
**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 March 31, 2005

Commission File Number 1-3924

MAXXAM INC.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

95-2078752
(I.R.S. Employer
Identification Number)

1330 Post Oak Blvd., Suite 2000
Houston, Texas
(Address of Principal Executive Offices)

77056
(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 **9**

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes : No **9**

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, as of the last business day of the registrant's most recently completed second fiscal quarter: \$82.4 million.

Number of shares of common stock outstanding at May 1, 2005: 5,976,542

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MAXXAM INC. AND SUBSIDIARIES

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

	March 31, 2005	December 31, 2004
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents (\$4.5 and \$3.1, restricted, respectively)	\$ 31.5	\$ 21.4
Marketable securities and other short-term investments (\$27.3 and \$25.1, restricted, respectively)	130.6	131.7
Trade and other receivables, net of allowance of \$0.6 and \$0.6, respectively	19.4	16.5
Inventories:		
Lumber	12.8	17.0
Logs	2.7	7.2
Real estate held for sale	16.7	21.1
Prepaid expenses and other current assets	15.1	16.6
Total current assets	228.8	231.5
Property, plant and equipment, net of accumulated depreciation of \$190.2 and \$183.4, respectively	366.2	370.2
Timber and timberlands, net of accumulated depletion of \$223.9 and \$222.1, respectively	213.2	213.6
Real estate	56.0	52.5
Deferred income taxes	94.8	94.8
Restricted cash, marketable securities and other investments	4.9	15.6
Intangible assets	3.6	3.8
Long-term receivables and other assets	32.8	33.2
	<u>\$ 1,000.3</u>	<u>\$ 1,015.2</u>
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	\$ 10.3	\$ 14.4
Accrued interest	11.8	24.9
Other accrued liabilities	38.5	39.9
Short-term borrowings and current maturities of long-term debt	73.6	51.4
Total current liabilities	134.2	130.6
Long-term debt, less current maturities	899.2	912.0
Accrued pension and other postretirement benefits	42.5	41.8
Losses in excess of investment in Kaiser	516.2	516.2
Other noncurrent liabilities	79.6	71.7
Total liabilities	1,671.7	1,672.3
Commitments and contingencies (see Note 8)		
Stockholders' deficit:		
Preferred stock, \$0.50 par value; \$0.75 liquidation preference; 2,500,000 shares authorized; Class A \$0.05 Non-Cumulative Participating Convertible Preferred Stock; 669,019 shares issued; 668,119 and 668,174 shares outstanding, respectively	0.3	0.3
Common stock, \$0.50 par value; 13,000,000 shares authorized; 10,063,359 shares issued; 5,976,542 and 5,976,487 shares outstanding, respectively	5.0	5.0
Additional capital	225.3	225.3
Accumulated deficit	(680.6)	(666.4)
Accumulated other comprehensive loss	(96.7)	(96.6)
Treasury stock, at cost (shares held: preferred – 845; common – 4,086,817 and 4,086,872, respectively)	(124.7)	(124.7)
Total stockholders' deficit	(671.4)	(657.1)
	<u>\$ 1,000.3</u>	<u>\$ 1,015.2</u>

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

MAXXAM INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS
(In millions of dollars, except per share information)

	Three Months Ended March 31,	
	2005	2004
	(Unaudited)	
Net sales:		
Forest products	\$ 47.3	\$ 43.4
Real estate	22.8	11.0
Racing	12.9	14.5
	<u>83.0</u>	<u>68.9</u>
Cost and expenses:		
Cost of sales and operations:		
Forest products	42.1	32.0
Real estate	6.8	4.6
Racing	10.6	11.5
Selling, general and administrative expenses	11.8	18.7
Depreciation, depletion and amortization	8.9	8.7
	<u>80.2</u>	<u>75.5</u>
Operating income (loss):		
Forest products	(2.8)	(0.3)
Real estate	6.7	(1.8)
Racing	(0.2)	0.6
Corporate	(0.9)	(5.1)
	2.8	(6.6)
Other income (expense):		
Investment and interest income	1.2	3.8
Other income	—	1.3
Interest expense	(17.7)	(18.2)
Amortization of deferred financing costs	(0.5)	(0.6)
Loss before income taxes	(14.2)	(20.3)
Provision for income taxes	—	—
Net loss	<u>\$ (14.2)</u>	<u>\$ (20.3)</u>
Basic and diluted loss per common and common equivalent share	<u>\$ (2.38)</u>	<u>\$ (3.40)</u>

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

MAXXAM INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS
(In millions of dollars)

	Three Months Ended March 31,	
	2005	2004
	(Unaudited)	
Cash flows from operating activities:		
Net loss	\$ (14.2)	\$ (20.3)
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation, depletion and amortization	8.9	8.7
Non-cash stock-based compensation (benefit) expense	(1.6)	2.2
Net gains on marketable securities	(0.2)	(2.0)
Equity in loss (earnings) of unconsolidated affiliates, net of dividends	0.2	(1.0)
Amortization of deferred financing costs and discounts on long-term debt	0.5	0.6
Increase (decrease) in cash resulting from changes in:		
Receivables	(2.6)	(2.9)
Inventories	8.5	0.5
Prepaid expenses and other assets	1.5	2.0
Accounts payable	(4.2)	(0.7)
Other accrued liabilities	(1.3)	1.1
Accrued interest	(13.1)	(13.8)
Long-term assets and long-term liabilities	10.8	1.2
Other	(0.1)	(0.6)
Net cash used for operating activities	<u>(6.9)</u>	<u>(25.0)</u>
Cash flows from investing activities:		
Net sales of marketable securities and other investments	3.3	8.6
Capital expenditures	(3.3)	(14.2)
Other	(0.1)	0.3
Net cash used for investing activities	<u>(0.1)</u>	<u>(5.3)</u>
Cash flows from financing activities:		
Proceeds from issuances of long-term debt	2.4	0.5
Redemptions and repurchases of, and principal payments on, long-term debt	(14.8)	(15.5)
Borrowings under revolving and short-term credit facilities	21.5	33.3
Restricted cash withdrawals, net	8.6	10.1
Other	(0.6)	(0.6)
Net cash provided by financing activities	<u>17.1</u>	<u>27.8</u>
Net increase (decrease) in cash and cash equivalents	10.1	(2.5)
Cash and cash equivalents at beginning of the period	21.4	13.8
Cash and cash equivalents at end of the period	<u>\$ 31.5</u>	<u>\$ 11.3</u>
Supplemental disclosure of non-cash investing and financial activities:		
Repurchases of debt using restricted cash	\$ —	\$ 3.6
Supplemental disclosure of cash flow information:		
Interest paid, net of capitalized interest	\$ 30.8	\$ 32.1

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

MAXXAM INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The information contained in the following condensed 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 read 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 Inc. and its majority and wholly owned subsidiaries (but exclusive of Kaiser and its subsidiaries), unless otherwise indicated or the context indicates otherwise. All references to specific entities refer to the respective companies and their subsidiaries, unless otherwise indicated 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 March 31, 2005, the consolidated results of operations for the three months ended March 31, 2005 and 2004, and the consolidated cash flows for the three months ended March 31, 2005 and 2004.

Financial Difficulties of Certain Forest Products Entities

Regulatory and environmental matters as well as legal actions have played and are expected to continue to play a significant role in the Company's forest products operations. Scotia LLC has previously experienced delays in the approval of its THPs as the result of regulatory compliance and related litigation, and expects these difficulties to persist. Moreover, the Company expects a recurrence of the additional delays that have recently been experienced in harvesting on previously-approved THPs due to regulatory oversight by the North Coast Water Board (see below). The foregoing matters have in the past adversely affected timber harvest and timber harvesting and other costs; these effects are expected to continue.

The North Coast Water Board is requiring Palco and Scotia LLC to apply various waste discharge reporting, mitigation and erosion control requirements in respect of timber harvesting activities in several watersheds, and may impose additional measures in the future. The North Coast Water Board in December 2003 directed its staff to formulate WWDRs for the Freshwater and Elk River watersheds on the Scotia LLC Timberlands. The WWDRs have not yet been formulated, and, as a result, the North Coast Water Board has failed to release for harvest THPs already approved by the other government agencies which review Scotia LLC's THPs and significantly delayed the release of a substantial number of other previously-approved THPs. The THPs approved for release by the North Coast Water Board restrict the harvest allowed to only 75% of the harvest limit established by the CDF for the Freshwater and Elk River watersheds. Moreover, a hearing officer acting on behalf of the State Water Board has issued a stay order which precludes harvest on a portion of the THPs that were released for harvest by the North Coast Water Board. Palco and Scotia LLC are continuing efforts to obtain clearance from the North Coast Water Board of the remaining THPs, which constitute a significant portion of the harvest planned for the first six months of 2005. Palco and Scotia LLC are also in the process of appealing the decision of the State Water Board hearing officer. There can be no assurance that these efforts will be successful. Additionally, should the Freshwater-Elk River WWDRs not be formulated during 2005 or in the first few months of 2006, there could be a material adverse impact on Palco's and Scotia LLC's future cash flows from operations. See Note 8 for further discussion of these matters.

The foregoing matters have materially adversely impacted the cash flows of both Scotia LLC and Palco. Scotia LLC estimates that its cash flows from operations, together with funds available under the Scotia LLC Line of Credit, will be inadequate to pay all of the interest due on the July 20, 2005 payment date for the Timber Notes, which would be an event of default under the Timber Notes Indenture. Under the new Revolving Credit Facility and Term Loan (discussed below), Palco is permitted to invest up to \$5.0 million in Scotia LLC. However, there can be no assurance that Palco will make such investment in whole or part.

In the event of a failure to pay interest on the Timber Notes in full when due, the Trustee under the Timber Notes Indenture or the holders of at least 25% of the aggregate outstanding principal amount of the Timber Notes may cause all principal, interest and other amounts related to the Timber Notes to become immediately due and payable. Also, in

the event of a failure by Palco or Scotia LLC to perform its respective covenants or agreements under the Master Purchase Agreement or the failure by Palco to perform its covenants or agreements under the Services Agreement, which failure continues for 30 days after notice from the Trustee or the holders of 25% or more of the outstanding principal amount of the Timber Notes, the holders of a majority of the aggregate outstanding principal amount of the Timber Notes may cause all principal, interest and other amounts related to the Timber Notes to become immediately due and payable. In the event of any such acceleration, the agent under the Scotia LLC Line of Credit may also accelerate the advances then outstanding thereunder. If such accelerations of Timber Notes and/or advances under the Scotia LLC Line of Credit occur, the Trustee may exercise all rights under the Timber Notes Indenture and related security documents, including applying funds to pay accelerated amounts, and selling the Scotia LLC Timberlands and other assets and using the proceeds thereof to pay accelerated amounts. In the event that Scotia LLC were to seek protection by filing under the Bankruptcy Code, all amounts related to the Timber Notes would become immediately due and payable under the Timber Notes Indenture and all advances under the Scotia LLC Line of Credit agreement could be accelerated. The foregoing rights of the Trustee and holders of Timber Notes are subject to the rights of Scotia LLC under the Bankruptcy Code.

Scotia LLC has entered into an agreement for UBS Securities LLC to assist in seeking to restructure its obligations with respect to its outstanding Timber Notes. There can be no assurance that Scotia LLC will be successful in its efforts to restructure its Timber Notes.

At March 31, 2005, Palco continued to be in default under the Palco Credit Agreement and its liquidity crisis continued. Previously-granted waivers of default were subsequently extended through April 22, 2005. On April 19, 2005, Palco and Britt, as borrowers, closed the five-year \$30.0 million secured, asset-based Revolving Credit Facility and the five-year \$35.0 million secured Term Loan. The Term Loan was fully funded on April 19, 2005 and the Borrowers used approximately \$10.8 million of the funds from the Term Loan to pay off amounts previously borrowed under the Palco Credit Agreement and terminated that facility. As of April 30, 2005, no borrowings had been made under the Revolving Credit Facility. Palco estimates that its cash flow from operations will not provide sufficient liquidity to fund its operations until the fourth quarter of 2006. Accordingly, Palco expects to be dependent on the funds available under the Term Loan and Revolving Credit Facility to fund its working capital requirements in 2005 and 2006. Borrowings under the Revolving Credit Facility are limited to the sum of 85% of the Borrowers' eligible accounts receivable plus 75% of the Borrowers' eligible inventories (up to a maximum of \$30.0 million, subject to limitations such as the ability of the lender to establish reasonable reserves). Additionally, both the Term Loan and the Revolving Credit Facility contain EBITDA maintenance covenants that, if not met, could trigger a mandatory prepayment of the borrowings. The operating cash flow estimates used to establish the EBITDA maintenance covenants are subject to a number of assumptions about future operating cash flow and actual results could differ from these estimates. Accordingly, the availability of these funds is largely dependent on Palco's ability to harvest adequate timber from the Scotia LLC Timberlands and reduce operating costs. See Note 4 for further discussion of these new debt facilities.

