UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 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**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.50 par value	American

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes 9 No :

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes 9 No :

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. :

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (Check one):
Large accelerated filer 9 Accelerated filer : Non-accelerated filer 9

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes 9 No :

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: $71.6 million.

Number of shares of common stock outstanding at March 1, 2006: 5,967,942

DOCUMENTS INCORPORATED BY REFERENCE:

Certain portions of Registrant's definitive proxy statement, to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the close of the Registrant's fiscal year, are incorporated by reference under Part III.

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PART I

ITEM 1. BUSINESS

General

MAXXAM Inc. and its controlled subsidiaries are collectively referred to herein as the **"Company"** or **"MAXXAM"** unless otherwise indicated or the context indicates otherwise. The term **"MAXXAM Parent"** refers to the Company on a stand-alone basis without its subsidiaries. Some terms used herein are defined in the Glossary of Defined Terms. The Company conducts the substantial portion of its operations through its subsidiaries, which operate in three principal industries. Any reference herein to a company includes the subsidiaries of that company unless otherwise noted or the context indicates otherwise.

- Forest products, through MAXXAM Group Inc. (**"MGI"**) and MGI's wholly owned subsidiary, The Pacific Lumber Company (**"Palco"**), and Palco's wholly owned subsidiaries, Scotia Pacific Company LLC (**"ScoPac"**) and Britt Lumber Co., Inc. (**"Britt"**). MGI engages in the growing and harvesting of redwood and Douglas-fir timber, the milling of logs into lumber and related operations. Housing, construction and remodeling are the principal markets for the Company's lumber products.

- Real estate investment and development, through MAXXAM Property Company (**"MPC"**) and other wholly owned subsidiaries of the Company, as well as joint ventures. These subsidiaries are engaged in the business of residential and commercial real estate investment and development, primarily in Arizona, California, Puerto Rico and Texas, including associated golf course or resort operations in certain locations, and also own several commercial real estate properties that are subject to long-term lease arrangements.

- Racing operations, through Sam Houston Race Park, Ltd. (**"SHRP, Ltd."**), a Texas limited partnership, wholly owned by the Company. SHRP, Ltd. owns and operates a Class 1 pari-mutuel horse racing facility in the greater Houston metropolitan area, and a pari-mutuel greyhound racing facility in Harlingen, Texas.

In addition to the above, the Company owns approximately 50,000,000 shares (**"Kaiser Shares**") of the common stock of Kaiser Aluminum Corporation (**"Kaiser"**), which represent approximately 63% of Kaiser's common stock. However, in 2002-2003, Kaiser and a number of its subsidiaries filed for reorganization under Chapter 11 of the United States Bankruptcy Code (**"Bankruptcy Code"**). Kaiser's plan of reorganization, which provides for the cancellation of the equity interests of current shareholders without consideration or obligation, was confirmed by the Bankruptcy Court supervising the Kaiser bankruptcy cases (**"Kaiser Bankruptcy Court"**) in February 2006. However, Kaiser's plan of reorganization is not yet final, as it must still be approved by the U.S. District Court before Kaiser can emerge from Chapter 11, and is also subject to appeal. See "– Kaiser Aluminum" and Notes 1 and 10 to the Consolidated Financial Statements contained herein for further information. Except as otherwise indicated, all references herein to "Notes" represent the Notes to the Consolidated Financial Statements contained herein.

This Annual Report on Form 10-K contains statements which constitute"forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (**"PSLRA"**). *These statements appear in a number of places (see Item 1."Business–Forest Products Operations–Timber and Timberlands" and "–Regulatory and Environmental Factors;" most sections under Item 3. "Legal Proceedings;" and several sections under Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations"). Such statements can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "estimates," "should," "could," "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, the ability to obtain financing, new or modified statutory, environmental or regulatory requirements, litigation developments, and changing prices and market conditions. This Report identifies 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.*

Forest Products Operations

General

The Company engages in forest products operations through MGI, Palco, Britt and ScoPac. Palco, which has been in continuous operation for over 130 years, engages in the growing and harvesting of redwood and Douglas-fir timber, the milling of logs into lumber products, and certain related operations. Palco has over the past several years implemented a number of changes intended to allow it to operate on a more efficient and cost effective basis. These changes included undertaking a mill improvement project that included constructing a new technologically advanced sawmill, installing a new planer facility, closing two of its older sawmills (Carlotta and Fortuna) and most of its remanufacturing facilities, and eliminating certain of its facilities, such as its company-staffed logging operations. See "– Production Facilities."

The Company's forest products operations have been significantly and adversely affected by, among other things, the failure of the California North Coast Regional Water Quality Control Board (**"North Coast Water Board"**) to release for harvest a number of ScoPac's timber harvesting plans (**"THPs"**) even though the plans have already been approved by the other government agencies which review ScoPac's THPs and are in compliance with Palco's habitat conservation plan. See "–Regulatory and Environmental Factors–Water Quality" and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Financial Condition and Investing and Financing Activities– Forest Products Operations."

Timber and Timberlands

This section contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. See this section, "Business–General" above and Item 1A. "Risk Factors" below for cautionary information with respect to such forward-looking statements.

Palco owns and manages, principally through ScoPac, approximately 217,000 acres of virtually contiguous commercial timberlands located in Humboldt County along the northern California coast, an area which has very favorable soil and climate conditions for growing timber. These timberlands, which are located in close proximity to Palco's sawmills and have an extensive network of roads, contain predominantly conifer timber. Palco's conifers consist (by volume) of approximately 66% redwood, 30% Douglas-fir, and 4% other conifer timber. Approximately 204,000 acres of Palco's timberlands are owned by ScoPac (**"ScoPac Timberlands"**), and ScoPac has the exclusive right to harvest (**"ScoPac Timber Rights"**) approximately 12,200 acres of timberlands owned by Palco and its subsidiary, Salmon Creek LLC (**"Salmon Creek"**). The timber in respect of the ScoPac Timberlands and the ScoPac Timber Rights is collectively referred to as the **"ScoPac Timber"** and the timberlands in respect of the ScoPac Timber are referred to as the **"ScoPac Timber Property."** The ScoPac Timber Property and the timberlands of Palco and Salmon Creek are collectively referred to as the **"Palco Timberlands."** Substantially all of ScoPac's assets are pledged as security for its 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 (collectively, the **"Timber Notes"**). The Indenture governing the Timber Notes is referred to herein as the **"Timber Notes Indenture."** Under a master purchase agreement between Palco and Scopac (**"Master Purchase Agreement"**), Palco harvests and purchases from ScoPac virtually all of the logs harvested from the ScoPac Timber. See "–Relationships among the Palco Companies" below for a description of this and other relationships among the Palco, Scopac and Salmon Creek.

Timber generally is categorized by species and the age of a tree when it is harvested. **"Old growth"** trees are often defined as trees which have been growing for approximately 200 years or longer and **"young growth"** or **"second growth"** trees are those which have been growing for less than 200 years. The forest products industry grades lumber into various classifications according to quality. The two broad categories into which all grades fall based on the absence or presence of knots are called "upper" and "common" grades, respectively. Old growth trees have a higher percentage of upper grade lumber than young growth trees.

ScoPac's foresters, wildlife and fisheries biologists, geologists, botanists and other personnel provide a number of forest stewardship techniques, including protecting ScoPac Timber from forest fires, erosion, insects and other damage, overseeing reforestation activities, and implementing and monitoring environmental and regulatory compliance. ScoPac's personnel also prepare THPs and maintain and update the information contained in its geographical information system (**"GIS"**). See "–Harvesting Practices" below for a description of the GIS updating process and the THP preparation process. Palco and ScoPac engage in extensive efforts to supplement the natural regeneration of timber and increase the amount of timber on the Palco Timberlands. ScoPac and Palco are required to comply with California forestry regulations regarding reforestation, which generally require that an area be reforested to specified standards within an established period of time. Pursuant to the services agreement (**"Services Agreement"**) between Palco and ScoPac described below (see "–Relationships among the Palco Companies"), Palco conducts regeneration activities on the ScoPac Timber Property on behalf of ScoPac. Reforestation of redwood timber generally is accomplished through redwood sprouts from the stumps of harvested trees and the planting of redwood seedlings at levels designed to optimize growth. Douglas-fir timber is regenerated almost entirely by planting seedlings. During 2005, Palco planted an estimated 1,350,000 redwood and Douglas-fir seedlings.

California law requires large timberland owners, including Palco, to demonstrate that their timber operations will not decrease the sustainable productivity of their timberlands. The applicable regulations require 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. A timber company may comply with this requirement by submitting a sustained yield plan to the California Department of Forestry and Fire Protection (**"CDF"**) for review and approval. Timber companies which do not have a sustained yield plan are allowed to follow alternative procedures (see below).

Palco and ScoPac are also subject to federal and state laws providing for the protection and conservation of wildlife species which have been designated as endangered or threatened, certain of which are found on the Palco Timberlands. These laws generally prohibit certain adverse impacts on such species (referred to as a **"take"**), except for incidental take which does not jeopardize the continued existence of the affected species and occurs as a result of operations that comply with an approved habitat conservation plan and related incidental take permit. A habitat conservation plan analyzes the impact of the incidental take and specifies measures to monitor, minimize and mitigate such impact. As part of the Headwaters Agreement **(**see "–Regulatory and Environmental Factors–Environmental Plans"), the federal and state governments approved a sustained yield plan (**"SYP"**) (see "–Regulatory and Environmental Factors–Environmental Plans") and a comprehensive multi-species habitat conservation plan (**"HCP"**, and together with the SYP, the **"Environmental Plans"**) in respect of substantially all of the Palco Timberlands.

In connection with two lawsuits filed against the Palco Companies, a California trial court invalidated the SYP and the incidental take permits issued by California in connection with the Environmental Plans (**"California Permits"**). However, the Palco Companies appealed this decision, and in December 2005, the appeals court reversed the trial court's ruling. See Item 3. "Legal Proceedings–Forest Products Litigation" for further information regarding this matter. As a result of these cases, ScoPac from October 2002 until March 2005 obtained review and approval of its THPs under an alternative procedure in the California forest practice rules known as "Option C." Option C is available to landowners who have submitted an "Option A" plan to the CDF for review (as was done by Palco). An approved Option A plan is an alternative to obtaining approval of a sustained yield plan. Palco's Option A plan (**"Option A Plan"**) was approved by the CDF in March 2005. The Palco Companies are currently relying upon its Option A Plan to obtain THP approvals, and will likely continue to do so in the future.

Harvesting Practices

The ability of Palco to harvest timber depends in large part upon the ability to obtain regulatory approval of THPs prepared by ScoPac's foresters. Prior to harvesting timber in California, companies are obligated to obtain the CDF's approval of a detailed THP for the area to be harvested. A THP must be submitted by a Registered Professional Forester and is required to include information regarding the method of proposed timber operations for a specified area, whether the operations will have any adverse impact on the environment and, if so, the mitigation measures to be used to reduce any such impact. The CDF's evaluation of THPs incorporates review and analysis of such THPs by several California and federal agencies and public comments received with respect to such THPs. The number of ScoPac's approved THPs and the amount of timber covered by such THPs can vary significantly from time to time, depending upon the timing of agency review and other factors. Timber covered by an approved THP is typically harvested within a one-year period from the date that harvesting first begins.

The Timber Notes Indenture requires ScoPac to use its best efforts (consistent with prudent business practices) to maintain a number of pending THPs which, together with THPs previously approved, would cover rights to harvest a quantity of ScoPac Timber adequate to pay interest and principal amortization based on the Minimum Principal Amortization schedule (as set forth in the Timber Notes Indenture) for the Timber Notes for the next succeeding twelve-month period. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Financial Condition and Investing and Financing Activities–Forest Products Operations" regarding delays by the North Coast Water Board in releasing already-approved THPs for harvest. Also see "–Regulatory and Environmental Factors," Item 3. "Legal Proceedings–Forest Products Litigation," and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for various legal, regulatory, environmental and other challenges being faced by Palco in connection with timber harvesting and other operations on its timberlands.

ScoPac maintains the GIS, a detailed geographical information system covering the Palco Timberlands. The GIS covers numerous aspects of these timber properties, including timber type, site productivity class, wildlife and botanical data, geological information, roads, rivers and streams. Pursuant to the Services Agreement, Palco, to the extent necessary, assists ScoPac in updating, upgrading and improving the GIS and the other computer systems owned by ScoPac. By carefully monitoring and updating this data base and conducting field studies, ScoPac's foresters are better able to develop detailed THPs addressing the various regulatory requirements. ScoPac also utilizes a Global Positioning System (**"GPS"**), which can provide precise location of geographic features through satellite positioning. Use of the GPS greatly enhances the quality and efficiency of the GIS data.

ScoPac employs a variety of well-accepted methods of selecting trees for harvest designed to achieve optimal growth and regeneration. These methods, referred to as "silvicultural systems" in the forestry profession, range from very light thinnings (aimed at enhancing the growth rate of retained trees) to clear cutting, which results in the harvest of nearly all trees in an area (with the exception of sub-merchantable trees and trees retained for wildlife protection and future stand enhancement) and replacement with a new forest stand. In between are a number of varying levels of partial harvest that can be employed.

Production Facilities

Palco operates two highly mechanized sawmills and related facilities located in Scotia, California and Arcata, California. Palco's sawmills had historically been supplied almost entirely from timber harvested from its timberlands. More recently, Palco has had to supplement its internal log supply with logs purchased from third parties. Palco has over the years implemented numerous technological advances that have increased the operating efficiency of its production facilities and the recovery of finished products from its timber.

In April 2004, Palco commenced a mill improvement project, including a new sawmill located in Scotia. The new sawmill was constructed in two phases. The first phase of the project, the processing of smaller diameter second growth logs (up to 24" in diameter) is a high-speed processing line that includes advanced scanning and optimization technology intended to maximize lumber recovery. The second phase, the relocation of large log equipment from the Carlotta mill, came on line in October 2005. This phase allows for processing of larger logs up to 60" in diameter. Although there were more difficulties than Palco expected, since commencing production, Palco has made substantial progress in refining the production process in the new mill, particularly the high-speed small log processing line. There have been delays in completion of the large log processing line, however, and it is not yet operating at planned production rates, primarily due to a current imbalance between small diameter and large diameter logs which impacts the mill's throughput. Palco also completed a new $5.0 million planer project in Scotia in January 2004. This high speed system processes rough sawn boards into finished lumber at rates up to four times faster than the older planers at the former Carlotta and Fortuna mills.

Britt's primary business is the processing of small diameter redwood logs into fencing products for sale to retail and wholesale customers. Britt purchases, primarily from Palco but also from other timberland owners, small diameter (6 to 15 inch) redwood logs of varying lengths. Britt processes these logs at its mill into a variety of fencing products, including "dog-eared" 1" by 6" fence stock in six foot lengths, 4" by 4" fence posts in 6 through 12 foot lengths, and other lumber products in 6 through 12 foot lengths. Britt's mill and related facilities are located in Arcata, California. Britt produced approximately 79, 86 and 76 million board feet of lumber in 2005, 2004 and 2003, respectively.

Subject to market conditions and lumber supply, Palco dries a portion of its lumber before it is processed or sold. Air or kiln-dried lumber generally commands higher prices than "green" lumber, which is lumber sold before it has been dried. Drying also allows Palco to compete in additional markets (due to lower shipping costs resulting from the moisture and weight reduction which occurs in the drying process). Palco owns and can operate up to 31 kilns having an annual capacity of approximately 38 million board feet.

Palco had previously operated a finishing and remanufacturing plant in Scotia that processed rough lumber into a variety of finished products. However, the facility was closed in 2005 as part of Palco's ongoing efforts to operate more efficiently.

Palco owns and operates a cogeneration power plant which is fueled by the wood residue from logging and lumber production operations. The operations of Palco and Britt supplied 53% of the fuel in 2005. The power plant is capable of producing up to 32.5 megawatts per hour and generates substantially all of the energy requirements of Scotia, California, the town located in the midst of the Palco Timberlands. Several of Palco's facilities are located in Scotia and a number of its employees live there. Palco sells surplus power to Pacific Gas and Electric Company. In 2005, the sale of surplus power accounted for approximately 6% of MGI's total revenues.

Products

MGI produced 266.8, 298.1 and 289.3 million board feet of lumber in 2005, 2004 and 2003, respectively. The following table sets forth the distribution of MGI's lumber production (on a net board foot basis) and revenues by product line:

	Year Ended December 31, 2005			Year Ended December 31, 2004		
Product	**% of Total Lumber Production Volume**	**% of Total Lumber Revenues**	**% of Total Revenues**	**% of Total Lumber Production Volume**	**% of Total Lumber Revenues**	**% of Total Revenues**
Upper grade redwood lumber	2%	5%	4%	6%	13%	12%
Common grade redwood lumber	64%	72%	61%	70%	71%	63%
Total redwood lumber	66%	77%	65%	76%	84%	75%
Upper grade Douglas-fir lumber	– %	– %	– %	1%	1%	1%
Common grade Douglas-fir lumber	33%	22%	19%	21%	14%	12%
Total Douglas-fir lumber	33%	22%	19%	22%	15%	13%
Other grades of lumber	1%	1%	1%	2%	1%	1%
Total lumber	100%	100%	85%	100%	100%	89%
Logs			5%			3%
Wood chips			2%			2%

In 2005, MGI sold 281.9 million board feet of lumber. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Results of Operations–Forest Products Operations" for additional information. Lumber products vary greatly by the species and quality of the timber from which they are produced. Lumber is sold not only by grade (such as "upper" grade versus "common" grade), but also by board size and the drying process associated with the lumber.

Redwood lumber has historically been MGI's largest product category. Redwood is commercially available only along the northern coast of California and possesses certain unique characteristics that permit it to be sold at a premium to many other wood products. Such characteristics include its natural beauty, superior ability to retain paint and other finishes, dimensional stability and innate resistance to decay, insects and chemicals. Typical applications include exterior siding, trim and fascia for both residential and commercial construction, outdoor furniture, decks, planters, retaining walls and other specialty applications. Redwood also has a variety of industrial applications because of its chemical resistance and because it does not impart any taste or odor to liquids or solids.

Upper grade redwood lumber, which is derived primarily from larger diameter logs and is characterized by an absence of knots and other defects, little to no sapwood, and a tighter grain, is used primarily in distinctive interior and exterior applications. Common grade redwood lumber, historically MGI's largest volume product, has many of the same aesthetic and structural qualities of redwood uppers, but has some knots, sapwood and a coarser grain. Such lumber is commonly used for construction purposes, including outdoor structures such as decks and fencing.

Douglas-fir lumber is used primarily for new construction and some decorative purposes and is widely recognized for its strength, hard surface and attractive appearance. Douglas-fir is grown commercially along the west coast of North America and in Chile and New Zealand. Upper grade Douglas-fir lumber is derived primarily from larger diameter Douglas-fir timber and is used principally in finished carpentry applications. Common grade Douglas-fir lumber is used for a variety of general construction purposes and is somewhat interchangeable with common grades of other whitewood species, although the strength of Douglas-fir makes it more desirable in certain applications.

During 2005, MGI purchased approximately 47.0 million board feet of logs from third parties. MGI does not have any significant contractual relationships with third parties relating to the purchase of logs. Palco produces softwood chips from the wood residue from its milling operations. These chips are sold to third parties for the production of wood pulp and paper products. Subject principally to economic feasibility, Palco also produces and sells to third parties wood chips from hardwood trees.

Backlog and Seasonality

MGI's backlog of sales orders at December 31, 2005 was $11.8 million, of which it is estimated that $5.3 million will be shipped in the first quarter of 2006. The sales backlog at December 31, 2004, was $50.8 million, of which $13.8 million was shipped in the first quarter of 2005. MGI has historically experienced lower first quarter sales due largely to the general decline in construction-related activity during the winter months. As a consequence, MGI's results in any one quarter are not necessarily indicative of results to be expected for the full year. See also "–Regulatory and Environmental Factors" below and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Financial Condition and Investing and Financing Activities–Forest Products Operations."

Marketing

The housing, construction and remodeling markets are the primary markets for MGI's lumber products. MGI's goal is to maintain a wide geographic distribution of its products. MGI's accounts are primarily wholesale, followed by industrial end users, manufacturers, retailers and exporters. MGI's redwood and Douglas-fir lumber is sold throughout the entire United States, as well as to export markets. Common grades of redwood lumber are sold principally west of the Mississippi River, with California accounting for approximately 80% of common redwood sales in 2005. Common grades of Douglas-fir lumber are sold primarily in California. In 2005, MGI's largest three customers accounted for approximately 16%, 6% and 6%, respectively, of MGI's total net lumber sales. Exports of lumber accounted for less than 1% of MGI's total net lumber sales in 2005. MGI markets its products through its own sales staff, which focuses primarily on domestic sales.

MGI actively follows trends in the housing, construction and remodeling markets in order to maintain an appropriate level of inventory and assortment of products. Due to its high quality products, strong brand recognition, competitive prices and long history, MGI believes it has a strong degree of customer loyalty. However, this customer loyalty would be severely tested if long-term product shortages result from the regulatory and other difficulties being experienced by Palco. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Financial Condition and Investing and Financing Activities–Forest Products Operations."

Competition

MGI's lumber is sold in highly competitive markets. Competition is generally based upon a combination of price, service, product availability and product quality. MGI's products compete not only with other wood products but with metals, masonry, plastic and other construction materials made from non-renewable resources. The level of demand for

MGI's products is dependent on such broad factors as overall economic conditions, interest rates and demographic trends. In addition, competitive considerations, such as total industry production and competitors' pricing, as well as the price of other construction products, affect the sales prices for MGI's lumber products. Competition in the common grade redwood and Douglas-fir lumber market is intense, with MGI competing with numerous large and small lumber producers. MGI primarily competes with the northern California mills of Simpson, Redwood Empire, Sierra Pacific, Canadian cedar lumber producers, as well as other imports and non-wood alternatives.

Employees

As of March 1, 2006, MGI had approximately 635 employees.

Relationships among the Palco Companies

The Palco Companies are parties to several agreements between or among themselves, including the Master Purchase Agreement, the Services Agreement, an additional services agreement, a reciprocal rights agreement, and an environmental indemnification agreement.

The Master Purchase Agreement between Palco and ScoPac governs the sale to Palco of logs harvested from the ScoPac Timber Property. As Palco purchases logs from ScoPac pursuant to the Master Purchase Agreement, Palco is responsible, at its own expense, for harvesting and removing the standing ScoPac Timber covered by approved THPs, with the purchase price being based upon "stumpage prices." Title to, and the obligation to pay for, harvested logs passes to Palco when the logs are measured. The Master Purchase Agreement contemplates that all sales of logs by ScoPac to Palco will be at fair market value (based on stumpage prices) for each species and category of timber. The Master Purchase Agreement provides that if the purchase price equals or exceeds the SBE Price (as defined below) 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 ScoPac is required to engage an independent forestry consultant to confirm that the purchase price reflects fair market value. **"SBE Price"** is the stumpage price for each species and category of timber as set forth in the most recent **"Harvest Value Schedule"** (or any successor publication) published by the California State Board of Equalization (or any successor agency) applicable to the timber sold during the applicable period. Harvest Value Schedules are published twice a year for purposes of computing a yield tax imposed on timber harvested between January 1 through June 30 and July 1 through December 31. SBE Prices are not necessarily representative of actual prices that would be realized from unrelated parties at subsequent dates.

ScoPac relies on Palco, pursuant to the Services Agreement between the companies, to provide operational, management and related services not performed by ScoPac's own employees with respect to the ScoPac Timber Property. These services include protecting the ScoPac Timber from fire, disease and insects; maintaining and rehabilitating roads on the ScoPac Timber Property; building new roads to permit the harvesting of ScoPac Timber; providing certain timber management services, such as replanting and reforestation, designed to supplement the natural regeneration of, and increase the amount of, ScoPac Timber; assisting ScoPac to comply with all applicable environmental laws; advising and consulting with ScoPac regarding legislative matters; preparing and filing on behalf of ScoPac (at Palco's cost) all pleadings and motions, and otherwise diligently pursuing, appeals of any denial and defense of any challenge to approval of any THP or the Environmental Plans or similar plan or permit and related matters; and otherwise furnishing all equipment, personnel and expertise not within the ScoPac's possession and reasonably necessary for the operation and maintenance of the ScoPac Timber Property and ScoPac Timber.

Palco is required to provide all services under the Services Agreement in a manner consistent in all material respects with prudent business practices which are consistent with then-current applicable industry standards and are in compliance in all material respects with all applicable timber laws. ScoPac pays Palco a services fee, which is adjusted annually based on a specified government price index relating to wood products, and which covers a portion of Palco's costs of providing services. ScoPac also reimburses Palco for the cost of constructing, rehabilitating and maintaining roads, and performing reforestation services, on the ScoPac Timber Property. Certain of such reimbursable expenses vary in relation to the amount of timber harvesting in any given period.

ScoPac is required to provide certain services to Palco pursuant to an additional services agreement between the companies. These services include (i) assisting Palco to operate, maintain and harvest its own timber properties, (ii) updating and providing access to the GIS with respect to information concerning Palco's own timber properties, and (iii) assisting Palco with its statutory and regulatory compliance. This agreement provides that Palco shall pay ScoPac a fee for such services equal to ScoPac's actual cost of providing such services, as determined in accordance with accounting principles generally accepted in the United States.

The Palco Companies are parties to a reciprocal rights agreement whereby, among other things, the parties have granted to each other certain reciprocal rights of egress and ingress through their respective properties in connection with the operation and maintenance of such properties and their respective businesses. In addition, Palco and ScoPac are parties to an environmental indemnification agreement, pursuant to which Palco has agreed to indemnify ScoPac from and against certain present and future liabilities arising with respect to hazardous materials, hazardous materials contamination or disposal sites, or under environmental laws with respect to the ScoPac Timber Property. In particular, Palco is liable with respect to any contamination which occurred on the ScoPac Timber Property prior to the date of its transfer to ScoPac.

Regulatory and Environmental Factors

This section contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. See this section and "Business–General" above and Item 1A. "Risk Factors" below for cautionary information with respect to such forward-looking statements.

General

The businesses of Palco and ScoPac are 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. Compliance with such laws and regulations also plays a significant role in these companies' businesses. The California Forest Practice Act (**"Forest Practice Act"**) and related regulations adopted by the California Board of Forestry and Fire Protection (**"BOF"**) set forth detailed requirements for the conduct of timber harvesting operations in California. These requirements include the obligation of timber companies to obtain regulatory approval of detailed THPs containing information with respect to areas proposed to be harvested. See "–Harvesting Practices" above. California law also requires large timberland owners, including Palco, to demonstrate that their proposed timber operations will not exceed the maximum sustainable production of their timberlands over time. See "–Timber and Timberlands" above.

The federal Endangered Species Act (**"ESA"**) and California Endangered Species Act (**"CESA"**) provide in general for the protection and conservation of specifically listed wildlife and plants. These laws generally prohibit the take of certain species, except for specifically authorized incidental take pursuant to otherwise lawful activities which do not jeopardize the continued existence of the affected species and which are made in accordance with an approved habitat conservation plan and related incidental take permits. A habitat conservation plan, among other things, specifies measures to minimize and mitigate the potential impact of the incidental take of species and to monitor the effects of the activities covered by the plan. Palco is also subject to the California Environmental Quality Act (**"CEQA"**), which provides for protection of the state's air and water quality and wildlife, and the California Porter-Cologne Water Quality Control Act and federal Clean Water Act (**"CWA"**), which require that Palco conduct its operations so as to reasonably protect the water quality of nearby rivers and streams. Compliance with such laws and related regulations and judicial and administrative interpretations, together with other regulatory and environmental matters, have resulted in substantial restrictions on the scope and timing of Palco's timber operations, increased operational costs significantly, and engendered continual litigation and other challenges to its operations. Moreover, the cash flows of Palco and ScoPac have been adversely affected by the failure of the North Coast Water Board to release for harvest THPs which have already been approved by the other government agencies that approve ScoPac's THPs. See "–Water Quality" below.

Environmental Plans

In March 1999, Palco, ScoPac and Salmon Creek (collectively, the **"Palco Companies"**) consummated the Headwaters Agreement (**"Headwaters Agreement"**) with the United States and California. Pursuant to the agreement, approximately 5,600 acres of timberlands owned by the Palco Companies were transferred to the United States government in exchange for (i) an aggregate of $300.0 million, (ii) approximately 7,700 acres of timberlands, and (iii) approval by the federal and state governments of the Environmental Plans. In connection with approval of the Environmental Plans, the California Permits and federal incidental take permits (**"Federal Permits,"** and together with the California Permits, the **"Permits"**), were issued with respect to certain threatened, endangered and other species found on the timberlands covered by the Environmental Plans. The Permits were to cover the 50-year term of the HCP and allow incidental take of 17 different species covered by the HCP, including nine species which are found on the Palco Timberlands that have been listed under the ESA and/or the CESA. In October 2003, a California trial court entered a judgment invalidating the SYP and the California Permits. Palco appealed this decision and in December 2005 the appeals court reversed the trial court's ruling. See Item 3. "Legal Proceedings–Forest Products Litigation" for further information regarding this matter. The agreements which implement the Environmental Plans also provide for various remedies (including the issuance of written stop orders and liquidated damages) in the event of a breach by the Palco Companies of these agreements or the Environmental Plans.

Under the HCP, harvesting activities are prohibited or restricted on certain areas of the Palco Timberlands. Some of these restrictions continue for the entire 50-year term of the HCP. For example, several areas (containing substantial quantities of timber, including old growth redwood and Douglas-fir timber) are designated as habitat conservation areas for the marbled murrelet, a coastal seabird, and certain other species. Harvesting in certain other areas of the Palco Timberlands is currently prohibited while these areas are evaluated for the potential risk of landslide. Further, additional areas alongside streams have been designated as buffers, in which harvesting is prohibited or restricted, to protect aquatic and riparian habitat. Restrictions on harvest in streamside buffers and potential landslide prone areas may be adjusted up or down, subject to certain minimum and maximum buffers, based upon the ongoing watershed analysis process described below. The adaptive management process described below may also be used to modify most of these restrictions.

The first analysis of a watershed, Freshwater, was released in June 2001. This analysis was used by the Palco Companies and the government agencies to develop proposed harvesting prescriptions. Since then watershed analysis has been completed and prescriptions approved for three additional watersheds: Van Duzen in January 2004, Lower Eel-Eel Delta in March 2004, and Elk River in November 2005. The Freshwater, Van Duzen, Lower Eel, and Elk River prescriptions each resulted in a reduction in the size of the streamside buffers set forth in the Environmental Plans and also provide for geologic reviews in order to conduct harvesting activities on some potential landslide-prone areas in lieu of no-harvest restrictions. This effectively reduced both constrained acreage and operational restrictions of the HCP in these watersheds. The analysis for a fifth watershed, Upper Eel is in the process of being submitted for agency and public review, and prescriptions for this watershed are being developed.

The HCP required the Palco Companies, together with the government agencies, to establish a schedule resulting in completion of the initial watershed analysis process for all covered lands within five years. However, due largely to the number of agencies involved and the depth and complexity of the analyses, the process has required more time than originally anticipated. Accordingly, the Palco Companies continue to work with the government agencies to establish appropriate timelines and to streamline watershed analyses on the remaining portions of Palco Timberlands to ensure that such studies are time and cost efficient and continue to provide scientific results necessary to evaluate potential changes to the harvesting restrictions on those lands. The Palco Companies have received an extension to March 2007 of the time in which the watershed analysis process must be completed.

The HCP contains an adaptive management provision, which both the state and federal governments have clarified will be implemented on a timely and efficient basis, and in a manner which will be both biologically and economically sound. This provision allows the Palco Companies to propose changes to many of the HCP prescriptions based on, among other things, economic considerations. The regulatory agencies have also clarified that in applying this adaptive management provision, to the extent the changes proposed do not result in the jeopardy of a particular species, the regulatory agencies will consider the practicality of the suggested changes, including the cost, and economic feasibility and viability. The Palco Companies and the agencies have implemented various adaptive management changes related to wildlife and rare plants, and other changes relating to roads and streamside buffers. These adaptive management changes have increased the ability to conduct harvesting operations on the Palco Timberlands and/or reduced operating costs while still meeting the obligations of the Environmental Plans.

The HCP imposes certain restrictions on the use of roads on the timberlands covered by the HCP during several months of the year and during periods of wet weather. However, Palco has conducted, and expects to be able to continue to conduct, some harvesting during these periods. An adaptive management change approved in 2003 for the road restrictions has improved the ability to construct and use roads on the Palco Timberlands in ways that are consistent with the operational needs of the Palco Companies. The HCP also requires that 75 miles of roads be stormproofed (i.e., reconstructed to reduce sediment generation) on an annual basis and that certain other roads must be improved or repaired. The nature of this work requires that it be performed in the dry periods of the year. To date, over 465 miles of roads have been stormproofed consistent with the HCP schedule.

Water Quality

Laws and regulations dealing with water quality are impacting the Palco Companies primarily in four areas: efforts by the federal Environmental Protection Agency (**"EPA"**) and the North Coast Water Board to establish total maximum daily load limits (**"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 Palco Timberlands and in some cases, clean-up or preventive 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 watershed-wide waste discharge requirements **("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 ScoPac Timber Property. On the Palco Timberlands, the relevant contaminant is simple sediment – dust, dirt and gravel – that is abundant in watercourses largely as a function of the area's normally heavy rainfall and soil that erodes easily. The Company expects the process of establishing TMDLs to continue into 2010. In December 1999, the EPA issued a report dealing with TMDLs on two of the nine watercourses. The agency indicated that the requirements under the HCP would significantly address the sediment issues that resulted in TMDL requirements for these watercourses. The North Coast Water Board has begun the process of establishing the TMDL requirements applicable to two other watercourses on the Palco Timberlands, with a targeted completion of 2007 for these two watercourses. ScoPac's scientists are actively working with North Coast Water Board staff to ensure that these TMDLs recognize and incorporate the environmental protection measures of the HCP. The final TMDL requirements applicable to the ScoPac Timber Property 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.

For each of the winter periods since 2002, Palco and ScoPac have been required to submit reports on sediment discharges and erosion control practices to the North Coast Water Board in order to conduct winter harvesting operations in the Freshwater and Elk River watersheds. After consideration of these reports, the North Coast Water Board imposed requirements on the Palco Companies to implement additional mitigation and erosion control practices in these watersheds for each of these winter operating periods. The North Coast Water Board has also extended the requirements for certain mitigation and erosion control practices in three additional watersheds (Bear, Jordan and Stitz Creek). The Palco Companies and the North Coast Water Board are currently in discussions to determine what these measures will be. The requirements imposed to date by the North Coast Water Board have significantly increased operating costs; additional requirements imposed in the future could further increase costs and cause additional delays in THP approvals.

The North Coast Water Board has also issued a clean up and abatement order for the Elk River watershed (**"Elk River Order"**), which is aimed at addressing existing sediment production sites 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 Resources Control Board (**"State Water Board"**) was denied. Palco has appealed the decision of the State Water Board in state court, but has held such appeal in abeyance until a decision was reached by the California Supreme Court on the *THP No. 520 lawsuit* (see Item 3. "Legal Proceedings–Forest Products Litigation"). Now that the California Supreme Court has reached a decision, Palco is in the process of considering whether or not to pursue its appeal of the Elk River Order.

The North Coast Water Board in December 2003 directed its staff to formulate WWDRs for the Freshwater and Elk River watersheds on the ScoPac Timber Property. As harvesting activities on the ScoPac Timber Property cannot readily be moved between watersheds due to, among other things, historic harvest patterns, adjacency restrictions, and the age classes of trees, development of WWDRs and the other matters described herein are expected to result in reduced harvest levels in the future. The staff of the North Coast Water Board has circulated for public review and comment draft WWDRs for the Freshwater and Elk River watersheds. If these draft WWDRs are approved in their current form there would likely be a significant adverse impact on current and future harvest levels.

