agreement: The September 28, 1996, agreement between Pacific Lumber, Scotia LLC, Salmon Creek Corporation, the United States and California which provided the framework for the acquisition by the United States and California of the Headwaters Timberlands

Headwaters Timberlands: Approximately 5,600 acres of Pacific Lumber timberlands consisting of two forest groves commonly referred to as the Headwaters Forest and the Elk Head Springs Forest which were sold to the United States and California on March 1, 1999

Kaiser: Kaiser Aluminum Corporation, an equity investee of the Company engaged in aluminum operations

Kaiser Shares: 27,938,250 shares of the common stock of Kaiser, of which 20,553,418 shares are pledged as collateral for the MGHI Notes as of the date hereof

Lakepointe Assets: Lakepointe Assets Holdings LLC, a limited liability company, and its subsidiaries, all of which are indirect wholly owned subsidiaries of the Company

Lakepointe Notes: Lakepointe Assets' 7.56% notes due June 8, 2021

MAXXAM: MAXXAM Inc.

MAXXAM Note: Intercompany note issued by MAXXAM to the Company for an initial principal amount of \$125.0 million

MBF: One thousand board feet

Mbfe: A concept developed for use in structuring the Timber Notes; under this concept one thousand board feet, net Scribner scale, of residual old growth redwood timber equates to one Mbfe

MGHI Notes: The Company's 12% Senior Secured Notes due August 1, 2003

MGI: MAXXAM Group Inc., a wholly owned subsidiary of the Company

Motel Assets: Motel Assets; Holdings LLC, a limited liability company, and its subsidiaries, all of which are indirect wholly owned subsidiaries of the Company

Motel Notes: Motel Assets' 7.03% notes due May 1, 2018

North Coast Water Board: North Coast Regional Water Quality Control Board

Pacific Lumber: The Pacific Lumber Company, a wholly-owned subsidiary of MGI

Pacific Lumber Credit Agreement: The revolving credit agreement between Pacific Lumber and a bank which provides for borrowings of up to \$45.0 million

Permits: The incidental take permits issued by the United States and California pursuant to the HCP

Salmon Creek: Salmon Creek LLC, a wholly owned subsidiary of Pacific Lumber

SAR Account: Funds held in a reserve account to support principal payments on the Timber Notes

SBE Price: The applicable stumpage price for a particular species and size of log, as set forth in the most recent Harvest Value Schedule

Scheduled Amortization: The amount of principal which Scotia LLC must pay through each Timber Note payment date in order to avoid prepayment or deficiency premiums

Scotia LLC: Scotia Pacific Company LLC, a limited liability company wholly owned by Pacific Lumber

Scotia LLC Line of Credit: The agreement between a group of lenders and Scotia LLC pursuant to which it may borrow in order to pay up to one year's interest on the Timber Notes

SFAS No. 143: Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations"

SFAS No. 144: Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets"

SFAS No. 145: Statement of Financial Accounting Standards No. 145, “Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections”

SFAS No. 146: Statement of Financial Accounting Standards No. 146, “Accounting for Costs Associated with Exit or Disposal Activities”

SYP: The sustained yield plan approved on March 1, 1999, in connection with the consummation of the Headwaters Agreement

THP: Timber harvesting plan required to be filed with and approved by the CDF prior to the harvesting of timber

Timber Notes: Scotia LLC’s \$867.2 million original aggregate principal amount of 6.55% Series B Class A-1 Timber Collateralized Notes, 7.11% Series B Class A-2 Timber Collateralized Notes and 7.71% Series B Class A-3 Timber Collateralized Notes due July 20, 2028

Timber Notes Indenture: The indenture governing the Timber Notes

TMDLs: Total maximum daily load limits

USWA lawsuit: An action entitled *United Steelworkers of America, AFL-CIO, CLC, and Donald Kegley v. California Department of Forestry and Fire Protection, The Pacific Lumber Company, Scotia Pacific Company LLC and Salmon Creek Corporation* (No. 99CS00626) filed March 31, 1999 in the Superior Court of Sacramento County

Wrigley lawsuit: An action entitled *Kristi Wrigley, et al. v. Charles Hurwitz, John Campbell, Pacific Lumber, MAXXAM Group Holdings Inc., Scotia Pacific Holding Company, MAXXAM Group Inc., MAXXAM Inc., Scotia Pacific Company LLC and Federated Development Company* (No. 9700399) filed December 2, 1997 in the Superior Court of Humboldt County