In the event of a Scotia LLC default under the Timber Note Indenture or a future Palco liquidity shortfall, Palco and Scotia LLC could be forced to take extraordinary actions, which may include: reducing expenditures by laying off employees and shutting down various activities; seeking other sources of liquidity, such as from asset sales; and seeking protection by filing under the Bankruptcy Code. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

On February 7, 2005, Moody's lowered the ratings on the Class A-1 Timber Notes from A1 to Baa2; the Class A-2 Timber Notes from A3 to Baa3; and the Class A-3 Timber Notes from Baa2 to Bal. On April 7, 2005, S&P announced that it had further lowered its ratings on all classes of the Timber Notes to CCC-. On December 8, 2004, S&P lowered Palco's credit rating from B- to CCC+ and on April 7, 2005, S&P announced that it had further lowered Palco's credit rating to CCC- (which rating it affirmed on April 28, 2005). As a result of the S&P credit actions, Palco may be required to post a security deposit for workers compensation liabilities in July 2005 in the amount of \$9.9 million. If Palco's credit rating is raised to B- or better, or if a waiver of this requirement is allowed under applicable law, then posting of such a security deposit may not be necessary. However, there can be no assurance that such a security deposit will not be required. Palco management is also evaluating whether other potential obligations or unanticipated adverse financial consequences may result from the S&P credit actions described above.

The liquidity issues being experienced by Scotia LLC, and those recently experienced by Palco should they recur, could result in claims against and could have adverse impacts on MAXXAM Parent, MGHI and/or MGI. For example, under ERISA law, were Palco to terminate its pension plan, MAXXAM Parent and its wholly owned subsidiaries would be jointly and severally liable for any unfunded pension plan obligations. The unfunded obligation attributable to Palco's pension plan as of December 31, 2004, is estimated to have been in the range of approximately \$35 million based upon annuity placement interest rate assumptions at that time. In addition, it is possible that certain transactions could be

entered into in connection with a potential restructuring or reorganization of Palco or Scotia LLC, such as a sale of all or a portion of the equity ownership in Palco and/or Scotia LLC, a sale of a substantial portion of Palco's and/or Scotia LLC's assets and/or a cancellation of some or all of Palco's and/or Scotia LLC's indebtedness, which could require the utilization of all or a substantial portion of, or the loss of a significant portion of, the Company's net operating losses for federal and state income tax purposes and could require tax payments in future periods.

In addition, 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 lumber or log prices, will not have a material adverse effect on the Company's financial condition, results of operations or liquidity. See Note 8 for further discussion regarding regulatory and legislative matters and legal proceedings relating to the Company's forest products operations.

Under generally accepted accounting principles, consolidation is generally required for investments of more than 50% of the outstanding voting stock of an investee, except when control is not held by the majority owner. Under these rules, legal reorganization or bankruptcy represent conditions which can preclude consolidation in instances where control rests with the bankruptcy court, rather than the majority owner. As discussed above, Palco and Scotia LLC's cash flows have been adversely impacted by ongoing delays in approvals from the North Coast Water Board. If Scotia LLC is unable to make its July interest payment or were Palco's liquidity problems to recur, one of the actions that would be considered is seeking protection by filing for bankruptcy. Were this to occur, the financial results of the subsidiaries which file for bankruptcy would be deconsolidated on the date of such filing, and the Company would begin reporting its investments in such subsidiaries using the cost method. If Palco and/or Scotia LLC were among the subsidiaries which filed for bankruptcy, the resulting impact on the Company's financial statements would be significant.

The following condensed pro forma financial information reflects the Company's results as if MGI and its subsidiaries are not consolidated, and the impact of reporting the Company's investment in MGI and its subsidiaries on the cost method (in millions). This information is on a pro forma basis as of March 31, 2005 only, however, and the actual impact of a deconsolidation at some point in the future would differ. Furthermore, this pro forma information assumes that MGI and all of its subsidiaries file for bankruptcy, rather than the impact of only one or more subsidiaries filing.

	Three Months Ended March 31, 2005
Revenues	\$ 35.7
Costs and expenses	(30.0)
Operating income	5.7
MAXXAM's equity in MGI's losses	(16.3)
Other expenses - net	(3.6)
Income tax benefit	—
Net loss	<u>\$ (14.2)</u>
	March 31, 2005
Current assets	\$ 153.2
Property, plant, and equipment (net)	250.8
Other assets	173.0
Total assets	<u>\$ 577.0</u>
Current liabilities	37.5
Long-term debt, less current maturities	223.3
Other liabilities	82.9
Losses recognized in excess of investment in MGI and certain intercompany items	388.5
Losses recognized in excess of investment in Kaiser	516.2
Total liabilities	1,248.4
Stockholders' deficit	(671.4)
Total liabilities and stockholders' deficit	<u>\$ 577.0</u>

In the event that MGI and /or any of its subsidiaries file for bankruptcy, the Company believes that it is not probable that it would be obligated to fund losses related to its investment in such subsidiaries.

Deconsolidation of Kaiser

On February 12, 2002, Kaiser and certain of its subsidiaries filed for reorganization under Chapter 11 of the

Bankruptcy Code. As a result, the Company discontinued consolidating Kaiser's financial results beginning February 12, 2002, and the Company began reporting its investment in Kaiser using the cost method, under which the investment is reflected as a single amount on the Company's balance sheet of \$(516.2) million, and the recording of earnings or losses from Kaiser was discontinued after February 11, 2002.

Through February 11, 2002, under generally accepted principles of consolidation, the Company had recognized losses in excess of its investment in Kaiser of \$516.2 million. Since Kaiser's results are no longer consolidated and the Company believes that it is not probable that it will be obligated to fund losses related to its investment in Kaiser, any adjustments reflected in Kaiser's financial statements subsequent to February 12, 2002 (relating to the recoverability and classification of recorded asset amounts and classification of liabilities or the effects on existing stockholders' deficit as well as adjustments made to Kaiser's financial information for loss contingencies and other matters), are not expected to affect the Company's financial results.

The Company expects it will consider reversal of its losses in excess of its investment in Kaiser when either: (1) Kaiser's bankruptcy is resolved and the amount of the Company's remaining investment in Kaiser is determined or (2) the Company disposes of its shares of Kaiser common stock. Accordingly, these consolidated financial statements do not reflect any adjustments related to the deconsolidation of Kaiser other than presenting the Company's investment in Kaiser using the cost method. When either of the events described above occurs, the Company will re-evaluate the appropriate accounting treatment of its investment in Kaiser based upon the facts and circumstances at such time. It is likely that the Company's ownership interest in Kaiser will be cancelled. In such event, the Company will reverse the \$516.2 million of losses in excess of its investment in Kaiser and recognize the entire amount in income for the period. Such benefit would be reduced, however, by losses, if any, which the Company estimates it would be obligated to fund. See Note 7 for further discussion of the Company's investment in Kaiser.

Use of Estimates and Assumptions

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect (1) the reported amounts of assets and liabilities, (2) the disclosure of contingent assets and liabilities known to exist as of the date the financial statements are published and (3) the reported amount of revenues and expenses recognized during each period presented. The Company reviews all significant estimates affecting its consolidated financial statements on a recurring basis and records the effect of any necessary adjustments prior to filing the consolidated financial statements with the Securities and Exchange Commission. Adjustments made to estimates often relate to improved information not previously available. Uncertainties regarding such estimates and related assumptions are inherent in the preparation of the Company's consolidated financial statements; accordingly, actual results could differ from these estimates.

Risks and uncertainties are inherent with respect to the ultimate outcome of the matters discussed in Note 8. The results of a resolution of such uncertainties could have a material effect on the Company's consolidated financial position, results of operations or liquidity. In addition, uncertainties related to the projection of future taxable income could affect the realization of the Company's deferred tax assets. Estimates of future benefit payments used to measure the Company's pension and other postretirement benefit obligations are subject to a number of assumptions about future experience, as are the estimated future cash flows projected in the evaluation of long-lived assets for possible impairment. To the extent there are material differences between these estimates and actual results, the Company's financial statements or liquidity could be affected.

Reclassifications

Certain reclassifications have been made to prior periods' consolidated financial statements to be consistent with the current period's presentation. The reclassification of prior period balances includes \$10.9 million of auction rate securities which were reclassified from cash and cash equivalents to marketable securities in the Consolidated Statement of Cash Flows.

2. New Accounting Standards

Postretirement Medical Costs

In May 2004, the FASB issued FSP FAS 106-2 related to the Prescription Drug Act. FSP FAS 106-2 applies only to sponsors of single-employer defined benefit postretirement health care plans for which (1) the employer has concluded that prescription drug benefits available under the plan to some or all participants, for some or all future years, are "actuarially equivalent" to Medicare Part D and thus qualify for the subsidy provided by the Prescription Drug Act, and (2) the expected subsidy will offset or reduce the employer's share of the cost of the underlying postretirement prescription drug coverage on which the subsidy is based. FSP FAS 106-2 provides guidance on the accounting for the

effects of the Prescription Drug Act on a company's accumulated postretirement benefit obligation. In addition, FSP FAS 106-2 addresses accounting for plan amendments and requires certain financial statement disclosures regarding the Prescription Drug Act and its effects.

FSP FAS 106-2 was effective for the first interim period beginning after June 15, 2004. The Company believes that the benefits provided by the Company's postretirement medical plan are actuarially equivalent to Medicare Part D; however, based on the proposed regulations issued to date and the Company's understanding of the Prescription Drug Act, the Company is uncertain as to the potential future subsidies which may be realized under the Prescription Drug Act. Therefore, measures of the accumulated postretirement benefit obligation and net periodic benefit cost included herein do not reflect any amount associated with potential subsidies under the Prescription Drug Act. The Company expects to be able to determine amounts of potential subsidies when additional clarification and final regulations are issued.

Accounting for Stock Options

In December 2004, the FASB issued SFAS No. 123(r), *Share Based Payments*. SFAS No. 123(r) will require compensation costs related to share-based payments determined by the fair value of the equity or liability instruments issued on the grant date. In addition, liability awards will be remeasured each reporting period. Compensation cost will be recognized over the period that an employee provides service in exchange for the award. SFAS No. 123(r) also requires that for the portion of outstanding awards for which the requisite service has not yet been rendered, compensation cost is recognized as of the required effective date based on the grant-date fair value of those awards. SFAS No. 123(r) applies to all awards granted after the required effective date. SFAS No. 123(r) was originally effective as of the first interim or annual reporting period that begins after June 15, 2005; however, the SEC has deferred the required effective date until the first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005, making it applicable to the Company on January 1, 2006. The Company is in the process of evaluating the effects of this Statement on its financial condition and results of operations.

Inventory Costs

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4*. SFAS No. 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overhead to inventory based on the normal capacity of the production facilities. The new Statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is in the process of evaluating the effects of this Statement on its financial condition and results of operations.

Exchanges of Nonmonetary Assets

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29*. SFAS No. 153 is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Opinion No. 29 provided an exception to this principle for exchanges of similar productive assets. Under Opinion No. 29, an exchange of a productive asset was based on the recorded amount of the asset relinquished. SFAS No. 153 eliminated this exception and replaced it with an exception for exchanges of nonmonetary assets that do not have commercial substance. The new Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Management does not expect that adoption of this Statement will have a material impact on the Company's financial condition and results of operations.

3. Segment Information and Other Items

Net sales and operating income (loss) for each reportable segment are presented in the Consolidated Statement of Operations. Operating income (loss) for "Corporate" represents general and administrative expenses not directly attributable to the reportable segments. The amounts reflected in the "Corporate" column also serve to reconcile the total of the reportable segments' amounts to totals in the Company's consolidated financial statements.

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

	<u>Reportable Segments</u>				<u>Consolidated Total</u>
	<u>Forest Products</u>	<u>Real Estate</u>	<u>Racing</u>	<u>Corporate</u>	
Depreciation, depletion and amortization for the three months ended:					
March 31, 2005	\$ 4.9	\$ 3.6	\$ 0.4	\$ —	\$ 8.9
March 31, 2004	4.8	3.5	0.4	—	8.7
Total assets as of:					
March 31, 2005	423.3	346.6	33.9	196.5	1,000.3
December 31, 2004	440.0	338.2	33.2	203.8	1,015.2

Forest Products

In March 2005, Palco entered into a \$3.1 million settlement of a lawsuit filed by Palco against several insurance companies for reimbursement of settlement payments and defense costs related to a legal matter which was concluded in 2002. As of April 30, 2005, Palco has received \$1.4 million and, under the terms of the agreement, is required to be paid the remaining \$1.7 million by May 18, 2005. This settlement was fully recognized in operating income, as a reduction of selling, general and administrative expenses, in the first quarter of 2005.