As WWDRs had not been formulated, the North Coast Water Board for some time failed to release for harvest a number of ScoPac's THPs that had already been approved by the other governmental agencies which approve ScoPac's THPs. In February 2005, the Executive Officer of the staff of the North Coast Water Board released sufficient THPs to allow the harvest of up to 50% of the harvest limit established by the CDF for these two watersheds (**"CDF Harvest Limit"**). On March 16, 2005, the North Coast Water Board ordered the enrollment of additional THPs that would allow the harvest of up to 75% of the CDF Harvest Limit for these two watersheds. Third parties subsequently appealed this decision to the State Water Board. On June 16, 2005, the State Water Board heard this appeal and rendered a decision (**"State Water Board Order"**), which had the effect of disallowing further harvesting on the additional 25% of the CDF Harvest Limit approved by the North Coast Water Board on March 16, 2005. The State Water Board's decision also has the effect of disallowing further harvesting in the Freshwater and Elk River watersheds until WWDRs for these watersheds are adopted by the North Coast Water Board.

On July 14, 2005, Palco and ScoPac filed an action entitled *The Pacific Lumber Company and Scotia Pacific Company LLC v. State Water Resources Control Board, et al.* (No. CV050516) in Humboldt County Superior Court (**"State Water Board action"**) appealing the State Water Board Order. The companies' appeal requested both a stay of the State Water Board Order and a writ of mandate seeking reversal of the State Water Board Order. Following a December 8, 2005, hearing on the companies' requests, the state court denied the request for a stay, but granted a hearing on the request for a writ of mandate. A hearing on the writ of mandate was held on February 6, 2006 and Palco and Scopac await the court's decision.

On September 2, 2005, the North Coast Water Board set hearings on the draft WWDRs for September 14 and 15, 2005. On September 9, 2005, Palco and ScoPac filed a petition in California state court seeking an order mandating that the North Coast Water Board not take any further action on the proposed WWDRs. The petition alleged defects in the proposed WWDRs and the North Coast Water Board's hearing procedures. Palco and ScoPac requested a preliminary injunction to prevent the North Coast Water Board from taking any further action until their petition is heard. The Court denied the preliminary injunctions following a hearing on November 9, 2005, and Palco and ScoPac subsequently dismissed the case.

On February 17, 2006, the North Coast Water Board held a status conference to determine a timetable for consideration and approval of WWDRs in the Freshwater and Elk River watersheds. Although a formal timetable has not been published, it appears likely that WWDRs will not be approved before May 2006. Such a timetable would further reduce 2006 harvest levels.

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 ScoPac Timber Property are classified as sediment-impaired, implementation of this law could result in additional 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* described in Item 3. "Legal Proceedings–Forest Products Litigation."

Impact of Future Developments

Laws, regulations and related judicial decisions and administrative interpretations dealing with MGI's business are subject to change, and new laws and regulations are frequently introduced concerning the California timber industry. From time to time, bills are introduced in the California legislature and the U.S. Congress which relate to the business of MGI, including the protection and acquisition of old growth and other timberlands, threatened and endangered species, environmental protection, air and water quality, and the restriction, regulation and administration of timber harvesting practices. In addition to existing and possible new or modified statutory enactments, regulatory requirements and administrative and legal actions, the California timber industry remains subject to potential California or local ballot initiatives, and federal and California judicial decisions which could affect timber harvesting practices. It is not possible to assess the effect of such future legislative, judicial and administrative developments on MGI or its business.

Timber Operators License

In order to conduct logging operations, road building, stormproofing and certain other activities, a company must obtain a Timber Operator's License from the CDF. In December 2005, Palco was granted a Timber Operator's License for 2006-2007.

Real Estate Operations

General

The Company, principally through its wholly owned subsidiaries, invests in and develops residential and commercial real estate, primarily in Puerto Rico, Arizona, California, and Texas. Real estate properties and receivables as of December 31, 2005 are as follows:

		Book Value as of December 31, 2005 (In millions)
Palmas del Mar (Puerto Rico):		
Undeveloped land and parcels held for sale	1,094 acres	$ 31.7
Property, plant and equipment, receivables and other, net		7.2
Total		38.9
Resort operations – Palmas Country Club[1]		23.1
Total		62.0
Fountain Hills (Arizona):		
Residential developed lots and lots under development	147 lots	8.1
Undeveloped residential land	431 acres	4.6
Property, plant, equipment and receivables, net		1.3
Total		14.0
Mirada (California):		
Residential developed lots	29 lots	11.2
Property, plant, equipment and receivables, net		1.1
Total		12.3
Commercial lease properties:		
Property, plant and equipment, net:		
Lake Pointe Plaza (Texas)		107.7
Cooper Cameron building (Texas)		28.5
Motel 6 facilities (10 states)		43.6
Other		3.0
Total		182.8
Other, principally receivables		1.7
Total real estate properties and receivables		$ $272.8

(1) Palmas Country Club operations include two 18-hole golf courses, a 20 court tennis facility, a member clubhouse, and a beach club. Amounts shown are net of accumulated depreciation.

	Book Value as of December 31, 2005
	(In millions)
Joint Ventures:	
FireRock, LLC[1]	
Golf course, clubhouse and other club facilities	$ 15.1
Other property, plant and equipment, net	2.8
Total	$ 17.9
Investment in FireRock, LLC	$ 2.7
RMCAL, LLC [1]	
Residential units under development	$ 22.0
Investment in RMCAL, LLC	$ 1.9

[1] 50% owned. Amounts reflect the book value of that 50% interest.

Revenues from real estate operations were as follows in 2005 and 2004 (see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Results of Operations–Real Estate Operations" for additional details regarding 2005, 2004 and 2003 results):

	Years Ended December 31,	
	2005	2004
Palmas del Mar:		
Real estate sales	$ 42.3	$ 30.9
Commercial, resort operations and other	12.1	10.9
Total	54.4	41.8
Fountain Hills:		
Real estate sales	42.9	12.7
Commercial operations and other	5.4	6.7
Total	48.3	19.4
Mirada:		
Real estate sales	56.9	16.1
Commercial operations and other	0.1	0.1
Total	57.0	16.2
Commercial lease properties:		
Lake Pointe Plaza	10.9	9.9
Cooper Cameron building	2.3	2.3
Motel 6 facilities	4.8	4.8
Other	0.3	0.2
Total	18.3	17.2
Other:		
Real estate sales	0.1	–
Commercial operations and other	0.2	0.2
Total	0.3	0.2
Total	$ 178.3	$ 94.8
FireRock, LLC[1]:		
Real estate sales	$ –	$ 15.1
Golf course operations	3.4	3.0
Total	$ 3.4	$ 18.1

[1] 50% owned. Amount reflects the revenues attributable to that 50% interest.

Palmas del Mar

Palmas del Mar, a master-planned residential community and resort located on the southeastern coast of Puerto Rico near Humacao (**"Palmas"**), was acquired by a subsidiary of the Company in 1984. Originally over 2,700 acres, the Company now has approximately 1,100 acres of undeveloped land remaining at Palmas. The Company conducts its operations at Palmas through Palmas del Mar Properties, Inc. (**"PDMPI"**) and PDMPI's subsidiaries. PDMPI seeks developers and investors to acquire its acreage. Resort operations at Palmas include a country club with two golf courses and tennis and beach club facilities. Certain other amenities, including a hotel, marina, equestrian center and various restaurants, are owned and operated by third parties.

Fountain Hills

In 1968, a subsidiary of the Company purchased and began developing approximately 12,100 acres of real property in Fountain Hills, Arizona, which is located near Phoenix and adjacent to Scottsdale, Arizona. The year-round population of Fountain Hills is over 21,000. Development of Fountain Hills is substantially complete. Future sales are expected to consist of fully developed lots in two developments known as Eagles Nest and Adero Canyon. Eagles Nest, a 506-acre custom lot development planned to include 245 lots, commenced sales in 2004. Lots are being released in phases, with 20 lots and 78 lots having been sold in 2004 and 2005, respectively. Development plans have been formulated for Adero Canyon, a 431-acre custom lot development planned to include 171 lots. Financing of the Adero Canyon development will be accomplished either through new or existing credit facilities or joint venture arrangements.

In 1998, a subsidiary of the Company entered into and holds a 50% interest in a joint venture named FireRock LLC (**"FireRock LLC"**) to develop an 808-acre area in Fountain Hills known as FireRock Country Club. The development is a residential, golf-oriented, upscale master-planned community consisting of custom lots, multifamily parcels and a private country club. The club's championship-level private 18-hole golf course opened in 2000. The multi-family parcels were sold in 2001-2002 and custom lot sales concluded in 2004. The venture continues to own and operate the country club.

Mirada

In 1991, a subsidiary of the Company acquired Mirada, a 220-acre luxury resort-residential project located in Rancho Mirage, California. Mirada is a master-planned community in the Santa Rosa Mountains, 650 feet above the Coachella Valley floor. Three of the six parcels within the project have been developed, the first being a custom lot subdivision of 46 estate lots. The Lodge at Rancho Mirage, formerly the Ritz-Carlton Rancho Mirage Hotel, which is owned and operated by a third party, was developed on the second parcel. The third parcel is a custom lot subdivision comprised of 63 estate lots. Sales of these lots began in 2003, and as of December 31, 2005, 35 lots had been sold. In April 2004, a subsidiary of the Company and a third party real estate development company formed a joint venture to develop a 27 acre residential parcel located in the Mirada development. In connection with the formation of the joint venture, the Company sold a 50% interest in the parcel and contributed the remainder of the parcel to the joint venture in return for a 50% interest in the venture.

The joint venture, named RMCAL, LLC **("RMCAL"**) will construct and sell 46 villas to be built on the parcel. The Company's two remaining parcels encompassing approximately 39 acres were sold in 2005.

Commercial Lease Properties

In June 2001, subsidiaries of the Company acquired Lake Pointe Plaza, an office complex located in Sugar Land, Texas, for a purchase price of $131.3 million. The transaction was financed by the subsidiaries through the issuance of $122.5 million of non-recourse notes and the balance from available cash. The office complex is fully leased to affiliates of the seller through May 2021 and under which all lease payments are guaranteed by the parent company of the current tenant.

In November 2002, a subsidiary of the Company acquired the Cooper Cameron building, an office building located in Houston, Texas, for a purchase price of $32.7 million. The transaction was financed by the subsidiary through a cash payment of $3.0 million and the issuance of $29.7 million in non-recourse notes. At the time of the acquisition, the subsidiary simultaneously leased the property back to the seller for a period of 22 years.

In December 2002, a subsidiary of the Company acquired two business trusts which own a portfolio of sixteen motel properties located in ten different states. The purchase price consisted of a cash payment of $3.5 million and the assumption of certain non-recourse notes with an outstanding principal balance of $49.4 million secured by the properties. The properties were acquired subject to an existing lease agreement under which the properties are fully leased through April 2019, and under which all obligations are guaranteed by the parent company of the current tenant.

Marketing

The Company is engaged in marketing and sales programs of varying magnitudes at its real estate developments. The Company intends to continue selling undeveloped acreage and semi-developed parcels, generally to builders and developers, and fully developed lots to individuals and builders. All sales are made directly to purchasers through the Company's wholly owned brokerage operations and its marketing personnel, as well as through independent contractors such as real estate brokers who are compensated by means of customary real estate brokerage commissions. The Company may also continue to enter into joint ventures with third parties similar to those entered into in connection with the FireRock and RMCAL projects.

Competition and Regulation and Other Industry Factors

There is intense competition among companies in the real estate investment and development business. Sales and payments on real estate sales obligations depend, in part, on available financing and/or disposable income and, therefore, are affected by changes in general economic conditions and other factors. The real estate development and commercial real estate businesses are subject to other risks such as shifts in population, fluctuations in the real estate market, and unpredictable changes in the desirability of residential, commercial and industrial areas. The resort business of Palmas competes with similar businesses in the Caribbean, Florida and other vacation/holiday destinations. The Company's Arizona real estate operations compete with similar businesses in the areas in and surrounding Phoenix, Arizona, and the Company's Mirada development faces competition from other developments in the area, many with golf courses and other amenities.

The Company's real estate operations are subject to comprehensive federal, state and local regulation. Applicable statutes and regulations may require disclosure of certain information concerning real estate developments and credit policies of the Company and its subsidiaries. Periodic approval is required from various agencies in connection with the design of developments, the nature and extent of improvements, construction activity, land use, zoning and numerous other matters. Failure to obtain such approval, or periodic renewal thereof, could adversely affect the real estate development and marketing operations of the Company and its subsidiaries. Various jurisdictions also require inspection of properties by appropriate authorities, approval of sales literature, disclosure to purchasers of specific information, bonding for property improvements, approval of real estate contract forms and delivery to purchasers of a report describing the property.

Employees

As of March 1, 2006, the Company's real estate operations had approximately 220 employees.

Racing Operations

General

SHRP, Ltd. owns and operates Sam Houston Race Park, a Texas Class 1 horse racing facility located within the greater Houston metropolitan area and Valley Race Park, a greyhound racing facility located in Harlingen, Texas. In January 2004, a subsidiary of the Company applied to the Texas Racing Commission ("**Racing Commission**") for an additional license to construct and operate a Class 2 horse racing facility in Laredo, Texas. The review process is 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. A hearing before a State administrative law judge to review both applications is scheduled to begin on March 27, 2006.

Racing Operations and Facilities

Sam Houston Race Park and Valley Race Park offer pari-mutuel wagering on live thoroughbred, quarter horse and greyhound racing during meets approved by the Racing Commission on a yearly basis and on simulcast horse and greyhound racing throughout the year. Under the Texas Racing Act and related regulations (collectively, **"Racing Act"**), commission revenues for both facilities are a designated portion of the pari-mutuel handle. Sam Houston Race Park had 120 days of live racing in 2005 and currently has 110 days of live racing scheduled for 2006. Valley Race Park had 89 live racing days during 2005, and currently has 95 live racing days scheduled for 2006.

Revenues are also earned on simulcast racing through both guest simulcast arrangements (the receipt by Sam Houston Race Park and Valley Race Park of live broadcasts of racing being conducted other racetracks) and host simulcast arrangements (the live broadcast to other race tracks and off track wagering sites of racing being conducted at Sam Houston Race Park and Valley Race Park). Sam Houston Race Park and Valley Race Park also derive revenues from food and beverages sales, admission and parking fees, group sales and advertising sales.

Regulation of Racing Operations

The ownership and operation of horse and greyhound racetracks in Texas are subject to significant regulation by the Racing Commission under the Racing Act. The Racing Act provides, among other things, for the allocation of wagering proceeds among betting participants, purses, racetracks, the State of Texas and for other purposes, and empowers the Racing Commission to license and regulate substantially all aspects of horse and greyhound racing in the state. The Racing Commission must approve the number of live racing days that may be offered each year, as well as all simulcast agreements. Class 1 horse racetracks in Texas are entitled to conduct at least seventeen weeks of live racing for each breed of horses (thoroughbreds and quarter horses), while greyhound tracks are entitled to conduct live racing nearly year round.

Marketing and Competition

SHRP, Ltd.'s management believes that the majority of Sam Houston Race Park's patrons reside within a 25-mile radius, which includes most of the greater Houston metropolitan area, and that a secondary market of occasional patrons exists outside the 25-mile radius but within a 50-mile radius of the facility. Sam Houston Race Park uses a number of marketing strategies in an attempt to reach these people and make them more frequent visitors to Sam Houston Race Park. Recent changes to strategies include increased newspaper ad sizes, expansion of website capabilities, radio advertising, increased marketing of items offered outside of the racing product, a VIP program with exclusive promotional offers, and greater focus on casual and event-oriented customers. Valley Race Park employs similar strategies to attract patrons. Both Race Parks also rent out facilities and grounds for group events, which increase revenues and expose the facility to potential customers even though the events are often unrelated to racing.

Sam Houston Race Park competes with other forms of wagering and entertainment, including a Louisiana "racino" (horse or dog tracks with slot machines or other forms of gaming) located approximately 120 miles from Houston, casinos located approximately 140 miles from Houston, a greyhound racetrack located 55 miles away, a wide range of sporting events and other entertainment activities in the Houston area, the Texas State Lottery, and charitable bingo. Other competitive pressures include simulcast signals broadcast by racinos, which are able to offer larger purses and competitive fields, resorts with gaming, and increasing use of the Internet for horse wagering and gaming, including Internet betting services with customer incentives such as cash rebates. Sam Houston Race Park could in the future also compete with other forms of gambling in Texas, including casino gambling on Indian reservations or otherwise. While Sam Houston Race Park believes that the location of Sam Houston Race Park is a competitive advantage over the other more distant gaming ventures mentioned above, the most significant challenges for Sam Houston Race Park are to maintain its customer base in spite of the above competitive pressures and to develop and educate new racing fans in a market where pari-mutuel wagering had been absent from the 1930's to 1994. Other competitive factors faced by Sam Houston Race Park include the allocation of sufficient live racing days by the Racing Commission and attraction of a sufficient number and quality of race horses to run at Sam Houston Race Park, particularly in view of the larger purses able to be offered by racinos. Competitive factors faced by Valley Race Park include the Texas State Lottery, charitable bingo and Internet-based gaming, as well as the attraction of sufficient greyhounds to run live racing, along with the ability of Valley Race Park to market its simulcast signal due to its brief live racing season.

During the regular legislative session of the Texas Legislature that ended in May 2005 and two subsequent 30-day special sessions, a variety of alternatives were considered 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. However, neither the regular session nor the two special sessions resulted in any such legislation. The Company intends to continue to vigorously pursue legislation favorable to it. A special session is expected to be called in 2006 and the next regular session of the Texas Legislature will begin in January of 2007. As some legislation may 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 would be or its effect on the Company.

Employees

As of March 1, 2006, the Company's racing operations had approximately 370 full and part-time employees and approximately 330 additional seasonal employees.

Kaiser Aluminum

The Company and its subsidiary, MAXXAM Group Holdings Inc. (**"MGHI"**), collectively own 50,000,000 shares of common stock of Kaiser, which represent approximately 63% of Kaiser's common stock. In 2002-2003, Kaiser and a number of its subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. Kaiser's plan of reorganization, which provides for the cancellation of the equity interests of current shareholders without consideration or obligation, was confirmed by the Kaiser Bankruptcy Court in February 2006. However, Kaiser's plan of reorganization is not yet final, as it must still be approved by the U.S. District Court before Kaiser can emerge from Chapter 11, and is also subject to appeal. See Note 10 for additional information regarding the Debtors' reorganization proceedings and related matters. Also see Item 3. "Legal Proceedings–Kaiser Litigation, " Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Financial Condition and Investing and Financing Activities–Kaiser's Operations," and "–Critical Accounting Policies and Estimates–Principles of Consolidation-Deconsolidation of Kaiser" and Note 10.

Segment Information

See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Results of Operations" and Note 3 for additional information regarding revenues, income or loss, and total assets of the Company's three segments, as well as revenues from the principal products offered by each. None of the Company's segments have material foreign sales or assets.

Employees

At March 1, 2006, MAXXAM and its subsidiaries had approximately 1,580 year-round and seasonal employees (excluding those employed by Kaiser), none of whom are covered by a collective bargaining agreement.

ITEM 1A. RISK FACTORS

Risks Related to Liquidity and Capital Resources of Our Forest Products Subsidiaries

ScoPac is highly leveraged and its debt service requirements are substantial.

As of December 31, 2005, ScoPac's indebtedness totaled $774.4 million, consisting of approximately $743.1 million principal amount of Timber Notes and approximately $31.3 million aggregate principal amount of indebtedness under its Line of Credit (**"ScoPac Line of Credit"**). ScoPac's annual interest payments on its Timber Notes are approximately $54.0 million.

ScoPac's annual cash flows from operations are expected to be substantially below the minimum levels necessary to satisfy its debt service obligations over at least the next several years.

The Company expects that ScoPac's cash flows from operations, together with funds available under the ScoPac Line of Credit, will be insufficient, by a substantial amount, to pay the interest on the Timber Notes due on the July 20, 2006, payment date. ScoPac also expects to incur principal and interest shortfalls for at least the next several years. ScoPac's failure to pay interest on the Timber Notes when due would constitute an event of default under the Timber Notes Indenture.

If ScoPac's efforts to address its liquidity issues are unsuccessful, ScoPac may default on interest payments on its Timber Notes.

For ScoPac to avoid defaulting on interest payments on its Timber Notes, ScoPac must successfully implement one or more strategies beyond the ordinary course of business, such as the following:

- *Restructure its Timber Notes to decrease its minimum payment obligations*. ScoPac in 2005 devoted considerable resources in an attempt to restructure the Timber Notes. Those efforts were unsuccessful, and ScoPac does not currently expect to restructure its required minimum payments on its Timber Notes through negotiations with holders of the Timber Notes.

- *Obtain significant regulatory relief and accommodations in order to increase its harvest levels and ease its regulatory costs*. Various regulatory actions have substantially reduced ScoPac's timber harvest and increased its costs, reducing cash flows from operations. ScoPac may not be able to obtain any significant regulatory relief or accommodations.

- *Further reduce its expenditures, by laying off employees and shutting down operations*. ScoPac has already eliminated a substantial portion of the personnel and operations it believes can be eliminated consistent with performing its obligations under the Timber Notes Indenture and otherwise. As a result, ScoPac has very limited capacity to further reduce operating costs.

- *Avoid incurring new liquidity, cash flow or operational problems as a result of regulatory, litigation or other developments*. ScoPac cannot control or predict the results of its pending, or potential additional future, regulatory and litigation proceedings and matters.

- *Seek and obtain other timely sources of liquidity, such as from asset sales*. ScoPac's efforts to seek other sources of liquidity, most importantly through the ScoPac Land Sale Program (as defined in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Financial Condition and Investing and Financing Activities–Forest Products Operations–ScoPac Liquidity Issues."), may not be completed in time or at sufficient levels to enable ScoPac to generate the cash required in order to avoid defaulting on its Timber Notes and the ScoPac Line of Credit. Regulatory approvals will be required in connection with the ScoPac Land Sale Program, and these approvals may not be timely received.

If ScoPac's efforts to increase its cash flow are unsuccessful or untimely, ScoPac may default on the Timber Notes and the ScoPac Line of Credit or seek protection by filing under the Bankruptcy Code. In that event, all principal, interest and other amounts related to the Timber Notes may become immediately due and payable and the ScoPac Line of Credit debt may also be accelerated. If these accelerations occur, the trustee under the Timber Notes Indenture (**"Trustee"**) may exercise all rights under the Timber Notes Indenture and related security documents, including applying funds to pay accelerated amounts, and selling the ScoPac Timber and other assets and using the proceeds to pay accelerated amounts. A ScoPac bankruptcy could adversely affect Palco by, among other things, adversely affecting the supply of logs that Palco is able to purchase from ScoPac and/or by increasing the price of those logs.

Palco is highly leveraged and is currently in default under its debt facilities.

Palco is highly leveraged. Moreover, due to financial covenant breaches, Palco and Britt are currently in default under their $35 million term loan agreement **("Palco Term Loan"**) and their $30 million revolving credit facility (**"Palco Revolving Credit Facility"**). Palco and Britt may be unable to obtain waivers of these defaults from the lenders under these two facilities. Palco and Britt may be unable to obtain waivers of these defaults from the lenders under these two facilities, which are secured by liens on substantially all of their assets except for Palco's equity interest in ScoPac. Without waivers of these defaults, the lenders may exercise a variety of rights and remedies, such as reducing the amount of funds available for borrowing under the Palco Revolving Credit Facility, declaring any or all loans and other amounts owed under the Palco Term Loan and the Palco Revolving Credit Facility to be immediately due and payable, and exercising all rights to collateral.

Palco may be adversely affected by an inability to obtain additional liquidity or timely complete asset sales.

In an effort to reduce its overall debt load, Palco is in the process of marketing certain assets (**"Palco Asset Sale Program"**) and seeking other sources of liquidity. Palco may not be able to obtain additional liquidity and may not be able to timely complete the Palco Asset Sale Program. Regulatory approvals required to complete the program could delay receipt of liquidity from the program.

ScoPac may not be able to sell its logs to third parties.

Although it is currently contemplated that all or substantially all of ScoPac's revenues will be derived from the sale of logs to Palco, should Palco be unable to continue to purchase all of ScoPac's logs, ScoPac would need to seek third party purchasers. Such purchasers may not be available or, if available, such purchasers may not acquire sufficient quantities of logs on terms that would allow ScoPac to generate cash flow equivalent to what sales to Palco would have generated. A Palco bankruptcy or default on its payment obligations to ScoPac would imperil ScoPac's ability to fund its cash needs and could cause ScoPac to default on its Timber Notes obligations.

Amounts on deposit in the SAR Account may not be sufficient to fund anticipated Timber Notes amortization in January 2007.

Amounts on deposit in the SAR Account are used on each Timber Notes payment date, as needed, to make principal payments on the Timber Notes sufficient to reduce outstanding principal to an amount specified by the Timber Notes Indenture. ScoPac anticipates that the amount needed to reduce the principal of the Timber Notes to the specified amount on the January 20, 2007, Timber Notes payment date will be approximately $21.7 million. ScoPac projects that the SAR Account will at that time contain approximately $8.0 million, together with the amount of cash, if any, realized by that date from sale of the approximately $55.4 million (face amount) of Timber Notes held in the SAR Account (at December 31, 2005). ScoPac may not be able to sell these Timber Notes by January 2007 because, among other things, the Timber Notes are thinly traded instruments. Even if ScoPac is able to sell these Timber Notes, the net proceeds are currently expected to be significantly less than their face amount. If the amount on deposit in the SAR Account on a Timber Notes payment date is less than what is needed to reduce outstanding principal to the amount specified by the Timber Notes Indenture, only the lesser amount on deposit in the SAR Account is required to be paid as a principal payment on the Timber Notes.

Palco's high levels of debt and covenant restrictions increase the difficulty of operating its business.

Palco's high level of debt and covenant restrictions under the Palco Term Loan and Palco Revolving Credit Facility could have a variety of important negative consequences, including:

- limiting its ability to borrow additional amounts for working capital, capital expenditures, debt service requirements, execution of its operating strategies or other purposes;
- increasing its vulnerability to general adverse economic and industry conditions;
- limiting its ability to capitalize on business opportunities, such as purchasing additional log inventories from third parties, and to react to competitive pressures and adverse government regulation and litigation developments; and
- limiting its ability, or increasing the costs, to refinance indebtedness.

ScoPac's high level of debt could similarly have important negative consequences, including:

- limiting its ability to use operating cash flow in other areas of its business because it must dedicate a substantial portion of these funds to service its debt;
- increasing its vulnerability to general adverse economic and industry conditions; and
- limiting its ability to respond to adverse government regulation and litigation developments.

Any of these or other factors could further exacerbate the liquidity difficulties being experienced by Palco and ScoPac.

The need to purchase third party logs will increase Palco's working capital requirements.

Palco expects that it will in the future be required to increase the percentage of logs it purchases from third parties. These purchases may not be available, or may be available on terms that are not acceptable or are significantly adverse to Palco. Palco's working capital needs are likely to increase substantially during 2006 and beyond to accommodate these increased purchases of third party logs. Palco may not be able to obtain this additional working capital, given its liquidity problems.

ScoPac's and Palco's liquidity issues could result in claims and potential liabilities for certain affiliates.

The liquidity issues being experienced by Palco and ScoPac could result in claims against and could have adverse impacts on MAXXAM Parent, MGHI and/or MGI. For example, 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 (estimated to be approximately $31.0 million at December 31, 2005). In addition, it is possible that actions by creditors, or transactions that might be entered into in connection with a potential restructuring or reorganization of Palco or ScoPac, 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 or other tax attributes for federal and state income tax purposes and could require tax payments.

Risks Related to Forest Products Regulatory Matters

Regulatory and legislative actions have the power to limit ScoPac's harvest levels and require ScoPac and Palco to incur additional costs and have other adverse consequences.

Regulatory and legislative actions, among others, are now having, or have the potential to have material adverse impacts on ScoPac and Palco:

- The North Coast Water Board has failed to release for harvest a number of ScoPac's previously-approved THPs, reducing current and projected harvest levels significantly. Continued failure of the North Coast Water Board to release THPs for harvest would worsen the cash flow difficulties of Palco and ScoPac.

- The final TMDL requirements applicable to the ScoPac Timber Property may require aquatic protection measures that are different from or in addition to those in the HCP or that result from the watershed analysis process provided for in the HCP. These requirements may further reduce the cash flows of ScoPac and Palco.

- The North Coast Water Board has issued the Elk River Order, which is aimed at addressing existing sediment production sites through clean up actions in the Elk River watershed, and has initiated the process which could result in similar orders for other watersheds. The Elk River Order has resulted in increased costs that could extend over a number of years, and additional orders for other watersheds could have similar effects.

- The North Coast Water Board has imposed requirements for certain mitigation and erosion control practices in several watersheds within the ScoPac Timber Property. The requirements imposed to date have significantly increased operating costs. Additional requirements imposed in the future could further increase costs and cause delays in THP approvals.

- The staff of the North Coast Water Board has circulated for public review and comment draft WWDRs for the Freshwater and Elk River watersheds. If these draft WWDRs are approved in their current form, there would likely be a further significant adverse impact on current and future harvest levels and the cash flows of both ScoPac and Palco.

- The Company is uncertain of the operational and financial effects that will ultimately result from Senate Bill 810. Implementation of this law could, however, result in delays in obtaining approvals of THPs, lower harvest levels and increased costs and additional protection measures beyond those contained in the HCP.

- The designation of a species as endangered or threatened under the ESA or the CESA can significantly reduce ScoPac's and Palco's harvest levels if that species inhabits the Palco Timberlands or if the habitat of the Palco Timberlands is deemed favorable to the species. While the HCP covers 17 different species, it is possible that additional species could be designated as endangered or threatened under both the ESA and the CESA

- Laws, regulations and related judicial decisions and administrative interpretations dealing with forest products operations are subject to change and new laws and regulations are frequently introduced concerning the California timber industry. From time to time, bills are introduced or ballot initiatives commenced relating to the Company's forest products operations.

Risks Related to Litigation

Litigation proceedings could result in adverse effects on the Company's forest products operations.

Palco and ScoPac are involved in a variety of pending legal proceedings. Some of these legal proceedings, were they to be decided against the companies, could have an adverse effect upon them, which effect could under certain circumstances be materially adverse to their financial condition, results of operations, or liquidity. Moreover, additional legal proceedings could be filed against Palco and ScoPac, further increasing litigation costs and subjecting the companies to potential adverse decisions. See Item 3. "Legal Proceedings–Forest Products Litigation."

Risks Related to the Timber Industry

Adverse weather conditions restrict Palco's ability to harvest timber and deliver logs to its log decks and to its customers, adversely affecting Palco's and ScoPac's cash flows.

Wet weather conditions restrict Palco's ability to harvest using efficient logging methods and deliver timber. Palco's use of inefficient logging methods, such as helicopter logging, decreases ScoPac's revenues, and increases Palco's costs and reduces its operating margins.

The cyclical nature of ScoPac's and Palco's businesses could adversely affect their results of operations.

Historically, lumber prices have been subject to wide swings in price. The demand for lumber is affected primarily by the level of new construction activity and, to a lesser extent, remodeling and repair activity, and other industrial uses. These activities are, in turn, subject to fluctuations due to, among other factors:

- changes in domestic and international economic conditions;
- interest rates;
- population growth and changing demographics; and
- seasonal weather cycles (e.g., dry summers, wet winters) and other weather driven events.

Decreases in the level of residential construction activity or repair and remodeling activity generally reduce demand for logs and wood products. In addition, timber owners generally increase production volumes for logs and products during favorable price environments. Such increased production, however, when coupled with declines in demand for these products in general, could lead to oversupply and lower prices.

The ability to harvest timber may be subject to other limitations which could adversely affect operations.

In addition to the limitations resulting from regulatory requirements and litigation proceedings described above, there are many factors that could restrict the ability to harvest on the Palco Timberlands, including:

- damage by fire, insect infestation, or disease;
- prolonged drought;
- natural disasters;
- timber growth cycles;
- weather conditions and
- availability of contract loggers.

We do not maintain insurance coverage with respect to damage to the Palco Timberlands.

Competition in the forest products business could materially adversely affect our net sales and our market share.

The forest products business is highly competitive. We compete primarily on the basis of:

- price;
- service;
- product availability; and
- product quality.

Our lumber products compete not only with other wood products which are often times less expensive but with metals, masonry, plastic and other construction materials made from non-renewable resources. Competitive considerations, such as total industry production and competitors' pricing, as well as the price of other construction products, affect the sales prices for our lumber products. Competition in the common grade redwood and Douglas-fir lumber market is intense, and we compete with numerous large and small lumber producers. An increase in the amount of competition that we face could have a material adverse effect on our forest product revenues.

The loss of key customers would reduce Palco's cash flows.

Palco has one customer that accounted for 16% of its revenues in 2005. The loss of key customers would adversely impact Palco's cash flows.

Risks Relating to Our Real Estate Operations

Revenues for our real estate operations are expected to decline for the foreseeable future.

In 2005, our real estate operations realized substantial revenues related to sales of residential lots and acreage at our Fountain Hills, Mirada and Palmas developments. As the proceeds from these asset sales have not been redeployed in other real estate assets, this level of sales activity is not expected to recur for the foreseeable future.

Real estate development is a cyclical industry and is affected by changes in general and local economic conditions.

The real estate development industry is cyclical and is significantly affected by changes in general and local economic conditions, including:

- Employment levels and population shifts;
- Interest rates and availability of financing;
- Consumer confidence; and
- Changes in the desirability of residential and commercial areas.

Development of a project begins, and financial and other resources are committed, long before a real estate project comes to market, which could occur at a time when the real estate market is depressed.

Our real estate operations are subject to various land use regulations and governmental approvals.

The Company's real estate operations are subject to comprehensive federal, state and local regulation concerning zoning, infrastructure design, subdivision of land, and construction. Periodic approval is required from various agencies in connection with various matters. Certain jurisdictions also require the inspection of properties, approval of sales literature, disclosure to purchasers of specific information, bonding for property improvements, and approval of real estate contract forms. Failure to comply with such regulations and requirements to obtain any such approvals could adversely affect the Company's real estate operations.

The land use approval processes we must follow to ultimately develop our projects have become increasingly complex. Moreover, the statutes, regulations and ordinances governing the approval processes provide third parties the opportunity to challenge the proposed plans and approvals, which would result in additional costs and delays in obtaining approvals or bringing a development to market, and could result in litigation outcomes unfavorable to the Company in a variety of ways such as affecting the timing, design, completion, scope, plans and profitability of a project.

We are in competition with other developments for customers and residents.

There is intense competition among companies in the real estate investment and development business. Our Palmas acreage sales and resort operations compete with similar businesses in the Caribbean, Florida and other vacation/holiday destinations, and our developments and operations in Arizona face increased competition in the area. Our Mirada development faces competition from both existing and future developments, many with golf courses and other amenities.

Claims relating to infrastructure obligations could be filed against our real estate operations.

Our real estate operations rely on third party contractors to complete various contractual infrastructure requirements at its real estate developments, such as installing electrical lines, piping, water tanks, drainage and roads. The failure of the contractors to perform or their faulty workmanship could result in claims against the Company's real estate operations.

Risks Relating to Our Racing Operations

The significant competition we face from other gaming and entertainment operations can be expected to continue adversely affecting the racing segment's operating performance.

Sam Houston Race Park competes with many other forms of wagering and entertainment, including Louisiana gaming facilities, a nearby greyhound racetrack, the Texas State Lottery, bingo and a wide range of sporting events and other entertainment activities. Other competitive pressures include simulcast signals broadcast by race tracks able to offer larger purses and competitive fields, resorts with gaming, and increasing use of the Internet for horse wagering and gaming, including Internet betting services with customer incentives such as cash rebates. Future risks include approval of new forms of gaming in Texas or elsewhere. Our racing operations are also affected by the allocation of sufficient live racing days by the Racing Commission and their ability to attract a sufficient number and quality of race horses and greyhounds. Sam Houston Race Park and Valley Race Park face a substantial challenge to maintain and grow their customer base in light of these competitive pressures.

It will be difficult to obtain legislation that would allow our racing operations to increase their revenues.

The Company's two racing facilities would be able to increase their revenues, likely to a substantial degree, were additional forms of gaming to be allowed at our existing horse and dog racing tracks. The Company and other industry participants have pursued legislation that would permit video lottery terminals at Texas tracks during prior regular sessions of the Texas Legislature and two special sessions in 2005. None of these sessions resulted in the passage of such legislation. While we intend to continue vigorously pursuing legislation favorable to our racing operations, no assurances can be given that it will be enacted or become effective as some legislation may require the approval of two-thirds of each legislative house and a majority of Texas voters. Moreover, it is impossible to determine what the provisions of any such legislation would be or its ultimate effect on our racing operations.

Other Risk Factors

Claims could arise from prior acquisitions by the Company.

The Company or its affiliates have over time acquired a variety of properties or entities, some with long operating histories. These properties and entities may be subject to environmental or other liabilities that were not identified at the time of acquisition. Any such claims would likely be costly to defend and their settlement or other resolution could potentially have a material adverse effect upon the Company's financial condition, results of operation or liquidity.

Natural disasters or other catastrophic events could adversely affect various operations of the Company.

In addition to the fire and other risks associated with the Company's timber operations, the Company's other operations are subject to risks from natural disasters and other catastrophic events. For instance, the Company's Palmas resort in Puerto Rico, as well as its racing operations at Sam Houston Race Park and Valley Race Park, are particularly subject to damage from hurricanes. The Company's Mirada development and its forest products operations in Scotia and Arcata, California are particularly subject to the risk of earthquakes. The Scotia-based lumber operations are also subject to a special risk of flooding from the Eel River, which is adjacent to the mill. Moreover, all of the Company's operations are subject to general risks such as fire or adverse weather conditions.

Uninsured claims and litigation could adversely impact our operating results

We have insurance coverage against a variety of operating hazards including business interruption, liability and other losses to the extent deemed prudent by our management and to the extent insurance is available, but the nature and amount of that insurance may not be sufficient to fully cover liabilities arising out of pending and future claims and litigation. This insurance has deductibles or self-insured retentions and contains certain coverage exclusions. Insurance does not provide complete protection against losses and risks, and our results of operations would be adversely affected by unexpected claims not covered by insurance.

We depend on our management and employees.

Our success is largely dependent on the skills, experience, efforts and availability of our management and employees. The loss of the services of one or more members of our senior management or of numerous employees with critical skills or the unionization of our workforce could have a negative effect on our business, financial conditions, results of operations or growth. Given the severe operating problems experienced by Palco and ScoPac, we may find it even more difficult to retain employees at these subsidiaries, especially in view of their remote location relative to large population centers.

Compliance with and changes in laws and regulations and risks from legal proceedings could adversely affect operating results

Our operations can be affected by expected and unexpected changes in the legal and business environments in which we operate. Changes that could affect the legal environment include new legislation, new regulations, new policies, legal proceedings and new interpretations of existing legal rules and regulations. Changes that affect the business environment include changes in accounting standards, changes in environmental laws, changes in tax rates or tax laws that could have a variety of effects, including, by way of example, the ability to fully utilize our tax loss carryforwards and tax credits could have a significant financial impact on the Company.

MAXXAM Parent's investment portfolio could be adversely affected by market conditions and other factors.

MAXXAM Parent has substantial assets invested in a variety of liquid money market instruments; U.S. corporate debt securities, U.S. treasury obligations and other debt securities; and equity interests in several limited partnerships which invest in diversified portfolios of common stocks and equity securities, in addition to exchange-traded options, futures, forward foregoing currency contracts, and other arbitrage opportunities. While MAXXAM Parent tries to minimize its risk with respect to its investment portfolio, there can be no assurance that a variety of market and other factors, such as interest rate changes and general market fluctuations, will not adversely affect the performance of MAXXAM Parent's investment portfolio.

Our Chairman controls the election of the Company's Board of Directors.

Charles E. Hurwitz, the Company's Chairman of the Board, controls a majority of the Company's common stock (**"Common Stock"**) and 75.0% of the Company's total combined voting power. As a result, Mr. Hurwitz is able to control the election of the Company's Board of Directors and controls the vote on virtually all matters which might be submitted to a vote of our stockholders.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

For information concerning the principal properties of the Company, see Item 1. "Business."

ITEM 3. LEGAL PROCEEDINGS

General

Several sections in this Item contain statements which constitute "forward-looking statements" within the meaning of the PSLRA. See this Item, Item 1. "Business–General" and Item 1A. "Risk Factors" above for cautionary information with respect to such forward-looking statements.

The following describes certain legal proceedings in which the Company or its subsidiaries are involved. The Company and certain of its subsidiaries are also involved in various claims, lawsuits and other proceedings not discussed herein which relate to a wide variety of matters. Uncertainties are inherent in the final outcome of those and the below-described matters, and it is presently impossible to determine the resolution of these matters or the actual costs that ultimately may be incurred.

Certain present and former directors and officers of the Company are defendants in certain of the actions described below. 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.

MAXXAM Inc. Litigation

This section describes certain legal proceedings in which MAXXAM Inc. (and in some instances, certain of its subsidiaries) is involved. The term "Company," as used in this section, refers to MAXXAM Inc., except where reference is made to the Company's consolidated financial position, results of operations or liquidity.

OTS Contingency and Related Matters

On December 26, 1995, the United States Department of Treasury's Office of Thrift Supervision (**"OTS"**) initiated a formal administrative proceeding (**"OTS action"**) against the Company and others alleging, among other things, misconduct by the Company and certain of its affiliated persons (collectively, the **"Respondents"**) and others with respect to the failure of United Savings Association of Texas (**"USAT"**). The OTS sought damages ranging from $326.6 million to $821.3 million under various theories. Following 110 days of proceedings before an administrative law judge during 1997-1999, and over two years of post-trial briefing, on September 12, 2001, the administrative law judge 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 the *OTS action*, a related civil action, alleging damages in excess of $250 million, was subsequently dismissed. This action, entitled *Federal Deposit Insurance Corporation, as manager of the FSLIC Resolution Fund v. Charles E. Hurwitz* (**"FDIC action"**), was originally filed by the Federal Deposit Insurance

Corporation (**"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* in the U.S. District Court in Houston, Texas (No. H95-3956). On November 8, 2002, the Respondents filed an amended counterclaim and an amended motion for sanctions (collectively, **"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 December 31, 2005, such fees were in excess of $40.6 million. On August 23, 2005, a U.S. District Court ruled on the Sanctions Motion, ordering the FDIC to pay the Respondents $72.3 million. The FDIC has appealed the District Court decision to the U.S. Fifth Circuit Court of Appeals. The U.S. District Court award has not been accrued as of December 31, 2005. There can be no assurance that the Company will ultimately collect this award.

On January 16, 2001, an action was filed against the Company, Federated Development Company (the predecessor of a principal shareholder of the Company; "**Federated**") and certain of the Company's directors in the Court of Delaware Chancery Court entitled *Alan Russell Kahn v. Federated Development Co., MAXXAM Inc., et al.*, Civil Action 18623NC (**"Kahn lawsuit"**). 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 have 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.

Forest Products Litigation

Various pending judicial and administrative proceedings could adversely affect the ability of the Palco Companies to implement the HCP, implement certain approved THPs, or carry out other operations, as discussed below. Certain pending matters are described below. See Item 1. "Business–Forest Products Operations–Regulatory and Environmental Factors–Water Quality" for a description of additional legal proceedings involving the Palco Companies. The Services Agreement generally requires Palco to prepare and file on behalf of ScoPac (at Palco's cost) all pleadings and motions, and otherwise diligently pursue, appeals of any denial, and defense of any challenge to approval, of any THP or the Environmental Plans or similar plan or permit and related matters.

In March 1999, 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. (**"EPIC-SYP/Permits lawsuit"**) was filed in Superior Court in Humboldt County, California (No. CV-990445). This action alleged, among other things, various violations of the CESA and the CEQA, and challenged, among other things, the validity and legality of the SYP and the California Permits and sought, among other things, to prevent implementation of THPs approved in reliance upon these documents. In March 1999, a similar 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* (**"USWA lawsuit"**), was filed in Humboldt County Superior Court (No. CV-990452) challenging the validity and legality of the SYP. The *EPIC-SYP/Permits* and *USWA lawsuits* were consolidated for trial.

Following the trial, the Court in October 2003 entered a judgment invalidating the SYP and the California Permits and in September 2004 granted the plaintiffs' request for reimbursement of an aggregate of $5.8 million in attorneys' fees and other expenses. The Palco Companies and the State of California appealed both decisions. In December 2005, the appellate court reversed the trial court's decision invalidating the SYP, and on January 11, 2006, the appellate court denied plaintiffs' petition for rehearing. The plaintiffs have appealed the appellate court's decision to the California Supreme Court, which has not yet indicated whether it will review the matter. The defendants' appeal of the trial court's award of attorneys fee and expenses is still pending at the appellate court.

In July 2001, an action entitled *Environmental Protection Information Association v. Pacific Lumber, Scotia Pacific Company LLC* (No. C01-2821)(**"Bear Creek lawsuit"**) was filed in the U.S. District Court for the Northern District of California, and later amended to add the EPA as a defendant. The lawsuit alleges that harvesting and other forestry activities under certain of ScoPac'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. In October 2003, the Court upheld the validity of an EPA regulation that 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 that 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. The Company has filed a motion for summary judgment on the ground that it has met the requirements for a storm water pollution prevention permit under a general permit issued by the State of California. The plaintiff has also filed a motion for summary judgment seeking to establish Palco's liability for discharging storm water without a permit. A hearing on the two summary judgment motions was held on March 6, 2006 and the parties are awaiting a decision.

Should the Court's October 2003 decision ultimately become final and be held to apply to all of the timber operations of Palco and ScoPac, 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. The Company believes that civil penalties should not 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 ScoPac Timber Property will not reach levels harmful to the environment. While the impact of a conclusion to this case that upholds the October 2003 ruling may be adverse, the Company does not believe that such an outcome should 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, two similar actions entitled *Alan Cook, et al. v. Gary Clark, et al.* (**"Cook action"**) and *Steve Cave, et al. v. Gary Clark, et al.* (**"Cave action"**) were filed in Humboldt County Superior Court (No.'s DR020718 and DR020719, respectively), which also name Palco and certain affiliates as defendants. 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 Palco 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 Palco Timberlands). On October 13, 2005, an action entitled *Edyth Johnson, et.al v. Charles E. Hurwitz, an individual; MAXXAM Inc. et al.* (No. DR040720) was filed in Humboldt County Superior Court ("**Johnson action"**) and contains allegations similar to the *Cave* and *Cook actions*. 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 a civil suit entitled *The People of the State of California v. The Pacific Lumber Company, Scotia Pacific Holding Company and Salmon Creek Corporation* in the Humboldt County Superior Court (No. DR030070) (**"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 the harvest of 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. On June 14, 2005, the Court dismissed this matter in its entirety. On September 19, 2005, the District Attorney appealed this decision, however, the Company believes that the dismissal ruling has substantially diminished the exposure of the Palco Companies with respect to this matter.

On November 2, 2004, an action entitled *Environmental Protection Information Center v. U.S. Fish & Wildlife Service, NOAA Fisheries, et al.* (No. C04-4647) was filed in the U.S. District Court for the Northern District of California (**"EPIC-USFWS/NOAA lawsuit"**). 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 asserts 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. On April 22, 2005, pursuant to motions to dismiss filed by the Palco Companies and the federal defendants, the Court dismissed several of the claims, significantly reducing the scope of the case. On February 6, 2006, plaintiffs voluntarily dismissed the remaining claims.

On August 8, 2005, an action entitled *Center for Biological Diversity v. California Department of Fish and Game, et al.* (No. 05CS01166) was filed in Sacramento County Superior Court against the California Department of Fish and Game (**"CDFG"**) and the Palco Companies seeking to overturn and prevent CDFG and the Palco Companies from taking any action to implement or rely upon certain CDFG "Consistency Determinations" issued in February 2005. Following various court proceedings, this case was voluntarily dismissed by the plaintiff in January 2006.

On November 16, 2001, Palco filed a case entitled *The Pacific Lumber Company, et al. v. California State Water Resources Control Board* (No. DR010860) in Humboldt County Superior Court (**"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 appealed to the State Water Board, which imposed certain of the requested mitigation measures and rejected others. Palco filed the *THP No. 520 lawsuit* challenging the State Water Board's decision, and in January 2003, the Superior Court granted Palco's 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. Palco appealed the decision of the appellate court to the California Supreme Court. On January 30, 2006, the California Supreme Court issued a decision denying Palco's appeal and upholding the appellate court's decision. The adverse outcome of the *THP No. 520 lawsuit* confirms the authority the regional and state water boards and their staffs have been exercising over harvesting from the ScoPac Timber Property, resulting in controls and limitations beyond those provided for by the Environmental Plans.

In December 2005, Palco and ScoPac filed a claim (the **"Claim"**) with the California Victim Compensation and Government Claims Board (the **"Claims Board"**) against the North Coast Water Board, the State Water Board and the State of California (Claim No. G558159). The Claim alleges that the defendants have substantially impaired the contractual and legal rights of Palco and ScoPac under the Headwaters Agreement and the related permits, authorizations and approvals. The Claim also alleges that the actions of the defendants have caused the companies substantial damages, but does not specify an amount. While the Claims Board has indicated that it is investigating the matter, it failed to approve or deny the claim by the statutory deadline. As a result, the Claim is by operation of law treated as having been denied, and Palco may now file a claim for damages in California state court. Palco and ScoPac are considering how best to proceed with respect to this matter.

Other Matters

On September 2, 2004, the Company was advised that the New Jersey Department of Environmental Protection **("NJDEP"**) alleged that one of its former subsidiaries is a successor to a company that manufactured munitions for the U.S. Navy during World War II. The owner of the underlying property, which is located in Cranbury, New Jersey, was seeking the Company's participation in efforts to address contamination of the site which resulted from such operations. In January 2005, MGI and the owner of the property entered into an Administrative Consent Order with the NJDEP providing for, among other things, cleanup of the facility. In April 2005, MGI filed a Complaint against the United States of America, the U.S. Navy, and the U.S. Army for cost recovery and contribution; the defendants subsequently denied all of the claims. In early 2006, the property was sold to a new owner. MGI has recently entered into an amendment to the Administrative Consent Order substituting the new owner for the original property owner. MGI has also reached an agreement with several potentially responsible parties regarding cleanup at the site, the terms of which the Company believes will not result in a material adverse effect on the Company's consolidated financial position, results of operations or liquidity. MGI retained its cause of action against the government parties noted above.

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 position, results of operations or liquidity.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock and Related Stockholder Matters

The Company's Common Stock, $.50 par value, is traded on the American Stock Exchange. The stock symbol is MXM. The following table sets forth, for the calendar periods indicated, the high and low sales prices per share of the Company's Common Stock as reported on the American Stock Exchange Consolidated Composite Tape.

	2005		2004	
	High	Low	High	Low
First quarter	$ 33.80	$ 28.50	$ 28.57	$ 18.51
Second quarter	28.89	21.21	31.60	23.50
Third quarter	35.25	23.00	30.00	25.85
Fourth quarter	36.24	30.11	33.50	27.00

As of March 1, 2006, there were 2,673 record holders of the Company's Common Stock. The Company has not declared any cash dividends on its capital stock and has no present intention to do so.

Issuer Purchases of Equity Securities

The Company may from time to time purchase shares of its Common Stock on national exchanges or in privately negotiated transactions. In June 2005, the Company purchased 8,600 shares of its Common Stock over the American Stock Exchange at $22.05 per share for a total of $0.2 million. Such purchase was not made pursuant to a share repurchase plan or program.

ITEM 6. SELECTED FINANCIAL DATA

The following summary of consolidated financial information for each of the five years ended December 31, 2005 is not reported upon herein by independent public accountants and should be read in conjunction with the Consolidated Financial Statements and the Notes thereto which are contained in Item 8 herein.

	Years Ended December 31,				
	2005	2004	2003	2002[1]	2001[1]
	(In millions of dollars, except per share amounts)				
Consolidated statement of operations:					
Net sales	$ 406.4	$ 347.5	$ 336.6	$ 366.7	$ 1,064.9
Loss before income taxes, minority interests and discontinued operations[2]	(4.1)	(46.9)	(10.6)	(96.0)	(307.1)
Loss from continuing operations	(4.0)	(46.6)	(11.6)	(81.4)	(780.7)
Income (loss) from discontinued operations, net of tax[3]	–	–	–	(2.6)	324.7
Net loss	(4.0)	(46.6)	(11.6)	(84.0)	(456.0)
Consolidated balance sheet at end of period:					
Total assets[3]	1,048.3	1,015.2	1,060.8	1,107.3	3,935.3
Long-term debt, less current maturities	889.6	912.0	953.5	982.3	1,706.8
Stockholders' deficit	(661.3)	(657.1)	(601.9)	(582.5)	(475.6)
Per share information:					
Basic and diluted net loss per share	$ (0.66)	$ (7.79)	$ (1.79)	$ (12.87)	$ (69.28)

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(1) Results for the Company's aluminum operations have been included for the period from January 1, 2002, through February 11, 2002 and for the year ended December 31, 2001. Such results have been excluded for the subsequent periods. See Notes 1 and 10 for a discussion of the Chapter 11 filings by the Debtors (which commenced February 12, 2002).

(2) Loss before income taxes and minority interests includes the following items:

- 2005 includes a $0.7 million charge for employee severance and benefit costs at Palco (see Note 3). 2005 also includes a $1.9 million charge in connection with an environmental matter associated with a former subsidiary of the Company (see Note 3), a $3.1 million gain from an insurance settlement, and a $4.6 million asset impairment charge at Palco (see Note 5).
- 2005 includes a $4.3 million benefit to correct the cumulative effect of an overstatement of intercompany interest from 1995 to 2000.
- 2004 includes a $1.4 million charge for employee severance and benefit costs at Palco (see Note 3). 2004 also includes a $1.9 million charge in connection with an environmental matter associated with a former subsidiary of the Company (see Note 3).
- 2003 includes a gain on the sale of acreage in the Grizzly Creek grove of $16.8 million (see Note 13), $8.0 million of insurance recoveries related to the *OTS* and *FDIC actions* (see Note 3), as well as a $1.4 million charge to write-down the Company's casino-related assets to estimated fair value (see Note 3).
- 2002 includes other items of $0.5 million attributable to Kaiser for the period from January 1, 2002, through February 11, 2002 (see Note 3).
- 2001 includes the following related to Kaiser: additional valuation allowances related to Kaiser's deferred tax assets of $505.4 million (see Note 8), business interruption insurance recoveries of $36.6 million, a gain of $163.6 million on the sale of an approximate 8.3% interest in Queensland Alumina Limited (**"QAL"**), a charge of $57.2 million for asbestos-related claims, and net gains on power sales and several other non-recurring items totaling $163.6 million. 2001 results include the following related to Palco: a gain of $16.7 million on the sale of acreage in the Grizzly Creek grove.

(3) MAXXAM Inc. did not declare or pay any cash dividends during the five year period ended December 31, 2005.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following should be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto appearing in Item 8.

Results of Operations

This section contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. See Item 1. "Business–General," Item 1A. "Risk Factors" and below for cautionary information with respect to such forward-looking statements.

The Company operates in three industries: forest products, through MGI and its wholly owned subsidiaries, principally Palco, ScoPac and Britt; real estate investment and development, through various subsidiaries and 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 63% of the common stock of Kaiser, a producer of fabricated aluminum products. Any reference herein to a company includes the subsidiaries of that company unless otherwise noted or the context indicates otherwise.

Consolidated Operations

Selected Operational Data

The following table presents selected financial information for the years ended December 31, 2005, 2004 and 2003 for the Company's consolidated operations.

	Years Ended December 31,		
	2005	2004	2003
	(In millions of dollars)		
Net sales	$ 406.4	$ 347.5	$ 336.6
Costs and expenses	(351.2)	(333.3)	(312.7)
Gains on sales of timberlands and other assets	0.3	0.1	17.5
Operating income	55.5	14.3	41.4
Other income	18.6	12.8	25.0
Interest expense	(78.2)	(74.0)	(77.0)
Loss before income taxes	(4.1)	(46.9)	(10.6)
Benefit (provision) for income taxes	0.1	0.3	(1.0)
Net loss	$ (4.0)	$ (46.6)	$ (11.6)
Revenues by segment as a percentage of total:			
Forest products	44.7 %	58.2 %	61.9%
Real estate	43.9 %	27.3 %	23.3%
Racing	11.4 %	14.5 %	14.8%
	100.0 %	100.0 %	100.0 %

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 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.

Kaiser's plan of reorganization, which provides for the cancellation of the Company's 50,000,000 Kaiser common shares without consideration or obligation, was confirmed by the Kaiser Bankruptcy Court in February 2006. However, Kaiser's plan of reorganization is not yet final, as it must still be approved by the U.S. District Court before Kaiser can emerge from Chapter 11, and is also subject to appeal. These consolidated financial statements do not reflect any adjustment related to the deconsolidation of Kaiser other than presenting the Company's investment in Kaiser using the cost method. The Company expects to reverse the $516.2 million of losses in excess of its investment in Kaiser, net of accumulated other comprehensive losses of $85.3 million related to Kaiser, and recognize the net amount, including the related tax effects, in the period during which Kaiser emerges from bankruptcy, which is expected to occur in 2006. Upon effectiveness of Kaiser's plan of reorganization, the Company also expects it will take a worthless stock deduction on its consolidated federal income tax return related to the cancellation of the Kaiser shares and will at that time evaluate whether it expects to realize the resulting tax asset of approximately $135.8 million. Although the Company does not expect that it will be obligated to fund losses in Kaiser, the amount of the reversal would be reduced by any losses which the Company later estimates it would be obligated to fund.

See Notes 1 and 10 for further discussion of Kaiser's reorganization proceedings and other information regarding the Company's investment in Kaiser.

Overview of Consolidated Results of Operations

Net Sales

Net sales for 2005 totaled $406.4 million, compared to $347.5 million in 2004. Sales for the Company's real estate segment increased from $94.8 million in 2004 to $178.3 million in 2005. This substantial increase was due primarily to large acreage sales at Palmas and Mirada, favorable pricing and higher volume of lot sales at Fountain Hills and Mirada, and higher profit participation payments at Palmas. This increase was offset by a $20.3 million decline in net sales for the Company's forest products segment and a $4.3 million decline net sales for the racing segment. Net sales for the Company's forest products segment declined due to a decrease in product volume attributable to reduced harvesting caused by regulatory delays, as well as an unfavorable shift in lumber sold from redwood to lower-priced, common grade Douglas-fir lumber. Net sales for the racing segment declined due to fewer live race days being held in 2005.

Net sales for 2004 totaled $347.5 million, compared to $336.6 million in 2003. Net sales for the real estate segment increased $16.5 million due to higher sales of real estate acreage at the Company's Palmas del Mar and Mirada developments. Net sales for the racing segment increased $0.8 million due to more live race days being held. Net sales for the Company's forest products segment decreased $6.4 million primarily due to lower lumber revenues. Lumber sales for 2004 were impacted by lower shipments resulting from lower harvest levels.

Operating Income (Loss)

Operating income increased $41.2 million from $14.3 million in 2004 to $55.5 million in 2005, primarily due to the performance of the Company's real estate segment, which realized operating income of $89.0 million in 2005. The Company's forest products segment incurred 2005 operating losses of $13.4 million, as compared to operating income of $5.4 million in 2004, primarily as a result of a decline in lumber shipments, compounded by an unfavorable shift in lumber sold from redwood lumber to lower-priced, common grade Douglas-fir lumber, exacerbated by higher harvesting, hauling, and production costs and substantial legal and professional fees, including fees relating to the Company's efforts in 2005 to pursue a negotiated restructuring of the Timber Notes.

The Company recorded operating income of $14.3 million in 2004 compared to operating income of $41.4 million for the prior year. Operating results for the forest products segment decreased by $29.1 million, primarily as a result of the decrease in net sales noted above and an increase in cost of sales due primarily to declines in harvest, which led to increased third-party log purchases. The real estate segment recorded 2004 operating income of $29.7 million versus operating income of $17.1 million in 2003, primarily due to the increases in net sales noted above. The racing segment's operating loss increased by $1.2 million despite an increase in live race days due primarily to an increase in marketing and development costs. The corporate segment's operating loss increased by $9.4 million from 2003 due primarily to an increase in stock-based compensation expense which is adjusted as the market value of the Company's Common Stock changes, in addition to a $1.9 million charge for an environmental matter discussed under "Other Matters" in Note 11.

Loss Before Income Taxes

The Company's consolidated loss before income taxes, was $4.1 million in 2005 as compared to $46.9 million in 2004. This significant improvement is primarily the result of strong sales, higher operating income by the Company's real estate segment and an increase in investment earnings, offset by a reduction in equity earnings from the Company's investment in FireRock LLC due to the sell-out of lots at the development in 2004.

The Company's consolidated loss before income taxes, increased by $36.3 million in 2004 compared to the prior year, primarily as a result of the decrease in operating income discussed above. Investment, interest and other income decreased by $12.2 million, primarily because results for 2003 included non-recurring income related to an $8.0 million reimbursement from an insurer for certain costs incurred in connection with the *OTS* and *FDIC actions*.

Forest Products Operations

Industry Overview and Selected Financial and Operating Data

This section contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. See this section, Item 1. "Business–General" and Item 1A. "Risk Factors" for cautionary information with respect to such forward-looking statements.

The Company's forest products operations are conducted through MGI and its wholly owned subsidiaries, principally Palco, ScoPac and Britt. The segment's business is becoming increasingly unpredictable due to regulatory constraints and ongoing litigation challenges and is somewhat seasonal, its net sales having historically been higher in the months of April through November than in the months of December through March. Management expects that the segment's revenues and cash flows will continue to be unpredictable and somewhat seasonal. Accordingly, the segment'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 had and are expected to continue to adversely affect the Company's forest products operations. See Item 1. "Business–Forest Products Operations–Regulatory and Environmental Factors," Item 1A. "Risk Factors," and Note 11 for information regarding these matters. Regulatory compliance and related litigation have caused and are expected to continue to cause delays in approval of THPs and delays in harvesting on THPs once they are approved. This has resulted and is expected to continue to result in a significant decline in harvest and increased costs related to timber harvest litigation.

The cash flows of Palco and ScoPac have both been adversely impacted by the failure of the North Coast Water Board to release for harvest a number of already-approved THPs. ScoPac's management has concluded that, in the absence of significant regulatory relief and accommodations, ScoPac's annual timber harvest levels and cash flows from operations will for at least several years be substantially below both historical levels and the minimum levels necessary to allow ScoPac to satisfy its debt service obligations in respect of the Timber Notes. ScoPac projects that, without additional liquidity, its cash flows from operations, together with funds available under its line of credit, will be insufficient, by a substantial amount, to pay the entire amount of interest due on the July 20, 2006, payment date on its Timber Notes. Scopac also expects to incur interest shortfalls for at least the next several years after the July 20, 2006 payment date.

Palco and Britt are in default under the $35.0 million Palco Term Loan and the $30.0 million asset-based Revolving Credit Facility. Palco estimates that without necessary amendments to these credit agreements and/or sufficient additional liquidity, its cash flow from operations, together with funds available under the Palco Revolving Credit Facility, will not provide sufficient liquidity to fund its current level of operations for the next several years. For further information, see "–Financial Condition and Investing and Financing Activities–Forest Products Operations."

In the event that Palco is unable to secure the necessary liquidity to fund its expected future working capital shortfalls, it would be forced to take extraordinary actions, which may include: further reducing expenditures by laying off employees, shutting down various operations, and seeking protection by filing under the Bankruptcy Code. To the extent that ScoPac is unable to generate sufficient liquidity from the ScoPac Land Sale Program or other sources, the Company expects that ScoPac will be forced to take extraordinary actions, which may include: laying off employees, shutting down various operations, and seeking protection by filing under the Bankruptcy Code.

Furthermore, there can be no assurance that 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 also have material adverse effects 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 Factors," Item 1A. "Risk Factors," Item 3. "Legal Proceedings–Forest Products Operations" and Note 11 ("Regulatory and Environmental Factors" and "Contingencies–Timber Harvest Litigation") for further information regarding regulatory and legislative matters and legal proceedings relating to the Company's 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. Since 2001, Palco has implemented a number of changes, including: closing three of its four sawmills; eliminating certain of its operations, including its company-staffed logging operations (now relying exclusively on contract loggers), its soil amendment and concrete block activities, and its Scotia finishing and remanufacturing plant; and adopting various cost saving measures. Palco has continued to examine ways in which to achieve cost savings. In April 2004, Palco commenced a mill improvement project, including a new sawmill located in Scotia, California. The new sawmill was constructed in two phases. The first phase of the project, the processing of smaller diameter second growth logs (up to 24" in diameter) is a high-speed processing line that includes advanced scanning and optimization technology intended to maximize lumber recovery. The second phase, the relocation of the large log equipment from the Carlotta mill, came on line in October 2005. This phase allows for processing of larger logs up to 60" in diameter. Although there were more difficulties than Palco expected, since commencing production, Palco has made substantial progress in refining the production process in the new mill, particularly the high-speed small log processing line. There have been delays in the completion of the large log processing line, however, and it is not yet operating at planned production rates, primarily due to a current imbalance between small diameter and large diameter logs which impacts the mill's throughput. Palco also completed a new $5.0 million planer project in Scotia in January 2004. This high speed system processes rough sawn boards into finished lumber at rates up to four times faster than the older planers at the Carlotta and Fortuna mills. Palco has spent $28.1 million through December 31, 2005, on the new sawmill ($20.5 million of which was expended in 2004). Funds for this project were provided from borrowings under the Palco Term Loan and the Palco Revolving Credit Facility.

The following table presents selected operational and financial information for the years ended December 31, 2005, 2004 and 2003 for the Company's forest products operations.

	Years Ended December 31, 2005	2004	2003
	(In millions of dollars, except shipments and prices)		
Timber harvest[1]	145.5	144.1	166.3
Shipments:			
Lumber: [2]			
Redwood upper grades	6.4	17.4	26.4
Redwood common grades	178.8	209.2	215.8
Douglas-fir upper grades	0.6	2.5	4.4
Douglas-fir common grades	92.6	61.6	44.4
Other	3.6	6.2	7.7
Total lumber	282.0	296.9	298.7
Cogeneration power [3]	164.0	162.0	163.5
Average sales price:			
Lumber: [4]			
Redwood upper grades	$ 1,243	$ 1,352	$ 1,275
Redwood common grades	620	613	601
Douglas-fir upper grades	914	980	1,249
Douglas-fir common grades	373	408	346
Cogeneration power [5]	65	65	61
Net sales:			
Lumber, net of discount	$ 155.9	$ 179.2	$ 184.0
Logs	8.2	6.1	6.5
Cogeneration power	10.9	10.8	11.4
Wood chips	3.5	3.1	3.4
Other	3.3	2.9	3.2
Total net sales	$ 181.8	$ 202.1	$ 208.5
Operating income (loss) [6][7]	$ (13.4)	$ 5.4	$ 34.5
Loss before income taxes	$ (69.9)	$ (49.3)	$ (18.1)

(1) Timber harvest is expressed in millions of board feet, net Scribner scale.
(2) Lumber shipments are expressed in millions of board feet.
(3) Power deliveries are expressed in thousands of megawatt hours.
(4) Dollars per thousand board feet.
(5) Dollars per megawatt hour.
(6) Operating income for 2003 includes a $16.8 million gain on the sale of timberlands in the Grizzly Creek grove.
(7) Operating income for 2005 includes a $4.6 million impairment charge related to the write-down to estimated salvage value of certain long-lived assets.

Net Sales

Net sales for the forest products segment in 2005 were $20.3 million below the prior year's net sales. The decline was due primarily to a reduction in total lumber shipments, compounded by an unfavorable shift in lumber sold from redwood lumber to lower-priced, common grade Douglas-fir lumber. Sales of logs, power and other products, which accounted for 14.2% of the segment's sales product mix in 2005, increased $3.0 million compared to the prior year.

Net sales for the forest products segment in 2004 were $6.4 million below the prior year's net sales. While total lumber shipments were only slightly lower than the prior year and prices in most categories of lumber improved, there was a shift in the mix of products sold from higher-priced redwood and upper grade Douglas-fir lumber to lower-priced common grade Douglas fir, which produced an overall decline of $4.8 million in net sales of lumber. Sales of logs, power and other products, which accounted for 11.3% of the segment's sales product mix in 2004, were down a combined $1.6 million compared to the prior year.

Operating Income (Loss)

The forest products segment incurred operating losses of $13.4 million in 2005 and operating income of $5.4 million in 2004. The decline was primarily attributable to four factors: the decline in net sales discussed above, higher harvesting, hauling, and production costs, substantial legal and professional fees relating to the Company's efforts to pursue a negotiated restructuring of the Timber Notes, and asset impairment charges of $4.6 million due to changes in the expected use of certain facilities and revised estimates of undiscounted cash flows of those facilities.

Operating income for the forest products segment was $5.4 million in 2004, which was substantially below the prior year's operating income of $34.5 million. The decline was primarily attributable to three factors: the decline in net sales discussed above, an increase in the per unit production cost of lumber, and the 2003 gain of $16.8 million on the sale of timberlands in the Grizzly Creek grove. Per unit lumber production costs were adversely affected by the declines in harvest, which led to increased third party log purchases approximating 35.3 mmbf in 2004, as compared to 21.4 mmbf in 2003.

Loss Before Income Taxes

The loss before income taxes of $69.9 million, as compared to $49.3 million of losses in 2004, reflects the effects of the factors discussed above compounded by additional interest expense related to additional outstanding debt.

The loss before income taxes increased $31.2 million in 2004 as compared to 2003, primarily due to the decreases in operating income discussed above. In addition, earnings on cash, cash equivalents and other investments declined due to lower investment balances and lower returns during 2004 versus 2003. The declines on returns on investment funds was partially offset by a decrease in interest expense.

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. Results of operations between periods for the Company's real estate operations are generally not comparable due to the timing of individual real estate transactions and cash collections. In 2005, the Company's real estate operations realized substantial revenues related to sales at the Company's Fountain Hills, Mirada and Palmas developments; this level of sales activity is not expected to recur for the foreseeable future. The following table presents selected financial and operating information for the years ended December 31, 2005, 2004 and 2003, respectively, for the Company's real estate operations.

	Years Ended December 31,		
	2005	2004	2003
	(In millions of dollars)		
Net sales:			
Real estate:			
Fountain Hills	$ 42.9	$ 12.7	$ 19.3
Mirada	56.9	16.1	5.3
Palmas	42.3	30.9	16.3
Other	0.1	–	8.8
Total	142.2	59.7	49.7
Resort, commercial and other:			
Fountain Hills	5.4	6.7	4.0
Mirada	0.1	0.1	0.3
Palmas	12.1	10.9	8.2
Commercial lease properties	18.3	17.2	15.9
Other	0.2	0.2	0.2
Total	36.1	35.1	28.6
Total net sales	$ 178.3	$ 94.8	$ 78.3
Operating income (loss):			
Fountain Hills	$ 23.3	$ 4.1	$ 9.8
Mirada	35.9	6.0	–
Palmas	22.6	13.3	(5.4)
Commercial lease properties	8.3	7.2	5.9
Other	(1.1)	(0.9)	6.8
Total operating income	$ 89.0	$ 29.7	$ 17.1
Investment, interest and other income (expense), net:			
Equity in earnings (losses) from real estate joint ventures	$ (1.0)	$ 2.8	$ 0.7
Other	3.4	5.3	5.2
	$ 2.4	$ 8.1	$ 5.9
Income before income taxes	$ 74.0	$ 19.5	$ 4.1

Net Sales

Net sales for the real estate segment include: revenues from sales of developed lots, acreage and other real property associated with the Company's real estate developments; revenues from resort and other commercial operations conducted at these real estate developments; and lease revenues from a number of commercial properties.

Net sales for the real estate segment increased $83.5 million in 2005 from the year-ago period. The substantial increase was due primarily to large acreage sales at Palmas and Mirada, favorable pricing and higher volume of lot sales at Fountain Hills and Mirada, and higher profit participation payments at Palmas.

Net sales for the real estate segment increased $16.5 million in 2004 from 2003, principally due to acreage sales at Palmas and Mirada, an increase in lot sales at Fountain Hills and Mirada, and increases in net sales from commercial operations at Palmas and Fountain Hills. Acreage sales at Fountain Hills declined between periods, and Other net sales in 2003 included $8.8 million from the sale of a parcel of real estate in Lake Havasu, Arizona.

Operating Income (Loss)

Operating income increased $59.3 million from $29.7 million in 2004 to $89.0 million in 2005 due to increased sales as discussed above.