Palco has announced the permanent closure of its Carlotta and Fortuna mills. In connection therewith, certain equipment from these mills is being and will be moved to Palco's new mill in Scotia. Management is considering alternative uses for the properties and remaining equipment, including sales to third parties, and future write-downs of certain assets may be required if the net book value (less costs to sell) of the remaining assets exceeds their estimated realizable values.

Real Estate

Operating income from real estate operations improved for the first quarter of 2005 as compared to the same period of 2004 primarily due to receipt and recognition of deferred profits at the Company's Palmas development and higher sales at the Company's Mirada and Fountain Hills developments.

Racing

Net sales for the racing operations declined \$1.6 million for the first quarter of 2005 as compared to the same period in 2004, primarily due to lower average daily attendance and reduced simulcasting wagering.

Other Items not Directly Related to Industry Segments

The Corporate segment's operating results improved primarily due to a \$1.6 million benefit recognized in the first quarter of 2005 related to changes in stock-based compensation expense, which is adjusted as the market value of the Company's Common Stock changes. In the first quarter of 2004, expense of \$2.2 million was recognized related to changes in stock-based compensation expense. Additionally, the first quarter of 2004 included \$0.8 million of lease termination costs.

4. Debt

Palco

At March 31, 2005, \$12.3 million in borrowings and \$0.3 million in letters of credit were outstanding under the Palco Credit Agreement. As of December 31, 2004 and March 31, 2005, Palco was in default under the Palco Credit Agreement, but obtained limited waivers of the default through April 22, 2005.

On April 19, 2005, the Borrowers closed the Revolving Credit Facility and the Term Loan. The Term Loan was fully funded on April 19, 2005 and the Borrowers used approximately \$10.8 million of the funds from the Term Loan to pay off amounts previously borrowed under the Palco Credit Agreement and terminated that facility. Deferred loan costs of \$1.3 million related to the Palco Credit Agreement were written off in April 2005 and direct loan costs of \$2.3 million related to the Revolving Credit Facility and the Term Loan were capitalized and will be amortized using the effective interest rate method beginning in April 2005. As of April 30, 2005, no borrowings had been made under the Revolving Credit Facility.

Borrowings under the Revolving Credit Facility are limited to the sum of 85% of the Borrowers' eligible accounts receivable plus 75% of the Borrowers' eligible inventories (up to a maximum of \$30 million, subject to limitations such

as the ability of the lender to establish reasonable reserves). Loans under the Revolving Credit Facility will bear interest, at the Borrowers' option, at the rate of LIBOR plus 2.25% or prime plus 0.50%. The Revolving Credit Facility matures on April 19, 2010. The Term Loan bears interest, at the Borrowers' option, at the rate of LIBOR plus 6% or prime plus 5%. The Term Loan is repayable in quarterly installments of \$87,500 each, beginning on June 1, 2005. A balloon payment of the remaining principal balance is due on April 19, 2010.

The Revolving Credit Facility and Term Loan are each secured by a security interest in the stock of Palco held by its immediate parent, MGI, and substantially all of the assets of the Borrowers (other than Palco's equity interest in Scotia LLC). The Revolving Credit Facility and the Term Loan contain substantially identical restrictive covenants that limit the Borrowers' ability to incur debt, grant liens, make investments, pay dividends, make capital expenditures in excess of stated amounts or merge or consolidate, and require the Borrowers to maintain minimum levels of EBITDA throughout the life of the loans. The Revolving Credit Facility and the Term Loan contain customary events of default and customary remedies with respect to the occurrence of an event of default.

The Revolving Credit Facility includes a prepayment premium of 1% payable in connection with any prepayment or reduction in the commitment occurring within the first two years. The Term Loan includes prepayment premiums of 4%, 3%, 2% and 1% payable in connection with any prepayment of the Term Loan that occurs during the first, second, third and fourth years, respectively. No prepayment premium will be payable under either credit facility to a lender who is also a lender under any refinancing used to prepay such credit facility. The Term Loan also requires certain mandatory prepayments in connection with asset sales by Borrowers.

Under the new Revolving Credit Facility and Term Loan, Palco is permitted to invest up to \$5.0 million in Scotia LLC. However, there can be no assurance that Palco will make such investment in whole or part.

Scotia LLC

On the note payment date in January 2005, Scotia LLC used the funds available under the Scotia LLC Line of Credit to pay all of the \$28.5 million of interest due (\$26.3 million net of interest due in respect of Timber Notes held by Scotia LLC). Scotia LLC also repaid \$10.6 million of principal on the Timber Notes (an amount equal to Scheduled Amortization) using funds held in the SAR Account.

With respect to the note payment date in July 2005, as a result of the matters discussed in Notes 1 and 8, Scotia LLC estimates that its cash flows from operations, together with funds available under the Scotia LLC Line of Credit, will be inadequate to pay all of the \$27.9 million of interest which will be due (\$25.9 million net of interest relating to the Timber Notes held by Scotia LLC), which would be a default under the Timber Notes Indenture.

At March 31, 2005, the maximum availability under the Scotia LLC Line of Credit was \$55.9 million, and there was \$40.4 million in borrowings outstanding under this facility.

5. Income Taxes

The Company generated a loss before income taxes of \$14.2 million for the first quarter of 2005; however, the Company has recorded no tax benefit associated with the loss for this period. Each period, the Company evaluates appropriate factors in determining the realizability of the deferred tax assets attributable to losses and credits generated in the current period and those being carried forward. These factors are discussed further in Note 9 to the Company's consolidated financial statements included in the Form 10-K. Based on this evaluation, the Company provided valuation allowances with respect to the deferred tax assets attributable to the losses and credits generated during the three months ended March 31, 2005. These valuation allowances were in addition to the valuation allowances which were provided in prior years.

6. Employee Benefit Plans

The components of pension and other postretirement benefits expense are as follows (in millions):

	<u>Pension Benefits</u>		<u>Medical/Life Benefits</u>	
	<u>Three Months Ended March 31,</u>			
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Components of net periodic benefit costs:				
Service cost	\$ 0.9	\$ 0.7	\$ 0.1	\$ 0.1
Interest cost	1.4	1.3	0.2	0.2
Expected return on assets	(1.3)	(1.3)	—	—
Amortization of prior service costs	—	—	(0.1)	(0.1)
Recognized net actuarial loss	0.2	—	—	—
Net periodic benefit costs	<u>\$ 1.2</u>	<u>\$ 0.7</u>	<u>\$ 0.2</u>	<u>\$ 0.2</u>

Management estimates that contributions to the Company's pension and other postretirement benefit plans during 2005 will range from \$3.0 million to \$3.3 million.

7. Investment in Kaiser

As discussed further in the Form 10-K, Kaiser, its wholly owned subsidiary, KACC, and 24 of KACC's subsidiaries have filed separate voluntary petitions in the Bankruptcy Court for reorganization under Chapter 11 of the Bankruptcy Code. The Debtors currently believe that it is likely that substantially all pre-Filing Date claims will be settled at less than 100% of their face value and the equity of Kaiser's stockholders, including the Company, will likely be cancelled without consideration.

As provided by the Bankruptcy Code, the Original Debtors had the exclusive right to propose a plan of reorganization for 120 days following the initial Filing Date. The Bankruptcy Court has subsequently approved several extensions of the exclusivity period for the Debtors. The Bankruptcy Court has approved the extension of the exclusivity period to April 30, 2005 for certain Debtors and June 30, 2005 for the remaining Debtors. Kaiser has filed a motion for further extension beyond April 30, 2005 and has indicated that additional extensions may be sought. However, no assurance can be given that any future extension requests will be granted by the Bankruptcy Court. If the Debtors fail to file a plan of reorganization during the exclusivity period, or if such plan is not accepted by the requisite number of creditors and equity holders entitled to vote on the plan, other parties in interest in the Cases may be permitted to propose their own plans of reorganization for the Debtors.

Kaiser's common stock is publicly traded on the OTC Bulletin Board under the trading symbol "KLUCQ.OB." The market value for the 50,000,000 Kaiser Shares, based on the price per share quoted at the close of business on April 29, 2005, was \$4.0 million. There can be no assurance that such value would be realized should the Kaiser Shares be sold.

8. Contingencies

Forest Products Operations

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, dealing with timber harvesting practices, threatened and endangered species and habitat for such species, and air and water quality.

Environmental Plans

From March 1999 until October 2002, Scotia LLC prepared THPs in accordance with the SYP. The SYP was intended to comply with CDF regulations requiring timber companies to project timber growth and harvest on their timberlands over a 100-year planning period and to demonstrate sustained yield, i.e. that their projected average annual harvest for any decade within the 100-year planning period will not exceed the average annual growth level at the end of the 100-year planning period. The forest practice rules allow companies which do not have a sustained yield plan to follow alternative procedures to document compliance with the sustained yield requirements. As discussed below, on October 31, 2003, the Court hearing the *EPIC-SYP/Permits lawsuit* entered a judgment invalidating the SYP and the California Permits, and that decision is now on appeal. As a result of an earlier stay order issued in this case, Scotia LLC has since October 2002 been obtaining review and approval of THPs under alternative procedures pending approval of the Option A Plan, which is an alternative to a sustained yield plan. The Option A Plan was approved by the CDF in March 2005.

The HCP and related Federal Permits allow incidental “take” of certain federally listed species located on the Scotia LLC Timberlands 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 HCP and Federal Permits have terms of 50 years. Since the consummation of the Headwaters Agreement in March 1999, there has been a significant amount of work and additional costs required in connection with the implementation of the HCP and SYP, and this work and the additional costs are expected to continue for the foreseeable future.

Water Quality

Laws and regulations dealing with water quality are impacting Palco and Scotia LLC primarily in four areas: efforts by the federal EPA and the North Coast Water Board to establish TMDLs in watercourses that have been declared to be water quality impaired; actions by the North Coast Water Board to impose waste discharge reporting requirements in respect of watersheds on the Scotia LLC Timberlands and, in some cases, clean-up or prevention measures; actions by the North Coast Water Board during the THP approval process which impose certain operational requirements on individual THPs; and a directive of the North Coast Water Board to its staff to develop WWDRs for the Freshwater and Elk River watersheds.

Under the CWA, the EPA is required to establish TMDLs in watercourses 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 many northern California rivers and certain of their tributaries, including nine watercourses that flow within the Scotia LLC Timberlands. The Company expects this process to continue into 2010. The final TMDL requirements applicable to the Scotia LLC 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.

Beginning with the 2002-2003 winter operating period, Palco has been required to submit “Reports of Waste Discharge” to the North Coast Water Board each year in order to conduct winter harvesting activities in the Elk River and Freshwater watersheds. After consideration of these reports, the North Coast Water Board imposed requirements on Palco to implement additional mitigation and erosion control practices in these watersheds for these winter operating periods. In addition, the North Coast Water Board has extended the requirements for certain mitigation and erosion control practices to the Bear, Jordan and Stitz watersheds. Reporting and mitigation requirements imposed by the North Coast Water Board have significantly increased operating costs and may in the future further increase costs or cause delays in THP approvals or harvesting on approved THPs.

The North Coast Water Board has also issued the Elk River Order, which is a clean up and abatement order aimed at addressing existing sediment production sites in the Elk River watershed through clean up actions. The North Coast Water Board has also initiated the process which could result in similar orders for the Freshwater and Bear Creek watersheds, and is contemplating similar actions for the Jordan and Stitz Creek watersheds. The Elk River Order has resulted in increased costs to Palco that could extend over a number of years. Additional orders in other watersheds (should they be issued) may also result in further cost increases. Palco’s appeal of the Elk River Order to the State Water Board was denied. Palco has appealed the decision of the State Water Board but is holding such appeal in abeyance until resolution of the *THP 520 lawsuit* discussed below.

In addition to the foregoing actions, the North Coast Water Board in December 2003 directed its staff to formulate WWDRs for the Freshwater and Elk River watersheds. As harvesting activities on the Scotia LLC Timberlands cannot readily be moved between watersheds due to, among other things, historic harvest patterns, adjacency restrictions, and the age classes of trees, that action and the other matters described above could, in addition to the potential effects noted above, individually or collectively result in reduced harvest. In that regard, the staff of the North Coast Water Board has not yet formulated the required WWDRs for the Freshwater and Elk River watersheds. As a result, the North Coast Water Board for some time failed to release for harvest a number of Scotia LLC’s THPs which had already been approved by the other governmental agencies which approve Scotia LLC’s THPs. On February 25, 2005, the Executive Officer of the staff of the North Coast Water Board enrolled THPs that would allow the harvest of up to 50% of the harvest limit established by the CDF for the Freshwater and Elk River watersheds. On March 16, 2005, the North Coast Water Board ordered that additional THPs be enrolled that would allow the harvest of up to 75% of the harvest limit established by the CDF for the Freshwater and Elk River watersheds. This decision was subsequently appealed to the State Water Board and on April 6, 2005, a hearing officer acting on behalf of the State Water Board issued a stay order that precludes harvest of a portion of the THPs that were released for harvest by the North Coast Water Board. The Company’s request for emergency reconsideration by the full State Water Board of this decision was denied. The State Water Board is expected to hold a hearing on the merits of the appeal in June 2005.