Operating results increased by $12.6 million for 2004 versus 2003 primarily due to increased sales as discussed above. In addition, operating results for 2003 include a $1.4 million impairment charge related to Palmas' casino assets arising from foreclosure of a hotel which was owned and operated by a third party from whom the casino leased space.

Income Before Income Taxes

The segment's income before income taxes increased to $74.0 million in 2005, from $19.5 million in 2004, due to the higher operating results discussed above offset by a reduction in equity earnings from the Company's investment in FireRock LLC due to the sell-out of lots in 2004.

The segment's income before income taxes increased by $15.4 million for 2004 versus 2003 due to the higher operating results discussed above, as well as an increase in equity earnings from FireRock LLC.

Racing Operations

Industry Overview and Selected Operational Data

The Company indirectly owns SHRP, Ltd., a Texas limited partnership that 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 this segment 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 years ended December 31, 2005, 2004 and 2003, respectively, for the Company's racing operations.

	Years Ended December 31,		
	2005	2004	2003
	(In millions of dollars)		
Number of live racing days:[1]			
Sam Houston Race Park	120	167	127
Valley Race Park	89	110	110
Handle:			
Sam Houston Race Park:			
On-track handle	$ 126.6	$ 137.0	$ 134.2
Off-track handle	140.9	173.7	173.4
Total	$ 267.5	$ 310.7	$ 307.6
Valley Race Park:			
On-track handle	$ 19.0	$ 19.4	$ 20.0
Off-track handle	2.5	3.6	4.0
Total	$ 21.5	$ 23.0	$ 24.0
Net sales:			
Sam Houston Race Park:			
Gross pari-mutuel commissions	$ 32.1	$ 34.9	$ 34.5
Other revenues	8.8	10.0	9.4
Total	40.9	44.9	43.9
Valley Race Park:			
Gross pari-mutuel commissions	4.4	4.6	4.7
Other revenues	1.0	1.1	1.2
Total	5.4	5.7	5.9
Total net sales	$ 46.3	$ 50.6	$ 49.8
Operating income (loss):			
Sam Houston Race Park	$ (3.5)	$ (2.1)	$ (1.2)
Valley Race Park	(0.6)	(1.0)	(0.7)
Total operating loss	$ (4.1)	$ (3.1)	$ (1.9)
Income (loss) before income taxes	$ (4.1)	$ (3.1)	$ (1.7)

(1) In 2004, Sam Houston Race Park was granted an additional 40 live race days over what it received in 2003 due to circumstances that are not expected to recur.

Net Sales

Total net sales for the racing segment declined $4.3 million in 2005, as compared to the prior year, primarily due to fewer live racing days at Sam Houston Race Park. Net sales for Valley Race Park for 2005 were comparable to the prior year.

Net sales for the racing segment for 2004 increased by $0.8 million compared to the prior year due primarily to more live racing days at Sam Houston Race Park. Net sales for Valley Race Park for 2004 were comparable to the prior year. Average daily attendance declined at both facilities.

Operating Loss and Income Before Income Taxes

Racing operations' operating loss and loss before income taxes for 2005 increased from 2004, principally due to lower net sales partially offset by lower operating costs associated with the reduced number of live racing days at Sam Houston Race Park.

Despite an increase in net sales for 2004, the operating loss for the segment increased versus the prior year primarily due to higher costs of sales and operations. The increase in costs of sales and operations was due to the increase in live racing days during the year, which led to higher utility, payroll and other operating expenses.

Other Items Not Directly Related to Industry Segments

	Years Ended December 31,		
	2005	2004	2003
	(In millions of dollars)		
Operating loss	$ (16.0)	$ (17.7)	$ (8.3)
Income (loss) before income taxes	(4.1)	(14.0)	5.1

Operating Loss

The Corporate segment's operating losses represent general and administrative expenses that are not specifically attributable to the Company's segments. Operating loss improved $1.7 million for 2005 as compared to 2004, primarily due to $2.4 million decline in stock compensation expense and continued cost cutting initiatives. For 2005 and 2004, operating losses include a $1.9 million charge related to an environmental matter discussed under "Other Matters" in Note 11. Results for 2004 also include $6.1 million increase from 2003 in stock-based compensation expense, which is adjusted as the market value of the Company's Common Stock changes and as awards vest.

Income (Loss) Before Income Taxes

Income (loss) before income taxes includes operating losses, investment, interest and other income (expense) and interest expense, which are not attributable to the Company's segments. Results for 2005 include approximately $8.0 million investment, interest and other income, a $4.1 million improvement over 2004, as well as a $4.3 million benefit to correct the cumulative effect of an overstatement of intercompany interest during the period 1995 to 2000. Results for 2003 include income related to an $8.0 million reimbursement from an insurer for certain costs incurred in connection with the *OTS* and *FDIC actions* (see Note 11).

Provision for Income Taxes

The Company generated a loss before income taxes of $4.1 million for 2005; however, the Company has recorded no tax benefit associated with the loss for the period. Each period, the Company evaluates the 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 8. Based on this evaluation, the Company provided full valuation allowances with respect to the deferred tax assets attributable to losses and credits generated during 2005. These valuation allowances were in addition to the valuation allowances which were provided in prior years.

Financial Condition and Investing and Financing Activities

This section contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. See this section and Item 1. "Business–General" for cautionary information with respect to such forward-looking statements.

Overview

The Company conducts its operations primarily through its subsidiaries. Accordingly, 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 ScoPac, 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. ScoPac is highly leveraged and has significant debt service requirements (see Note 1). Palco is also highly leveraged, has significant debt service obligations, and is currently in default of covenants on the Palco Term Loan and the Palco Revolving Credit Facility, which could result in the acceleration of Palco's debt obligations.

Cash Flow

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

	Forest Products								
	Scotia LLC	Palco and Other	MGI	Real Estate	Racing	MGHI	MAXXAM Parent	Total
				(In millions of dollars)				
Debt and credit facilities (excluding intercompany notes)								
Short-term borrowings and current maturities of long-term debt:								
December 31, 2005	$ 18.2	$ 34.9	$ –	$ 4.1	$ 0.1	$ –	$ –	$ 57.3
Long-term debt, excluding current maturities:								
December 31, 2005	$ 669.6	$ –	$ –	$ 219.7	$ 0.3	$ –	$ –	$ 889.6
Revolving credit facilities:								
December 31, 2005:								
Availability of lender credit	$ 55.4	$ 34.1	$ –	$ 9.6	$ –	$ –	$ –	$ 99.1
Borrowings	31.3	23.9	–	–	–	–	–	55.2
Letters of credit	–	10.2	–	9.0	–	–	–	19.2
Unused and available credit	24.1	–	–	0.6	–	–	–	24.7
Cash, cash equivalents, marketable securities and other investments								
December 31, 2005:								
Current restricted amounts	$ 23.0	$ –	$ 2.0	$ 2.2	$ 1.9	$ –	$ –	$ 29.1
Other current amounts	2.4	0.8	–	50.4	3.0	–	150.9	207.5
	25.4	0.8	2.0	52.6	4.9	–	150.9	236.6
Long-term restricted amounts	$ 2.5	$ –	$ –	$ 1.4	$ –	$ –	$ –	$ 3.9
Other long-term restricted amounts	–	2.4	–	1.6	–	–	–	4.0
	2.5	2.4	–	3.0	–	–	–	7.9
	$ 27.9	$ 3.2	$ 2.0	$ 55.6	$ 4.9	$ –	$ 150.9	$ 244.5

Table and Notes continued on next page

	Forest Products							
	Scotia LLC	Palco and Other	MGI	Real Estate	Racing	MGHI	MAXXAM Parent	Total
	(In millions of dollars)							
Changes in cash and cash equivalents								
Capital expenditures:								
December 31, 2005[1]	$ 6.5	$ 8.2	$ –	$ 1.2	$ 3.4	$ –	$ 0.4	$ 19.7
December 31, 2004[1]	7.8	22.0	–	2.4	0.2	–	0.3	32.7
December 31, 2003[1]	7.7	11.4	–	3.5	1.0	–	0.2	23.8
Net proceeds from dispositions of property and investments:								
December 31, 2005	$ –	$ 0.1	$ –	$ –	$ –	$ –	$ –	$ 0.1
December 31, 2004	–	0.3	–	–	–	–	–	0.3
December 31, 2003[2]	11.4	10.1	–	1.0	–	–	–	22.5
Borrowings (repayments) of debt and credit facilities, net of financing costs:								
December 31, 2005	$ (2.5)	$ 42.0	$ –	$ (4.6)	$ (0.1)	$ –	$ –	$ 34.8
December 31, 2004	1.0	12.0	–	(21.5)	–	–	–	(8.5)
December 31, 2003	(16.6)	(0.1)	–	(8.5)	0.3	–	–	(24.9)
Dividends, advances including interest paid and tax sharing payments received (paid):								
December 31, 2005	$ –	$ 8.0	$ 1.7	$ (66.2)	$ 9.3	$ 0.1	$ 47.1	$ –
December 31, 2004	–	0.1	0.3	(29.5)	–	0.1	29.0	–
December 31, 2003	–	(0.5)	0.4	(17.6)	(1.2)	–	18.9	–

(1) Capital expenditures for Palco include $4.9 million for a new planer in 2003, as well as $7.6 million and $20.5 million towards a new sawmill project in 2005 and 2004, respectively.

(2) Proceeds from dispositions of property and investments includes $8.2 million and $10.0 million in 2003 for Scotia LLC and Palco, respectively, from the sale of acreage in the Grizzly Creek grove.

Operating Activities

Net cash provided by operating activities of $53.3 million for the year ended December 31, 2005 principally reflects cash generated from the Company's real estate segment, offset by continued operating cash shortfalls experienced by the Company's forest products, and racing operations.

Net cash provided by operating activities of $26.9 million for the year ended December 31, 2004 principally reflects net loss (after adding back depreciation, depletion, amortization and other reconciling items, totaling $2.9 million), in addition to a $4.4 million decrease in inventories, a $5.6 million decrease in long-term assets (primarily real estate), and a $12.1 million increase in long-term liabilities (primarily attributable to increases in deferred sales revenue at Fountain Hills of $6.6 million, increases in membership deposits at Palmas of $2.2 million, and increases in pension liabilities of $2.3 million related to the Company's defined benefit pension plans).

Net cash provided by operating activities of $13.9 million for the year ended December 31, 2003 principally reflects net loss (after adding back depreciation, depletion, amortization and other reconciling items, totaling $6.9 million), a $4.4 million decrease in inventories, a $1.8 million decrease in long-term assets and an $8.0 million increase in long-term liabilities, offset by net changes to other working capital accounts totaling $5.1 million.

Investing Activities

Net cash used for investing activities of $34.2 million for the year ended December 31, 2005 principally reflects capital expenditures of $19.7 million, and purchases of marketable securities and other short-term investments, net of restricted cash deposits, of $15.6 million.

Net cash used for investing activities of $11.1 million for the year ended December 31, 2004 principally reflects capital expenditures of $32.7 million, $20.5 million of which were related to Palco's new sawmill project, offset by net proceeds from restricted cash of $13.0 million and the sale of marketable securities and other short-term investments of $5.8 million.

Net cash provided by investing activities of $13.9 million for the year ended December 31, 2003 principally reflects capital expenditures of $23.8 million, partly offset by proceeds from the sale of timberlands and other assets of $22.5 million, and net proceeds from restricted cash of $13.3 million.

Financing Activities

Net cash provided by financing activities of $34.6 million for the year ended December 31, 2005 principally reflects net proceeds of $35.0 million from the Palco refinancing that occurred in April 2005, as well as net borrowings on the ScoPac and Palco lines of credit of $13.1 million and $10.9 million, partially offset by principal payments on the Timber Notes of $16.0 million.

Net cash used for financing activities of $8.5 million for the year ended December 31, 2004 principally reflects net borrowings on the ScoPac and Palco lines of credit of $18.2 million and $13.1 million, respectively, as well as borrowings on real estate credit facilities of $5.3 million, offset by repayments on real estate credit facilities of $25.7 million (principally related to the Mirada development) and principal payments on and repurchases of Timber Notes.

Net cash used for financing activities of $33.9 million for the year ended December 31, 2003 principally reflects repayments on real estate credit facilities of $11.1 million, treasury stock purchases of $9.0 million, principal payments on and repurchases of Timber Notes of $16.5 million, offset by proceeds from borrowings on credit facilities (primarily real estate) of $2.9 million.

MAXXAM Parent

MAXXAM Parent and MGHI own the 50,000,000 Kaiser Shares, representing an approximate 63% interest in Kaiser. Kaiser's plan of reorganization, which provides for the cancellation of the equity interests of current shareholders without consideration or obligation, was confirmed by the Kaiser Bankruptcy Court in February 2006. However, Kaiser's plan of reorganization is not yet final, as it must still be approved by the U.S. District Court before Kaiser can emerge from Chapter 11, and it is also subject to appeal. See also Notes 1 and 10.

MAXXAM Parent has in the past provided, and may from time to time in the future under appropriate circumstances provide, various forms of financial assistance to its subsidiaries, or may enter into financing or other transactions with its subsidiaries, including secured or unsecured loans, or asset purchases. Additionally, the Company may from time to time purchase shares of its common stock on national exchanges or in privately negotiated transactions.

MAXXAM Parent expects that its general and administrative costs, net of cost reimbursements from subsidiaries, will range from $8.0 million to $10.0 million for the next year. MAXXAM Parent's minimum pension funding payments related to its pension plan are expected to be approximately $3.5 million in 2006.

Although there are no restrictions on the Company's ability to pay dividends on its capital stock, the Company has not paid any dividends for a number of years and has no present intention to do so.

At December 31, 2005, MAXXAM Parent had unrestricted cash, cash equivalents and marketable securities and other investments of $150.9 million and MAXXAM Parent did not have any external debt. 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 future distributions from the real estate segment, will be sufficient to meet its long-term working capital requirements. See "–Forest Products Operations" below regarding potential adverse impacts upon MAXXAM Parent as a result of the liquidity issues being experienced by Palco and ScoPac.

Forest Products Operations

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

Regulatory and environmental matters as well as legal actions have had and are expected to continue to have a significant adverse effect on the Company's forest products operations and liquidity. See Item 1. "Business–Forest Products Operations – Regulatory and Environmental Factors," Item 1A. "Risk Factors," and Note 11 for information regarding these matters. The ability to harvest ScoPac Timber (as defined in Item 1. "Business–Forest Products Operations–Timber and Timberlands") depends in large part upon ScoPac's ability to obtain regulatory approval of

THPs. ScoPac has experienced difficulties and delays in the approval of its THPs as the result of regulatory and litigation challenges, and expects these challenges to persist. Moreover, the Company expects to continue to experience further difficulties, limitations and delays in being able to harvest on previously-approved THPs due to, among other things, the actions by the North Coast Water Board described below. The foregoing matters have resulted in declines in actual and expected harvest levels and cash flows, a significant increase in the cost of logging operations and increased costs related to timber harvest litigation, all of which have severely and negatively impacted the historical cash flows of both Palco and ScoPac. These adverse effects are expected to continue.

As discussed in Item 1. "Business–Forest Products Operations–Regulatory and Environmental Factors–Water Quality," and Item 1A. "Risk Factors," the North Coast Water Board is requiring Palco and ScoPac to apply various waste discharge reporting, mitigation and erosion control requirements in respect of timber harvesting activities in several watersheds, and is likely to impose or seek to 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 ScoPac Timber Property. As harvesting activities on the ScoPac Timber Property cannot readily be moved between watersheds due to, among other things, historic harvest patterns, adjacency restrictions, and the age classes of trees, development of WWDRs and the other matters described in Item 1. "Business–Forest Products Operations–Regulatory and Environmental Factors–Water Quality," and Item 1A. "Risk Factors," and the "Water Quality" section of Note 11 are expected to result in reduced harvest and less predictability in the future regarding the mix of logs available for sale by ScoPac to Palco.

The North Coast Water Board for some time failed to release for harvest a number of ScoPac's THPs that had already been approved by the other governmental agencies which approve ScoPac's THPs. The North Coast Water Board subsequently allowed harvesting on a portion of the approved THPs; however, the State Water Board later disallowed harvesting on a portion of the THPs that had been released by the North Coast Water Board. The unreleased and disallowed THPs in the Freshwater and Elk River watersheds represented a significant portion of the harvest that was planned for 2005. These unreleased and disallowed THPs, as well as additional THPs in the Freshwater and Elk River watersheds, also represent a significant portion of the harvest planned for 2006. As discussed below, ScoPac has announced that its projected average annual harvest level over the ten-year period beginning 2006 is estimated to be approximately 100 million board feet per year. This projection is significantly below historical harvest levels, and actual harvest levels and actual harvest levels may be even lower, depending on the ultimate outcome of various assumptions.

On February 17, 2006, the North Coast Water Board held a status conference to determine a timetable for consideration of approval of WWDRs in the Freshwater and Elk River watersheds. Although a formal timetable has not been published, it appears likely that WWDRs in these two watersheds will not be approved before May 2006; such a timetable would further reduce 2006 annual harvest levels.

As a result of these material and ongoing harvesting restrictions, the Company expects that ScoPac's cash flows from operations, together with funds available under the ScoPac Line of Credit with a group of banks pursuant to which ScoPac may borrow to pay interest on its Timber Notes, will be insufficient, by a substantial amount, to pay the entire amount of interest due on the July 20, 2006, payment date. ScoPac also expects to incur interest shortfalls for at least the next several years after the July 20, 2006, payment date. The failure of ScoPac to pay all of the required amounts of interest on the Timber Notes when due would constitute an event of default under Timber Notes Indenture. See the "ScoPac Liquidity Issues" section below for information regarding ScoPac's efforts to obtain additional liquidity in order to avoid an event of default under the Timber Notes Indenture.

The ScoPac Line of Credit allows ScoPac to borrow up to one year's interest on the Timber Notes. On June 20, 2003, the ScoPac Line of Credit was extended to July 7, 2006. ScoPac intends to request that the ScoPac Line of Credit be extended for an additional period of not less than 364 days. If not extended, ScoPac may draw upon the full amount available. The amount drawn would be repayable in 12 semiannual installments on each Timber 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, 2005, the maximum availability under the ScoPac Line of Credit was $55.4 million, and outstanding borrowings were $31.3 million. At January 31, 2006, the maximum availability under the ScoPac Line of Credit was $54.1 million, after giving effect to principal payments made on the January 20, 2006, Timber Notes payment date and there were $54.9 million in borrowings outstanding under this facility.

In the event of a failure to pay interest or principal on the Timber Notes in full when due, the Trustee 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 ScoPac to perform its respective covenants or agreements under the Master Purchase Agreement or by Palco to perform its covenants or agreements under the Services Agreement, which failure in the case of certain covenants or agreements 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 ScoPac Line of Credit may also accelerate the advances then outstanding thereunder. If such accelerations of Timber Notes and/or advances under the ScoPac 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 ScoPac Timberlands and ScoPac Timber Rights and other assets and using the proceeds thereof to pay accelerated amounts. In the event that ScoPac 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 ScoPac Line of Credit agreement could be accelerated. The foregoing rights of the Trustee and holders of Timber Notes would be subject to the rights of ScoPac under the Bankruptcy Code if it sought protection by filing under the Bankruptcy Code.

Palco and Britt are currently in default under the Palco Term Loan and the Palco Revolving Credit Facility. As a waiver has not been obtained, amounts outstanding under the Palco Term Loan and the Palco Revolving Credit Facility have been classified as a current liability at December 31, 2005. Palco estimates that, without necessary amendments to the Palco Term Loan and the Palco Revolving Credit Facility and/or sufficient additional liquidity, its cash flows from operations, together with funds available from the Palco Revolving Credit Facility, will not provide sufficient liquidity to fund Palco's current level of operations for the next several years. See the "Palco Liquidity Issues" section below for information regarding Palco's efforts to resolve the defaults and obtain additional liquidity necessary to fund anticipated working capital shortfalls.

Without waivers of the defaults under the Palco Term Loan and the Palco Revolving Credit Facility, the lenders may take any or all of the following actions: reduce the amount of funds available for borrowing under the Palco Revolving Credit Facility; refuse to make new loans or to issue new letters of credit under the Palco Revolving Credit Facility; declare any or all loans and other amounts owed under the agreement to be immediately due and payable; require Borrowers (as defined below) to cash collateralize all outstanding letters of credit under the Palco Revolving Credit Facility; or pursue their other rights and remedies under the Palco Term Loan, Palco Revolving Credit Facility and related security agreements. As a result of the defaults, the Palco Term Loan and Palco Revolving Credit Facility lenders are requiring Palco to pay interest on amounts borrowed under the Palco Term Loan and Palco Revolving Credit Facility at a per annum rate 2% higher than the rate at which interest would be owed if no default existed.

In addition to the material adverse effects being experienced by Palco and ScoPac due to continuing regulatory, environmental and litigation difficulties, there can be no assurance that certain other pending legal, regulatory and environmental matters or future governmental regulations, additional litigation or legislation, judicial or administrative decisions, adverse weather conditions, or low lumber or log prices, will not also result in additional material adverse effects 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 Factors," Item 3. "Legal Proceedings" and the "Regulatory and Environmental Factors" and "Contingencies–Timber Harvest Litigation" sections in Note 11 for further information of the regulatory and environmental matters and legal proceedings relating to the Company's forest products operations.

The liquidity problems being experienced by Palco and ScoPac 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 termination obligation attributable to Palco's pension plan as of December 31, 2005 is estimated to have been approximately $31.0 million based upon current annuity placement interest rate assumptions. In addition, it is possible that certain transactions could be entered into in connection with a potential restructuring or reorganization of Palco or ScoPac, such as a sale of all or a portion of the equity ownership in Palco and/or ScoPac, a sale of a substantial portion of Palco's and/or ScoPac's assets and/or a cancellation of some or all of Palco's and/or ScoPac'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.

As discussed above, both Palco and ScoPac continue to experience liquidity shortfalls and expect their liquidity shortfalls to continue for at least the next several years. ScoPac management estimates that a substantial amount of additional liquidity, which will vary based on a number of factors, will be required to fund an anticipated interest shortfall on the July 20, 2006, Timber Notes payment date.

See the "Palco Liquidity Issues" and "ScoPac Liquidity Issues" sections below for further information regarding Palco and ScoPac's plans to obtain the additional liquidity to fund their operations and pay debt obligations when due. There can be no assurance that their efforts will be successful.

Capital expenditures for forest products operations are expected to be approximately $9.0 million to $12.0 million in 2006 and Palco's 2006 minimum pension funding requirements are estimated to be $8.6 million.

Palco Liquidity Issues

As of December 31, 2005, Palco and Britt, as Borrowers (**"Borrowers"**), were in default under the Palco Term Loan and the Palco Revolving Credit Facility due to financial covenant breaches. The Borrowers are pursuing discussions with the lenders in an effort to resolve the defaults and obtain additional liquidity necessary to fund anticipated future working capital shortfalls.

There can be no assurance that Palco will be able to obtain waivers of defaults from the lenders. As of December 31, 2005, $34.7 million was outstanding under the Palco Term Loan, $24.0 million was outstanding under the Palco Revolving Credit Facility, and $10.2 million of letters of credit were outstanding under the Palco Revolving Credit Facility. The Palco Revolving Credit Facility and Palco Term Loan are each secured by a security interest in the stock of Palco held by MGI, and substantially all of the assets of the Borrowers (other than Palco's equity interest in ScoPac).

In an effort to reduce its overall debt level, Palco has commenced the Palco Asset Sale Program pursuant to which it is marketing certain assets, and is also seeking other sources of liquidity. The Palco Term Loan and the Palco Revolving Credit Facility each contain provisions requiring that the net cash proceeds of asset sales be used to prepay amounts outstanding under the two facilities. Accordingly, proceeds generated from the Palco Asset Sale Program would not be available to fund working capital needs until the Palco Term Loan is paid in full. There can be no assurance that these marketing efforts will be successful or that Palco will be successful in securing sufficient additional liquidity.

In the event that Palco is unable to secure the necessary liquidity to fund its expected future working capital shortfalls, it would be forced to take extraordinary actions, which may include: further reducing expenditures by laying off employees, shutting down various operations, and seeking protection by filing under the Bankruptcy Code.

In April 2005, Palco and Britt, as Borrowers, closed the Palco Term Loan and the Palco Revolving Credit Facility. The $35.0 million Palco Term Loan was fully funded at closing. The Palco Revolving Credit Facility provides for borrowings up to a maximum of $30.0 million, subject to borrowing base and other limitations. During 2005, Palco received net cash proceeds of approximately $60.0 million from the Palco Term Loan and Palco Revolving Credit Facility and borrowed an additional $6.0 million from MGI (see Note 7 for further discussion.) These borrowings were utilized primarily in the following areas: (i) $10.8 million was used to pay off amounts previously borrowed under Palco's previous revolving credit facility (which was terminated); (ii) approximately $ 8.0 million was used to fund capital expenditures related primarily to Palco's new sawmill in Scotia, California; (iii) $9.9 million was used as collateral to secure Palco's workers' compensation liabilities (which reduced the Company's availability under the Palco Revolving Credit Facility); (iv) $18.9 million was used to build primarily large log (larger than 24" in diameter) inventory levels; and (v) the remainder was used to pay advisor fees and to fund working capital shortfalls. The working capital shortfalls experienced in 2005 resulted primarily from delays in completion of the large log processing line at Palco's sawmill in Scotia. The sawmill's operational difficulties experienced in 2005, related to the large log processing line, compounded Palco's liquidity challenges as Palco has been unable to mill its large log inventories (purchased in 2005 using the funds available under the Palco Revolving Credit Facility) in 2005 as planned. While production levels at the new sawmill continue to improve, the new sawmill (primarily the large log processing line) is not yet operating at planned production rates, primarily due to a current imbalance between small diameter and large diameter logs which impacts the mill's throughput. In January 2006 and February 2006, additional liquidity was needed at Palco to fund working capital shortfalls and Palco borrowed an additional $5.0 million from MGI to meet these shortfalls. See Note 7 for information regarding the terms of the Palco Revolving Credit Facility and the Palco Term Loan.

Palco will require additional funds in order to meet its working capital and capital expenditure requirements for the next several years. Palco's ability to meet such requirements will be adversely affected should Palco be unsuccessful in its efforts to (i) meet planned production rates at the new sawmill, (ii) obtain waivers of default from its term and revolving credit lenders, and (iii) obtain sufficient additional liquidity from the Palco Asset Sale Program or from other sources. Furthermore, Palco's cash flows from operations may be adversely affected by diminished availability of smaller logs from ScoPac or other third parties, lower lumber prices, adverse weather conditions, pending or future legal, legislative, regulatory and environmental matters, or continued increased funding requirements for its pension plan. The percentage of the logs purchased from third parties that Palco uses in its lumber operations is expected to increase. Under the Master Purchase Agreement, between Palco and ScoPac (**"Master Purchase Agreement"**), Palco is required to pay for logs purchased from ScoPac by the 20th day of the following month, whereas payment for logs purchased from third parties is generally due upon delivery. Accordingly, Palco's working capital needs are likely to increase substantially during 2006 and beyond absent favorable regulatory action affecting ScoPac's THPs. See "–Results of Operations–Forest Products Operations" above, as well as Note 11, for discussion of regulatory, environmental and legal matters affecting harvest levels and operating costs.

With respect to long-term liquidity, until such time as Palco is able to obtain or generate sufficient liquidity, there can be no assurances 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.

ScoPac Liquidity Issues

Due to its highly leveraged condition, ScoPac is more sensitive than less leveraged companies to factors affecting its operations, including low log prices, governmental regulation and litigation affecting timber harvesting operations on the ScoPac Timber (see "–Results of Operations–Forest Products Operations" above, Item 1A. "Risk Factors," and Note 11), and general economic conditions. ScoPac's cash flows from operations are significantly impacted by harvest volumes and log prices. The Master Purchase Agreement between ScoPac and Palco (see Item 1. "Business–Forest Products Operations–Relationships among the Palco Companies") contemplates that all sales of logs by ScoPac to Palco will be at fair market value (based on stumpage prices) for each species and category of timber. 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 ScoPac is required to engage an independent forestry consultant to confirm that the purchase price reflects fair market value. In January 2006, the State Board of Equalization adopted the new Harvest Value Schedule for the first half of 2006. The prices published in that schedule reflected a 5.3% increase in the SBE Price for small redwood logs and a 5.6% decrease for small Douglas-fir logs from the prices published for the second half of 2005.

ScoPac has conducted extensive reviews and analyses of its assets, operations and future prospects. As a result of these extensive reviews and analyses, ScoPac's management has concluded that, in the absence of significant regulatory relief and accommodations, ScoPac's future annual timber harvest levels and cash flows from operations will for at least the next several years be substantially below both historical levels and the minimum levels necessary in order to allow ScoPac to satisfy its debt service obligations in respect of the Timber Notes. ScoPac has announced that its projected average annual harvest level over the ten-year period beginning 2006 is estimated to be approximately 100 million board feet per year. This harvest level reflects ScoPac management's estimate of the cumulative impact of ongoing regulatory limitations, prescriptions, and other actions and is based upon a number of assumptions that may or may not prove to be accurate. Actual harvest levels may even be lower, depending on the outcome of various assumptions.

During 2005, ScoPac devoted significant management resources, and spent approximately $6.1 million, on efforts to restructure the Timber Notes consistent with management expectations as to future harvest levels and cash flows. These efforts were unsuccessful and have largely been abandoned. The Company does not expect that ScoPac will be able to restructure its required minimum payments on the Timber Notes through negotiations with holders of the Timber Notes. Accordingly, additional liquidity will be needed to avoid an event of default under the Timber Notes Indenture.

On the January 20, 2005, Timber Notes payment date, ScoPac used funds available under the ScoPac Line of Credit to fund the interest payment. Prior to the July 20, 2005, Timber Notes payment date, ScoPac requested that Palco make an early payment, equal to an expected $2.2 million cash shortfall, in respect of certain logs that had already been delivered to and purchased by Palco from ScoPac. Palco approved and delivered the early log payment, which allowed ScoPac to fund the July 20, 2005, cash shortfall and pay all of the interest due. As the January 20, 2006, Timber Notes payment date approached, it became apparent that there would be a cash shortfall of $2.3 million. In January 2006, ScoPac and MGI consummated a "Lump Sum Sale" (and as such term is defined in the Timber Notes Indenture) of specified ScoPac Timber. In accordance with the Timber Notes Indenture, the specified Company Timber was released from the liens securing the Timber Notes and that timber was purchased by MGI. The cash purchase price of $2.3 million paid in the Lump Sum Sale, was calculated using the applicable prices established by the California State Board of Equalization for the first half of 2006, and provided ScoPac the additional funds needed to pay all of the interest due on the January 20, 2006, Timber Notes payment date.

ScoPac management estimates that its cash flows from operations, together with the ScoPac Line of Credit will be insufficient, by a substantial amount, to pay a substantial portion of the interest due on the July 20, 2006, Timber Notes payment date. In an effort to address this expected shortfall, and future cash shortfalls expected over at least the next several years, and avoid an event of default under the Timber Notes Indenture, ScoPac is seeking to sell certain non-timberland properties such as ranchlands and recreational areas, as well as certain timberlands (**"ScoPac Land Sale Program"**). There can be no assurance that these marketing efforts will be successful.

To the extent that ScoPac is unable to generate sufficient liquidity from the ScoPac Land Sale Program or other sources, the Company expects that ScoPac will be forced to take extraordinary actions, which may include: laying off employees, shutting down various operations, and seeking protection by filing under the Bankruptcy Code.

At December 31, 2005, the SAR Account balance was $75.9 million (including $52.9 million of Timber Notes held in the SAR Account and $23.0 million in cash), all of which is restricted for future principal payments on the Timber Notes. The SAR Account net cash balance of $23.0 million is sufficient to cover the Scheduled Amortization in 2006, but will not be sufficient to cover the Scheduled Amortization on the January 20, 2007, Timber Note payment date and beyond. Accordingly, ScoPac's ability to make the Scheduled Amortization payments on the Timber Notes beyond 2006 is dependent upon ScoPac's ability to sell all or a portion of the Timber Notes held in the SAR Account. No assurance can be given that ScoPac will be successful in its efforts to sell the Timber Notes held in the SAR Account before the January 20, 2007, Timber Notes payment date or as to the proceeds that might result from any such sale.

Accordingly, ScoPac will require substantial additional funds in order to meet its debt service requirements for the next year. ScoPac's ability to meet such requirements will be adversely affected (a) if ScoPac is unsuccessful in its efforts to (i) generate sufficient cash flows from the ScoPac Land Sale Program, (ii) sell a portion of its Timber Notes holdings, or (iii) obtain additional financing, or (b) if Palco is unable to obtain sufficient additional liquidity to continue to purchase and pay for logs as they are purchased from ScoPac.

With respect to long-term liquidity, until such time as ScoPac has adequate cash flows from operations, there can be no assurance that ScoPac 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 approximately $25.0 million to $30.0 million in 2006. The Company expects that these expenditures will be funded by existing cash and available credit facilities.

Subject to available resources, the Company's real estate segment may purchase additional properties and/or seek other investment ventures from time to time as appropriate opportunities arise.

Real estate management believes that the existing cash and credit facilities are sufficient to fund the segment's working capital and capital expenditure requirements for 2006. With respect to the segment's long-term liquidity, real estate management believes that the ability to generate cash from the sale of existing assets, together with the ability to obtain financing and joint venture partners, should provide sufficient funds to meet the working capital and capital expenditure requirements.

Racing Operations

Capital expenditures are expected to be approximately $0.3 million in 2006.

Subject to available resources, the Company's racing segment may purchase additional properties and/or seek to expand its operations as appropriate opportunities arise.

During 2005, SHRP, Ltd. borrowed $9.3 million from MAXXAM Parent to fund its 2005 capital expenditures and improve its working capital position. SHRP, Ltd.'s management expects that SHRP, Ltd. will 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 the long-term liquidity of SHRP, Ltd.

Kaiser's Operations

With respect to the Company's interest in Kaiser, the Kaiser plan of reorganization, which provides for the cancellation of the equity interests of current shareholders without consideration or obligation, was confirmed by the

Kaiser Bankruptcy Court in February 2006. However, it is not yet final as it must still be approved by the U.S. District Court before Kaiser can emerge from Chapter 11, as is also subject to appeal. See Note 10 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 and disclosed below, or unconsolidated special purpose entities. The Company does not use derivatives for any of its treasury or risk management activities.

Contractual Obligations

The following table presents information with respect to the Company's contractual obligations as of December 31, 2005 (in millions).

		Payments Due by Period					
Contractual Obligations	**Total**	**2006**	**2007**	**2008**	**2009**	**2010**	**Thereafter**
Debt obligations	$ 1,002.1	$ 112.5	$ 31.4	$ 30.1	$ 25.4	$ 28.8	$ 773.9
Interest due on long-term debt obligations [1]	642.0	75.9	74.7	72.0	67.4	65.6	286.4
Operating lease obligations	11.7	3.3	2.9	2.0	0.8	0.8	1.9
Purchase obligations[2]	–	–	–	–	–	–	–
Pension funding obligations [3]	21.5	12.2	7.4	1.8	0.1	–	–
Other long-term liabilities reflected on the Company's balance sheet[4][5][6][7]	6.2	1.9	2.5	1.8	–	–	–
Total	$ 1,683.5	$ 205.8	$ 118.9	$ 107.7	93.7	95.2	$ 1,062.2

(1) Interest due on debt obligations is net of additional interest due in respect of Timber Notes held by ScoPac in the SAR Account.
(2) Excludes ordinary course of business purchase orders.
(3) Represents expected funding for pension benefits for 2006 and subsequent years.
(4) Excludes reserves for litigation, environmental remediation, self-insurance claims, and other contingent liabilities due to uncertainty as to when cash payments will be required.
(5) Includes $0.8 million in 2006 and $1.8 million in 2007 under the terms of various executive compensation agreements.
(6) Includes $2.1 million in 2008 (for PDMPI's cost sharing agreement with the Puerto Rico Power Authority for the construction of an electrical substation that will provide capacity to new projects within PDMPI.
(7) Include $1.1 million in 2006 and 0.4 million in 2007 for contractual amounts owed under agreements with various professional firms (principally audit and tax compliance fees).

Trends

Forest Products Operations

Harvest levels at the Company forest products operations are expected to decline significantly, as compared to historical harvest levels, in 2006 and beyond. Consequently, cash flows from ScoPac's operations will not be sufficient to allow ScoPac to satisfy its debt service obligations in respect of its Timber Notes. In an effort to address expected future cash shortfalls, ScoPac is seeking to sell certain non-timberlands properties such as ranchlands and recreational areas, as well as certain timberlands. There can be no assurance that these marketing efforts will be successful.

Palco is also expecting significant future cash shortfalls. In an effort to reduce its overall debt level, Palco has commenced the Palco Asset Sale Program pursuant to which it is marketing certain assets, and is also seeking other sources of liquidity. There can be no assurance that these marketing efforts will be successful.

Real Estate Operations

The Company is engaged in marketing and sales programs of varying magnitudes at its real estate developments. The Company intends to continue selling undeveloped acreage and semi-developed parcels, generally to builders and developers. In 2005, the Company's real estate operations realized substantial revenues related to sales at the Company's Fountain Hills, Mirada and Palmas developments. As the proceeds from these asset sales have not been redeployed on other real estate assets, this level of sales activity is not expected to recur for the foreseeable future.

Racing Operations

During the regular legislative session of the Texas Legislature that ended in May 2005 and two subsequent 30-day special sessions, a variety of alternatives were considered 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. However, neither the regular session nor the two special sessions resulted in any such legislation. The Company intends to continue to vigorously pursue legislation favorable to it. A special session is expected to be called in 2006 and the next regular session of the Texas Legislature will begin in January of 2007. As some legislation may 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.

In January 2004, a subsidiary of the Company applied to the Racing Commission for an additional license to construct and operate a Class 2 horse racing facility in Laredo, Texas. The review process is 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. A hearing before a State administrative law judge to review both applications is scheduled to begin on March 27, 2006.

Critical Accounting Policies and Estimates

This section contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. See Item 1. "Business–General," Item 1A. "Risk Factors," and below for cautionary information with respect to such forward-looking statements.

The discussion and analysis of the Company's financial condition and results of operations is based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. Estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. The result of this process forms the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. The Company re-evaluates its estimates and judgments on a regular, ongoing basis. Actual results may differ from these estimates due to changed facts, circumstances and conditions.

The following accounting policies and estimates are considered critical in light of the potentially material impact that the estimates, judgments and uncertainties affecting the application of these policies might have on the Company's reported financial information.

Principles of Consolidation–Deconsolidation of Kaiser

Under generally accepted accounting principles for entities consolidated through voting interests, 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. 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 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.

Kaiser's plan of reorganization, which provides for the cancellation of the Company's 50,000,000 Kaiser common shares without consideration or obligation, was confirmed by the Kaiser Bankruptcy Court in February 2006. However, Kaiser's plan of reorganization is not yet final, as it must still be approved by the U.S. District Court before Kaiser can emerge from Chapter 11, and is also subject to appeal. These consolidated financial statements do not reflect any adjustment related to the deconsolidation of Kaiser other than presenting the Company's investment in Kaiser using the cost method. The Company expects to reverse the $516.2 million of losses in excess of its investment in Kaiser, net of accumulated other comprehensive losses of $85.3 million related to Kaiser, and recognize the net amount, including the related tax effects, in the period in which the Kaiser Shares are cancelled, currently expected to occur during 2006. Upon effectiveness of Kaiser's plan of reorganization, the Company also expects it will take a worthless stock deduction on its consolidated federal income tax return related to the cancellation of the Kaiser Shares and will at that time evaluate whether it expects to realize the resulting tax asset of approximately $135.8 million. Although the Company does not currently expect that it will be obligated to fund losses in Kaiser, the amount of the reversal would be reduced by any losses which the Company later estimates it would be obligated to fund.

Gain and Loss Contingencies

The Company is involved in various claims, lawsuits and other proceedings discussed in Note 11. Such matters involve uncertainty as to reasonably possible losses and gains the Company may ultimately realize when one or more future events occur or fail to occur. The Company accrues and charges to income estimated losses (including related estimated legal fees) from contingencies when it is probable (at the balance sheet date) that an asset has been impaired or liability incurred and the amount of loss can be reasonably estimated. The Company recognizes gain contingencies when realization is assured. Differences between estimates recorded and actual amounts determined in subsequent periods are treated as changes in accounting estimates (i.e., they are reflected in the financial statements in the period in which they are determined to be losses, with no retroactive restatement).

The Company estimates the probability of gains and losses on legal contingencies based on the advice of internal and external counsel, the outcomes from similar litigation, the status of the lawsuits (including settlement initiatives), legislative and regulatory developments, and other factors. For larger environmental matters, the Company estimates the losses using estimates prepared by third party experts and the advice of internal and external counsel. Risks and uncertainties are inherent with respect to the ultimate outcome of litigation and environmental contingencies. See Note 11 for further discussion of the Company's material contingencies.

Income Taxes

The Company accrues and charges to income estimated taxes when it is probable (at the balance sheet date) that a liability has been incurred and the amount of the liability can be reasonably estimated, including situations in which the Company has and has not received tax assessments from the relevant taxing authority. Taxes are provided in those instances where the Company considers it probable that additional tax may be due in excess of amounts reflected in our tax returns as filed. The Company believes amounts currently provided for any such potential assessments will not be settled within the next twelve months and settlement of such amounts would not have a significant impact on the Company's consolidated financial position, results of operations and/or liquidity. See Note 8 for further discussion of the Company's income taxes.

Deferred Tax Asset Valuation Allowances

As of December 31, 2005, the Company had $134.6 million of deferred tax assets (net of $102.7 million in valuation allowances) and $50.7 million of deferred tax liabilities. The deferred tax assets and liabilities reported in the Company's balance sheet reflect the amount of taxes that the Company has prepaid or for which it will receive a tax benefit (an asset) or will have to pay in the future (a liability) because of temporary differences that result from differences in timing of revenue recognition or expense deductibility between generally accepted accounting principles and the Internal Revenue Code. Accounting rules require that a deferred tax asset be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50%) that all or some portion of the deferred tax asset will not be realized. The Company considers all available evidence, both positive and negative, to determine whether a valuation allowance is needed. The need for a valuation allowance ultimately depends on the existence of sufficient taxable income to realize the benefit of a future deductible amount.

Assessing the need for and amount of a valuation allowance for deferred tax assets requires significant judgment. The fact that a benefit may be expected for a portion but not all of a deferred tax asset increases the judgmental complexity of the determination. Projections of future taxable income, by their very nature, require estimates and judgments about future events that, although they might conceivably be predictable, are far less certain than events that have already occurred and can be objectively measured.

Uncertainties that might exist with respect to the realization of the Company's deferred tax assets relate to future taxable income. See Note 8 for further discussion of the Company's valuation allowances on deferred tax assets.

Pension and Other Postretirement Benefit Plan Obligations and Expenses

Estimating future benefit payments for purposes of measuring pension benefit obligations requires the Company to make a number of assumptions about future experience. These assumptions are combined with the terms of the Company's plans to produce an estimate of required future benefit payments, which is discounted to reflect the time value of money. As a result, assumptions about the covered population (demographic assumptions) and about the economic environment (economic assumptions) significantly affect pension and other postretirement benefit obligations. The most significant demographic assumptions are expected retirement age, life expectancy, and turnover, while the key economic assumptions are the discount rate, the salary growth rate, and the expected return on plan assets. At December 31, 2005, the MAXXAM Pension Plan and the Palco Retirement Plan were frozen. As a result, these plans will continue, but no additional benefits will accrue to participants subsequent to December 31, 2005. Future benefit payments will continue to be measured based on the same types of demographic and economic assumptions, with the exception of salary growth as no new benefits will be accrued.

The projected benefit obligation for the Company's pension plans and the accumulated postretirement benefit obligation for the Company's other postretirement benefit plans was determined using a discount rate of 5.625% at December 31, 2005, and 5.875% at December 31, 2004. As the pension plans were frozen December 31, 2005, there is no assumed weighted average long-term rate of compensation. The assumed weighted average long-term rate of return on plan assets is 8.5%. Plan assets consist principally of common stocks and U.S. government and other fixed-income obligations.

The estimated impact of a 1% decrease in the discount rate (from 5.625% to 4.625%) would increase the Company's aggregate pension obligation by approximately $16.1 million, while the estimated impact of a 1% increase in the discount rate (from 5.625% to 6.625%) would decrease the Company's aggregate pension obligation by approximately $13.1 million.

Generally accepted accounting principles are applied to determine the expense that the Company recognizes related to pension obligations, while pension plan funding is governed by tax and labor laws. The Company expects pension expense to be approximately $0.4 million in 2006, while cash contributions are expected to be approximately $12.2 million in 2006. This compared to pension expense of $3.4 million and cash contributions of $2.3 million in 2005.

At December 31, 2005, the Company had $34.8 million in accrued liabilities related to pension benefits. This amount consists of an accrued liability of $21.6 million reflecting the cumulative excess of the amount the Company has expensed over the amount the Company has funded since inception of its plans, as well as an additional minimum liability of $13.2 million reflecting the excess of the accumulated benefit obligation over the fair value of plan assets.

See Note 9 for further discussion of the Company's obligations related to pension and other postretirement benefit plans.

Impairment of Noncurrent Assets

The Company reviews noncurrent assets for impairment when circumstances indicate that the carrying amount of such assets may not be recoverable. Impairment is indicated if the total undiscounted future cash flows expected to result from use of the assets, including the possible residual value associated with their eventual disposition, are less than the carrying amount of the assets. Assets are written down to fair value and a loss is recognized upon impairment. Fair value increases on assets previously written down for impairment losses are not recognized.

Considerable judgment is exercised in the Company's assessment of the need for an impairment write-down. Indicators of impairment must be present. The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require management's subjective judgments. In some instances, situations might exist where impairments are the result of changes in economic conditions or other factors that develop over time, which increases the subjectivity of assumptions made. Depending on the assumptions and estimates used, the estimated future cash flows projected in the evaluation of long-lived assets can vary within a wide range of outcomes. A probability-weighted approach is used for situations in which alternative courses of action to recover the carrying amount of long-lived assets are under consideration or a range is estimated for the amount of possible future cash flows.

As part of Palco's on-going evaluation of activities in 2005, several sites were subject to an impairment review due to changes in their expected use. As a result of the impairment review, two facilities, the Carlotta mill and the Scotia remanufacturing facility, were deemed impaired and an impairment charge of $4.6 million, was recognized in 2005.

New Accounting Standards

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to changes in interest rates primarily under the ScoPac Line of Credit and the Palco Term Loan and Palco Revolving Credit Facility, as well as certain other debt facilities used to finance real estate development activities. These facilities bear interest at either the prime interest rate or LIBOR, plus specified percentage point spreads. The Company's objective in maintaining its other variable rate borrowings is flexibility in borrowing funds and making repayments without penalties. As of December 31, 2005, there were $90.0 million in borrowings outstanding under all variable rate facilities. Based on the amount of borrowings outstanding under these facilities during 2005, a 1.0% change in interest rates effective from the beginning of the year would have resulted in an increase or decrease in annual interest expense of $1.1 million. Due to breaches of financial covenants, interest on each of the Palco Term Loan and Palco Revolving Credit Facility was increased by 2.0% per annum.

All of the Company's other debt is fixed-rate and, therefore, does not expose the Company to the risk of higher interest payments due to changes in market interest rates. The Company does not utilize interest rate swaps or similar hedging arrangements.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
MAXXAM Inc.
Houston, Texas

We have audited the accompanying consolidated balance sheets of MAXXAM Inc. and subsidiaries (**"Company"**) as of December 31, 2005 and 2004, and the related consolidated statements of operations, cash flows, and stockholders' deficit for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedules listed in the Index at Item 15(a)(2). These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedules based on our audits. We did not audit the financial statements of Sam Houston Race Park, Ltd. (a subsidiary), which statements reflect total revenue constituting 11.4 percent, 14.5 percent, and 14.8 percent of the Company's consolidated total revenues for the years ended December 31, 2005, 2004, and 2003, respectively. Such financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Sam Houston Race Park, Ltd., is based solely on the report of such other auditors.

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

In our opinion, based on our audits and the report of other auditors, such consolidated financial statements present fairly, in all material respects, the financial position of MAXXAM Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, based on our audits and (as to the amounts included for Sam Houston Race Park, Ltd.) the report of other auditors, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

The accompanying consolidated financial statements have been prepared assuming that MAXXAM Inc., and its subsidiaries will continue as going concerns. As discussed in Note 1 to the consolidated financial statements, at December 31, 2005, the cash flows of MAXXAM Inc.'s wholly owned subsidiary, The Pacific Lumber Company (**"Palco"**) and Palco's wholly owned subsidiary, Scotia Pacific Company LLC (**"ScoPac"**) have been adversely affected by delays in obtaining regulatory approvals on harvest timber and other difficulties. Palco was in default under its term loan and revolving credit facility. ScoPac has estimated that without additional liquidity from asset sales or other sources, ScoPac will be unable to pay the entire amount of interest due in July 2006 on its timber notes. Such failure to pay interest would constitute an event of default under the indenture governing the timber notes. The difficulties of Palco in meeting its loan agreement covenants and ScoPac in paying the interest on the timber notes raise substantial doubts about Palco's and ScoPac's ability to continue as going concerns. Further, the difficulties of these subsidiaries raise substantial doubt about the ability of MAXXAM Inc. and subsidiaries to realize their timber-related assets and discharge their timber-related liabilities in the normal course of business and to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 14, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

DELOITTE & TOUCHE LLP

Houston, Texas
March 14, 2006

MAXXAM INC. AND SUBSIDIARIES

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

	December 31, 2005	December 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 72.0	$ 18.3
Marketable securities and other short-term investments	135.5	106.6
Receivables:		
Trade, net of allowance for doubtful accounts of $0.8 and $0.6, respectively	11.1	13.1
Other	5.4	3.4
Inventories:		
Lumber	7.6	17.0
Logs	18.9	7.2
Real estate inventory	12.6	21.1
Prepaid expenses and other current assets	16.4	16.6
Restricted cash and marketable securities	29.1	28.2
Total current assets	308.6	231.5
Property, plant and equipment, net of accumulated depreciation of $207.9 and $183.4, respectively	355.0	370.2
Timber and timberlands, net of accumulated depletion of $226.3 and $218.6, respectively	208.7	213.6
Real estate	43.2	52.5
Deferred income taxes	95.1	94.8
Intangible assets	2.9	3.8
Long-term receivables and other assets	26.9	33.2
Restricted cash and marketable securities	7.9	15.6
	$ 1,048.3	$ 1,015.2
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	$ 11.2	$ 14.4
Accrued interest	25.9	24.9
Accrued compensation and related benefits	20.7	12.1
Other accrued liabilities	37.0	27.8
Short-term borrowings and current maturities of long-term debt	112.5	51.4
Total current liabilities	207.3	130.6
Long-term debt, less current maturities	889.6	912.0
Accrued pension and other postretirement benefits	34.1	41.8
Losses in excess of investment in Kaiser	516.2	516.2
Other noncurrent liabilities	62.4	71.7
Total liabilities	1,709.6	1,672.3
Commitments and contingencies (see Note 11)		
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; 668,964 and 669,019 shares issued, respectively; 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; 5,967,942 and 5,976,487 outstanding, respectively	5.0	5.0
Additional capital	225.3	225.3
Accumulated deficit	(670.4)	(666.4)
Accumulated other comprehensive loss	(96.6)	(96.6)
Treasury stock, at cost (shares held: preferred – 845; common – 4,095,417 and 4,086,872, respectively)	(124.9)	(124.7)
Total stockholders' deficit	(661.3)	(657.1)
	$ 1,048.3	$ 1,015.2

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

MAXXAM INC. AND SUBSIDIARIES

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

	Years Ended December 31, 2005	2004	2003
Net sales:			
Forest products	$ 181.8	$ 202.1	$ 208.5
Real estate	178.3	94.8	78.3
Racing	46.3	50.6	49.8
	406.4	347.5	336.6
Cost and expenses:			
Cost of sales and operations:			
Forest products	146.3	150.1	144.4
Real estate	52.0	31.7	25.1
Racing	40.1	42.7	41.0
Selling, general and administrative expenses	72.3	71.7	63.7
Gains on sales of timberlands and other assets	(0.3)	(0.1)	(17.5)
Impairment of assets	4.6	–	1.4
Depreciation, depletion and amortization	35.9	37.1	37.1
	350.9	333.2	295.2
Operating income (loss):			
Forest products	(13.4)	5.4	34.5
Real estate	89.0	29.7	17.1
Racing	(4.1)	(3.1)	(1.9)
Corporate	(16.0)	(17.7)	(8.3)
	55.5	14.3	41.4
Other income (expense):			
Investment and interest income	17.5	8.6	13.8
Other income	1.1	4.2	11.2
Interest expense	(78.2)	(74.0)	(77.0)
Loss before income taxes	(4.1)	(46.9)	(10.6)
Benefit (provision) for income taxes	0.1	0.3	(1.0)
Net loss	$ (4.0)	$ (46.6)	$ (11.6)
Basic and diluted loss per common and common equivalent share	$ (0.66)	$ (7.79)	$ (1.79)

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

MAXXAM INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions of dollars)

	Years Ended December 31, 2005	2004	2003
Cash flows from operating activities:			
Net loss	$ (4.0)	$ (46.6)	$ (11.6)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation, depletion and amortization	35.9	37.1	37.1
Non-cash stock-based compensation expense	3.7	6.1	0.8
Non-cash impairment charge	4.6	–	1.4
Gains on sales and/or disposal of timberlands and other assets	(0.3)	(0.1)	(18.3)
Net losses (gains) on marketable securities	(6.6)	2.2	(5.2)
Amortization of deferred financing costs and discounts on long-term debt	3.8	2.2	2.1
Equity in loss (earnings) of unconsolidated affiliates, net of dividends received	1.0	(0.4)	(0.1)
Increase (decrease) in cash resulting from changes in:			
Receivables	5.4	(0.8)	(0.2)
Inventories	(1.1)	4.4	4.4
Prepaid expenses and other assets	0.5	1.5	(2.6)
Accounts payable	(3.4)	2.5	(1.1)
Accrued and deferred income taxes	0.2	0.2	0.6
Other accrued liabilities	8.1	1.6	(1.6)
Accrued interest	1.0	(0.9)	(0.2)
Long-term assets and long-term liabilities	4.6	17.7	8.9
Other	(0.1)	0.2	(0.5)
Net cash provided by operating activities	53.3	26.9	13.9
Cash flows from investing activities:			
Net proceeds from dispositions of property and investments	0.1	0.3	22.5
Net sales (purchases) of marketable securities and other investments	(20.8)	5.8	0.1
Net proceeds from restricted cash	5.2	13.0	13.3
Capital expenditures	(19.7)	(32.7)	(23.8)
Return of investment in joint venture	0.8	2.1	1.4
Other	0.2	0.4	0.4
Net cash provided by (used for) investing activities	(34.2)	(11.1)	13.9
Cash flows from financing activities:			
Proceeds from issuances of long-term debt	38.0	5.4	2.9
Redemptions and repurchases of, and principal payments on, long-term debt	(22.6)	(43.1)	(27.7)
Borrowings under revolving and short-term credit facilities	23.0	30.0	–
Incurrence of deferred financing costs	(3.6)	(0.8)	(0.1)
Treasury stock purchases	(0.2)	–	(9.0)
Net cash provided by (used for) financing activities	34.6	(8.5)	(33.9)
Net increase (decrease) in cash and cash equivalents	53.7	7.3	(6.1)
Cash and cash equivalents at beginning of year	18.3	11.0	17.1
Cash and cash equivalents at end of year	$ 72.0	$ 18.3	$ 11.0

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

MAXXAM INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
(In millions, except per share information)

	Years Ended December 31, 2005	2004	2003
Preferred Stock ($.50 Par)			
Balance at beginning and end of year	$ 0.3	$ 0.3	$ 0.3
Common Stock ($.50 Par)			
Balance at beginning and end of year	$ 5.0	$ 5.0	$ 5.0
Additional Capital			
Balance at beginning and end of year	$ 225.3	$ 225.3	$ 225.3
Accumulated Deficit			
Balance at beginning of year	$ (666.4)	$ (619.8)	$ (608.2)
Net loss	(4.0)	(46.6)	(11.6)
Balance at end of year	$ (670.4)	$ (666.4)	$ (619.8)
Accumulated Other Comprehensive Income (Loss)			
Minimum pension liability adjustment, net of taxes	$ 0.1	$ (6.9)	$ 1.0
Unrealized gains (losses) on available-for-sale investments	(0.1)	(1.7)	0.2
Other comprehensive income (loss)	–	(8.6)	1.2
Accumulated other comprehensive loss at beginning of year	(96.6)	(88.0)	(89.2)
Accumulated other comprehensive loss at end of year	$ (96.6)	$ (96.6)	$ (88.0)
Treasury Stock			
Balance at beginning of year	$ (124.7)	$ (124.7)	$ (115.7)
Treasury stock purchases	(0.2)	–	(9.0)
Balance at end of year	$ (124.9)	$ (124.7)	$ (124.7)
Comprehensive Loss			
Net loss	$ (4.0)	$ (46.6)	$ (11.6)
Other comprehensive loss	–	(8.6)	1.2
Total comprehensive loss	$ (4.0)	$ (55.2)	$ (10.4)

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Index of Notes

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of MAXXAM Inc. and its majority and wholly owned controlled subsidiaries. The term **"MAXXAM Parent"** refers to the Company on a stand-alone basis without its subsidiaries. All references to the **"Company"** include MAXXAM Inc. and its majority owned and wholly owned consolidated subsidiaries, unless otherwise noted or the context indicates otherwise. Intercompany balances and transactions have been eliminated. Investments in entities over which the Company can exert significant influence but not control (generally 20% to 50% ownership) are accounted for using the equity method of accounting.

The Company conducts the substantial portion of its operations through its subsidiaries, which operate in three principal industries:

- Forest products, through MAXXAM Group Inc. (**"MGI"**) and MGI's wholly owned subsidiary, The Pacific Lumber Company (**"Palco"**), and Palco's wholly owned subsidiaries, Scotia Pacific Company LLC (**"ScoPac"**) and Britt Lumber Co., Inc. (**"Britt"**). MGI engages in the growing and harvesting of redwood and Douglas-fir timber, the milling of logs into lumber, and certain related operations. Housing, construction and remodeling are the principal markets for the Company's lumber products.

- Real estate investment and development, through MAXXAM Property Company (**"MPC"**) and other wholly owned subsidiaries of the Company, as well as joint ventures. These subsidiaries are engaged in the business of residential and commercial real estate investment and development, primarily in Arizona, California, Puerto Rico and Texas, including associated golf course or resort operations in certain locations, and also own several commercial real estate properties that are subject to long-term lease arrangements.

- Racing operations, through Sam Houston Race Park, Ltd. (**"SHRP, Ltd."**), a Texas limited partnership, wholly owned by the Company. SHRP, Ltd. owns and operates a Class 1 pari-mutuel horse racing facility in the greater Houston metropolitan area, and a pari-mutuel greyhound racing facility in Harlingen, Texas.

In addition to the above, the Company owns 50,000,000 shares (**"Kaiser Shares"**) common stock of Kaiser Aluminum Corporation (**"Kaiser"**), which represent approximately 63% of Kaiser's common stock. However, in 2002-2003, Kaiser and a number of its subsidiaries filed for reorganization under Chapter 11 of the United States Bankruptcy Code (**"Bankruptcy Code"**). As a result, the Company discontinued consolidating Kaiser's financial results beginning February 12, 2002, and began reporting its investment in Kaiser using the cost method. Kaiser's plan of reorganization, which provides for the cancellation of the equity interests of current shareholders without consideration or obligation, was confirmed by the Bankruptcy Court supervising the Kaiser bankruptcy cases (**"Kaiser Bankruptcy Court"**) in February 2006. However, Kaiser's plan of reorganization is not yet final, as it must still be approved by the U.S. District Court before Kaiser can emerge from Chapter 11, and it is also subject to appeal. These consolidated financial statements do not reflect any adjustment related to the Company's investment in Kaiser. See "– Deconsolidation of Kaiser Aluminum" below and Note 10 for further information.

Results and activities for MAXXAM Inc. (excluding its subsidiaries) and for MAXXAM Group Holdings Inc. (**"MGHI"**) are not included in the above segments. MGHI owns 100% of MGI and is a wholly owned subsidiary of the Company.

Financial Difficulties of Forest Products Entities

Regulatory Situation

Regulatory and environmental matters as well as legal actions have had and are expected to continue to have a significant adverse effect on the Company's forest products operations and liquidity. See Note 11 for information regarding these matters. The ability to harvest ScoPac Timber (as defined below) depends in large part upon ScoPac's ability to obtain regulatory approval of timber harvesting plans ("**THPs**"). ScoPac has experienced difficulties and delays in the approval of its THPs as the result of regulatory and litigation challenges, and expects these challenges to persist. Moreover, the Company expects to continue to experience further difficulties, limitations and delays in being able to harvest on previously-approved THPs due to, among other things, the actions by the California North Coast Regional Water Quality Control Board (**"North Coast Water Board"**) (see below). The foregoing matters have resulted in declines in actual and expected harvest levels and cash flows, significant increases in the cost of logging operations and increased costs related to timber harvest litigation, all of which have severely and negatively impacted the historical cash flows of both Palco and ScoPac. These adverse effects are expected to continue. The timber on the timberlands owned by ScoPac (**"ScoPac Timberlands"**) and the timber which ScoPac has the exclusive right to harvest (**"ScoPac Timber Rights"**) is collectively referred to as the **"ScoPac Timber."** The timberlands in respect of the ScoPac Timber is referred to as the **"ScoPac Timber Property."**

The North Coast Water Board is requiring Palco and ScoPac to apply various waste discharge reporting, mitigation and erosion control requirements in respect of timber harvesting activities in several watersheds, and is likely to impose additional measures in the future. The North Coast Water Board in December 2003 directed its staff to formulate watershed-wide waste discharge requirements (**"WWDRs"**) for the Freshwater and Elk River watersheds on the ScoPac Timber Property. As harvesting activities on the ScoPac Timber Property cannot readily be moved between watersheds due to, among other things, historic harvest patterns, adjacency restrictions, and the age classes of trees, development of WWDRs and the other matters described in the "Forest Products Operations" section of Note 11 are expected to result in reduced harvest and less predictability in the future regarding the mix of logs available for sale by ScoPac to Palco.

The North Coast Water Board for some time failed to release for harvest a number of ScoPac's THPs that had already been approved by the other governmental agencies which approve ScoPac's THPs. The North Coast Water Board subsequently allowed harvesting on a portion of the approved THPs; however, the State Water Board later disallowed harvesting on a portion of the THPs that had been released by the North Coast Water Board. The unreleased and disallowed THPs in the Freshwater and Elk River watersheds represented a significant portion of the harvest that was planned for 2005. These unreleased and disallowed THPs, as well as additional THPs in the Freshwater and Elk River watersheds, also represent a significant portion of the harvest planned for 2006. As discussed below, ScoPac has announced that its projected average annual harvest level over the ten-year period beginning 2006 is estimated to be approximately 100 million board feet per year. This projection is significantly below historical harvest levels, and actual harvest levels may be even lower, depending on the ultimate outcome of various assumptions.

On February 17, 2006, the North Coast Water Board held a status conference to determine a timetable for consideration of approval of WWDRs in the Freshwater and Elk River watersheds. Although a formal timetable has not been published, it appears likely that WWDRs in these two watersheds will not be approved before May 2006; such a timetable would further reduce 2006 harvest levels.

As a result of these material and ongoing harvesting restrictions, the Company expects that ScoPac's cash flows from operations, together with funds available under an agreement (**"ScoPac Line of Credit"**) with a group of banks pursuant to which ScoPac may borrow to pay interest on its 6.55% Class A-1, 7.11% Class A-2 and 7.71% Class A-3 Timber Collateralized Notes due 2028 (**"Timber Notes"**) will be insufficient, by a substantial amount, to pay the entire amount of interest due on the July 20, 2006, payment date. ScoPac also expects to incur interest shortfalls for at least the next several years after the July 20, 2006, payment date. The failure of ScoPac to pay all of the interest on the Timber Notes when due would constitute an event of default under the indenture governing the Timber Notes (**"Timber**

Notes Indenture"). See the "ScoPac Liquidity Issues" section below regarding ScoPac's efforts to obtain additional liquidity to avoid an event of default under the Timber Notes Indenture.

In the event of a failure to pay interest or principal on the Timber Notes in full when due, the trustee under the Timber Notes Indenture (**"Trustee"**) 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 ScoPac to perform its respective covenants or agreements under the Master Purchase Agreement or by Palco to perform its covenants or agreements under the Services Agreement, which failure in the case of certain covenants or agreements 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 ScoPac Line of Credit may also accelerate the advances then outstanding thereunder. If such accelerations of Timber Notes and/or advances under the ScoPac 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 ScoPac Timberlands and ScoPac Timber Rights and other assets and using the proceeds thereof to pay accelerated amounts. In the event that ScoPac 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 ScoPac Line of Credit agreement could be accelerated. The foregoing rights of the Trustee and holders of Timber Notes would be subject to the rights of ScoPac under the Bankruptcy Code if it sought protection by filing under the Bankruptcy Code.

Palco and Britt are currently in default under their $35.0 million term loan agreement (**"Palco Term Loan"**) and their $30.0 million asset-based revolving credit agreement (**"Palco Revolving Credit Facility"**). As waivers have not been obtained, amounts outstanding under the Palco Term Loan and the Palco Revolving Credit Facility have been classified as a current liability at December 31, 2005. Palco estimates that, without necessary amendments to the Palco Term Loan and the Palco Revolving Credit Facility and/or sufficient additional liquidity, its cash flows from operations, together with funds available from the Palco Revolving Credit Facility, will not provide sufficient liquidity to fund Palco's current level of operations for the next several years. See the "Palco Liquidity Issues" section below for Palco's efforts to resolve the defaults and obtain additional liquidity necessary to fund anticipated working capital shortfalls.

Without waivers of the defaults under the Palco Term Loan and the Palco Revolving Credit Facility, the lenders may take any or all of the following actions: reduce the amount of funds available for borrowing under the Palco Revolving Credit Facility; refuse to make new loans to or issue new letters of credit under the Palco Revolving Credit Facility; declare any or all loans and other amounts owed under the agreement to be immediately due and payable; require Borrowers (as defined below) to cash collateralize all outstanding letters of credit under the Palco Revolving Credit Facility; or pursue their other rights and remedies under the Palco Term Loan, Palco Revolving Credit Facility and related security agreements. As a result of the defaults, the Palco Term Loan lender and Palco Revolving Credit Facility lender is requiring Palco to pay interest on amounts borrowed under the Palco Term Loan and Palco Revolving Credit Facility lender at a per annum rate 2% higher than the rate at which interest would be owed if no default existed.

In addition to the material adverse effects being experienced by Palco and ScoPac due to continuing regulatory, environmental and litigation difficulties, there can be no assurance that certain other pending legal, regulatory and environmental matters or future governmental regulations, additional litigation, legislation, 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 the "Forest Products Operations" section in Note 11 for further discussion of the regulatory and environmental matters and legal proceedings affecting the Company's forest products operations.

Palco Liquidity Issues

As of December 31, 2005, Palco and Britt, as Borrowers (**"Borrowers"**), were in default under the Palco Term Loan and the Palco Revolving Credit Facility due to financial covenant breaches. The Borrowers are pursuing discussions with the lenders in an effort to resolve the defaults and obtain additional liquidity necessary to fund anticipated future working capital shortfalls.

There can be no assurance that Palco will be able to obtain waivers of defaults from its lenders. As of December 31, 2005, $34.7 million was outstanding under the Palco Term Loan, $24.0 million was outstanding under the Palco Revolving Credit Facility, and $10.2 million of letters of credit outstanding under the Palco Revolving Credit Facility. The Palco Revolving Credit Facility and Palco Term Loan are each secured by a security interest in the stock of Palco held by MGI, and substantially all of the assets of the Borrowers (other than Palco's equity interest in ScoPac).

In an effort to reduce its overall debt level, Palco is in the process of marketing certain assets (**"Palco Asset Sale Program"**) and seeking other sources of liquidity. The Palco Term Loan and the Palco Revolving Credit Facility each contain provisions requiring that the net cash proceeds from asset sales be used to prepay amounts outstanding under the two facilities. Accordingly, proceeds generated from the Palco Asset Sale Program would not be available to fund working capital needs until the Palco Term Loan is paid in full. There can be no assurance that these marketing efforts will be successful or that Palco will be successful in securing sufficient additional liquidity.

In the event that Palco is unable to secure the necessary liquidity to fund its expected future working capital shortfalls, it would be forced to take extraordinary actions, which may include: further reducing expenditures by laying off employees, shutting down various operations, and seeking protection by filing under the Bankruptcy Code.

In April 2005, Palco and Britt, as Borrowers, closed the Palco Term Loan and Palco Revolving Credit Facility. The $35.0 million Palco Term Loan was fully funded at closing. The Revolving Credit Agreement provided for borrowings up to a maximum of $30.0 million, subject to borrowing base and other limitations. During 2005, Palco received net cash proceeds of approximately $60.0 million from the Palco Term Loan and Palco Revolving Credit Facility and borrowed an additional $6.0 million from MGI (see Note 7 for further discussion.) These borrowings were utilized primarily in the following areas: (i) $10.8 million was used to pay off outstanding amounts borrowed under Palco's previous revolving credit facility (which was terminated; (ii) approximately $8.0 million was used to fund capital expenditures related primarily to Palco's new sawmill in Scotia, California; (iii) $9.9 million was used as collateral to secure Palco's workers' compensation liabilities (which reduced the Company's availability under the Palco Revolving Credit Facility); (iv) $18.9 million was used to build primarily large log (larger than 24" in diameter) inventory levels; and (v) the remainder was used to pay advisor fees and to fund working capital shortfalls. The working capital shortfalls experienced in 2005 resulted primarily from delays in completion of the large log processing line at Palco's new sawmill in Scotia. The sawmill's operational difficulties experienced in 2005, related to the large log processing line; compounded Palco's liquidity challenges as Palco was unable to mill its large log inventories (purchased in 2005 using the funds available under the Palco Revolving Credit Agreement in 2005 as planned). While production levels at the new sawmill continue to improve, the new sawmill (primarily the large log processing line) is not yet operating at planned production rates, primarily due to a current imbalance between small diameter and large diameter logs which impacts the mill's throughput. In January 2006 and February 2006, additional liquidity was needed at Palco to fund working capital shortfalls and Palco borrowed an additional $5.0 million from MGI to meet these shortfalls.

ScoPac Liquidity Issues

ScoPac has conducted extensive reviews and analyses of its assets, operations and future prospects. As a result of these extensive reviews and analyses, ScoPac's management has concluded that, in the absence of significant regulatory relief and accommodations, ScoPac's future annual timber harvest levels and cash flows from operations will for at least the next several years be substantially below both historical levels and the minimum levels necessary in order to allow ScoPac to satisfy its debt service obligations in respect of the Timber Notes. ScoPac has announced that its projected average annual harvest level over the ten-year period beginning 2006 is estimated to be approximately 100 million board feet per year. This harvest level reflects ScoPac management's estimate of the cumulative impact of ongoing regulatory limitations, prescriptions, and other actions and is based upon a number of assumptions that may or may not prove to be accurate. Actual harvest levels may even be lower, depending on the outcome of various assumptions.

During 2005, ScoPac devoted significant management resources, and spent approximately $6.1 million, on efforts to restructure the Timber Notes consistent with management expectations as to future harvest levels and cash flows. These efforts were unsuccessful and have been largely abandoned. The Company does not expect that ScoPac will be able to restructure its required minimum payments on the Timber Notes through negotiations with holders of the Timber Notes. Accordingly, additional liquidity will be needed to avoid an event of default under the Timber Notes Indenture.

On the January 20, 2005, Timber Notes payment date, ScoPac used funds available under the ScoPac Line of Credit to fund the payment. Prior to the July 20, 2005, Timber Notes payment date, ScoPac requested that Palco make an early payment, equal to an expected $2.2 million cash shortfall, in respect of certain logs that had already been delivered to and purchased by Palco from ScoPac. Palco approved and delivered the early log payment, which allowed ScoPac to fund the July 20, 2005, cash shortfall and pay all of the interest due. As the January 20, 2006, Timber Notes payment date approached, it became apparent that there would be a cash shortfall of $2.3 million. In January 2006, ScoPac and MGI consummated a "Lump Sum Sale" (as such term is defined in the Timber Notes Indenture) of specified ScoPac Timber. In accordance with the Timber Notes Indenture, the specified Company Timber was released from the liens securing the Timber Notes and purchased by MGI. The cash purchase price of $2.3 million paid in the Lump Sum Sale, was calculated using the applicable prices established by the California State Board of Equalization for the first half of

2006, and provided ScoPac the additional funds needed to pay all of the interest due on the January 20, 2006, Timber Notes payment date.