The unreleased and stayed THPs represent a significant portion of the Company's planned harvest for the first half of 2005. The ongoing regulatory, environmental and litigation matters faced by Palco and Scotia LLC, exacerbated by the developments described in the previous paragraph, have materially adversely impacted the cash flows of both Palco and Scotia LLC. Furthermore, it is likely that additional delays in the development of the Freshwater and Elk River WWDRs will occur, and such delays are expected to continue.

Effective January 1, 2004, California Senate Bill 810 provides regional water quality control boards with additional authority related to the approval of THPs on land within impaired watersheds. The Company is uncertain of the operational and financial effects which will ultimately result from Senate Bill 810; however, because substantially all rivers and waterbodies on the Scotia LLC Timberlands are classified as sediment-impaired, implementation of this law could result in delays in obtaining approvals of THPs, lower harvest levels and increased costs and additional protection measures beyond those contained in the HCP. Also see the description of the *THP No. 520 lawsuit* below.

Timber Harvest Litigation

A California state court has invalidated the SYP in connection with two lawsuits filed against Palco, as described below, which decision has been appealed. Other pending judicial and administrative proceedings, as described below, could affect Palco's and Scotia LLC's ability to implement the HCP, implement certain approved THPs, or carry out other operations, as described below.

In March 1999, the *EPIC-SYP/Permits lawsuit* was filed. This action alleged, among other things, various violations of the CESA and the California Environmental Quality Act, and challenged, among other things, the validity and legality of the SYP and the California Permits. The plaintiffs sought, among other things, to set aside California's approval of the SYP and the California Permits and injunctive relief to prevent implementation of THPs approved in reliance upon these documents. In March 1999, a similar action, the *USWA lawsuit*, was filed challenging the validity and legality of the SYP. The *EPIC-SYP/Permits* and *USWA lawsuits* were consolidated for trial.

Following trial, the Court on October 31, 2003, entered a judgment invalidating the SYP and the California Permits due to several deficiencies in agency procedures and the failure of the Palco Companies to submit a complete and comprehensible SYP. The Court's decision, however, allowed for harvesting on THPs which rely on the SYP and were approved prior to July 23, 2003. The short-term effect of the ruling was to preclude approval, under the SYP, of a small number of THPs which were under review but had not been approved, and a minor reduction in 2003 harvesting that had been expected from those specific THPs. As a result of this case, Scotia LLC has, since October 2002, when the Court issued a stay order preventing future reliance upon the SYP, been obtaining review and approval of new THPs under alternative procedures pending approval of the Option A Plan. As noted above, the Option A Plan was approved by the CDF in March 2005. The Palco Companies and the State of California have appealed the October 31, 2003 decision. In September 2004, the Court granted the plaintiffs' request for reimbursement of an aggregate of \$5.8 million in attorneys fees and other expenses incurred in connection with these matters. The Palco Companies and the State of California have also appealed this decision.

In July 2001, the *Bear Creek lawsuit* was filed and later amended to add the EPA as a defendant. The lawsuit alleges that harvesting and other forestry activities under certain of Scotia LLC's approved 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 and is seeking to enjoin these activities until such permit has been obtained. The plaintiff also seeks civil penalties of up to \$27,500 per day for the alleged continued violation of the CWA. On October 14, 2003, in connection with certain motions that had been filed, the Court upheld the validity of an EPA regulation which exempts harvesting and other forestry activities from certain discharge requirements.

Both state and federal agencies, along with Palco and other timber companies, have relied upon this regulation for more than 25 years. However, the Court interpreted the regulation in such a way as to narrow the forestry operations which are exempted, thereby limiting the regulation's applicability and subjecting culverts and ditches to permit requirements. This ruling has widespread implications for the timber industry in the United States. The case is not yet final as the trial has not yet been held, and there are many unresolved issues involving interpretation of the Court's decision and its application to actual operations. Should the decision ultimately become final and held to apply to all of Palco's timber operations, it may have some or all of the following effects: imposing additional permitting requirements, delaying approvals of THPs, increasing harvesting costs, and adding water protection measures beyond those contained in the HCP. Nonetheless, it is not likely that civil penalties will be awarded for operations that occurred prior to the Court's decision due to the historical reliance by timber companies on the regulation and Palco's belief that the requirements under the HCP are adequate to ensure that sediment and pollutants from harvesting activities on the

Scotia LLC Timberlands will not reach levels harmful to the environment. While the impact of a conclusion to this case that upholds the October 14, 2003 ruling may be adverse, the Company does not believe that such an outcome would have a material adverse impact on the Company's consolidated financial condition, results of operations or liquidity. Nevertheless, due to the numerous ways in which the Court's interpretation of the regulation could be applied to actual operations, there can be no assurance that this will be the case.

On November 20, 2002, the *Cook action* and the *Cave action* were filed, which name Palco, Scotia LLC and certain affiliates as defendants. On April 4, 2003, the plaintiffs in these actions filed amended complaints and served the defendants with notice of the actions. The *Cook action* alleges, among other things, that defendants' logging practices have contributed to an increase in flooding along Freshwater Creek (which runs through the Scotia LLC Timberlands), resulting in personal injury and damage to the plaintiffs' properties. Plaintiffs further allege that in order to have THPs approved in the affected areas, the defendants engaged in certain unfair business practices. The plaintiffs seek, among other things, compensatory and exemplary damages, injunctive relief, and appointment of a receiver to ensure that the watershed is restored. The *Cave action* contains similar allegations and requests similar relief with respect to the Elk River watershed (a portion of which is contained on the Scotia LLC Timberlands). The Company does not believe the resolution of these actions should result in a material adverse effect on its consolidated financial condition, results of operations or liquidity.

On February 25, 2003, the District Attorney of Humboldt County filed the *Humboldt DA action*. The suit was filed under California's unfair competition law and alleges that the Palco Companies used certain unfair business practices in connection with completion of the Headwaters Agreement, and that this resulted in these companies being able to harvest significantly more trees under the Environmental Plans than would have otherwise been the case. The suit sought a variety of remedies including a civil penalty of \$2,500 for each additional tree that has been or will be harvested due to this alleged increase in harvest, as well as restitution and an injunction in respect of the additional timber harvesting allegedly being conducted. In response to motions filed by the Palco Companies for sanctions and dismissal of this suit, on April 30, 2004, the Court issued a ruling requiring the District Attorney to amend his suit to prove that "extrinsic" fraud occurred. In addition, the Court eliminated the remedies being sought, other than for civil penalties, and suggested that it would be inappropriate to base civil penalties on the additional trees harvested. The Court also ruled that it declined "at this juncture" to impose sanctions on the District Attorney. The District Attorney subsequently amended his suit, and the Palco Companies later filed new motions to dismiss and for sanctions. After delays resulting from the District Attorney's efforts to disqualify the trial judge, and that judge's later self-disqualification, a hearing on these motions was held on February 18, 2005. The Court rejected the sanctions motion, but has not yet ruled on the motion for dismissal. The Company believes that this suit is without merit and that the April 30, 2004 ruling diminished significantly its exposure with respect to this matter; however, there can be no assurance that the Palco Companies will ultimately prevail or that an adverse outcome would not be material to the Company's consolidated financial condition, results of operations or liquidity.

On November 2, 2004, the *EPIC-USFWS/NOAA lawsuit* was filed. This lawsuit alleges that two federal agencies have violated certain federal laws and related regulations in connection with their oversight of the HCP and Federal Permits. The plaintiff also alleges that the Federal Permit for the northern spotted owl was unlawfully issued and asserted several claims, including that the Palco Companies violated California's unfair competition law by using false advertising and making misleading environmental claims. The plaintiff seeks a variety of remedies including requiring additional actions by the federal agencies and precluding them from authorizing take of the northern spotted owl, an injunction requiring the Palco Companies to cease certain alleged unlawful activities, as well as restitution and remediation by Palco. On April 22, 2005, pursuant to motions to dismiss filed by the Palco Companies and the federal defendants, the Court dismissed all but one of the claims. The Company does not believe the resolution of this action should result in a material adverse effect on its consolidated financial condition, results of operations or liquidity.

On November 16, 2001, Palco and Scotia LLC filed the *THP No. 520 lawsuit* alleging that the State Water Board had no legal authority to impose mitigation measures that were requested by the staff of the North Coast Water Board during the THP review process and rejected by the CDF prior to approving the THP. When the staff of the North Coast Water Board attempted to impose these mitigation measures in spite of the CDF's decision, Palco and Scotia LLC appealed to the State Water Board, which imposed certain of the requested mitigation measures and rejected others. Palco and Scotia LLC filed the *THP No. 520 lawsuit* challenging the State Water Board's decision, and in January 2003, the Superior Court granted their request for an order invalidating the imposition of these additional measures. The State Water Board appealed this decision, and on March 18, 2004, the appellate court reversed the decision of the Superior Court. The appellate court's decision could result in increased demands by the regional and state water boards and their staffs to impose controls and limitations upon Palco's timber harvesting beyond those provided for by the Environmental Plans or could provide additional regulatory powers to the regional and state water boards and their staffs beyond those

provided in Senate Bill 810. Palco and Scotia LLC filed a petition for review of the appellate court's decision by the California Supreme Court, which in June 2004 agreed to review the decision. Briefing was completed on April 26, 2005, but no date has been set for oral argument.

OTS Contingency and Related Matters

On December 26, 1995, the OTS initiated the *OTS action* against the Company and others alleging, among other things, misconduct by the Respondents and others with respect to the failure of USAT. The OTS sought damages ranging from \$326.6 million to \$821.3 million under various theories. Following a lengthy administrative hearing during portions of 1997-1999, the administrative law judge on September 12, 2001, issued a recommended decision in favor of the Respondents on each claim made by the OTS. On October 17, 2002, the *OTS action* was settled for \$0.2 million with no admission of wrongdoing on the part of the Respondents.

As a result of the dismissal of *OTS action*, a related civil action, the *FDIC action*, alleging damages in excess of \$250.0 million, was subsequently dismissed. The *FDIC action* was originally filed by the FDIC in August 1995 against Mr. Charles E. Hurwitz (Chairman and Chief Executive Officer of the Company).

On May 31, 2000, the Respondents filed a counterclaim to the *FDIC action*. On November 8, 2002, the Respondents filed the Sanctions Motion. The Sanctions Motion states that the FDIC illegally paid the OTS to bring the *OTS action* against the Respondents and that the FDIC illegally sued for an improper purpose (i.e., in order to acquire timberlands held by a subsidiary of the Company). The Respondents are seeking as a sanction to be made whole for the attorneys' fees they have paid (plus interest) in connection with the *OTS* and *FDIC actions*. As of March 31, 2005, such fees were in excess of \$40.5 million. The Respondents are pursuing this claim vigorously.

The Company's bylaws provide for indemnification of its officers and directors to the fullest extent permitted by Delaware law. The Company is obligated to advance defense costs to its officers and directors, subject to the individual's obligation to repay such amount if it is ultimately determined that the individual was not entitled to indemnification. In addition, the Company's indemnity obligation can, under certain circumstances, include amounts other than defense costs, including judgments and settlements.

On January 16, 2001, the *Kahn lawsuit* was filed. The plaintiff purports to bring this action as a stockholder of the Company derivatively on behalf of the Company. The lawsuit concerns the *OTS* and *FDIC actions*, and the Company's advancement of fees and expenses on behalf of Federated and certain of the Company's directors in connection with these actions. It alleges that the defendants have breached their fiduciary duties to the Company, and wasted corporate assets, by allowing the Company to bear all of the costs and expenses of Federated and certain of the Company's directors related to the *OTS* and *FDIC actions*. The plaintiff seeks to require Federated and certain of the Company's directors to reimburse the Company for all costs and expenses incurred by the Company in connection with the *OTS* and *FDIC actions*, and to enjoin the Company from advancing to Federated or certain of the Company's directors any further funds for costs or expenses associated with these actions. The parties to the *Kahn lawsuit* have agreed to an indefinite extension of the defendants' obligations to respond to the plaintiffs' claims. Although it is impossible to assess the ultimate outcome of the *Kahn lawsuit*, the Company believes that the resolution of this matter should not result in a material adverse effect on its consolidated financial condition, results of operations or liquidity.