ScoPac management estimates that its cash flows from operations, together with the ScoPac Line of Credit and other available funds will be inadequate to pay a substantial portion of the interest due on the July 20, 2006, Timber Notes payment date. In an effort to address this expected shortfall, and future cash shortfalls expected over at least the next several years, and avoid an event of default under the Timber Notes Indenture, ScoPac is seeking to sell certain non-timberland properties such as ranchlands and recreational areas, as well as certain timberlands (**"ScoPac Land Sale Program"**). There can be no assurance that these marketing efforts will be successful.

To the extent that ScoPac is unable to generate sufficient liquidity from the ScoPac Land Sale Program or other sources, the Company expects that ScoPac will be forced to take extraordinary actions, which may include: laying off employees, shutting down various operations, and seeking protection by filing under the Bankruptcy Code.

At December 31, 2005, the balance in the Scheduled Amortization Reserve Account (**"SAR Account"**) was $75.9 million (consisting of $52.9 million of Timber Notes held in the SAR Account and $23.0 million in cash), all of which is restricted for future principal payments on the Timber Notes. The SAR Account net cash balance of $23.0 million is sufficient to cover Scheduled Amortization in 2006, but will not be sufficient to cover Scheduled Amortization on the January 20, 2007, Timber Note payment date and beyond. Accordingly, ScoPac's ability to make the Scheduled Amortization payments on the Timber Notes beyond 2006 is dependent upon ScoPac's ability to sell all or a portion of the Timber Notes held in the SAR Account. No assurance can be given that ScoPac will be successful in its efforts to sell its Timber Notes held in the SAR Account before the January 20, 2007, Timber Note payment date or as to the proceeds that might result from any such sale.

Potential Impact on Registrant and Certain Related Entities

The liquidity issues being experienced by Palco and ScoPac 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 termination obligation attributable to Palco's pension plan as of December 31, 2005 is estimated to have been approximately $31.0 million based upon current annuity placement interest rate assumptions. In addition, it is possible that certain transactions could be entered into in connection with a potential restructuring or reorganization of Palco or ScoPac, such as a sale of all or a portion of the equity ownership in Palco and/or ScoPac, a sale of a substantial portion of Palco's and/or ScoPac's assets and/or a cancellation of some or all of Palco's and/or ScoPac'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.

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 ScoPac's cash flows have been adversely impacted by, among other things, ongoing delays in THP approvals from the North Coast Water Board, and one of the actions that has been 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 investment in such subsidiaries using the cost method. If Palco and/or ScoPac 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 MGI's results on a deconsolidated basis, and the impact of reporting the Company's investment in MGI on the cost method (in millions). This information is, however, on a pro forma basis only 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.

	Year Ended December 31, 2005
Revenues	$ 224.6
Costs and expenses	(155.7)
Operating income (loss)	68.9
MAXXAM's equity in MGI's losses	(69.9)
Other income (expenses) - net	(3.1)
Income tax benefit	0.1
Net loss	$ (4.0)

	December 31, 2005
Current assets	$ 229.9
Property, plant, and equipment (net)	243.0
Other assets	154.0
Total assets	$ 626.9
Current liabilities	48.3
Long-term debt, less current maturities	220.0
Other liabilities	63.9
Losses recognized in excess of investment in MGI	439.8
Losses recognized in excess of investment in Kaiser	516.2
Total liabilities	1,288.2
Stockholder's deficit	(661.3)
Total liabilities and stockholder's deficit	$ 626.9

In the event that MGI and /or any of it 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, except as it relates to certain pension funding obligations and potential future tax payments, as noted above.

Deconsolidation of Kaiser

Under generally accepted accounting principles for entities consolidated through voting interests, 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. 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 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.

Kaiser's plan of reorganization, which provides for the cancellation of the Company's 50,000,000 Kaiser common shares without consideration or obligation, was confirmed by the Kaiser Bankruptcy Court in February 2006. However, Kaiser's plan of reorganization is not yet final, as it must still be approved by the U.S. District Court before Kaiser can emerge from Chapter 11, and is also subject to appeal. These consolidated financial statements do not reflect any adjustment related to the deconsolidation of Kaiser other than presenting the Company's investment in Kaiser using the cost method. The Company expects to reverse the $516.2 million of losses in excess of its investment in Kaiser, net of accumulated other comprehensive losses of $85.3 million related to Kaiser, and recognize the net amount, including the related tax effects, in the period in which the Kaiser Shares are cancelled , currently expected to occur during 2006. Upon effectiveness of Kaiser's plan of reorganization, the Company also expects it will take a worthless stock deduction on its consolidated federal income tax return related to the cancellation of the Kaiser Shares and will at that time evaluate whether it expects to realize the resulting tax asset of approximately $135.8 million. Although the Company does not currently expect that it will be obligated to fund losses in Kaiser, the amount of the reversal would be reduced by any losses which the Company later estimates it would be obligated to fund.

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 (i) the reported amounts of assets and liabilities (ii) the disclosure of contingent assets and liabilities known to exist as of the date the financial statements are published and (iii) 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 are inherent in such estimates and related assumptions; 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 11. 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 discussed in Note 8. Estimates of future benefit payments used to measure the Company's pension and other postretirement benefit obligations discussed in Note 9 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 years' consolidated financial statements to be consistent with the current year's presentation. This includes the reclassification of: (i) proceeds from restricted cash from financing activities to investing activities in the Consolidated Statements of Cash Flows, and (ii) restricted cash from cash and cash equivalents to restricted cash and marketable securities in the Consolidated Balance Sheets and in the Consolidated Statements of Cash Flows.

Summary of Significant Accounting Policies

Concentrations of Credit Risk

Cash equivalents and restricted marketable securities are invested primarily in short to medium-term investment grade debt instruments as well as other types of corporate and government debt obligations. The Company mitigates its concentration of credit risk with respect to these investments by generally purchasing investment grade products (ratings of A1/P1 short-term or at least BBB/Baa3 long-term). No more than 5% is invested in the same issue. Unrestricted marketable securities are invested primarily in debt securities. Other investments consist of interests in limited partnerships which invest in a wide variety of investment options, including debt securities, corporate common stocks and option contracts. These investments are managed by various financial institutions.

Available-for-Sale Securities

Management determines the appropriate classification of investment securities at the time of purchase and re-evaluates such designation as of each balance sheet date. Available-for-sale securities are stated at fair market value, with the unrealized gains and losses, net of tax, reported in other comprehensive income (loss), a separate component of shareholders' equity. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in investment and interest income. Interest and dividends on securities classified as available-for-sale are also included in investment and interest income. The cost of securities sold is determined using the first-in, first-out method. The fair value of substantially all securities is determined by quoted market prices. The fair value of marketable debt securities includes accrued interest.

Investments in Limited Partnerships

The Company invests in limited partnerships that acquire, hold, and sell a variety of investment options. Investments in limited partnerships are accounted for using the equity method of accounting.

Inventories

Inventories are stated at the lower of cost or market. Cost is primarily determined using the last-in, first-out method. Inventory costs consist of material, labor and manufacturing overhead, including depreciation and depletion.

Real Estate

Real estate inventories are stated at cost. In the event that facts and circumstances indicate that the value of real estate inventories may be impaired, an evaluation of recoverability would be performed. This evaluation would include the comparison of the future estimated undiscounted cash flows associated with the assets to the carrying amount of these assets to determine if a writedown to fair value is required.

Timber Harvest and Other Long-Term Assets

Direct costs associated with the preparation of THPs are capitalized and reflected in prepaid expenses and other current assets on the balance sheet. These costs are expensed as the timber covered by the related THP is harvested. Costs associated with the preparation of the Company's multi-species habitat conservation plan (**"HCP"**) and sustained yield plan (**"SYP,"** and together with the HCP, the **"Environmental Plans"**) (see Note 11) were capitalized and are reflected in long-term receivables and other assets. These costs are being amortized on a straight-line basis over 10 years.

The carrying amounts of the Company's SYP and HCP intangible assets are as follows (in millions):

	December 31,		
	2005	**2004**	**2003**
SYP/HCP	$ 8.3	$ 8.3	$ 8.3
Less: Accumulated amortization	(5.4)	(4.5)	(3.6)
	$ 2.9	$ 3.8	$ 4.7

The Company evaluates its intangible assets with finite lives for impairment whenever events or changes in circumstances indicate that such assets might be impaired. The remaining useful life of intangible assets with finite lives are evaluated annually to determine whether events or circumstances warrant changes in the estimated useful lives of such assets.

Amortization of intangible assets for the years ended December 31, 2005, 2004 and 2003, was $0.9 million per year. The estimated amortization expense for 2006 through 2008 is $0.9 million per year, and $0.2 million for 2009. Estimated amortization will change if events or circumstances warrant the revision of estimated useful lives.

Timber and Timberlands

Timber and timberlands are stated at cost, net of accumulated depletion. Depletion is computed utilizing the units-of-production method based upon estimates of timber quantities. Periodically, the Company will review its depletion rates considering currently estimated merchantable timber and will adjust the depletion rates prospectively.

Capital expenditures related to ScoPac's Timber Properties were $2.4 million, $3.0 million and $3.4 million for the years ended December 31, 2005, 2004 and 2003, respectively. Depletion expense for the years ended December 31, 2005, 2004 and 2003, was $6.1 million, $8.2 million and $9.9 million, respectively.

Revenue Recognition

Revenues from the sale of logs, lumber products and by-products are recorded when the legal ownership and risk of loss passes to the buyer, which is generally at the time of shipment.

The Company recognizes income from land sales in accordance with Statement of Financial Accounting Standards (**"SFAS"**) No. 66, "Accounting for Sales of Real Estate" (**"SFAS No. 66"**). In accordance with SFAS No. 66, certain real estate sales are accounted for under the percentage of completion method, under which income is recognized based on the estimated stage of completion of individual contracts. The unrecognized income associated with such sales has been recorded as deferred real estate sales and is reflected in other current and noncurrent liabilities on the balance sheet. Additionally, in certain circumstances the cost recovery or installment method is used under which the gross profit associated with these transactions is deferred and recognized when appropriate. The unrecognized income associated with such sales is reflected as a reduction of long-term receivables and other assets in the balance sheet.

The Company recognizes revenues from pari-mutuel commissions received on live and simulcast horse and greyhound racing in the period in which the performance occurred. The Company also receives revenues in the form of fees paid by other racetracks for the broadcast of the Company's live races to offsite locations. Other sources of revenue include food and beverage sales, admission and parking fees, corporate sponsorships and advertising, club memberships, suite rentals and other miscellaneous items.

Deferred Financing Costs

Costs incurred to obtain debt financing are deferred and amortized, generally on a straight-line basis, over the estimated term of the related borrowing. If debt with deferred financing costs is retired early, the related deferred finance costs are written off.

Long-Lived Assets

The Company reviews long-lived assets and identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Impairment losses are recorded on assets used in operations when indicators of impairment are present and the undiscounted cash flows to be generated by those assets are less than the carrying amount. Impairment losses are also recorded for long-lived assets which are expected to be disposed of.

The Company classifies long-lived assets as held-for-sale when the following conditions are satisfied: (i) management commits to a plan to sell a long-term operating asset, (ii) the asset is available for immediate sale, (iii) an active effort to locate a buyer is underway; and (iv) it is probable that the sale will be completed within one year. The assets classified as held-for-sale at December 31, 2005 and 2004 related primarily to real estate properties that are expected to be sold within a year.

Gain and Loss Contingencies

The Company is involved in various claims, lawsuits, environmental matters and other proceedings including those discussed in Note 11. Such matters involve uncertainty as to possible losses and potential gains the Company may ultimately realize when one or more future events occur or fail to occur. The Company accrues and charges to income estimated losses (including related estimated legal fees) from contingencies when it is probable (at the balance sheet date) that an asset has been impaired or liability incurred and the amount of loss can be reasonably estimated. The Company recognizes gain contingencies when realization is considered probable. Differences between estimates recorded and actual amounts determined in subsequent periods are treated as changes in accounting estimates (i.e., they are reflected in the financial statements in the period in which they are determined to be losses, with no retroactive restatement).

Income Taxes

Deferred income taxes are computed using the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities (temporary differences) and are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse.

The Company records valuation allowances to reduce deferred tax assets to the amount of future tax benefit that is more likely than not to be realized. The Company considers future taxable income and ongoing tax planning strategies in assessing the need for a valuation allowance. See Note 8 for further discussion of the Company's income taxes.

Stock-based Compensation

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (**"APB Opinion No. 25"**) and related interpretations in accounting for stock options (or stock appreciation rights, as applicable) issued to employees and outside directors. Under APB Opinion No. 25, because the exercise price of the Company's employee stock options equals or exceeds the market price of the underlying stock on the date of grant, no compensation expense is recognized when stock options are granted. However, compensation expense is recorded in each period prior to exercise based on the excess of market value at the end of each period over the exercise price, if applicable (i.e., compensation expense is adjusted up or down as the market value of the Company's stock changes).

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. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period (in millions, except per share information).

	Years Ended December 31,		
	2005	2004	2003
Net loss, as reported	$ (4.0)	$ (46.6)	$ (11.6)
Add: Stock-based employee compensation expenses included in reported net loss, net of related tax effects	3.7	6.1	0.8
Deduct: Total stock-based employee compensation expense determined under the fair value method for all awards, net of related tax effects	(3.7)	(6.5)	(2.0)
Pro forma net loss	$ (4.0)	$ (47.0)	$ (12.8)
Basic and diluted loss per share:			
As reported	$ (0.66)	$ (7.79)	$ (1.79)
Pro forma	(0.67)	(7.84)	(1.96)

The fair value of stock options granted were estimated at each reporting date using a Black-Scholes option pricing model and the following assumptions:

	Years Ended December 31,		
	2005	2004	2003
Dividend yield	–	–	–
Expected volatility	0.38	0.41	0.43
Risk-free interest rate	4.35%	3.63%	3.25%
Expected life (years)	6.44	6.63	6.67
Weighted average fair value	$15.40	$13.47	$ 4.50

Per Share Information

Basic earnings (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period, including the weighted average impact of any shares of common stock of the Company (**"Common Stock"**) issued and treasury stock acquired during the year from the date of issuance or repurchase and the dilutive effect of the Company's Class A $0.05 Non-Cumulative Participating Convertible Preferred Stock (**"Class A Preferred Stock")**, which is convertible into Common Stock. Diluted earnings per share calculations also include the dilutive effect of common and preferred stock options.

	2005	2004	2003
Weighted average shares outstanding:			
Common Stock	5,972,180	5,976,467	6,465,919
Effect of dilution:			
Class A Preferred Stock	–[1]	–[1]	–[1]
Weighted average number of common and common equivalent shares - Basic	5,972,180	5,976,467	6,465,919
Effect of dilution:			
Stock options	–[1]	–[1]	–[1]
Weighted average number of common and common equivalent shares - Diluted	5,972,180	5,976,467	6,465,919

(1) The Company had a loss for the years ended December 31, 2005, 2004 and 2003; the Class A Preferred Stock and options were therefore not included in the computation of earnings per share for the period as the effect would be anti-dilutive.

Accumulated Other Comprehensive Losses

Accumulated Other Comprehensive Losses ("AOCL") consists of the following (in millions):

	December 31,	
	2005	2004
AOCL related to Kaiser	$ 85.3	$ 85.3
Minimum pension liability, net of related income tax effects of $2.9 million	10.3	10.4
Unrealized losses on available for sale investments	0.7	0.6
Other	0.3	0.3
	96.6	96.6

2. New Accounting Standards

Accounting for Stock Options

In December 2004, the Financial Accounting Standards Board (**"FASB"**) issued SFAS No. 123(R), *Share Based Payments* (**"SFAS No. 123(R)"**). SFAS No. 123(R) will require compensation costs related to share-based payments to be determined by the fair value of the equity or liability instruments issued on the grant date. In addition, such 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 will be recognized as of the required effective date, January 1, 2006, based on the fair value of those awards. SFAS No. 123(R) applies to all awards granted after the required effective date. The Company that anticipates that the effects of this Statement on its results of operations will be an expense of $0.7 million that will be recorded in January 2006.

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. APB Opinion No. 29 provided an exception to this principle for exchanges of similar productive assets. Under APB 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 effective date of the new Statement for the Company is January 1, 2006. Management does not expect that adoption of this Statement will have a material impact on the Company's financial condition, results of operations, or liquidity.

Accounting Changes and Error Corrections

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (**"SFAS No. 154"**). SFAS No. 154 replaces Accounting Principles Board Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application of changes in accounting principle to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted SFAS No. 154 on January 1, 2006.

3. Segment Information and Other Items

Reportable Segments

As discussed in Note 1, the Company's operations are organized and managed as distinct business units which offer different products and services and are managed separately through the Company's subsidiaries.

The Company has three reportable segments and the accounting policies of the segments are the same as those described in Note 1. The Company evaluates segment performance based on net sales, operating income excluding depreciation, depletion and amortization, and income before income taxes and minority interests.

Net sales and operating income (loss) for each reportable segment is 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 financial information by reportable segment (in millions of dollars).

	December 31,	Reportable Segments Forest Products	Real Estate	Racing	Corporate	Consolidated Total
Investment, interest and other income (expense)[2], net	2005	$ 4.1	$ 2.4	$ –	$ 12.1	$ 18.6
	2004	1.0	8.1	–	3.7	12.8
	2003	5.5	5.9	0.2	13.4	25.0
Interest expense[1]	2005	60.6	17.4	–	0.2	78.2
	2004	55.7	18.3	–	–	74.0
	2003	58.1	18.9	–	–	77.0
Depreciation, depletion and amortization	2005	19.9	14.2	1.6	0.2	35.9
	2004	20.6	14.0	1.7	0.8	37.1
	2003	21.0	14.2	1.7	0.2	37.1
Income (loss) before income taxes	2005	(69.9)	74.0	(4.1)	(4.1)	(4.1)
	2004	(49.3)	19.5	(3.1)	(14.0)	(46.9)
	2003	(18.1)	4.1	(1.7)	5.1	(10.6)
Capital expenditures	2005	14.7	1.2	3.4	0.4	19.7
	2004	29.8	2.4	0.2	0.3	32.7
	2003	19.1	3.5	1.0	0.2	23.8
Total assets	2005	421.4	345.3	36.4	245.2	1,048.3
	2004	440.0	338.2	33.2	203.8	1,015.2

(1) Interest expense also includes amortization of deferred financing costs.

(2) 2005 Investment interest and other income for Corporate includes a $4.3 million benefit to correct the cumulative effect of an overstatement of intercompany interest from 1995 to 2000.

Other Items

Forest Products

In March 2005, Palco reached a $3.1 million settlement of a lawsuit filed by Palco against several insurance companies seeking reimbursement of settlement payments and defense costs related to a legal matter which was concluded in 2002. This settlement was recognized in March 2005 as a reduction of selling, general and administrative expense.

In April 2005, deferred loan costs of $1.0 million related to Palco's prior revolving credit facility were written off. Subsequently, loan costs of $2.7 million related to the Palco Revolving Credit Facility and Palco Term Loan were capitalized and, beginning in April 2005, are being amortized over the term of the loan.

Included in selling, general and administrative expense are severance costs of $0.7 million related to the closure of Palco's Fortuna mill. As of December 31, 2005, all of the severance and benefits amounts expensed during the period had been paid.

Included in operating income is a $4.6 million impairment charge related to the write-down to the estimated salvage/realizable value of certain long-lived assets (see Note 5 for further discussion).

In 2004, Palco implemented a voluntary reduction in workforce related to the closure of its Carlotta mill. In connection with the reduction, Palco charged $1.4 million against earnings for employee severance and benefit costs. This amount is reflected in selling, general and administrative expenses in the Consolidated Statement of Operations for 2004. The employee severance and benefit costs were related to the termination of approximately 107 regular employees, the majority of whom were engaged in milling and manufacturing activities at Palco's facilities. As of December 31, 2004 all of the $1.4 million in severance and benefits had been paid.

The forest products segment's operating income (loss) included gains on sales of timberlands in the Grizzly Creek grove of $16.8 million in November 2003.

In 2001, Palco recorded an environmental remediation charge of $3.4 million. The environmental accrual represents Palco's estimate of costs reasonably expected to be incurred based on presently enacted laws and regulations, currently available facts, existing technology, and Palco's assessment of the likely remediation actions to be taken. Palco incurred $0.2 million, $0.4 million and $0.7 million of costs related to this remediation liability during 2005, 2004 and 2003, respectively. Based on management's best estimates given the current facts and circumstances, $0.8 million is expected to be incurred in 2006 and the remaining $0.7 million in future years.

Real Estate

Investment, interest and other income (expense) for the real estate segment includes equity in earnings (losses) from real estate joint ventures of ($1.0) million, $2.8 million and $0.7 million for the years ended December 31, 2005, 2004 and 2003, respectively. Investment, interest and other income (expense) for the real estate segment also includes $0.8 million in 2003 for the gain realized on the sale of the Company's investment in the Sunridge Canyon real estate joint venture.

In connection with the 2003 termination of the Company's casino facility lease at its Palmas del Mar operation in Puerto Rico (**"Palmas"**), the Company recorded a charge to operating expenses of $1.4 million related to the write-down of casino-related assets to estimated fair value.

Corporate

For the years ended December 31, 2005 and 2004, the Company recognized stock compensation expense of $3.7 million and $6.1 million, respectively. The 2005 expense is primarily the impact of additional options vesting during the fourth quarter of 2005, while the 2004 expense is the result of additional options vesting and an increase in the market value of the Company's Common Stock. Stock compensation expense is adjusted as the market value of the Company's Common Stock changes and awards vest.

The Company recorded a charge to operating expense of $1.9 million in 2004 and an additional $1.9 million in 2005 in connection with an environmental matter associated with a former subsidiary of the Company. See Note 11 for further discussion.

Corporate investment, interest and other income (expense) for 2003 includes $8.0 million of insurance recoveries related to the *OTS* and *FDIC* actions (see Note 11).

Product Sales

The following table presents segment sales by primary products (in millions).

	Years Ended December 31,		
	2005	2004	2003
Forest products:			
Lumber, net of discount	$ 155.9	$ 179.2	$ 184.0
Logs	8.2	6.1	6.5
Wood chips	3.5	3.1	3.4
Cogeneration power	10.9	10.8	11.4
Other	3.3	2.9	3.2
Total forest products sales	$ 181.8	$ 202.1	$ 208.5
Real estate:			
Real estate and development	$ 142.2	$ 59.7	$ 49.7
Resort, commercial and other operations	17.8	17.9	12.7
Commercial lease properties	18.3	17.2	15.9
Total real estate sales	$ 178.3	$ 94.8	$ 78.3
Racing:			
Gross pari-mutuel commissions	$ 36.5	$ 39.5	$ 39.2
Other	9.8	11.1	10.6
Total racing sales	$ 46.3	$ 50.6	$ 49.8

Geographical Information

The Company's forest products and racing operations are located in the United States. The Company's real estate operations are located in the United States and Puerto Rico. For the year ended December 31, 2005, $0.9 million of net sales attributable to the Company's forest products segment were made to foreign customers.

Major Customers and Export Sales

For the years ended December 31, 2005, 2004 and 2003, sales to any one customer did not exceed 10% of consolidated revenues. Export sales were less than 1% of total revenues in 2005, 2004 and 2003. Approximately 40% of the real estate segment's 2005 revenue was attributable to five transactions.

4. Cash, Cash Equivalents, Marketable Securities and Investments in Limited Partnerships

The following table presents cash, cash equivalents, marketable securities and other investments, in the aggregate (in millions):

	December 31, 2005	December 31, 2004
Cash and cash equivalents	$ 83.5	$ 27.7
Marketable securities	129.8	77.4
Investments in limited partnerships	31.2	63.6
	244.5	168.7
Less: restricted cash and marketable securities	(37.0)	(43.8)
Unrestricted cash and marketable securities	$ 207.5	$ 124.9

Cash Equivalents

Cash equivalents consist of highly liquid money market instruments with maturities of three months or less. As of December 31, 2005 and 2004, the carrying amounts of the Company's cash equivalents approximated fair value.

Marketable Securities

Marketable securities generally consist of U.S. corporate debt securities, U.S. treasury obligations, and other debt securities with contractual maturities ranging from one year to five years and are classified as available-for-sale securities. The fair value of substantially all marketable securities is determined by quoted market prices. The estimated fair value of marketable securities at December 31, 2005 and 2004 was $129.9 million and $77.0 million, respectively. Investment, interest and other income (expense), net, includes gross realized gains (losses) on sales of available-for-sale securities as follows (in millions):

	Years Ended December 31, 2005	2004	2003
Gross realized gains	$ –	$ 0.6	$ 0.4
Gross realized losses	(0.4)	(0.4)	–

The net adjustment to unrealized holding gains (losses) on available-for-sale securities included as a separate component of shareholders' deficit totaled ($0.1) million, ($1.7) million, and $0.2 million in 2005, 2004, and 2003, respectively. The fair value of investment securities in a continuous unrealized loss position for less than twelve months and for twelve months or more as of December 31, 2005, was $18.1 million and $14.8 million, respectively. Gross unrealized losses on investment securities at December 31, 2005, were not material.

Investments in Limited Partnerships

The Company has an equity interest in several limited partnerships which invest in diversified portfolios of common stocks and equity securities, in addition to exchange-traded options, futures, forward foreign currency contracts, and other arbitrage opportunities. The Company's ownership percentages in these partnerships are not significant. The following table shows the Company's investment in these partnerships (in millions).

	December 31, 2005	December 31, 2004
Restricted	$ –	$ 16.0
Unrestricted	31.2	47.6
	$ 31.2	$ 63.6

Investment, interest and other income (expense), net, includes income from the Company's investment in these partnerships for each of the three years in the period ended December 31, 2005, as follows (in millions):

	Years Ended December 31,		
	2005	2004	2003
Earnings from investments in limited partnerships	$ 7.3	$ 1.8	$ 4.8

Restricted Cash, Cash Equivalents, Marketable Securities and Other Investments

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

	December 31,	
	2005	2004
Current:		
Restricted cash and cash equivalents	$ 6.1	$ 3.1
Restricted marketable securities, held in SAR Account	23.0	25.1
	29.1	28.2
Non Current:		
Restricted Timber Notes and other amounts held in SAR Account	52.9	68.5
Other amounts restricted under the Timber Notes Indenture	2.5	2.5
Other long-term restricted amounts	5.4	6.4
Less: Amounts attributable to Timber Notes held in SAR Account	(52.9)	(61.8)
	7.9	15.6
Total restricted cash and cash equivalents and marketable securities	$ 37.0	$ 43.8

Amounts in the SAR Account are being held by the Trustee to support principal payments on the Timber Notes. See Note 7 for further discussion of the SAR Account.

5. Property, Plant and Equipment

Property, plant and equipment, including capitalized interest, is stated at cost, net of accumulated depreciation. Depreciation is computed principally utilizing the straight-line method at rates based upon the estimated useful lives of the various classes of assets. The carrying value of property, plant and equipment is assessed when events and circumstances indicate that an impairment might exist.

The major classes of property, plant and equipment are as follows (dollar amounts in millions):

	Estimated Useful	December 31,	
	Lives	2005	2004
Land and improvements	5 – 30 years	$ 140.6	$ 135.4
Buildings	5 – 40 years	269.8	260.9
Machinery and equipment	3 – 15 years	144.8	135.3
Construction in progress		7.7	22.0
		562.9	553.6
Less: accumulated depreciation		(207.9)	(183.4)
		$ 355.0	$ 370.2

Capital expenditures for property, plant and equipment were $17.3 million, $29.7 million and $20.4 million for the years ended December 31, 2005, 2004 and 2003, respectively.

In 2005, as part of Palco's on-going evaluation of its sawmill activities, several sites were subject to an impairment review due to changes in their expected use and revised estimates of undiscounted cash flows. As a result, impairment charges of $4.6 million were recognized in 2005 primarily related to two sites, the Carlotta mill site and Palco's remanufacturing facility in Scotia. In 2003, the Company recorded an impairment charge of $1.4 million in respect of casino-related assets at Palmas.

Depreciation expense for the years ended December 31, 2005, 2004 and 2003 was $28.8 million, $27.9 million, and $26.3 million, respectively.

6. Investments in Unconsolidated Affiliates

RMCAL, LLC (Mirada Villas)

In April 2004, a subsidiary of the Company and a third party real estate development company formed a joint venture to develop a residential parcel located in the Mirada development. The Company is accounting for the joint venture under the equity method. In connection with the formation of the joint venture, the Company sold a 50% interest in the parcel for $4.5 million and contributed the remainder of the parcel to the joint venture in return for a 50% interest in the venture.

FireRock, LLC

A subsidiary of the Company continues to hold a 50% interest in a joint venture named FireRock LLC formed to develop an 808-acre area in Fountain Hills known as FireRock Country Club. The Company is accounting for the joint venture under the equity method. The development is a residential, golf-oriented, upscale master-planned community consisting of three phases of custom lots, three multifamily parcels and a private country club. The club's championship-level private 18-hole golf course opened in 2000. The multifamily parcels were sold in 2001-2002 and lot sales concluded in 2004. The venture continues to own and operate the country club.

7. Debt

Principal amounts of outstanding debt consist of the following (in millions):

	December 31,	
	2005	2004
Prior Palco Credit Agreement	$ –	$ 13.1
Palco Term Loan due April 19, 2010	34.7	–
Palco Revolving Credit Facility	24.0	–
ScoPac Line of Credit, due July 2006	31.3	18.1
6.55% ScoPac Class A-1 Timber Notes due July 20, 2028	36.6	61.7
7.11% ScoPac Class A-2 Timber Notes due July 20, 2028	243.2	243.2
7.71% ScoPac Class A-3 Timber Notes due July 20, 2028	463.3	463.3
7.56% Lakepointe Notes due June 8, 2021	114.8	115.8
7.03% Motel Notes due May 1, 2018	46.1	47.3
6.08% Beltway Notes due November 9, 2024	29.2	29.8
7.12% Palmas Notes due December 20, 2030	29.2	29.6
Other notes and contracts, primarily secured by receivables, buildings, real estate and equipment	5.1	6.4
	1,057.5	1,028.3
Less: current maturities	(112.5)	(51.4)
Timber Notes held in SAR Account	(55.4)	(64.9)
	$ 889.6	$ 912.0

Palco Credit Agreements

At December 31, 2004, $13.1 million was outstanding under Palco's prior revolving credit facility ("**Prior Palco Credit Agreement**") and Palco was in default under this facility, due to a breach of a financial covenant. Palco received a waiver of the default and in April 2005, the Prior Palco Credit Agreement was paid in full and the facility was terminated.

Palco and Britt, as Borrowers, entered into the Palco Revolving Credit Facility and the Palco Term Loan on April 19, 2005. The Palco Term Loan was fully funded and the Borrowers used approximately $10.8 million of the funds from the Palco Term Loan to pay off amounts previously borrowed under the Prior Palco Credit Facility. Prior to October 2005, borrowings under the Palco Revolving Credit Facility, an asset-based revolving credit facility, were limited to the sum of 85% of Palco and Britt's eligible accounts receivable plus 75% of their eligible inventories (up to a maximum of $30.0 million, subject to limitations such as the ability of the lender to establish reasonable reserves). In October 2005, Palco, Britt and certain of their affiliates entered into an amendment, which, among other things, temporarily increased the amount of the Palco Revolving Credit Facility from $30.0 million to $35.0 million and temporarily increased the advance rate applicable to the Borrowers' inventory from 75% to 80%. The increase in the inventory advance rate was subject to satisfactory inventory appraisals and the amount of the increase in such advances was capped at $1.5 million. The increase in the amount of the Palco Revolving Credit Facility and the increase in the inventory advance rate is being gradually phased out in January through March 2006. The amendment also revised financial covenants applicable to the Palco Revolving Credit Facility and the Palco Term Loan. MGI furnished cash collateral of $2.0 million as additional security for the Borrowers' obligations under the two facilities. This cash collateral was to be released on April 1, 2006, so long as the Borrowers have achieved earnings and borrowing availability targets to be determined by the lenders. These targets have not yet been established (see below regarding ongoing discussions between the Borrowers and the term and revolving credit lenders).

In November 2005, the Palco Term Loan and Palco Revolving Credit Facility were further amended to permit Palco to borrow $6.0 million from MGI. Palco used these loan proceeds to pay down outstanding borrowings under the Palco Revolving Credit Facility.

At December 31, 2005, Palco and Britt, as Borrowers, were in default under the Palco Term Loan and the Palco Revolving Credit Facility, due to financial covenant breaches. Without a waiver of the Borrowers' defaults under the Palco Term Loan and the Palco Revolving Credit Facility, the lenders may take any or all of the following actions: reduce the amount of borrowings available to the Borrowers; refuse to make new loans or to issue new letters of credit for the benefit of the Borrowers; declare any or all loans and other amounts owed under the two facilities to be immediately due and payable; require Palco to cash collateralize all outstanding letters of credit; or pursue its other rights and remedies under the Palco Term Loan, Palco Revolving Credit Facility and related security agreements. The existence of the defaults also requires Palco to pay interest on amounts borrowed under the Palco Term Loan at a per annum rate 2% higher than the rate at which interest would be owed if no default existed. The Borrowers are pursuing discussions with the lenders in an effort to resolve the defaults and obtain additional liquidity necessary to fund anticipated working capital shortfalls. There can be no assurances that Palco will be able to obtain a waiver of default from the lenders. As of December 31, 2005, $34.7 million was outstanding under the Palco Term Loan and $24.0 million was outstanding under the Palco Revolving Credit Facility. Because a waiver of the defaults has not been obtained to date, amounts outstanding under the Palco Term Loan and the Palco Revolving Credit Facility have been classified as a current liability at December 31, 2005.

In January 2006, the Palco Term Loan and Palco Revolving Credit Facility were further amended to permit Palco to borrow an additional $3.0 million from MGI. Palco used these loan proceeds to pay down outstanding borrowings under the Palco Revolving Credit Facility. In February 2006, the Palco Term Loan and Palco Palco Revolving Credit Facility were further amended to permit Palco to borrow an additional $2.0 million from MGI. Palco expects to use these loan proceeds to pay down outstanding borrowings under the Palco Revolving Credit Facility.

Loans under the Palco Revolving Credit Facility bear interest, at the Borrowers' option, at the rate of LIBOR plus 2.25% or prime plus 0.50%. The Palco Revolving Credit Facility matures on April 19, 2010. The Palco Term Loan bears interest, at the Borrowers' option, at the rate of LIBOR plus 6% or prime plus 5%. The Palco Term Loan is repayable in quarterly installments of $87,500 each, which began on June 1, 2005. A balloon payment of the remaining principal balance is due on April 19, 2010. Both the Palco Term Loan and the Palco Revolving Credit Facility contain EBITDA maintenance covenants that, if not met, could trigger a mandatory prepayment of outstanding 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.

The Palco Revolving Credit Facility and Palco Term Loan are each secured by a security interest in the stock of Palco held by MGI, and substantially all of the assets of the Borrowers (other than Palco's equity interest in ScoPac). Both the Palco Term Loan and the Palco Revolving Credit Facility have provisions requiring that the net cash proceeds of asset sales be used to prepay amounts outstanding under the loans. The Palco Revolving Credit Facility and the Palco 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 Palco Revolving Credit Facility and the Palco Term Loan contain customary events of default and customary remedies with respect to the occurrence of an event of default.

The Palco 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 Palco Term Loan includes prepayment premiums of 4%, 3%, 2% and 1% payable in connection with any prepayment of the Palco 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.

Under the Palco Revolving Credit Facility and Palco Term Loan, Palco is permitted to invest up to $5.0 million in ScoPac. No such investment had been made or committed to be made by Palco, and there can be no assurance that Palco will determine or be able to make any such investment in whole or part in the future.

ScoPac Line of Credit

The ScoPac Line of Credit allows ScoPac to borrow up to one year's interest on the aggregate outstanding principal balance of the Timber Notes (**"Required Liquidity Amount"**). On June 20, 2003, the ScoPac Line of Credit was extended to July 7, 2006. ScoPac intends to request that the ScoPac Line of Credit be extended for an additional period of not less than 364 days. If not extended, ScoPac may draw upon the full amount available. The amount drawn would be repayable in 12 semiannual installments on each Timber Notes 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, 2005, the maximum availability under the ScoPac Line of Credit was $55.4 million, and outstanding borrowings were $31.3 million. At January 31, 2006, the maximum availability under the ScoPac Line of Credit was $54.1 million, after giving effect to principal payments made on the January 20, 2006, Timber Notes payment date, and there were $54.9 million in borrowings outstanding.

Borrowings under the ScoPac Line of Credit generally bear interest at the Base Rate (as defined in the agreement) plus 0.25% or at LIBOR plus 1.0% (at any time the borrowings have not been continually outstanding for more than six months). As discussed further in Note 1, ScoPac is experiencing financial difficulties due to regulatory restrictions on its ability to harvest. As a result, ScoPac may not have adequate availability under the ScoPac Line of Credit and existing resources to pay the entire amount of interest due on the Timber Notes on July 20, 2006. Such a failure to pay interest would constitute an event of default under the Timber Notes Indenture.

ScoPac Timber Notes

In July 1998, ScoPac issued $867.2 million aggregate principal amount of Timber Notes, which are due July 20, 2028. The Timber Notes are senior secured obligations of ScoPac and do not constitute obligations of, and are not guaranteed by, Palco or any other person. The Timber Notes were issued in three classes: Class A-1 Timber Notes aggregating $160.7 million, Class A-2 Timber Notes aggregating $243.2 million, and Class A-3 Timber Notes aggregating $463.3 million. The Timber Notes Indenture permits ScoPac to have outstanding up to $75.0 million of non-recourse indebtedness to acquire additional timberlands, as well as to issue additional timber notes provided certain conditions are met (including repayment or redemption of the remaining $36.6 million of Class A-1 Timber Notes and that the remaining Timber Notes meet certain ratings standards). The Timber Notes and the Line of Credit are secured by a lien on (i) ScoPac's timber, timberlands and timber rights, (ii) certain contract rights and other assets, (iii) the proceeds of the foregoing and (iv) funds held by the Trustee in various accounts relating to the Timber Notes. Amounts payable on the Timber Notes are paid semi-annually, generally on January 20 and July 20 of each year (each, a **"Note Payment Date"**).

The Timber Notes were structured to link, to the extent of cash available, the deemed depletion of ScoPac Timber (through the harvest and sale of logs) to the required amortization of the Timber Notes. The required amount of amortization on any Timber Notes payment date is determined by various mathematical formulas set forth in the Timber Notes Indenture. Principal and interest are payable semi-annually, generally on January 20 and July 20 of each year. The minimum amount of principal which ScoPac must pay (on a cumulative basis and subject to available cash) through any Timber Notes payment date is referred to as Minimum Principal Amortization. If the Timber Notes were amortized in accordance with Minimum Principal Amortization, the final installment of principal would be paid on July 20, 2028. The minimum amount of principal which ScoPac must pay (on a cumulative basis) through any Timber Notes payment date in order to avoid payment of prepayment or deficiency premiums is referred to as **"Scheduled Amortization."** If all payments of principal were made in accordance with Scheduled Amortization, ScoPac would pay the final installment of principal on January 20, 2014. Such final installment would include a single "bullet" principal payment of $463.3 million related to the Class A-3 Timber Notes.

"Minimum Principal Amortization" of the Timber Notes represents the minimum amount of principal which ScoPac must pay (on a cumulative basis and subject to available cash) on such Class, to the extent of available funds on deposit in the Payment Account, through any Note Payment Date. If the Timber Notes were amortized in accordance with Minimum Principal Amortization, the final installments of principal would be paid on January 20, 2010, July 20, 2017 and July 20, 2028 for the Class A-1, Class A-2 and Class A-3 Timber Notes, respectively.

In November 1999, $169.0 million of funds from the sale of 5,600 acres of timberlands (**"Headwaters Timberlands"**) were contributed to ScoPac and set aside in the SAR Account. Amounts in the SAR Account are part of the collateral securing the Timber Notes and are used to make principal payments to the extent that cash flows from operations are insufficient to pay Scheduled Amortization on the Timber Notes. In addition, on or after January 20, 2014, any amounts then remaining in the SAR Account would be used to amortize the Class A-3 Timber Notes. Funds can be released to ScoPac from the SAR Account if the amount in the account at that time exceeds the Required Scheduled Amortization Reserve Balance (as defined and set forth in the Timber Notes Indenture). If the balance in the SAR Account falls below the Required Scheduled Amortization Reserve Balance, up to 50% of any Remaining Funds

(funds that could otherwise be released to ScoPac free of the lien securing the Timber Notes) are required to be used on each monthly deposit date to replenish the SAR Account. As of December 31, 2005, the amount held in the SAR Account was $45.4 million below the Required Scheduled Amortization Reserve Balance.

On the note payment date in January 2005, ScoPac used the funds available under the ScoPac Line of Credit to pay the $28.5 million of interest due ($26.3 million net of interest due in respect of Timber Notes held in the SAR Account). ScoPac also repaid $17.1 million of principal on the Timber Notes, an amount equal to Scheduled Amortization ($10.6) million net of principal in respect of Timber Notes held in the SAR Account) using funds held in the SAR Account.

On the note payment date in July 2005, ScoPac used its existing cash resources, all of the remaining funds available under the ScoPac Line of Credit, and the additional funds made available from a $2.2 million early log payment by Palco, to pay all of the $27.9 million of interest due ($25.9 million net of interest due in respect of Timber Notes held in the SAR Account). ScoPac also repaid $8.0 million of principal on the Timber Notes, an amount equal to Scheduled Amortization ($5.0 million net of principal in respect of Timber Notes held in the SAR Account) using funds held in the SAR Account.

On the note payment date in January 2006, ScoPac used its existing cash resources, all of the remaining funds available under the ScoPac Line of Credit, and the additional funds made available from a $2.3 million timber purchase by MGI, to pay all of the $27.7 million of interest due ($25.8 million net interest due in respect of Timber Notes in the SAR Account. ScoPac also repaid $19.3 million of principal on the Timber Notes an amount equal to Scheduled Amortization ($11.9 million net of principal in respect of Timber Notes held in the SAR Account) using funds held in the SAR Account.

During 2004, $10.9 million of funds from the SAR Account were used to repurchase $11.0 million principal amount of Timber Notes, as permitted under the Timber Notes Indenture, resulting in a loss of $0.3 million (net of unamortized deferred financing costs) on the repurchase of debt. During 2005, there were no repurchases of Timber Notes.

At December 31, 2005, the SAR Account balance was $75.9 million (including $52.9 million of Timber Notes held in the SAR Account and $23.0 million in cash), all of which is restricted for future principal payments on the Timber Notes. The SAR Account net cash balance of $23.0 million is sufficient to cover the Scheduled Amortization in 2006, but will not be sufficient to cover the Scheduled Amortization on the January 20, 2007, Timber Note payment date and beyond. Accordingly, ScoPac's ability to make the Scheduled Amortization payments on the Timber Notes beyond 2006 is dependent upon ScoPac's ability to sell all or a portion of the Timber Notes held in the SAR Account. No assurance can be given that ScoPac will be successful in its efforts to sell the Timber Notes held in the SAR Account before the January 20, 2007, Timber Notes payment date or as to the proceeds that might result from any such sale.

As discussed further in Note 1, ScoPac is experiencing financial difficulties due to regulatory restrictions on its ability to harvest and other factors. As a result, ScoPac may not have adequate funds to pay the entire amount of interest due on the Timber Notes in July 2006. Such an event would constitute an event of default under the Timber Notes Indenture.

Letters of Credit

On April 21, 2005, Moody's Investors Service (**"Moody's"**) lowered its ratings on the Class A-1 Timber Notes from Baa2 to Ba3; the Class A-2 Timber Notes from Baa3 to B1; and the Class A-3 Timber Notes from Bal to B1. On June 20, 2005, Moody's further lowered its ratings on all classes of the Timber Notes to Caal. Standard and Poor's Rating Service (**"S&P"**) announced on April 7, 2005, that it had lowered Palco's credit rating to CCC- (which rating it affirmed on April 28, 2005). As a result of the S&P credit rating actions related to Palco, Palco was required to post a $9.9 million letter of credit with the State of California to secure its workers compensation liabilities, which reduced Palco's availability under the Palco Revolving Credit Facility by a corresponding amount.

The Company's real estate segment has posted letters of credit in the amount of $9.0 million for the Company's estimated liability insurance obligations.

Lakepointe Notes

In June 2001, Lakepointe Assets Holdings LLC (**"Lakepointe Assets"**), an indirect wholly owned subsidiary of the Company, financed the purchase of Lake Pointe Plaza, an office complex located in Sugarland, Texas, with $122.5 million principal amount of 7.56% non-recourse notes due June 8, 2021 (**"Lakepointe Notes"**). The Lakepointe Notes are secured by operating leases, Lake Pointe Plaza and a $60.0 million residual value insurance contract and under which all lease payments are guaranteed by the parent company of the current tenant.

Beltway Notes

In November 2002, Beltway Assets LLC (**"Beltway Assets"**), an indirect wholly owned subsidiary of the Company, financed the purchase of an office building located in Houston, Texas, with $30.9 million principal amount of 6.08% non-recourse notes due November 9, 2024 (**"Beltway Notes"**). The Beltway Notes are secured by an operating lease, the building, and an $11.2 million residual value insurance contract.

Motel Notes

In December 2002, Motel Assets Holdings LLC (**"Motel Assets"**), an indirect wholly owned subsidiary of the Company, financed the purchase of a portfolio of sixteen motel properties located in ten different states with $49.4 million principal amount of 7.03% non-recourse notes due May 1, 2018 (**"Motel Notes"**). The Motel Notes are secured by an operating lease, the properties, and an $11.2 million residual value insurance contract and under which all lease payments are guaranteed by the parent company of the current tenant.

Palmas Country Club, Inc. Notes

In October 2000, Palmas Country Club, Inc., which owns two golf courses and other related assets, financed the construction and refurbishment of these assets with $30.0 million principal amount of 7.12% notes due December 20, 2030 (**"Palmas Notes"**). The Palmas Notes are secured by the entity's assets, a letter of credit, and cash reserves held by the lender.

Maturities

Scheduled maturities of outstanding indebtedness at December 31, 2005, are as follows (in millions):

	Years Ending December 31,					
	2006	2007	2008	2009	2010	Thereafter
Palco Term Loan	$ 34.7	$ –	$ –	$ –	$ –	$ –
Palco/Britt Revolving Credit Agreement	24.0	–	–	–	–	–
ScoPac Line of Credit	31.3	–	–	–	–	–
ScoPac Timber Notes	18.2	26.5	25.0	19.7	22.8	575.5
Lakepointe Notes	1.3	1.7	1.8	2.0	2.1	105.9
Motel Notes	1.4	1.4	1.8	2.2	2.3	37.0
Beltway Notes	0.6	0.7	0.7	0.8	0.8	25.6
Palmas Notes	0.5	0.5	0.5	0.5	0.6	26.6
Other	0.5	0.6	0.3	0.2	0.2	3.3
	$ 112.5	$ 31.4	$ 30.1	$ 25.4	$ 28.8	$ 773.9

The scheduled maturities for the Timber Notes reflected in the table above are based on Scheduled Amortization net of Timber Notes held in SAR Account. Payments in accordance with Scheduled Amortization are, however, subject to available cash in the SAR Account.

Capitalized Interest

Interest capitalized during the years ended December 31, 2005, 2004 and 2003 was $0.4 million, $0.8 million and $0.1 million, respectively. Interest capitalized related to Palco's new sawmill amounted to $0.4 million for the year ended December 31, 2005.

Loan Covenants

Certain debt instruments restrict the ability of the Company's subsidiaries to transfer assets, make loans and advances or pay dividends to the Company, and require certain subsidiaries to maintain a minimum net worth.

Estimated Fair Value

The Company's publicly traded debt instruments (the Timber Notes and the Palmas Notes) are thinly traded financial instruments; accordingly, their market prices at any balance sheet date may not be representative of the prices which would be derived from a more active market. The fair value of publicly traded debt is determined based on quoted market prices. The fair value of debt which is not publicly traded is estimated using cash flows discounted at current borrowing rates. At December 31, 2005, the estimated fair value of current and long-term debt was $864.5 million. At December 31, 2004, the estimated fair value of the Company's current and long-term debt was $840.8 million.

Weighted average interest on Short-Term Borrowings

During 2005 and 2004, the Company had average short-term borrowings outstanding of $67.2 million and $36.5 million, respectively, under the credit facilities described above. The weighted average interest rate for these facilities during 2005 and 2004 was 7.6% and 3.4%, respectively.

8. Income Taxes

The Company files a consolidated federal income tax return together with its domestic subsidiaries, other than Kaiser and its subsidiaries. Kaiser and its domestic subsidiaries are members of a separate consolidated return group that files its own consolidated federal income tax returns.

Loss before income taxes, minority interests and discontinued operations by geographic area is as follows (in millions):

	Years Ended December 31,		
	2005	2004	2003
Domestic	$ (4.1)	$ (46.9)	$ (10.6)
Foreign	–	–	–
	$ (4.1)	$ (46.9)	$ (10.6)

Income taxes are classified as either domestic or foreign based on whether payment is made or due to the United States or a foreign country. Certain income classified as foreign is subject to domestic income taxes.

The benefit (provision) for income taxes on loss before income taxes, minority interests and discontinued operations consists of the following (in millions):

	Years Ended December 31,		
	2005	2004	2003
Current:			
Federal	$ –	$ –	$ –
State and local	1.1	(1.3)	–
Foreign	(0.6)	(0.2)	–
	0.5	(1.5)	–
Deferred:			
Federal	–	–	–
State and local	(1.1)	1.8	(1.0)
Foreign	0.7	–	–
	(0.4)	1.8	(1.0)
	$ 0.1	$ 0.3	$ (1.0)

A reconciliation between the provision for income taxes and the amount computed by applying the federal statutory income tax rate to loss before income taxes, minority interests and discontinued operations is as follows (in millions):

	Years Ended December 31,		
	2005	2004	2003
Loss before income taxes	$ (4.1)	$ (46.9)	$ (10.6)
Amount of federal income tax benefit based upon the statutory rate	$ 1.4	$ 16.4	$ 3.7
Changes in valuation allowances and revision of prior years' tax estimates	(1.3)	(16.0)	(4.9)
Foreign taxes, net of federal tax benefit	0.1	(0.2)	–
State and local taxes, net of federal tax effect	–	0.4	0.5
Other	(0.1)	(0.3)	(0.3)
	$ 0.1	$ 0.3	$ (1.0)

Changes in valuation allowances and revision of prior years' tax estimates, as shown in the table above, include changes in valuation allowances with respect to deferred income tax assets, amounts for the reversal of reserves which the Company no longer believes are necessary, and other changes in prior years' tax estimates. The other reversals of reserves generally relate to the expiration of the relevant statute of limitations with respect to certain income tax returns or the resolution of specific income tax matters with the relevant tax authorities.

The components of the Company's net deferred income tax assets (liabilities) are as follows (in millions):

	December 31, 2005	December 31, 2004
Deferred income tax assets:		
Postretirement benefits other than pensions	$ 5.3	$ 5.1
Loss and credit carryforwards	146.5	141.3
Other liabilities	24.4	20.6
Real estate	11.1	17.3
Timber and timberlands	22.0	14.9
Other	28.0	34.2
Valuation allowances	(102.7)	(78.3)
Total deferred income tax assets, net	134.6	155.1
Deferred income tax liabilities:		
Property, plant and equipment	(41.4)	(60.3)
Other	(9.3)	(10.5)
Total deferred income tax liabilities	(50.7)	(70.8)
Net deferred income tax assets	$ 83.9	$ 84.3

The Company evaluated all appropriate factors in determining the realizability of the $146.5 million in deferred tax assets attributable to loss and credit carryforwards. These factors included any limitations on the use of loss and credit carryforwards, results of operations for 2005 and prior years, the reversal of deferred gains, other temporary differences, the year the carryforwards expire, and the levels of taxable income necessary for utilization. The Company also considered the potential recognition of the deferred gains on sales of timber and timberlands. Based on this evaluation, the Company provided valuation allowances of $13.4 million and $19.0 million related to loss and credit carryforwards in 2005 and 2004, respectively. With respect to the $56.3 million of deferred tax assets attributable to loss and credit carryforwards for which a valuation allowance has not been provided, the Company believes that it is more likely than not that it will realize the benefit for these carryforwards.

The net deferred income tax assets in the above table do not include any potential tax benefit attributable to the Company's investment in its 50,000,000 Kaiser Shares. For federal tax purposes, the Company's basis is estimated to be $388.0 million (as compared to ($516.2) million reflected in these financial statements), which would result in a federal tax benefit at current federal statutory income tax rates of approximately $135.8 million. As discussed in Note 1, upon effectiveness of Kaiser's plan of reorganization, the Company also expects it will take a worthless stock deduction on its consolidated federal tax return related to the cancellation of the Kaiser shares and at that time will evaluate whether it expects to realize the resulting tax asset of approximately $135.8 million. The Company can give no assurance that any tax benefit could be realized from the losses due to limitations imposed under the Internal Revenue Code relating to capital losses.

As of December 31, 2005 and 2004, $0.2 million and $0.2 million, respectively, of the net deferred income tax assets listed above are included in prepaid expenses and other current assets. Certain other portions of the deferred income tax liabilities listed above are included in other accrued liabilities and other noncurrent liabilities.

The following table presents the estimated tax attributes for federal income tax purposes at December 31, 2005, attributable to the Company (in millions). The utilization of certain of these tax attributes is subject to various limitations.

		Expiring
Regular tax attribute carryforwards:		
Prior year's net operating loss carryforwards	$ 368.3	2006-2024
Alternative minimum tax credits	2.5	Indefinite
General business tax credits	1.6	2025
Alternative minimum tax attribute carryforwards:		
Prior year's net operating losses	390.5	2006-2024

The Company's operations are subject to the jurisdiction of multiple tax authorities and their review of taxable income as reported in the Company's tax filings. Determination of taxable income in any jurisdiction requires the interpretation of tax laws, regulations and related judicial decisions and administrative interpretations of local tax authorities. As a result, the Company is subject to tax assessments in such jurisdictions including the re-determination of taxable income by tax authorities that may not agree with the Company's interpretations and positions taken. The Company believes that it has adequately provided for any such potential assessments under the guidance of Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" (**"SFAS No. 5"**). Further, the Company believes amounts currently provided for any such potential assessments will not be settled within the next twelve months and settlement of such amounts would not have a significant impact on the Company's consolidated financial position, results of operations and/or liquidity.

As discussed in Note 1, the liquidity issues being experienced by Palco and ScoPac could result in claims against and could have adverse impacts on MAXXAM Parent, MGHI and/or MGI. For example, it is possible that certain transactions could be entered into in connection with a potential restructuring or reorganization of Palco or ScoPac, such as a sale of all or a portion of the equity ownership in Palco and/or ScoPac, a sale of a substantial portion of Palco's and/or ScoPac's assets and/or a cancellation of some or all of Palco's and/or ScoPac'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.

9. Employee Benefit and Incentive Plans

Pension and Other Postretirement Benefit Plans

The Company has three defined benefit plans: the MAXXAM Pension Plan, the Palco Retirement Plan and the MAXXAM Supplemental Employee Retirement Plan (collectively, the **"Plans"**). The benefits are determined under formulas based on the employee's years of service, age and compensation. The MAXXAM Pension Plan and Palco Retirement Plan were frozen effective December 31, 2005; as a result, these plans will continue, but no additional benefits will accrue to participants subsequent to December 31, 2005.

The Company has unfunded postretirement medical benefit plans which cover most of its employees. Under the plans, employees are eligible for health care benefits upon retirement. Retirees make contributions for a portion of the cost of their health care benefits. The expected costs of postretirement medical benefits are accrued over the period the employees provide services to the date of their full eligibility for such benefits. Postretirement medical benefits are generally provided through a self-insured arrangement. The Company has not funded the liability for these benefits, which are expected to be paid out of cash generated by operations.

The funded status of the Company's pension and other postretirement benefit plans and the accrued benefit liability included in other long-term liabilities as of December 31, 2005 and 2004, respectively, were as follows (in millions):

	Pension Benefits		Medical/Life Benefits	
	Years Ended December 31,			
	2005	2004	2005	2004
Change in projected benefit obligation:				
Projected benefit obligation at beginning of year	$ 101.3	$ 87.2	$ 12.6	$ 11.4
Service cost	2.8	3.0	0.4	0.5
Interest cost	5.6	5.6	0.5	0.7
Actuarial (gain) loss	0.4	8.4	(1.9)	0.8
Curtailments, settlements and amendments	(8.1)	–	(1.0)	–
Benefits paid	(3.8)	(2.9)	(0.3)	(0.8)
Projected benefit obligation at end of year	$ 98.2	$ 101.3	$ 10.3	$ 12.6
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 60.3	$ 56.8	$ –	$ –
Actual return on assets	4.6	5.4	–	–
Employer contributions	2.3	1.0	0.3	0.8
Plan participants' contributions	–	–	1.7	1.7
Benefits paid	(3.8)	(2.9)	(2.0)	(2.5)
Fair value of plan assets at end of year	$ 63.4	$ 60.3	$ –	$ –
Funded status:				
Projected benefit obligation in excess of plan assets	$ (34.8)	$ (41.0)	$ (10.3)	$ (12.6)
Unrecognized actuarial loss	13.2	20.6	–	2.9
Unrecognized prior service costs	–	(0.2)	(1.4)	(1.8)
Net amount recognized	$ (21.6)	$ (20.6)	$ (11.7)	$ (11.5)
Amounts recognized in the Consolidated Balance Sheet:				
Accrued benefit liability	$ (34.8)	$ (33.8)	$ (11.7)	$ (11.5)
Accumulated other comprehensive income	13.2	13.2	–	–
Net amount recognized	$ (21.6)	$ (20.6)	$ (11.7)	$ (11.5)

A minimum pension liability adjustment is required when the actuarial present value of the accumulated benefit obligation exceeds the fair value of plan assets and accrued pension liability. In 2005, a minimum liability pre-tax adjustment of $0.08 million was reflected as an increase in accrued benefit liability with an offsetting pre-tax charge to stockholders' deficit recorded as a component of other comprehensive income (loss). In 2004, a minimum liability pre-tax adjustment of $6.9 million was reflected as an increase in accrued benefit liability with an offsetting pre-tax charge to stockholders' deficit recorded as a component of other comprehensive income (loss).

The aggregate accumulated benefit obligation and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets were $98.3 million and $63.4 million, respectively, as of December 31, 2005, and $94.0 million and $60.3 million, respectively, as of December 31, 2004.

The components of pension and other postretirement medical benefits expense for the three years ended December 31, 2005, were as follows (in millions):

	Pension Benefits			Medical/Life Benefits		
	Years Ended December 31,					
	2005	2004	2003	2005	2004	2003
Components of net periodic benefit costs:						
Service cost	$ 2.8	$ 3.1	$ 2.7	$ 0.4	$ 0.5	$ 0.4
Interest cost	5.6	5.6	5.1	0.5	0.7	0.6
Expected return on assets	(5.3)	(5.1)	(4.6)	–	–	–
Recognized net actuarial loss	0.7	–	–	–	–	–
Amortization of prior service costs	–	–	0.1	(0.2)	(0.2)	(0.2)
Net periodic benefit costs	3.8	3.6	3.3	0.7	1.0	0.8
Curtailments, settlements and other	(0.2)	–	0.1	(0.1)	(0.1)	0.3
Adjusted net periodic benefit costs	$ 3.6	$ 3.6	$ 3.4	$ 0.6	$ 0.9	$ 1.1

The measurement date used for the Company's pension and postretirement benefit plans was December 31, 2005. The underlying assumptions of the Company's pension and other postretirement benefit plans for the three years ended December 31, 2005, were as follows:

	Pension Benefits			Medical/Life Benefits		
	Years Ended December 31,					
	2005	2004	2003	2005	2004	2003
Weighted-average assumptions:						
Discount rate used to determine benefit obligation	5.625%	5.875%	6.25%	5.625%	5.875%	6.25%
Discount rate used to determine net periodic benefit cost	5.875%	6.25%	6.75%	5.875%	6.25%	6.75%
Expected return on plan assets	8.75%	8.50%	8.00%	–	–	–
Rate of compensation increase	– (1)	4.11%	4.20%	–	–	–

(1) Not applicable as the MAXXAM Pension Plan and Palco Retirement Plan were frozen effective December 31, 2005

The average annual assumed rate of increase in the per capita cost of covered benefits (i.e. health care cost trend rate) for 2006 is 9.0% for all participants. The rate of increase is assumed to decline gradually to 5.0% in 2010 for all participants and remain at that level thereafter. Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. A one-percentage-point change in assumed health care cost trend rates as of December 31, 2005 would have the following effects (in millions):

	1-Percentage-Point Increase	1-Percentage-Point Decrease
Effect on total of service and interest cost components	$ 0.1	$ (0.1)
Effect on the postretirement benefit obligations	1.3	(1.1)

The pension plans' investments are held under trust agreements with an independent trustee. The plans' Investment Committees establish the investment policies for the plans' assets and have selected certain investment funds maintained by the trustee (or its affiliates and third parties) for investment of plan assets. The Investment Committees also determine the portion of plan assets to be invested in such funds. The trustee's affiliates or third parties select the investment managers for these funds and the portion of each fund to be managed by the respective investment managers. The investment managers in turn determine in which equity, debt and/or other securities the assets under their direction will be invested. Actual investment results achieved by the investment funds are reviewed by the Investment Committees on a regular basis. As of December 31, 2005, the Investment Committees' target asset allocations were 70% for equity securities and 30% for fixed income securities.

The weighted-average asset allocations for the Company's pension plans at December 31, 2005 and 2004, by asset category are as follows:

	Years Ended December 31,	
	2005	**2004**
Asset Category:		
Equity securities	70%	71%
Debt securities	30	29
Total	100%	100%

The expected rate of return on plan assets assumption, used in the determination of net periodic pension cost, will be 8.75% for 2006. The Company's expected rate of return assumption is based on historical returns on plan assets and the expected long-term returns for the asset allocation targets in place at December 31, 2005.

The Company's funding policy is to make annual contributions to the plans which equal or exceed the minimum funding requirements of ERISA. The Company is in compliance with this policy. An assumed long-term rate of return on plan assets of 8.5% and 8.0% was used in the determination of the ERISA minimum funding requirements for the plan years ended December 31, 2005 and 2004, respectively. Expected funding requirements for pension benefits for 2006 are approximately $12.2 million. Expected funding requirements for postretirement medical benefits for 2006 are approximately $0.5 million.

The Company also has unfunded Supplemental Executive Retirement Plans that provide certain key employees defined pension benefits that supplement those provided by the Company's other retirement plans. The Company had $3.4 million and $3.2 million accrued as projected benefit obligations in the Consolidated Balance Sheet for such plans at December 31, 2005 and 2004, respectively.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid in respect of the Company's pension and postretirement benefit plans (in millions):

Years Ended December 31,	Pension Benefits	Medical/ Life Benefits
2006	$ 3.4	$ 0.5
2007	3.6	0.5
2008	3.8	0.5
2009	4.2	0.6
2010	4.5	0.6
Years 2011-2015	26.9	4.0

Savings and Incentive Plans

The Company has various defined contribution savings plans designed to enhance the existing retirement programs of participating employees. Expenses incurred by the Company for all of these plans were $0.8 million, $0.7 million and $0.7 million for the years ended December 31, 2005, 2004 and 2003, respectively.

10. Investment in Kaiser

Reorganization Proceedings

The Company and MGHI collectively own the 50,000,000 Kaiser Shares, which represents approximately 63% of Kaiser's common stock. In 2002-2003, Kaiser and a number of its subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. Kaiser's plan of reorganization, which provides for the cancellation of the equity interests of current stockholders without consideration or obligation, was confirmed by the Kaiser Bankruptcy Court in February 2006. However, Kaiser's plan of reorganization is not yet final, as it must still be approved by the U.S. District Court before Kaiser can emerge from Chapter 11, and is also subject to appeal. These consolidated financial statements do not reflect any adjustment related to the deconsolidation of Kaiser other than presenting the Company's investment in Kaiser using the cost method.

Also see "Deconsolidation of Kaiser" in Note 1.

11. Commitments, Regulatory and Environmental Factors and Contingencies

Commitments

The Company leases certain facilities and equipment under operating leases. Minimum rental commitments under operating leases at December 31, 2005, are as follows:

Years Ended December 31,	(In millions)
2006	$ 3.3
2007	2.9
2008	2.0
2009	0.8
2010	0.8
Thereafter	1.9
Total minimum lease payments	$ 11.7

Rental expense for operating leases was $4.2 million, $4.7 million and $4.3 million for the years ended December 31, 2005, 2004 and 2003, respectively.

The Company owns certain commercial properties which are leased to tenants under operating leases. Lease terms average 20 years. Minimum rentals on operating leases are contractually due as follows:

Years Ended December 31,	(In millions)
2006	$ 17.3
2007	17.5
2008	17.8
2009	18.0
2010	18.0
Thereafter	190.1
Total minimum rentals	$ 278.7

Regulatory and Environmental Factors

Forest Products Operations

Regulatory and environmental matters and litigation have had a significant adverse effect on 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, air and water quality and other matters. Compliance with such laws and regulations also plays a significant role in the Company's Forest Products business.

Environmental Plans

From March 1999 until October 2002, ScoPac prepared THPs in accordance with the SYP. The SYP was intended to comply with regulations of the California Department of Forestry and Fire Protection (**"CDF"**) requiring timber companies to demonstrate sustained yield, i.e. that their projected average annual harvest for any decade within a 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, (see "–Contingencies–Timber Harvest Litigation"), on October 31, 2003, the Court hearing the *EPIC-SYP/Permits lawsuit* entered a judgment invalidating the SYP and the incidental take permits issued by California pursuant to the HCP (**"California Permits"**), although that decision was reversed in December 2005. As a result of an earlier stay order issued in this case and the trial court's judgment, ScoPac from October 2002 until March 2005 obtained review and approval of its THPs under an alternative procedure in the California forest practice rules known as **"Option C"**. Option C is available to landowners who have submitted an "Option A" plan to the CDF for review (as was done by Palco). An approved Option A plan is an alternative to obtaining approval of a sustained yield plan. Palco's Option A plan (**"Option A Plan"**) was approved by the CDF in March 2005. ScoPac is currently relying upon its Option A Plan to obtain THP approvals, and will likely continue to do so in the future.

The HCP and related incidental take permits issued by the federal government pursuant to the HCP **("Federal Permits"**) allow incidental "take" of certain federally listed species located on the Palco 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 “Environmental Plans”, 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 the Palco Companies primarily in four areas: efforts by the federal Environmental Protection Agency (**“EPA”**) and the North Coast Water Board to establish total maximum daily load limits (**“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 Palco Timberlands and in some cases, clean-up or preventive 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 ScoPac Timber Property. On the Palco Timberlands, the relevant contaminant is simple sediment – dust, dirt and gravel – that is abundant in watercourses largely as a function of the area’s normally heavy rainfall and soil that erodes easily. The Company expects the process of establishing TMDLs to continue into 2010. In December 1999, the EPA issued a report dealing with TMDLs on two of the nine watercourses. The agency indicated that the requirements under the HCP would significantly address the sediment issues that resulted in TMDL requirements for these watercourses. The North Coast Water Board has begun the process of establishing the TMDL requirements applicable to two other watercourses on the Palco Timberlands, with a targeted completion of 2007 for these two watercourses. ScoPac’s scientists are actively working with North Coast Water Board staff to ensure that these TMDLs recognize and incorporate the environmental protection measures of the HCP. The final TMDL requirements applicable to the ScoPac Timber Property 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.

For each of the winter periods since 2002, Palco and ScoPac have been required to submit reports on sediment discharges and erosion control practices to the North Coast Water Board in order to conduct winter harvesting operations in the Freshwater and Elk River watersheds. After consideration of these reports, the North Coast Water Board imposed requirements on the Palco Companies to implement additional mitigation and erosion control practices in these watersheds for each of these winter operating periods. The North Coast Water Board has also extended the requirements for certain mitigation and erosion control practices in three additional watersheds (Bear, Jordan and Stitz Creek). The Palco Companies and the North Coast Water Board are currently in discussions to determine what these measures will be. The requirements imposed to date by the North Coast Water Board have significantly increased operating costs; additional requirements imposed in the future could further increase costs and cause additional delays in THP approvals.

The North Coast Water Board has also issued a clean up and abatement order for the Elk River watershed (**“Elk River Order”**), which is aimed at addressing existing sediment production sites 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 Resources Control Board (**“State Water Board”**) was denied. Palco has appealed the decision of the State Water Board in state court , but has held such appeal in abeyance until a decision was reached by the California Supreme Court on the *THP No. 520 lawsuit* (see “**–**Contingencies**–**Timber Harvest Litigation” below). Now that the California Supreme Court has reached a decision, Palco is in the process of considering whether or not to pursue its appeal of the Elk River Order.

The North Coast Water Board in December 2003 directed its staff to formulate WWDRs for the Freshwater and Elk River watersheds on the ScoPac Timber Property. As harvesting activities on the ScoPac Timber Property cannot readily be moved between watersheds due to, among other things, historic harvest patterns, adjacency restrictions, and the age classes of trees, development of WWDRs and the other matters described herein are expected to result in reduced harvest levels in the future. The staff of the North Coast Water Board has circulated for public review and comment draft WWDRs for the Freshwater and Elk River watersheds. If these draft WWDRs are approved in their current form, there would likely be a significant adverse impact on current and future harvest levels.

As WWDRs had not been formulated, the North Coast Water Board for some time failed to release for harvest a number of ScoPac's THPs that had already been approved by the other governmental agencies which approve ScoPac's THPs. In February 2005, the Executive Officer of the staff of the North Coast Water Board released sufficient THPs to allow the harvest of up to 50% of the harvest limit established by the CDF for these two watersheds (**"CDF Harvest Limit"**). On March 16, 2005, the North Coast Water Board ordered the enrollment of additional THPs that would allow the harvest of up to 75% of the CDF Harvest Limit for these two watersheds. Third parties subsequently appealed this decision to the State Water Board. On June 16, 2005, the State Water Board heard this appeal and rendered a decision (**"State Water Board Order"**), which had the effect of disallowing further harvesting on the additional 25% of the CDF Harvest Limit approved by the North Coast Water Board on March 16, 2005. The State Water Board's decision also has the effect of disallowing further harvesting in the Freshwater and Elk River watersheds until WWDRs for these watersheds are adopted by the North Coast Water Board.

On July 14, 2005, Palco and ScoPac filed an action entitled *The Pacific Lumber Company and Scotia Pacific Company LLC v. State Water Resources Control Board, et al.* in (No. CV050516) in Humboldt County Superior Court (**"State Water Board action"**) appealing the State Water Board Order. The companies' appeal requested both a stay of the State Water Board Order and a writ of mandate seeking reversal of the State Water Board Order. Following a December 8, 2005, hearing on the companies' requests, the state court denied the request for a stay, but granted a hearing on the request for a writ of mandate. A hearing on the writ of mandate was held on February 6, 2006 and Palco and ScoPac await the court's decision.

On September 2, 2005, the North Coast Water Board set hearings on the draft WWDRs for September 14 and 15, 2005. On September 9, 2005, Palco and ScoPac filed a petition in California state court seeking an order mandating that the North Coast Water Board not take any further action on the proposed WWDRs. The petition alleged defects in the proposed WWDRs and the North Coast Water Board's hearing procedures. Palco and ScoPac requested a preliminary injunction to prevent the North Coast Water Board from taking any further action until their petition is heard. The Court denied the preliminary injunctions following a hearing on November 9, 2005, and Palco and ScoPac subsequently dismissed the case.

On February 17, 2006, the North Coast Water Board held a status conference to determine a timetable for consideration and approval of WWDRs in the Freshwater and Elk River watersheds. Although a formal timetable has not been published, it appears likely that WWDRs in these two watersheds will not be approved before May 2006; such a timetable would further reduce 2006 harvest levels.