Other Matters

On September 2, 2004, the Company was advised that one of its former subsidiaries is a successor to a company which manufactured munitions for the U.S. Navy during World War II. The current owner of the underlying property, which is located in Cranbury, New Jersey, is seeking the Company's participation in efforts to address contamination of the site which resulted from such operations. The current owner estimates that the costs to determine what remedial actions are needed, and to perform any remedial actions determined necessary, could range from \$3.0 million to \$8.0 million. Costs for the investigation and remediation could exceed \$8.0 million as the result of information learned during the investigation. The Company is currently in the process of determining the extent of its liability, which could require payment of a substantial portion of the costs, as well as the availability of funding from the U.S. Navy and insurance coverage for these activities. Such investigation continues and is anticipated to be completed by the third quarter of 2005. On December 29, 2004, the NJDEP issued a directive against the current owner of the property, MGI, and the U.S. Navy requiring these parties to conduct a RI/RA in respect of the property. As further required by the directive, MGI and the current owner on January 28, 2005, entered into an Administrative Consent Order providing, among other things, that MGI and the current owner begin implementing the RI/RA within 120 days of execution of the Order. MGI and the current owner of the property have also entered into a Participation Agreement providing, among other things, for them to jointly fund the RI/RA and for a mediation process to assist in equitably allocating the costs of the RI/RA. The Company accrued its expected share of the estimated costs of the RI/RA in 2004. While the Company believes its

estimates are reasonable, as additional information is obtained, future charges may be required.

The Company is involved in other claims, lawsuits and proceedings. While uncertainties are inherent in the final outcome of such matters and it is presently impossible to determine the actual costs that ultimately may be incurred or their effect on the Company, management believes that the resolution of such uncertainties and the incurrence of such costs should not result in a material adverse effect on the Company's consolidated financial condition, results of operations or liquidity.

9. Stock-Based Compensation Plans

Stock options issued to employees and outside directors are accounted for under the intrinsic value method of accounting as defined by APB Opinion No. 25 and related interpretations. The Company has not yet changed to the fair value based method of accounting for stock-based employee compensation as prescribed by SFAS No. 123. The following table illustrates the pro forma effect on net income and earnings per share had the Company accounted for its stock options under the fair value method of accounting (in millions, except per share information):

	Three Months Ended March 31,	
	2005	2004
Net loss, as reported	\$ (14.2)	\$ (20.3)
Add: Stock-based employee compensation (income) expenses included in reported net loss, net of related tax effects	(1.6)	2.2
Deduct: Total stock-based employee compensation income (expense) determined under the fair value method for all awards, net of related tax effects	1.1	(2.7)
Pro forma net loss	<u>\$ (14.7)</u>	<u>\$ (20.8)</u>
Basic and diluted loss per share:		
As reported	\$ (2.38)	\$ (3.40)
Pro forma	(2.45)	(3.47)

10. Per Share Information

The weighted average number of shares used to determine basic and diluted earnings per share was:

	Three Months Ended March 31,	
	2005	2004
Weighted average shares outstanding:		
Common Stock	5,976,530	5,976,466
Effect of dilution:		
Class A Preferred Stock ⁽¹⁾	—	—
Weighted average number of common and common equivalent shares - Basic	5,976,530	5,976,466
Effect of dilution:		
Stock options ⁽¹⁾	—	—
Weighted average number of common and common equivalent shares - Diluted	<u>5,976,530</u>	<u>5,976,466</u>

⁽¹⁾ The Class A Preferred Stock and options were not included in the computation of basic or diluted earnings per share because the Company had a loss for the three months ended March 31, 2005 and 2004, respectively.

11. Comprehensive Loss

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

	Three Months Ended March 31,	
	2005	2004
Net loss:	\$ (14.2)	\$ (20.3)
Other comprehensive loss:		
Unrealized losses on available-for-sale investments	(0.1)	(0.3)
Applicable income tax benefit (expense)	—	—
Total comprehensive loss	<u>\$ (14.3)</u>	<u>\$ (20.6)</u>

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 Condensed Notes to Consolidated Financial Statements included herein.

This Quarterly Report on Form 10-Q contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. 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" "intends," "projects," "seeks," 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, environmental or regulatory requirements, litigation developments, and changing prices and market conditions. This Form 10-Q and the Form 10-K identify other factors which could cause differences between such 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 PSLRA. See the statement in Item 2. above for cautionary information with respect to such forward-looking statements.

The Company conducts the substantial portion of its operations through its subsidiaries, which operate in three principal industries: forest products, through MGI and its wholly owned subsidiaries, principally Palco and its subsidiaries; real estate investment and development, through MPC and other wholly owned subsidiaries as well as joint ventures; and racing operations through SHRP, Ltd. MGHI owns 100% of MGI and is a wholly owned subsidiary of the Company. In addition, the Company owns approximately 63% of Kaiser, a producer of fabricated aluminum products. All references to the "Company" include MAXXAM Inc. and its majority and wholly-owned subsidiaries (but exclusive of Kaiser and its subsidiaries), unless otherwise indicated or the context indicates otherwise. All references to specific entities refer to the respective companies and their subsidiaries, unless otherwise indicated or the context indicates otherwise.

Consolidated Operations

Selected Operational Data

The following table presents selected financial information for the three months ended March 31, 2005 and 2004 for the Company's consolidated operations.

	Three Months Ended March 31,	
	2005	2004
	(In millions of dollars)	
Net sales	\$ 83.0	\$ 68.9
Costs and expenses	(80.2)	(75.5)
Operating income (loss)	2.8	(6.6)
Other income, net	1.2	5.1
Interest expense, including amortization of deferred financing costs	(18.2)	(18.8)
Loss before income taxes	<u>\$ (14.2)</u>	<u>\$ (20.3)</u>

Deconsolidation of Kaiser

See Notes 1 and 7 for information regarding the deconsolidation of Kaiser's financial results and the Company's investment in Kaiser.

Overview of Consolidated Results of Operations

Net Sales

Net sales for the first quarter of 2005 totaled \$83.0 million, compared to \$68.9 million for the first quarter of 2004. Net sales for the Company's forest products operations increased \$3.9 million for the first quarter of 2005, as compared to the same quarter in 2004, primarily as a result of an increase in shipments of Douglas-fir lumber inventories. Real estate sales more than doubled in the first quarter of 2005, resulting in an increase of \$11.8 million in revenue over the same quarter in 2004. The increase was principally due to a higher volume of property sales at the Company's Fountain Hills and Mirada developments and receipt and recognition of deferred profits at the Company's Palmas development. Net sales for the racing segment decreased \$1.6 million, principally due to lower average daily attendance and reduced simulcasting wagering.

Operating Income (Loss)

The Company recorded operating income of \$2.8 million in the first quarter of 2005 compared to an operating loss of \$6.6 million in the first quarter of 2004. Operating results for forest products operations declined by \$2.5 million primarily as a result of increased logging, hauling and production costs partially offset by a \$3.1 million insurance settlement that was reached in the first quarter of 2005. See Note 3 for further information regarding this settlement. Operating results for real estate operations increased by \$8.5 million, primarily as a result of increased real estate sales, as discussed above. Operating results for racing operations decreased by \$0.8 million due principally to lower net sales as discussed above partially offset by lower expenses. The corporate segment's operating loss decreased by \$4.2 million primarily as a result of lower stock-based compensation expense in 2005, reflecting a reduction in the market value of the Company's stock since December 31, 2004.

Loss Before Income Taxes

The Company's consolidated loss before income taxes decreased by \$6.1 million in the first quarter of 2005 as compared to the prior year first quarter, principally due to the improved results of real estate operations partially offset by a decline in investment, interest and other income of \$3.9 million.

Forest Products Operations

Industry Overview and Selected Operational Data

The Company's forest products operations are conducted through MGI and its wholly owned subsidiaries, principally Palco and its subsidiaries. The segment's 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 MGI's revenues and cash flows will continue to be somewhat seasonal because of the harvesting, road use, wet weather and other restrictions imposed by the HCP and regulation. Accordingly, MGI's results for any one quarter are not necessarily indicative of results to be expected for the full year.

Regulatory and environmental matters as well as legal actions have played and are expected to continue to play a significant role in the Company's forest products operations. Scotia LLC has previously experienced delays in the approval of its THPs as the result of regulatory compliance and related litigation, and expects these difficulties to persist. Moreover, the Company expects a recurrence of the additional delays that have recently been experienced in harvesting on previously-approved THPs due to regulatory oversight by the North Coast Water Board. The foregoing matters have in the past adversely affected timber harvest and timber harvesting and other costs; these effects are expected to continue. In addition, 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 lumber or log prices, will not have a material adverse effect on the financial condition, results of operations or liquidity of the Company's forest products operations. See Item 1. "Business—Forest Products Operations—Regulatory and Environmental Matters" of the Form 10-K and Note 8 for further discussion of these matters.

The ongoing regulatory, environmental and litigation matters faced by Palco and Scotia LLC, exacerbated by certain recent developments, have materially adversely impacted the cash flows of both Scotia LLC and Palco. Scotia LLC estimates that its cash flows from operations, together with funds available under the Scotia LLC Line of Credit, will be inadequate to pay all of the interest due on the July 20, 2005 payment date for the Timber Notes, which would be an event of default under the Timber Notes Indenture. For further information, see "—Financial Condition and Investing and Financing Activities—Forest Products Operations."

During 2001, comprehensive external and internal reviews were conducted of Palco's business operations. These

reviews were conducted in an effort to identify ways in which Palco could operate on a more efficient and cost-effective basis. Based upon these reviews, Palco implemented a number of changes during the last quarter of 2001 and the first quarter of 2002, including closing two of its four sawmills, eliminating certain of its operations, including its company-staffed logging operations (now relying exclusively on contract loggers) and its soil amendment and concrete block activities, utilizing more efficient harvesting methods and adopting other cost saving measures. Palco has continued to examine ways in which to achieve cost savings. During 2004, Palco opened a new (replacement) planer facility and began construction on a new sawmill, both in Scotia, California. The new sawmill construction project is expected to cost \$27.3 million (\$20.5 million of which was expended in 2004) with the last phase scheduled for completion in the third quarter of 2005 (subject to available cash). Funds for this project have been provided from existing cash resources and borrowings under the Palco Credit Agreement and the remaining funds are expected to be provided by borrowings from the Term Loan and/or the Revolving Credit Facility. As part of the project, Palco's Carlotta mill was permanently closed in 2004 and, in April 2005, Palco announced that it would also close its Fortuna mill. Certain equipment from these mills is being and will be moved to Palco's new sawmill in Scotia and management is considering alternative uses for the properties and remaining equipment, including sales to third parties. Further actions may be taken during 2005 as a result of Palco's continuing evaluation process or in response to the financial difficulties discussed above, and writedowns of certain assets may be required.

The following table presents selected operational and financial information for the three months ended March 31, 2005 and 2004, for the Company's forest products operations.

		Three Months Ended March 31,	
		2005	2004
		(In millions of dollars, except shipments and prices)	
Shipments:			
Lumber: ⁽¹⁾			
Redwood upper grades		2.4	4.3
Redwood common grades		43.1	44.0
Douglas-fir upper grades		0.3	1.0
Douglas-fir common grades		33.0	14.7
Other		0.8	0.9
Total lumber		79.6	64.9
Cogeneration power ⁽²⁾		40.7	36.3
Average sales price:			
Lumber: ⁽³⁾			
Redwood upper grades	\$	1,183	\$ 1,321
Redwood common grades		610	603
Douglas-fir upper grades		895	939
Douglas-fir common grades		367	373
Cogeneration power ⁽⁴⁾		63	64
Net sales:			
Lumber, net of discount	\$	41.4	\$ 38.4
Logs		1.5	1.3
Cogeneration power		2.6	2.3
Wood chips		1.1	0.8
Other		0.7	0.6
Total net sales	\$	47.3	\$ 43.4
Operating loss	\$	(2.8)	\$ (0.3)
Loss before income taxes	\$	(16.3)	\$ (12.9)

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

⁽²⁾ Power deliveries are expressed in thousands of megawatts.

⁽³⁾ Dollars per thousand board feet.

⁽⁴⁾ Dollars per megawatt.

Net Sales

Net sales for forest products operations increased \$3.9 million for the first quarter of 2005, as compared to the same period in 2004. Shipments of Douglas-fir lumber inventories more than doubled, as compared to the same period in 2004, resulting in an increase in net sales of \$6.6 million. This increase was offset by lower shipments of redwood

lumber of \$2.8 million.

Operating Loss

Although sales improved, the operating loss for forest products operations increased by \$2.5 million for the first quarter of 2005, compared to the same period in 2004, primarily due to increased logging, hauling and production costs, partially offset by a \$3.1 million insurance settlement that was reached in the first quarter of 2005. See Note 3 for further discussion of this settlement. The gross margin percentage on lumber sales has decreased from 29% in the first quarter of 2004 to 10% in the first quarter of 2005, primarily due to the increased operating costs noted above. Selling, general and administrative expenses decreased for the first quarter of 2005, as compared to the same period in 2004, due primarily to the \$3.1 million insurance settlement and a reduction in administrative costs of \$0.4 million.

Loss Before Income Taxes

Forest products operations' loss before income taxes increased by \$3.4 million for the first quarter of 2005 as compared to the same period in 2004 primarily due to the decreased operating results discussed above and lower returns on cash, cash equivalents and investments of \$1.1 million.

Real Estate Operations

Industry Overview and Selected Operational Data

The Company, principally through its wholly owned subsidiaries and joint ventures, invests in and develops residential and commercial real estate primarily in Puerto Rico, Arizona, California, and Texas. The following table presents selected operational and financial information for the three months ended March 31, 2005 and 2004, for the Company's real estate operations.

	Three Months Ended March 31,	
	2005	2004
	(In millions of dollars)	
Net sales:		
Real estate:		
Fountain Hills	\$ 6.7	\$ 2.0
Mirada	2.6	0.5
Palmas	4.6	0.5
Total	<u>13.9</u>	<u>3.0</u>
Resort, commercial and other:		
Fountain Hills	1.4	1.4
Palmas	2.9	2.5
Commercial lease properties	4.5	4.0
Other	0.1	0.1
Total	<u>8.9</u>	<u>8.0</u>
Total net sales	<u>\$ 22.8</u>	<u>\$ 11.0</u>
Operating income (loss):		
Fountain Hills	\$ 2.6	\$ 0.6
Mirada	0.8	(0.8)
Palmas	1.8	(2.8)
Commercial lease properties	1.5	1.5
Other	—	(0.3)
Total operating income (loss)	<u>\$ 6.7</u>	<u>\$ (1.8)</u>
Investment, interest and other income (expense), net:		
Equity in earnings from real estate joint ventures	\$ (0.2)	\$ 1.0
Other	0.6	0.6
	<u>\$ 0.4</u>	<u>\$ 1.6</u>
Income (Loss) before income taxes	<u>\$ 2.7</u>	<u>\$ (4.9)</u>

Net Sales

Net sales for the real estate segment for the first quarter of 2005 more than doubled, as compared to the same period

in 2004, largely driven by increased sales activity at the Company's Fountain Hills and Mirada developments and the receipt and recognition of deferred profits at the Company's Palmas development.

Operating Income (Loss) and Income (Loss) Before Income Taxes

Operating income improved by \$8.5 million for the first quarter of 2005 as compared to the same period of 2004 primarily due to receipt and recognition of deferred profits at the Company's Palmas development and higher sales at the Company's Fountain Hills and Mirada developments. The segment's income before income taxes increased between quarters primarily due to the improved operating results discussed above, partially offset by \$1.2 million of decreased equity in earnings from the Company's investment in FireRock LLC as a result of the sell-out of lots at the development in 2004. FireRock LLC's sole remaining asset is the FireRock LLC Country Club.

Racing Operations

Industry Overview and Selected Operational Data

The Company indirectly owns SHRP, Ltd., which owns and operates Sam Houston Race Park, a Class 1 horse racing facility in Houston, Texas, and Valley Race Park, a greyhound racing facility located in Harlingen, Texas. Results of operations between quarterly periods are generally not comparable for these facilities due to the timing, varying lengths and types of racing meets held. Historically, Sam Houston Race Park and Valley Race Park have derived a significant amount of their annual pari-mutuel commissions from live racing and simulcasting. Pari-mutuel commissions have typically been highest during the first and fourth quarters of the year, the time during which Sam Houston Race Park and Valley Race Park have historically conducted live thoroughbred and greyhound racing, respectively.

The following table presents selected operational and financial information for the three months ended March 31, 2005 and 2004, for the Company's racing operations.

	Three Months Ended March 31,	
	2005	2004
	(In millions of dollars)	
Number of live race days:		
Sam Houston Race Park	42	48
Valley Race Park	86	75
Handle:		
Sam Houston Race Park:		
On-track handle	\$ 31.8	\$ 34.0
Off-track handle	73.1	96.6
Total	<u>\$ 104.9</u>	<u>\$ 130.6</u>
Valley Race Park:		
On-track handle	\$ 5.6	\$ 6.4
Off-track handle	1.5	2.8
Total	<u>\$ 7.1</u>	<u>\$ 9.2</u>
Net sales:		
Sam Houston Race Park:		
Gross pari-mutuel commissions	\$ 9.2	\$ 10.3
Other revenues	1.9	2.1
Total	<u>11.1</u>	<u>12.4</u>
Valley Race Park:		
Gross pari-mutuel commissions	1.4	1.6
Other revenues	0.4	0.5
Total	<u>1.8</u>	<u>2.1</u>
Total net sales	<u>\$ 12.9</u>	<u>\$ 14.5</u>
Operating income (loss):		
Sam Houston Race Park	\$ —	\$ 0.8
Valley Race Park	(0.2)	(0.2)
Total operating income (loss)	<u>\$ (0.2)</u>	<u>\$ 0.6</u>
Income (loss) before income taxes	<u>\$ (0.2)</u>	<u>\$ 0.6</u>

Net Sales

Net sales for racing operations declined \$1.6 million for the first quarter of 2005, as compared to the same period in 2004, principally due to lower simulcasting and live racing commissions as a result of lower average daily attendance and reduced simulcasting wagering.

Operating Income (Loss) and Income (Loss) Before Taxes

Racing operations' operating income and income before taxes for the first quarter of 2005 declined \$0.8 million from the comparable period in 2004 due principally to lower net sales as discussed above, partially offset by lower costs.

Other Items Not Directly Related to Industry Segments

	Three Months Ended March 31,	
	2005	2004
	(In millions)	
Operating loss	\$ (0.9)	\$ (5.1)
Loss before income taxes	(0.4)	(3.1)

Operating Loss

The operating losses represent corporate general and administrative expenses that are not attributable to the Company's industry segments. For the first quarter of 2004, such losses include \$2.2 million, related to an increase in stock-based compensation expense, which is adjusted as the market value of the Company's Common Stock changes. Additionally, the first quarter of 2004 included \$0.8 million of non-recurring lease termination costs. For the first quarter of 2005, there was a \$1.6 million benefit recognized for stock-based compensation, reflecting a reduction in the market value of the Company's Common Stock since December 31, 2004.

Loss Before Income Taxes

The loss before income taxes decreased in the first quarter of 2005 from the comparable period in 2004 due to lower corporate general and administrative expenses offset by lower returns on marketable securities and other short-term investments of \$1.7 million which are impacted by changing market conditions.

Financial Condition and Investing and Financing Activities

This section contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. See the statement in Item 2. above for cautionary information with respect to such forward-looking statements.

Overview

The Company conducts its operations primarily through its subsidiaries. Creditors of subsidiaries of the Company have priority with respect to the assets and earnings of such subsidiaries over the claims of the creditors of the Company. Certain of the Company's subsidiaries, principally Palco and Scotia LLC, are restricted by their various debt instruments as to the amount of funds that can be paid in the form of dividends or loaned to affiliates. Scotia LLC is highly leveraged and has significant debt service requirements. "MAXXAM Parent" is used in this section to refer to the Company on a stand-alone basis without its subsidiaries.

Cash Flow

Operating Activities

Net cash used for operating activities improved from \$25.0 million for the three months ended March 31, 2004 to \$6.9 million for the three months ended March 31, 2005. The reduction in cash used in operating activities resulted primarily from improved operating results, a reduction of forest products inventories and higher cash collections related to real estate sales.

Investing Activities

Net cash used for investing activities was \$0.1 million and \$5.3 million for the three months ended March 31, 2005 and 2004, respectively. In 2004, capital expenditures were \$14.2 million, \$10.9 million of which were related to Palco's sawmill project; comparable expenditures were not made in the first quarter of 2005. Additionally, net sales of marketable securities and other short-term investments were \$5.3 million lower than the first quarter of 2004.

Financing Activities

Net cash provided by financing activities was \$17.1 million and \$27.8 million for the three months ended March 31, 2005 and 2004, respectively. This change principally results from lower borrowings under revolving and short-term credit facilities.

MAXXAM Parent

MAXXAM Parent believes that its existing resources will be sufficient to fund its working capital requirements for the next year. With respect to long-term liquidity, MAXXAM Parent believes that its existing cash and cash resources, together with distributions from the real estate operations, should be sufficient to meet its working capital requirements. However, there can be no assurance that this will be the case. See “—Forest Products Operations” below and Note 8 regarding potential adverse impacts upon MAXXAM Parent as a result of liquidity issues in respect of Palco and Scotia LLC. Additionally, see “—Racing Operations” below regarding the cash flow needs of SHRP, Ltd., which were provided by MAXXAM Parent during the first quarter of 2005.

Forest Products Operations

Substantially all of MGI’s consolidated assets are owned by Palco, and a significant portion of Palco’s consolidated assets are owned by Scotia LLC. The holders of the Timber Notes have priority over the claims of creditors of Palco with respect to the assets and cash flows of Scotia LLC. The Revolving Credit Facility and Term Loan contain certain restrictive covenants which effectively preclude the distribution of funds from Palco to MGI.

Due to its highly leveraged condition, Scotia LLC is more sensitive than less leveraged companies to factors affecting its operations and financial results, including adverse weather conditions, low log prices, governmental regulation, environmental litigation and general economic conditions. Scotia LLC’s cash flows from operations are significantly impacted by harvest volumes and log prices.

Regulatory and environmental matters as well as legal actions have played and are expected to continue to play a significant role in the Company’s forest products operations. Scotia LLC has previously experienced delays in the approval of its THPs as the result of regulatory compliance and related litigation, and expects these difficulties to persist. Moreover, the Company expects a recurrence of the additional delays that have recently been experienced in harvesting on previously-approved THPs due to regulatory oversight by the North Coast Water Board (see below). The foregoing matters have in the past adversely affected timber harvest and timber harvesting and other costs; these effects are expected to continue. In addition, 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 lumber or log prices, will not have a material adverse effect on the financial condition, results of operations or liquidity of the Company’s forest product operations. See Item 1. “Business—Forest Products Operations—Regulatory and Environmental Matters” of the Form 10-K and Note 8 for further discussion of these matters.

The North Coast Water Board is requiring Palco and Scotia LLC to apply various waste discharge reporting, mitigation and erosion control requirements in respect of timber harvesting activities in several watersheds, and may impose additional measures in the future. The North Coast Water Board in December 2003 directed its staff to formulate WWDRs for the Freshwater and Elk River watersheds on the Scotia LLC Timberlands. The WWDRs have not yet been formulated, and, as a result, the North Coast Water Board has failed to release for harvest THPs already approved by the other government agencies which review Scotia LLC’s THPs and significantly delayed the release of a substantial number of other previously-approved THPs. The THPs approved for release by the North Coast Water Board restrict the harvest allowed to only 75% of the harvest limit established by the CDF for the Freshwater and Elk River watersheds. Moreover, a hearing officer acting on behalf of the State Water Board has issued a stay order which precludes harvest on a portion of the THPs that were released for harvest by the North Coast Water Board. Palco and Scotia LLC are continuing efforts to obtain clearance from the North Coast Water Board of the remaining THPs, which constitute a significant portion of the harvest planned for the first six months of 2005. Palco and Scotia LLC are also in the process of appealing the decision of the State Water Board hearing officer. There can be no assurance that these efforts will be successful. Additionally, should the Freshwater-Elk River WWDRs not be formulated during 2005 or in the first few months of 2006, there could be a material adverse impact on Palco’s and Scotia LLC’s future cash flows from operations. See Note 8 for further discussion of these matters.

The foregoing matters have materially adversely impacted the cash flows of both Scotia LLC and Palco. Scotia LLC estimates that its cash flows from operations, together with funds available under the Scotia LLC Line of Credit,

will be inadequate to pay all of the \$27.9 million of interest which will be due on the July 20, 2005 payment date for the Timber Notes, (\$25.9 million net of interest relating to Timber Notes held by Scotia LLC), which would be an event of default under the Timber Notes Indenture. Under the new Revolving Credit Facility and Term Loan, Palco is permitted to invest up to \$5.0 million in Scotia LLC. However, there can be no assurance that Palco will make such investment in whole or part.

In the event of a failure to pay interest on the Timber Notes in full when due, the Trustee under the Timber Notes Indenture or the holders of at least 25% of the aggregate outstanding principal amount of the Timber Notes may cause all principal, interest and other amounts related to the Timber Notes to become immediately due and payable. Also, in the event of a failure by Palco or Scotia LLC to perform its respective covenants or agreements under the Master Purchase Agreement or the failure by Palco to perform its covenants or agreements under the Services Agreement, which failure continues for 30 days after notice from the Trustee or the holders of 25% or more of the outstanding principal amount of the Timber Notes, the holders of a majority of the aggregate outstanding principal amount of the Timber Notes may cause all principal, interest and other amounts related to the Timber Notes to become immediately due and payable. In the event of any such acceleration, the agent under the Scotia LLC Line of Credit may also accelerate the advances then outstanding thereunder. If such accelerations of Timber Notes and/or advances under the Scotia LLC Line of Credit occur, the Trustee may exercise all rights under the Timber Notes Indenture and related security documents, including applying funds to pay accelerated amounts, and selling the Scotia LLC Timberlands and other assets and using the proceeds thereof to pay accelerated amounts. In the event that Scotia LLC were to seek protection by filing under the Bankruptcy Code, all amounts related to the Timber Notes would become immediately due and payable under the Timber Notes Indenture and all advances under the Scotia LLC Line of Credit agreement could be accelerated. The foregoing rights of the Trustee and holders of Timber Notes are subject to the rights of Scotia LLC under the Bankruptcy Code.

Scotia LLC has entered into an agreement for UBS Securities LLC to assist in seeking to restructure its obligations with respect to its outstanding Timber Notes. There can be no assurance that Scotia LLC will be successful in its efforts to restructure its Timber Notes.

At March 31, 2005, Palco continued to be in default under the Palco Credit Agreement and its liquidity crisis continued. Previously-granted waivers of default were subsequently extended through April 22, 2005. On April 19, 2005, Palco and Britt, as borrowers, closed the five-year \$30.0 million secured, asset-based Revolving Credit Facility and the five-year \$35.0 million secured Term Loan. The Term Loan was fully funded on April 19, 2005 and the Borrowers used approximately \$10.8 million of the funds from the Term Loan to pay off amounts previously borrowed under the Palco Credit Agreement and terminated that facility. As of April 30, 2005, no borrowings had been made under the Revolving Credit Facility. Palco estimates that its cash flow from operations will not provide sufficient liquidity to fund its operations until the fourth quarter of 2006. Accordingly, Palco expects to be dependent on the funds available under the Term Loan and Revolving Credit Facility to fund its working capital requirements in 2005 and 2006. Borrowings under the Revolving Credit Facility are limited to the sum of 85% of the Borrowers' eligible accounts receivable plus 75% of the Borrowers' eligible inventories (up to a maximum of \$30.0 million, subject to limitations such as the ability of the lender to establish reasonable reserves). Additionally, both the Term Loan and the Revolving Credit Facility contain EBITDA maintenance covenants that, if not met, could trigger a mandatory prepayment of the borrowings. The operating cash flow estimates used to establish the EBITDA maintenance covenants are subject to a number of assumptions about future operating cash flow and actual results could differ from these estimates. Accordingly, the availability of these funds is largely dependent on Palco's ability to harvest adequate timber from the Scotia LLC Timberlands and reduce operating costs. See Note 4 for further discussion of these new debt facilities.

In the event of a Scotia LLC default under the Timber Note Indenture or a future Palco liquidity shortfall, Palco and Scotia LLC could be forced to take extraordinary actions, which may include: reducing expenditures by laying off employees and shutting down various activities; seeking other sources of liquidity, such as from asset sales; and seeking protection by filing under the Bankruptcy Code. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

On February 7, 2005, Moody's lowered the ratings on the Class A-1 Timber Notes from A1 to Baa2; the Class A-2 Timber Notes from A3 to Baa3; and the Class A-3 Timber Notes from Baa2 to Bal. On April 7, 2005, S&P announced that it had further lowered its ratings on all classes of the Timber Notes to CCC-. On December 8, 2004, S&P lowered Palco's credit rating from B- to CCC+ and on April 7, 2005, S&P announced that it had further lowered Palco's credit rating to CCC- (which rating it affirmed on April 28, 2005). As a result of the S&P credit actions, Palco may be required to post a security deposit for workers compensation liabilities in July 2005 in the amount of \$9.9 million. If Palco's credit rating is raised to B- or better, or if a waiver of this requirement is allowed under applicable law, then posting of such a security deposit may not be necessary. However, there can be no assurance that such a security deposit will not

be required. Palco management is also evaluating whether other potential obligations or unanticipated adverse financial consequences may result from the S&P credit actions described above.

The liquidity issues being experienced by Scotia LLC, and those recently experienced by Palco should they recur, could result in claims against and could have adverse impacts on MAXXAM Parent, MGHI and/or MGI. For example, under ERISA law, were Palco to terminate its pension plan, MAXXAM Parent and its wholly owned subsidiaries would be jointly and severally liable for any unfunded pension plan obligations. The unfunded obligation attributable to Palco's pension plan as of December 31, 2004, is estimated to have been in the range of approximately \$35 million based upon annuity placement interest rate assumptions at that time. In addition, it is possible that certain transactions could be entered into in connection with a potential restructuring or reorganization of Palco or Scotia LLC, such as a sale of all or a portion of the equity ownership in Palco and/or Scotia LLC, a sale of a substantial portion of Palco's and/or Scotia LLC's assets and/or a cancellation of some or all of Palco's and/or Scotia LLC's indebtedness, which could require the utilization of all or a substantial portion of, or the loss of a significant portion of, the Company's net operating losses for federal and state income tax purposes and could require tax payments in future periods.

The Scotia LLC Line of Credit allows Scotia LLC to borrow up to one year's interest due on the Timber Notes. On June 20, 2003, the Scotia LLC Line of Credit was extended to July 7, 2006. At or near the completion of such extension, Scotia LLC intends to request that the Scotia LLC Line of Credit be extended for an additional 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 December 31, 2004, Scotia LLC could have borrowed a maximum of \$57.1 million under the Scotia LLC Line of Credit, and there were \$18.2 million in borrowings outstanding under the facility. At March 31, 2005, the maximum availability under the Scotia LLC Line of Credit was \$55.9 million, and there were \$40.4 million in borrowings outstanding under this facility.

On the note payment date in January 2005, Scotia LLC used the funds available under the Scotia LLC Line of Credit to pay all of the \$28.5 million of interest due (\$26.3 million net of interest due in respect of Timber Notes held by Scotia LLC). Scotia LLC also repaid \$10.6 million of principal on the Timber Notes (an amount equal to Scheduled Amortization) using funds held in the SAR Account.

The Master Purchase Agreement between Scotia LLC and Palco (see Item 1. "Business—Forest Products Operations—Relationships among the Palco Companies" of the Form 10-K) contemplates that all sales of logs by Scotia LLC to Palco will be at fair market value (based on stumpage prices) for each species and category of logs. The Master Purchase Agreement provides that if the purchase price equals or exceeds the SBE Price and a structuring price set forth in a schedule to the Timber Notes Indenture, the purchase price is deemed to be at fair market value. If the purchase price equals or exceeds the SBE Price, but is less than the structuring price, then Scotia LLC is required to engage an independent forestry consultant to confirm that the purchase price reflects fair market value. In December 2004, the California State Board of Equalization adopted the new Harvest Value Schedule for the first half of 2005. The prices published in that schedule (which exceeded the applicable structuring prices) reflected a 14.3% increase in the SBE Price for small redwood logs and a 12.5% increase for small Douglas-fir logs from the prices published for the second half of 2004.

Capital expenditures have been made by Palco during the past three years which are expected to improve production efficiency and reduce operating costs. During 2004, Palco opened a new (replacement) planner facility and began construction on a new sawmill, both in Scotia, California. The project is expected to cost \$27.3 million (\$20.5 million of which was expended in 2004), with the last phase scheduled for completion in the third quarter of 2005 (subject to available cash). Funds for this project have been provided from existing cash resources and borrowings under the Palco Credit Agreement and the remaining funds are expected to be provided by borrowings from the Term Loan and/or the Revolving Credit Facility. As part of the project, Palco's Carlotta mill was permanently closed in 2004 and, in April 2005, Palco announced that it would also close its Fortuna mill. Certain equipment from these mills is being and will be moved to Palco's new sawmill in Scotia and management is considering alternative uses for the properties and remaining equipment, including sales to third parties. Capital expenditures were \$2.7 million for the first quarter of 2005 and are estimated to be between \$8.7 million and \$16.1 million for the remainder of 2005 (subject to available cash). Palco and Scotia LLC may purchase additional timberlands from time to time as appropriate opportunities arise.

Palco expects that in 2005 it will be required to fund approximately \$1.6 million to \$1.8 million for pension and other postretirement benefits.

Palco will require funds available under the Revolving Credit Facility and Term Loan in order to meet its working capital and capital expenditure requirements for the next year. Furthermore, Palco's cash flows from operations may be adversely affected by diminished availability of logs from Scotia LLC, lower lumber prices, adverse weather conditions, pending legal, regulatory and environmental matters or increased funding requirements for its pension plan. See "—Results of Operations—Forest Products Operations" above, as well as Note 8, for discussion of the regulatory, environmental and legal matters affecting harvest levels and operating costs.

With respect to long-term liquidity, until such time as Palco has adequate cash flows from operations, there can be no assurance that Palco will be able to meet its working capital, capital expenditure and debt service obligations. Liquidity, capital resources and results of operations in the long-term may continue to be adversely affected by the same factors affecting short-term cash flows from operations, as discussed above.

Real Estate Operations

Capital expenditures and real estate improvements and development costs are expected to be between approximately \$30.0 million to \$35.0 million in 2005. The Company expects that these expenditures will be funded by existing cash and available credit facilities.

The Company believes that the existing cash and credit facilities of its real estate subsidiaries are sufficient to fund the working capital and capital expenditure requirements of such subsidiaries for the next year. With respect to the long-term liquidity of such subsidiaries, the Company believes that their ability to generate cash from the sale of their existing real estate, together with their ability to obtain financing and joint venture partners, should provide sufficient funds to meet their working capital and capital expenditure requirements. PDMPI and its subsidiaries, however, have required advances from MAXXAM Parent in prior years to fund their operations, and PDMPI may require such advances in the future.

Racing Operations

Capital expenditures and investments in new ventures are expected to be between \$2.0 million and \$2.5 million in 2005.

Subsequent to December 31, 2004, SHRP, Ltd. borrowed \$4.5 million from MAXXAM Parent to fund its 2005 capital expenditures and improve its working capital position. SHRP, Ltd.'s management expects that SHRP, Ltd. may require additional advances from MAXXAM Parent to fund its operations and capital expenditures in the future. SHRP, Ltd. is experiencing strong competition from internet wagering and "racinos" in surrounding states. These factors will also play a role in SHRP, Ltd.'s long-term liquidity.

In January 2004, a subsidiary of the Company applied to the Texas Racing Commission for an additional license to construct and operate a Class 2 horse racing facility in Laredo, Texas. The review process is only in the preliminary stages, and there can be no assurance that the Company will obtain this additional license as, among other things, there is a competing applicant. Additionally, the Company is considering a variety of alternatives for addressing (should the subsidiary be granted the Laredo license) a Racing Act provision that a person may not own a greater than five percent interest in more than two Texas-licensed race tracks.

Kaiser's Operations

With respect to the Company's interest in Kaiser, the Debtors have indicated that they believe that it is likely that the equity of Kaiser's stockholders will be cancelled without consideration. See Note 7 for further information.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet financing, other than operating leases entered into in the normal course of business, or unconsolidated special purpose entities. The Company does not use derivatives for any of its treasury or risk management activities.

Trends

Forest Products

See Note 8 and Part I, Item 2. “Management’s Discussion and Analysis of Financial Conditions and Results of Operations—Financial Condition and Investing and Financing Activities—Forest Products Operations” for information regarding various regulatory, environmental, litigation and other matters which have caused and are expected to continue to cause delays in the approval of the Company’s THPs and the ability to harvest on THPs once they are approved, as well as adverse impacts on harvest levels and timber harvesting and other costs.

Real Estate

PDMPI is considering various alternatives to accelerate sales of its remaining 1,130 acres of undeveloped land as well as disposition of other assets. In connection with this, PDMPI has been working with an agent to solicit developer and investor interest in acquiring such acreage and other assets. While some expressions of interest have been received, no assurance can be given that these efforts will be successful.

Racing

The Texas legislature, which is currently in its regular January to June 2005 session, is considering a variety of alternatives to address a projected budget shortfall, including enhancing state revenues through additional forms of gaming such as video lottery terminals at existing horse and dog racing tracks, gaming on Indian reservations, and full casinos. The Company is vigorously pursuing any such legislation which is favorable to it. As any legislation expanding gaming in Texas would require the approval of two-thirds of each legislative house and a majority of the state’s voters, no assurance can be given that any such legislation will be enacted or become effective. Moreover, it is impossible to determine what the provisions of any such legislation will be or its effect on the Company.

Contractual Obligations

At January 1, 2005, the Company entered into an operating lease for its Corporate offices. The lease began on January 1, 2005 and terminates on September 30, 2015. Minimum annual rental payments under the lease are \$0.1 million in 2005 and escalate to a maximum of \$0.4 million in 2014.

Critical Accounting Policies and Estimates

See Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates” of the Form 10-K for a discussion of the Company’s critical accounting policies. There have been no material changes to the Company’s critical accounting policies and estimates provided in the Form 10-Q.

New Accounting Pronouncements

See Note 2 for a discussion of new accounting pronouncements and their potential impact on the Company.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to changes in interest rates primarily under the Scotia LLC Line of Credit and the Revolving Credit Facility and Term Loan, as well as certain other debt facilities used to finance real estate development activities. As of March 31, 2005, there were \$52.7 million in borrowings outstanding under all variable rate facilities. Based on the amount of borrowings outstanding under these facilities during the three months ended March 31, 2005, a 1.0% change in interest rates effective from the beginning of the year would have resulted in an increase or decrease in interest expense for the period of \$0.1 million.

ITEM 4. 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 reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, 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.

As of the end of the period covered by this report, our management carried out an evaluation, under the supervision and with the participation of the Company's management, including our Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on the evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of March 31, 2005.

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 8 is incorporated herein by reference.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The Company may from time to time purchase shares of its Common Stock on national exchanges or in privately negotiated transaction. No such purchases occurred during the three months ended March 31, 2005, or through the date of this report.

ITEM 6. EXHIBITS

a. Exhibits:

- 10.1 Revolving Credit Agreement, dated April 19, 2005, among Palco, Britt, the lenders from time to time party thereto, and The CIT Group/Business Credit, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 25, 2005)
- 10.2 Term Loan Agreement, dated April 19, 2005, among Palco, Britt, the lenders from time to time party thereto and Credit Suisse First Boston (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on April 25, 2005)
- 10.3 Guarantee and Collateral Agreement, dated April 19, 2005, made by Palco, Britt, MGI, Salmon Creek and Scotia Inn Inc. in favor of The CIT Group/Business Credit, Inc. (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on April 27, 2005; the "April 27, 2005 Form 8-K")
- 10.4 Guarantee and Collateral Agreement, dated April 19, 2005, made by Palco, Britt, MGI, Salmon Creek and Scotia Inn Inc. in favor of Credit Suisse First Boston (incorporated herein by reference to Exhibit 10.4 to the April 27, 2005 Form 8-K)
- 10.5 Deed of Trust, Security Agreement, Assignment of Rents and Leases and Fixture Filing, dated April 19, 2005, by and from Palco to Fidelity National Title Company, for the benefit of The CIT Group/Business Credit, Inc., as administrative agent (incorporated herein by reference to Exhibit 10.5 to the April 27, 2005 Form 8-K)
- 10.6 Deed of Trust, Security Agreement, Assignment of Rents and Leases and Fixture Filing, dated April 19, 2005, by and from Palco to Fidelity National Title Company, for the benefit of Credit Suisse First Boston, as administrative agent (incorporated herein by reference to Exhibit 10.6 to the April 27, 2005 Form 8-K)

- 10.7 Executive Employment Agreement, dated April 1, 2005, between the Company and Emily Madison (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 1, 2005; the "April 1, 2005 Form 8-K")
 - 10.8 2005 Bonus Criteria for the MAXXAM Chief Executive Officer under the MAXXAM 1994 Executive Bonus Plan (incorporated herein by reference to Exhibit 10.2 to the April 1, 2005 Form 8-K)
 - 10.9 2005 Bonus Criteria for the MAXXAM President and Chief Financial Officer under the MAXXAM 1994 Executive Bonus Plan (incorporated herein by reference to Exhibit 10.3 to the April 1, 2005 Form 8-K)
 - 10.10 2005 Bonus Criteria for the MAXXAM Vice Chairman and General Counsel under the MAXXAM 1994 Executive Bonus Plan (incorporated herein by reference to Exhibit 10.4 to the April 1, 2005 Form 8-K)
 - 10.11 Undertaking, dated March 28, 2005, executed by the Company in favor of Diane Dudley (incorporated herein by reference to Exhibit 10.5 to the April 1, 2005 Form 8-K)
 - * 31.1 Section 302 Certification of Chief Executive Officer
 - * 31.2 Section 302 Certification of Chief Financial Officer
 - * 32.1 Section 906 Certification of Chief Executive Officer
 - * 32.2 Section 906 Certification of Chief Financial Officer
- * Included with this filing

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 INC.

Date: May 9, 2005

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

Date: May 9, 2005

By: /S/ M. EMILY MADISON
M. Emily Madison
Vice President, Finance
(Principal Accounting Officer)

Glossary of Defined Terms

Set forth below is a list of all terms used in this Report.

APB Opinion No. 25: Accounting Principles Board Opinion 25, “Accounting for Stock Issued to Employees”

Bankruptcy Code: The United States Bankruptcy Code

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

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

Borrowers: Palco and Britt, as borrowers under the Revolving Credit Facility and Term Loan

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

California Permits: The Permits issued by California pursuant to the HCP

California Senate Bill 810: Bill which became effective January 1, 2004 providing regional water quality control boards with additional authority related to the approval of THPs on land within impaired watersheds

Cases: The Chapter 11 proceedings of the Debtors

Cave action: An action entitled *Steve Cave, et al. v. Gary Clark, et al.* (No. DR020719) filed in the Superior Court of Humboldt County, California

CDF: California Department of Forestry and Fire Protection

CESA: California Endangered Species Act

Class A Preferred Stock: The Company’s Class A \$.05 Non-Cumulative Participating Convertible Preferred Stock

Common Stock: The Company’s \$0.50 par value common stock

Company: MAXXAM Inc., including its subsidiaries

Cook action: An action entitled *Alan Cook, et al. v. Gary Clark, et al.* (No. DR020718) filed in the Superior Court of Humboldt County, California

CWA: Federal Clean Water Act

Debtors: Kaiser, KACC and the subsidiaries of KACC which have filed petitions for reorganization

EBITDA: As defined in Section 1.01 in the Revolving Credit Agreement and Term Loan which, among other things, excludes the results of Scotia LLC

Elk River Order: Clean up and abatement order issued to Palco by the North Coast Water Board for the Elk River watershed

Environmental Plans: The HCP and the SYP

EPA: Federal 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.* filed in the Superior Court of Humboldt County, California (No. CV990445)

EPIC-USFWS/NOAA lawsuit: An action entitled *Environmental Protection Information Center v. U.S. Fish & Wildlife Service, NOAA Fisheries, et al.* (No. C04-4647) filed in U.S. Court for the Northern District of California against the Palco Companies and two federal agencies

ERISA: the Employee Retirement Income Security Act of 1974, as amended from time to time

FASB: Financial Accounting Standards Board

FDIC: Federal Deposit Insurance Corporation

FDIC action: An action entitled *Federal Deposit Insurance Corporation, as manager of the FSLIC Resolution Fund v. Charles E. Hurwitz* (No. H-95-3956) filed by the FDIC on August 2, 1995 in the U.S. District Court for the Southern District of Texas

Federal Permits: The Permits issued by the federal government pursuant to the HCP

Federated: Federated Development Company, a principal stockholder of the Company now known as Gideon Holdings, Inc.

Filing Date: With respect to any particular Debtor, the date on which such Debtor filed its Case

FireRock LLC: A 50% owned joint venture which developed and manages a real estate project in Arizona

Form 10-K: Annual Report on Form 10-K of the Company for the fiscal year ended December 31, 2004

FSP FAS 106-2: FASB Staff Position FAS 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003"

Harvest Value Schedule: A schedule setting forth SBE Prices which is published biannually by the California State Board of Equalization for purposes of computing yield taxes on timber sales

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

Headwaters Agreement: The agreement among Palco, Scotia LLC, Salmon Creek, the United States and California pursuant to which the Palco Companies transferred to the United States government 5,600 acres of timberlands in exchange for \$300 million, approximately 7,700 acres of timberlands, and federal and state government-approved habitat conservation and sustained yield plans

Humboldt DA action: A civil suit entitled *The People of the State of California v. Pacific Lumber, Scotia Pacific Holding Company and Salmon Creek Corporation* (No. DR030070) filed in the Superior Court of Humboldt County, California, by the District Attorney of Humboldt County

KACC: Kaiser Aluminum & Chemical Corporation, Kaiser's principal operating subsidiary

Kahn lawsuit: An action entitled *Alan Russell Kahn v. Federated Development Co., MAXXAM Inc., et. al.* (Civil Action 18623NC) filed in the Delaware Court of Chancery

Kaiser: Kaiser Aluminum Corporation, a subsidiary of the Company engaged in aluminum operations

Kaiser Shares: 50,000,000 shares of the common stock of Kaiser owned by the Company and MGHI

LIBOR: London Inter Bank Offering Rate

Master Purchase Agreement: The agreement between Palco and Scotia LLC that governs all purchases of logs by Palco from Scotia LLC

MAXXAM: MAXXAM Inc., including its subsidiaries

MAXXAM Parent: MAXXAM Inc., excluding its subsidiaries

Moody's: Moody's Investor Service

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

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

MPC: MAXXAM Property Company, a wholly owned subsidiary of the Company

NJDEP: New Jersey Department of Environmental Protection

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

Option A Plan: Palco's plan for complying with California's sustained yield requirements, which has been approved by the CDF

Original Debtors: Kaiser, KACC and the 15 subsidiaries of KACC that filed petitions for reorganization on February 12, 2002

OTS: The United States Department of Treasury's Office of Thrift Supervision

OTS action: A formal administrative proceeding initiated by the OTS against the Company and others on December 26, 1995

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

Palco Companies: Palco, Scotia LLC and Salmon Creek, collectively

Palco Credit Agreement: January 2004 revolving credit facility between Palco and a bank which provided for borrowings up to \$30.0 million, based upon certain collateral balances, which was terminated in connection with the closing of the Revolving Credit Facility and Term Loan

Palco Timberlands: The Scotia LLC Timberlands and the timberlands owned by Palco and Salmon Creek

Palmas: Palmas del Mar, a master-planned residential community and resort located on the southeastern coast of Puerto Rico near Humacao

PDMPI: Palmas del Mar Properties, Inc., a wholly owned subsidiary of the Company

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

Prescription Drug Act: Medicare Prescription Drug, Improvement, and Modernization Act of 2003

PSLRA: Private Securities Litigation Reform Act of 1995

Racing Act: The Texas Racing Act and related regulations

Respondents: The Company, Federated, Mr. Charles Hurwitz and the other respondents in the *OTS action*

Revolving Credit Agreement: The agreement evidencing the Revolving Credit Facility

Revolving Credit Facility: \$30 million revolving credit facility evidenced by the Revolving Credit Agreement dated as of April 19, 2005 among Palco and Britt, as borrowers, and Credit Suisse First Boston

Rights: The Series A and B Rights

RI/RA: Remedial investigation and remedial action

S&P: Standard & Poor's Rating Service

Salmon Creek: Salmon Creek LLC, a wholly owned subsidiary of Palco

Sam Houston Race Park: Class 1 horse racing facility in Houston, Texas operated by SHRP, Ltd.

Sanctions Motion: A counterclaim and motion for sanctions filed by the Respondents on November 8, 2002, in connection with the *FDIC action*

SAR Account: Funds held in a reserve account titled the Scheduled Amortization Reserve Account and used 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 Palco

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

Scotia LLC Timber: The timber in respect of the Scotia LLC Timberlands and the Scotia LLC Timber Rights

Scotia LLC Timberlands: Approximately 204,000 acres of timberlands owned by Scotia LLC

Scotia LLC Timber Rights: Scotia LLC's exclusive right to harvest on approximately 12,200 acres of timberlands owned by Palco and Salmon Creek

Services Agreement: The agreement between Palco and Scotia LLC regarding services to be provided to Scotia LLC by Palco

SEC: The Securities and Exchange Commission

SFAS: Statement of Financial Accounting Standards

SFAS No. 123(r): SFAS No. 123 (revised 2004), "Share-Based Payments"

SFAS No. 151: SFAS No. 151, "Inventory Costs"

SFAS No. 153: SFAS No. 153, "Exchange of Nonmonetary Assets," an amendment of APB Opinion No. 29

SHRP, Ltd.: Sam Houston Race Park, Ltd., a wholly owned subsidiary of the Company

State Water Board: California State Water Resources Control Board

SYP: The sustained yield plan approved in March 1999, as part of the Headwaters Agreement

take: Adverse impacts on species which have been designated as endangered or threatened

Term Loan: \$35.0 million term loan evidenced by the Term Loan Agreement dated as of April 19, 2005 among Palco and Britt, as borrowers, and The CIT Group/Business Credit, Inc.

Texas Racing Commission: The Racing Commission of the State of Texas

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

THP No. 520 lawsuit: An action entitled *The Pacific Lumber Company, et al. v. California State Water Resources Control Board* (No. DR010860) filed in the Superior Court of Humboldt County, California

Timber Notes: Scotia LLC's 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

Trustee: The trustee under the Timber Notes Indenture

USAT: United Savings Association of Texas

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. CV990452) filed in the Superior Court of Humboldt County, California

WWDRs: Watershed-wide discharge requirements