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 ScoPac Timber Property are classified as sediment-impaired, implementation of this law could result in additional 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* under "**–**Contingencies**–**Timber Harvest Litigation" below.

Contingencies

Certain present and former directors and officers of the Company are defendants in certain of the actions described below. 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.

Timber Harvest Litigation

A California state court had invalidated the SYP in connection with two lawsuits filed against Palco, as described below, which decision was appealed and was reversed December 12, 2005. Other pending judicial and administrative proceedings, as described below, could affect Palco's and ScoPac's ability to implement the HCP, implement certain approved THPs, or carry out other operations.

In March 1999, 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.* (**"EPIC-SYP/Permits lawsuit"**) was filed in Superior Court in Humboldt County, California (No. CV-990445). This action alleged, among other things, various violations of the California Endangered Species Act and the California Environmental Quality Act, and challenged, among other things, the validity and legality of the SYP and the California Permits and sought, among other things, to prevent implementation of THPs approved in reliance upon these documents. In March 1999, a similar 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* (**"USWA lawsuit"**), was filed in Humboldt County Superior Court (No. CV-990452) challenging the validity and legality of the SYP. The *EPIC-SYP/Permits* and *USWA lawsuits* were consolidated for trial.

Following the trial, the Court in October 2003 entered a judgment invalidating the SYP and the California Permits and in September 2004 granted the plaintiffs' request for reimbursement of an aggregate of $5.8 million in attorneys' fees and other expenses. The Palco Companies and the State of California appealed both decisions. In December 2005, the appellate court reversed the trial court's decision invalidating the SYP, and on January 11, 2006, the appellate court denied plaintiffs' petition for rehearing. The plaintiffs have appealed the appellate court's decision to the California Supreme Court, which has not yet indicated whether it will review the matter. The defendants' appeal of the trial court's award of attorneys fee and expenses is still pending at the appellate court.

In July 2001, an action entitled *Environmental Protection Information Association v. Pacific Lumber, Scotia Pacific Company LLC* (No. C01-2821)(**"Bear Creek lawsuit"**) was filed in the U.S. District Court for the Northern District of California, and later amended to add the EPA as a defendant. The lawsuit alleges that harvesting and other forestry activities under certain of ScoPac'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. In October 2003, the Court upheld the validity of an EPA regulation that 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 that 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. The Company has filed a motion for summary judgment on the ground that it has met the requirements for a storm water pollution prevention permit under a general permit issued by the State of California. The plaintiff has also filed a motion for summary judgment seeking to establish Palco's liability for discharging storm water without a permit. A hearing on the two summary judgment motions was held on March 6, 2006 and the parties are awaiting a decision.

Should the Court's October 2003 decision ultimately become final and be held to apply to all of the timber operations of Palco and ScoPac, 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. The Company believes that civil penalties should not 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 ScoPac Timber Property will not reach levels harmful to the environment. While the impact of a conclusion to this case that upholds the October 2003 ruling may be adverse, the Company does not believe that such an outcome should 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, two similar actions entitled *Alan Cook, et al. v. Gary Clark, et al.* (**"Cook action"**) and *Steve Cave, et al. v. Gary Clark, et al.* (**"Cave action"**) were filed in Humboldt County Superior Court (No.'s DR020718 and DR020719, respectively), which also name Palco and certain affiliates as defendants. 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 Palco 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 Palco Timberlands). On October 13, 2005, an action entitled *Edyth Johnson, et al. v. Charles E. Hurwitz, an individual; MAXXAM Inc., et al.* (No. DR040720) was filed in Humboldt County Superior Court (**"Johnson action"**) and contains allegations similar to the *Cave* and *Cook* actions. 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 a civil suit entitled *The People of the State of California v. The Pacific Lumber Company, Scotia Pacific Holding Company and Salmon Creek Corporation* in the Humboldt County Superior Court (No. DR030070) (**"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 the harvest of significantly more trees 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. On June 14, 2005, the Court dismissed this matter in its entirety. On September 19, 2005, the District Attorney appealed this decision, however, the Company believes that the dismissal ruling has substantially diminished the exposure of the Palco Companies with respect to this matter.

On November 2, 2004, an action entitled *Environmental Protection Information Center v. U.S. Fish & Wildlife Service, NOAA Fisheries, et al.* (No. C04-4647) was filed in the U.S. District Court for the Northern District of California (**"EPIC-USFWS/NOAA lawsuit"**). 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 asserts 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 the Palco Companies. On April 22, 2005, pursuant to motions to dismiss filed by the Palco Companies and the federal defendants, the Court dismissed several of the claims, significantly reducing the scope of the case. On February 6, 2006, plaintiffs voluntarily dismissed the remaining claims.

On August 8, 2005, an action entitled *Center for Biological Diversity v. California Department of Fish and Game, et al.* (No. 05CS01166) was filed in Sacramento County Superior Court against the California Department of Fish and Game (**"CDFG"**) and the Palco Companies seeking to overturn and prevent CDFG and the Palco Companies from taking any action to implement or rely upon certain CDFG "Consistency Determinations" issued in February 2005. Following various court proceedings, this case was voluntarily dismissed by the plaintiff in January 2006.

On November 16, 2001, Palco filed a case entitled *The Pacific Lumber Company, et al. v. California State Water Resources Control Board* (No. DR010860) in Humboldt County Superior Court (**"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 appealed to the State Water Board, which imposed certain of the requested mitigation measures and rejected others. Palco filed the *THP No. 520 lawsuit* challenging the State Water Board's decision, and in January 2003, the Superior Court granted Palco's 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. Palco appealed the decision of the appellate court to the California Supreme Court. On January 30, 2006, the California Supreme Court issued a decision denying Palco's appeal and upholding the appellate court decision. The adverse outcome of the *THP No. 520 lawsuit* confirms the authority the regional and state water boards and their staffs have been exercising over harvesting from the ScoPac Timber Property, resulting in controls and limitations beyond those provided for by the Environmental Plans.

In December 2005, Palco and ScoPac filed a claim (**"Claim"**) with the California Victim Compensation and Government Claims Board (**"Claims Board"**) against the North Coast Water Board, the State Water Board and the State of California (Claim No. G558159). The Claim alleges that the defendants have substantially impaired the contractual and legal rights of Palco and ScoPac under the Headwaters Agreement and the related permits, authorizations and approvals. The Claim also alleges that the actions of the defendants have caused the companies substantial damages, but does not specify an amount. While the Claims Board has indicated that it is investigating the matter, it failed to approve or deny the claim by the statutory deadline. As a result, the Claim is by operation of law treated as having been denied, and Palco may now file a claim for damages in California state court. Palco and ScoPac are considering how best to proceed with respect to this matter.

OTS Contingency and Related Matters

On December 26, 1995, the United States Department of Treasury's Office of Thrift Supervision (**"OTS"**) initiated a formal administrative proceeding (**"OTS action"**) against the Company and others alleging, among other things, misconduct by the Company and certain of its affiliated persons (collectively, **"Respondents"**) and others with respect to the failure of United Savings Association of Texas (**"USAT"**). The OTS sought damages ranging from $326.6 million to $821.3 million under various theories. Following 110 days of proceedings before an administrative law judge during 1997-1999, and over two years of post-trial briefing, on September 12, 2001, the administrative law judge 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 the *OTS action*, a related civil action, alleging damages in excess of $250 million, was subsequently dismissed. This action, entitled *Federal Deposit Insurance Corporation, as manager of the FSLIC Resolution Fund v. Charles E. Hurwitz* (**"FDIC action"**), was originally filed by the Federal Deposit Insurance Corporation (**"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* in the U.S. District Court in Houston, Texas (No. H95-3956). On November 8, 2002, the Respondents filed an amended counterclaim and an amended motion for sanctions (collectively, 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 December 31, 2005, such fees were in excess of $40.6 million. On August 23, 2005, a U.S. District Court ruled on the Sanctions Motion, ordering the FDIC to pay the Respondents $72.3 million. The FDIC has appealed the District Court decision to the U.S. Fifth Circuit Court of Appeals. The U.S. District Court award has not been accrued as of December 31, 2005. There can be no assurance that the Company will ultimately collect this award.

On January 16, 2001, an action was filed against the Company, Federated Development Company (the predecessor of a principal shareholder of the Company; "**Federated**") and certain of the Company's directors in the Court of Delaware Chancery Court entitled *Alan Russell Kahn v. Federated Development Co., MAXXAM Inc., et al.*, Civil Action 18623NC (**"Kahn lawsuit"**). 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 have 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 the New Jersey Department of Environmental Protection (**"NJDEP"**) alleged that one of its former subsidiaries is a successor to a company that manufactured munitions for the U.S. Navy during World War II. The owner of the underlying property, which is located in Cranbury, New Jersey, was seeking the Company's participation in efforts to address contamination of the site which resulted from such operations. In January 2005, MGI and the owner of the property entered into an Administrative Consent Order with the NJDEP providing for, among other things, cleanup of the facility. In April 2005, MGI filed a Complaint against the United States of America, the U.S. Navy, and the U.S. Army for cost recovery and contribution; the defendants subsequently denied all of the claims. In early 2006, the property was sold to a new owner. MGI has recently entered into an amendment to the Administrative Consent Order substituting the new owner for the original property owner. MGI has also reached an agreement with several potentially responsible parties regarding cleanup at the site, the terms of which the Company believes will not result in a material adverse effect on the Company's consolidated financial position, results of operations or liquidity. MGI retained its cause of action against the government parties noted above.

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.

12. Stockholders' Deficit

Preferred Stock

The holders of the Company's Class A Preferred Stock are entitled to receive, if and when declared, preferential cash dividends at the rate of $0.05 per share per annum and participate thereafter on a share for share basis with the holders of Common Stock in any cash dividends, other than cash dividends on the Common Stock in any fiscal year to the extent not exceeding $0.05 per share. Stock dividends declared on the Common Stock would result in the holders of the Class A Preferred Stock receiving an identical stock dividend payable in shares of Class A Preferred Stock. At the option of the holder, the Class A Preferred Stock is convertible at any time into shares of Common Stock at the rate of one share of Common Stock for each share of Class A Preferred Stock. Each holder of Class A Preferred Stock is generally entitled to ten votes per share on all matters presented to a vote of the Company's stockholders.

Stock Option Plans

In 2002, the Company adopted the MAXXAM 2002 Omnibus Employee Incentive Plan (**"2002 Omnibus Plan"**). Up to 700,000 shares of Common Stock and 70,000 shares of Class A Preferred Stock were reserved for awards pursuant to the 2002 Omnibus Plan, of which 142,354 and 70,000 shares, respectively, were available to be awarded at December 31, 2005. The 2002 Omnibus Plan replaced the MAXXAM 1994 Omnibus Plan (**"1994 Omnibus Plan"**). Any shares which were not then already the subject of grants under the 1994 Omnibus Plan are no longer available to be awarded.

The options (or rights, as applicable) granted in 2005, 2004 and 2003 generally vest at the rate of 20% per year commencing one year from the date of grant. The following table summarizes the options or rights outstanding and exercisable relating to the Company's stock option plans. The prices shown are the weighted average price per share for the respective number of underlying shares.

	2005		2004		2003	
	Shares	Price	Shares	Price	Shares	Price
Outstanding at beginning of year	1,162,498	$ 24.81	1,145,390	$ 24.16	992,650	$ 25.58
Granted	95,900	33.20	111,400	33.00	176,240	19.72
Exercised	(90,368)	15.08	(10,110)	15.76	–	–
Expired or forfeited	(29,324)	39.14	(84,182)	27.85	(23,500)	51.12
Outstanding at end of year	1,138,706	25.92	1,162,498	24.81	1,145,390	24.16
Exercisable at end of year	726,954	$ 27.32	666,118	$ 28.73	570,890	$ 31.74

The following table summarizes information about stock options outstanding as of December 31, 2005:

Range of Exercise Prices	Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
$9.40-$15.88	301,070	6.19	$ 11.90	218,670	$ 12.84
$16.38-$19.72	381,636	6.77	18.75	236,104	18.45
$28.65-$45.50	317,000	7.00	36.70	133,180	41.67
$46.80-$56.00	139,000	1.93	51.40	139,000	51.40
	1,138,706	6.09	25.92	726,954	27.32

In addition to the options reflected in the table above, 256,808 shares of restricted Common Stock granted under the 1994 Omnibus Plan are outstanding. These shares are subject to certain restrictions that lapse in 2014.

Concurrent with the adoption of the 1994 Omnibus Plan, the Company adopted the MAXXAM 1994 Non-Employee Director Plan (**"1994 Director Plan"**). Up to 35,000 shares of Common Stock are reserved for awards under the 1994 Director Plan. Options were granted to non-employee directors to purchase 2,400 shares of common stock in 2005, 2004 and 2003, respectively. The weighted average exercise prices of these options are $22.58, $24.90 and $12.15 per share, respectively, based on the quoted market price at the date of grant. The options vest at the rate of 25% per year commencing one year from the date of grant. At December 31, 2005, options for 20,600 shares were outstanding, 14,600 of which were exercisable.

Rights

On December 15, 1999, the Board of Directors of the Company declared a dividend to its stockholders consisting of (i) one Series A Preferred Stock Purchase Right (**"Series A Right"**) for each outstanding share of the Company's

Class A Preferred Stock and (ii) one Series B Preferred Stock Purchase Right (**"Series B Right"**) for each outstanding share of the Common Stock. The Series A Rights and the Series B Rights are collectively referred to herein as the **"Rights"**. The Rights are exercisable only if a person or group of affiliated or associated persons (an **"Acquiring Person"**) acquires beneficial ownership, or the right to acquire beneficial ownership, of 15% or more of the Company's Common Stock, or announces a tender offer that would result in beneficial ownership of 15% or more of the outstanding Common Stock. Any person or group of affiliated or associated persons who, as of December 15, 1999, was the beneficial owner of at least 15% of the outstanding Common Stock will not be deemed to be an Acquiring Person unless such person or group acquires beneficial ownership of additional shares of Common Stock (subject to certain exceptions). Each Series A Right, when exercisable, entitles the registered holder to purchase from the Company one share of Class A Preferred Stock at an exercise price of $165.00. Each Series B Right, when exercisable, entitles the registered holder to purchase from the Company one one-hundredth of a share of the Company's new Class B Junior Participating Preferred Stock, with a par value of $0.50 per share (**"Junior Preferred Stock"**), at an exercise price of $165.00 per one-hundredth of a share. The Junior Preferred Stock has a variety of rights and preferences, including a liquidation preference of $75.00 per share and voting, dividend and distribution rights which make each one-hundredth of a share of Junior Preferred Stock equivalent to one share of Common Stock.

Under certain circumstances, including if any person becomes an Acquiring Person other than through certain offers for all outstanding shares of stock of the Company, or if an Acquiring Person engages in certain "self-dealing" transactions, each Series A Right would enable its holder to buy Class A Preferred Stock (or, under certain circumstances, preferred stock of an acquiring company) having a value equal to two times the exercise price of the Series A Right, and each Series B Right shall enable its holder to buy Common Stock of the Company (or, under certain circumstances, common stock of an acquiring company) having a value equal to two times the exercise price of the Series B Right. Under certain circumstances, Rights held by an Acquiring Person will be null and void. In addition, under certain circumstances, the Board is authorized to exchange all outstanding and exercisable Rights for stock, in the ratio of one share of Class A Preferred Stock per Series A Right and one share of Common Stock per Series B Right. The Rights, which do not have voting privileges, expire on December 11, 2009, but may be redeemed by action of the Board prior to that time for $0.01 per right, subject to certain restrictions.

Shares Reserved for Issuance

At December 31, 2005, the Company had 2,858,327 shares of Common Stock and 115,000 shares of Class A Preferred Stock reserved for future issuances in connection with various options, convertible securities and other rights, as described above.

Voting Control

As of December 31, 2005, Mr. Charles E. Hurwitz beneficially owned (exclusive of securities acquirable upon exercise of stock options but inclusive of securities as to which Mr. Hurwitz disclaims beneficial ownership) directly and through various entities (principally Gilda Investments, LLC, a wholly owned subsidiary of Giddeon Holdings, Inc.) an aggregate of 99.2% of the Company's Class A Preferred Stock and 47.9% of the Company's Common Stock (resulting in combined voting control of approximately 75.0% of the Company). Mr. Hurwitz is the Chairman of the Board and Chief Executive Officer of the Company and President and Director of Giddeon Holdings, Inc. Giddeon Holdings, Inc. is wholly owned by Mr. Hurwitz, members of his immediate family and trusts for the benefit thereof.

13. Significant Acquisitions and Dispositions

Timberland Transactions

In November 2003, Palco and ScoPac sold 681 acres of timberlands within an area known as the Grizzly Creek grove. Palco received $10.0 million in cash, while ScoPac received $8.2 million in cash. The Company recognized a gain of $16.8 million in 2003 related to this sale.

Real Estate Transactions

During 2005, the Company realized substantial revenues from sales of properties at its Mirada development. Sales at Mirada were $57.0 million in 2005 as compared to $16.2 million in 2004.

Additionally, the Company during 2005 sold 78 lots at its Fountain Hills development. Sales at Fountain Hills were $48.3 million in 2005 as compared to $19.4 million in 2004.

At the Company's Palmas development, there were two transactions in 2005 that generated revenues aggregating $32.4 million.

14. Supplemental Cash Flow and Other Information

	Years Ended December 31, 2005	2004	2003
		(In millions)	
Supplemental information on non-cash investing and financing activities:			
Transfer of marketable debt securities from held-to-maturity to available-for-sale	$ –	$ –	$ 14.4
Repurchases of debt using restricted cash and marketable securities	–	10.9	5.4
Supplemental disclosure of cash flow information:			
Interest paid, net of capitalized interest	$ 73.5	$ 72.7	$ 75.0
Income taxes paid, net	0.3	0.4	0.4

15. Quarterly Financial Information (Unaudited)

Summary quarterly financial information for the years ended December 31, 2005 and 2004 is as follows (in millions, except share information):

	Three Months Ended March 31	June 30	September 30	December 31
2005:				
Net sales	$ 83.0	$ 87.2	$ 105.8	$ 130.4
Operating income	2.8	6.5	19.7	26.5
Income (loss) before income taxes	(14.2)	(9.6)	4.3	15.4
Net income (loss)	(14.2)	(9.6)	4.3	15.5
Basic earnings (loss) per common and common equivalent share	$ (2.38)	$ (1.60)	$ 0.72	$ 2.60
Diluted earnings (loss) per common and common stock equivalent share	$ (2.38)	$ (1.60)	$ 0.62	$ 2.22
2004:				
Net sales	$ 68.9	$ 92.5	$ 81.5	$ 104.6
Operating income (loss)	(6.6)	9.1	(1.5)	13.3
Loss before income taxes	(20.3)	(5.3)	(20.1)	(1.2)
Net loss	(20.3)	(5.3)	(20.2)	(0.8)
Basic and diluted loss per common and common equivalent share	$ (3.40)	$ (0.89)	$ (3.37)	$ (0.13)

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining 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 our management, including our 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 our 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 December 31, 2005.

Changes in Internal Control over Financial Reporting

Since September 30, 2005, there have been no changes in the Company's internal controls over financial reporting that materially affected or are reasonably likely to materially affect the internal controls over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

(1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the registrant;
(2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the registrant are being made only in accordance with authorizations of management and directors of the registrant; and
(3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the registrant's assets that could have a material effect on the financial statements.

In designing and evaluating the internal control over financial reporting, 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 our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. This evaluation was based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that the Company's internal control over financial reporting was effective as of December 31, 2005.

Dated: March 14, 2006

Attestation Report of the Registered Public Accounting Firm

To the Board of Directors and Stockholders of
MAXXAM Inc.
Houston, Texas

We have audited management's assessment, included in the accompanying Annual Report on Internal Controls over Financial Reporting, that MAXXAM Inc. and subsidiaries ("Company") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions involving, and dispositions of, the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2005 and 2004, and the related consolidated statements of operations, cash flows, and stockholders' deficit for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedules listed in the Index at Item 15(a)(2). Our report dated March 14, 2006 expressed an unqualified opinion on those financial statements and financial statement schedules based on our audit and the report of other auditors and included an explanatory paragraph regarding the ability of MAXXAM Inc. and subsidiaries to realize their timber related assets and discharge their timber related liabilities in the normal course of business and to continue as a going concern.

DELOITTE & TOUCHE LLP

Houston, Texas
March 14, 2006

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

Certain information required under Part III (Items 10 through 14) has been omitted from this Report since the Company intends to file with the Securities and Exchange Commission, not later than 120 days after the close of its fiscal year, a definitive proxy statement pursuant to Regulation 14A relating to the election of directors.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Index to Financial Statements

1. Financial Statements (included under Item 8):

2. Financial Statement Schedules:

All other schedules are not applicable or the required information is included in the Consolidated Financial Statements or the Notes thereto.

(b) Exhibits

Reference is made to the Index of Exhibits at the end of this Report, which index is incorporated herein by reference.

SCHEDULE I – CONDENSED FINANCIAL INFORMATION OF REGISTRANT

MAXXAM INC.

BALANCE SHEETS (Unconsolidated)
(In millions of dollars, except share information)

	December 31, 2005	December 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 45.2	$ 8.7
Marketable securities and other investments	105.7	100.9
Other current assets	6.1	7.0
Total current assets	157.0	116.6
Deferred income taxes	57.9	58.4
Other assets	1.1	0.4
	$ 216.0	$ 175.4
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable and other accrued liabilities	$ 8.7	$ 4.7
Total current liabilities	8.7	4.7
Payables to subsidiaries, net of receivables and loans	209.3	190.9
Losses recognized in excess of investment in Kaiser	516.2	516.2
Losses recognized in excess of investments in subsidiaries	108.5	87.1
Other noncurrent liabilities	34.6	33.6
Total liabilities	877.3	832.5
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; 668,964 and 669,019 shares issued, respectively; 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; 5,967,942 and 5,976,487 shares outstanding, respectively	5.0	5.0
Additional capital	225.3	225.3
Accumulated deficit	(670.4)	(666.4)
Accumulated other comprehensive loss	(96.6)	(96.6)
Treasury stock, at cost (shares held: preferred – 845; common – 4,095,417 and 4,086,872, respectively)	(124.9)	(124.7)
Total stockholders' deficit	(661.3)	(657.1)
	$ 216.0	$ 175.4

See notes to consolidated financial statements and accompanying notes.

SCHEDULE I – CONDENSED FINANCIAL INFORMATION OF REGISTRANT (Continued)

MAXXAM INC.

STATEMENTS OF OPERATIONS (Unconsolidated)
(In millions of dollars)

	Years Ended December 31,		
	2005	**2004**	**2003**
Investment, interest and other income, net	$ 7.8	$ 3.7	$ 13.4
Intercompany interest expense, net	(13.8)	(9.9)	(16.1)
Interest expense	(0.2)	(0.1)	–
General and administrative expenses	(15.0)	(16.0)	(8.4)
Equity in losses of subsidiaries	2.7	(28.9)	(8.9)
Loss before benefit in lieu of income taxes	(18.5)	(51.2)	(20.0)
Benefit in lieu of income taxes	14.5	4.6	8.4
Net loss	$ (4.0)	$ (46.6)	$ (11.6)

See notes to consolidated financial statements and accompanying notes.

SCHEDULE I – CONDENSED FINANCIAL INFORMATION OF REGISTRANT (Continued)

MAXXAM INC.

STATEMENTS OF CASH FLOWS (Unconsolidated)
(In millions of dollars)

	Years Ended December 31,		
	2005	2004	2003
Cash flows from operating activities:			
Net loss	$ (4.0)	$ (46.6)	$ (11.6)
Adjustments to reconcile net loss to net cash used for operating activities:			
Equity in losses of subsidiaries	(2.7)	28.9	8.9
Non-cash stock-based compensation expense	3.7	6.1	0.8
Net (gains) losses on marketable securities and other investments	(6.6)	2.2	(5.2)
Decrease in receivables, prepaids and other assets	0.8	0.7	10.9
Decrease (increase) in deferred income tax assets	0.8	3.2	(8.1)
(Increase) decrease in accounts payable and other liabilities	(0.5)	1.0	(2.3)
Net cash used for operating activities	(8.5)	(4.5)	(6.6)
Cash flows from investing activities:			
Net sales (purchases) of marketable securities and other investments	1.6	(17.5)	(7.6)
Dividends received from subsidiaries	26.2	5.9	4.3
Investments in and net advances from subsidiaries	35.1	23.0	19.6
Loans to subsidiaries	(17.3)	–	–
Capital expenditures	(0.4)	(0.3)	(0.1)
Net cash provided by investing activities	45.2	11.1	16.2
Cash flows from financing activities:			
Treasury stock repurchases	(0.2)	–	(9.0)
Net cash used for financing activities	(0.2)	–	(9.0)
Net increase in cash and cash equivalents	36.5	6.6	0.6
Cash and cash equivalents at beginning of year	8.7	2.1	1.5
Cash and cash equivalents at end of year	$ 45.2	$ 8.7	$ 2.1
Supplementary schedule of non-cash investing and financing activities:			
Deferral of interest payment on intercompany note payable	$ 5.2	$ 11.3	$ 11.4
Non-cash dividends received from subsidiaries	–	21.6	14.7
Supplemental disclosure of cash flow information:			
Interest paid	$ 6.1	$ 0.5	$ 0.4

See notes to consolidated financial statements and accompanying notes.

MAXXAM INC.

NOTES TO FINANCIAL STATEMENTS

1. Investment in Kaiser

On February 12, 2002, Kaiser Aluminum Corporation (**"Kaiser"**) and certain of its subsidiaries (**"Debtors"**) filed for reorganization under Chapter 11 of the United States Bankruptcy Code. As a result, Kaiser's financial results were deconsolidated beginning February 12, 2002, and MAXXAM Inc. (**"Company"**) began reporting its investment in Kaiser using the cost method. 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 made 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 impact the Company's financial results. Kaiser's plan of reorganization, which provides for the cancellation of the equity interests of current shareholders without consideration or obligation, was confirmed by the Bankruptcy Court supervising the Kaiser bankruptcy cases in February 2006. However, Kaiser's plan of reorganization is not yet final, as it must still be approved by the U.S. District Court before Kaiser can emerge from Chapter 11, and is also subject to appeal.

2. Deferred Income Taxes

The deferred income tax assets and liabilities reported in the accompanying unconsolidated balance sheets are determined by computing such amounts on a consolidated basis for the Company and members of its consolidated federal income tax return group, and then reducing such consolidated amounts by the amounts recorded by the Company's subsidiaries pursuant to their respective tax allocation agreements with the Company. The Company's net deferred income tax assets relate primarily to loss and credit carryforwards, net of valuation allowances. The Company evaluated all appropriate factors to determine the proper valuation allowances for these carryforwards, including any limitations concerning their use, the year the carryforwards expire and the levels of taxable income necessary for utilization. Based on this evaluation, the Company has concluded that it is more likely than not that it will realize the benefit of the carryforwards for which valuation allowances were not provided.

3. Notes Payable to Subsidiaries, Net of Notes Receivable and Advances

The Company's indebtedness to its subsidiaries, which includes accrued interest, consists of the following (in millions):

	December 31, 2005	December 31, 2004
Note payable to MAXXAM Group Holdings Inc. (**"MGHI"**)	$ 183.8	$ 182.3
Net advances	25.5	8.6
	$ 209.3	$ 190.9

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

MAXXAM INC.

Date: March 14, 2006 By: PAUL N. SCHWARTZ
Paul N. Schwartz
President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Date: March 14, 2006 By: CHARLES E. HURWITZ
Charles E. Hurwitz
Chairman of the Board and Chief Executive Officer

Date: March 14, 2006 By: J. KENT FRIEDMAN
J. Kent Friedman
Vice Chairman of the Board and
General Counsel

Date: March 14, 2006 By: ROBERT J. CRUIKSHANK
Robert J. Cruikshank
Director

Date: March 14, 2006 By: EZRA G. LEVIN
Ezra G. Levin
Director

Date: March 14, 2006 By: STANLEY D. ROSENBERG
Stanley D. Rosenberg
Director

Date: March 14, 2006 By: MICHAEL J. ROSENTHAL
Michael J. Rosenthal
Director

Date: March 14, 2006 By: PAUL N. SCHWARTZ
Paul N. Schwartz
President, Chief Financial Officer and Director
(Principal Financial Officer)

Date: March 14, 2006 By: M. EMILY MADISON
M. Emily Madison
Vice President, Finance
(Principal Accounting Officer)

INDEX OF EXHIBITS

Exhibit Number	Description
3.1	Restated certificate of incorporation of the Company (conformed to include all amendments and certificates of designation thereto and incorporated herein by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004)
3.2	Certificate of Powers, Designations, Preferences and Relative, Participating, Optional and Other Rights of the Company's Class B Junior Participating Preferred Stock (incorporated herein by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)
3.3	Certificate of Designations of Class A $.05 Non-Cumulative Participating Convertible Preferred Stock of the Company (incorporated herein by reference to Exhibit 3.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 1999; the **"Company 1999 Form 10-K"**)
3.4	Amended and Restated By-laws of the Company, dated March 30, 2000 (incorporated herein by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2000)
4.1	Rights Agreement, dated December 15, 1999, by and between the Company and American Stock Transfer & Trust Company (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K dated December 15, 1999)
4.2	Indenture dated July 20, 1998, between ScoPac and State Street Bank and Trust Company regarding ScoPac's Class A-1, Class A-2 and Class A-3 Timber Collateralized Notes (**"Timber Notes Indenture"**) (incorporated herein by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998; **"Company June 1998 Form 10-Q"**)
4.3	First Supplemental Indenture, dated July 16, 1999, to the Timber Notes Indenture (incorporated herein by reference to Exhibit 4.1 to ScoPac's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999; File No. 333-63825; **"ScoPac June 1999 Form 10-Q"**)
4.4	Second Supplemental Indenture, dated November 18, 1999, to the Timber Notes Indenture (incorporated herein by reference to Exhibit 99.3 to ScoPac's Report on Form 8-K dated November 19, 1999; File No. 333-63825)
4.5	Deed of Trust, Security Agreement, Financing Statement, Fixture Filing and Assignment of Proceeds, dated July 20, 1998, relating to the Timber Notes Indenture (incorporated herein by reference to Exhibit 4.2 to the Company June 1998 Form 10-Q)
	Note: Pursuant to Regulation § 229.601, Item 601(b)(4)(iii) of Regulation S-K, upon request of the Securities and Exchange Commission, the Company hereby agrees to furnish a copy of any unfiled instrument which defines the rights of holders of long-term debt of the Company and its consolidated subsidiaries (and for any of its unconsolidated subsidiaries for which financial statements are required to be filed) wherein the total amount of securities authorized thereunder does not exceed 10 percent of the total consolidated assets of the Company
10.1	Credit Agreement, dated July 20, 1998, among ScoPac, the financial institutions party thereto and Bank of America, N.A., as Agent (**"ScoPac Line of Credit"**) (incorporated herein by reference to Exhibit 4.3 to the Company June 1998 Form 10-Q)
10.2	First Amendment, dated July 16, 1999, to the ScoPac Line of Credit (incorporated herein by reference to Exhibit 4.2 to the 1999 Form 10-Q)
10.3	Second Amendment, dated June 15, 2001, to the ScoPac Line of Credit (incorporated herein by reference to Exhibit 4.1 to ScoPac's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001; File No. 333-63825)
10.4	Third Amendment, dated June 30, 2003, to the ScoPac Line of Credit (incorporated herein by reference to Exhibit 4.1 to ScoPac's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003; File No. 333-63825)

Exhibit Number	Description
10.5	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. (**"Palco Revolving Credit Agreement"**) (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed April 25, 2005)
10.6	Term Loan Agreement, dated April 19, 2005, among Palco, Britt, the lenders from time to time party thereto and Credit Suisse First Boston (**"Palco Term Loan Agreement"**) (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed April 25, 2005)
10.7	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 April 27, 2005; **"April 27, 2005 Form 8-K"**)
10.8	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)
10.9	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)
10.10	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)
10.11	Omnibus Amendment to Revolving Credit Agreement, Term Loan Agreement, Intercreditor Agreement and Guarantee and Collateral Agreements, dated October 26, 2005, relating to the Palco Revolving Credit Agreement and Palco Term Loan Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K of the Company filed October 28, 2005)
10.12	Third Amendment to the Palco Revolving Credit Agreement, dated November 18, 2005 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 10-K filed November 23, 2005)
10.13	Third Amendment to the Palco Term Loan Agreement, dated November 18, 2005 (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed November 23, 2005)
10.14	Fourth Amendment to the Palco Revolving Credit Agreement, dated January 20, 2006 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed January 26, 2006)
10.15	Fourth Amendment to the Palco Term Loan Agreement, dated January 20, 2006 (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed January 26, 2006)
10.16	Fifth Amendment to the Palco Revolving Credit Agreement, dated February 16, 2006 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed February 22, 2006)
10.17	Fifth Amendment to the Palco Term Loan Agreement, dated February 16, 2006 (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed February 22, 2006)
10.18	Loan Agreement, dated June 28, 2001, between Lakepointe Assets LLC and Legg Mason Real Estate Services, Inc. (incorporated herein by reference to Exhibit 4.2 to MGHI's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001; File No. 333-18723; the **"MGHI June 2001 Form 10-Q"**)
10.19	Promissory Note, dated June 28, 2001, between Lakepointe Assets LLC and Legg Mason Real Estate Services, Inc. (incorporated herein by reference to Exhibit 4.3 to the MGHI June 2001 Form 10-Q)
10.20	Lease Agreement, dated June 28, 2001, between Lakepointe Assets LLC and Fluor Enterprises Inc. (incorporated herein by reference to Exhibit 10.1 to the MGHI June 2001 Form 10-Q)
10.21	Guarantee of Lease dated June 28, 2001, between Fluor Corporation and Lakepointe Assets LLC (incorporated herein by reference to Exhibit 10.2 to the MGHI June 2001 Form 10-Q)

Exhibit Number	Description
10.22	Credit Agreement, dated January 23, 2004, among Palco, Britt, Bank of America, N.A., as Agent, and the Lenders from time to time party thereto ("**Prior Palco Credit Agreement**") (incorporated herein by reference to Exhibit 4.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)
10.23	Amendment No. 1 to the Prior Palco Credit Agreement, dated May 7, 2004 (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004)
10.24	Amendment No. 2 to the Prior Palco Credit Agreement, dated October 20, 2004 (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004)
10.25	Amendment No. 3 to the Prior Palco Credit Agreement, dated February 22, 2005 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated February 25, 2005)
10.26	Letter agreement, dated March 10, 2005, relating to the Prior Palco Credit Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 11, 2005)
10.27	Amendment No. 4 to Credit Agreement and Limited Waiver, dated March 18, 2005, relating to the Prior Palco Credit Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 22, 2005)
10.28	Letter agreement, dated April 18, 2005, relating to the Prior Palco Credit Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed April 18, 2005)
10.29	[Reserved]
10.30	Tax Allocation Agreement , dated December 23, 1996, between the Company and MGHI (**"MGHI Tax Allocation Agreement"**) (incorporated herein by reference to Exhibit 10.1 to MGHI's Registration Statement on Form S-4; Registration No. 333-18723)
10.31	Amendment of MGHI Tax Allocation Agreement, dated December 31, 2001 (incorporated herein by reference to Exhibit 10.2 to MGHI's Annual Report on Form 10-K for the year ended December 31, 2001; File No. 333-18723; **"MGHI 2001 Form 10-K"**)
10.32	Tax Allocation Agreement, dated August 4, 1993, between the Company and MGI (**"MGI Tax Allocation Agreement"**) (incorporated herein by reference to Exhibit 10.6 to Amendment No. 2 to MGI's Registration Statement on Form S-2; Registration No. 33-56332)
10.33	Amendment of MGI Tax Allocation Agreement, dated December 31, 2001, between the Company and MGI (incorporated herein by reference to Exhibit 10.4 to the MGHI 2001 Form 10-K)
10.34	Tax Allocation Agreement, dated May 21, 1988, among the Company, MGI, Palco and the corporations signatory thereto (incorporated herein by reference to Exhibit 10.8 to Palco's Annual Report on Form 10-K for the year ended December 31, 1988; File No. 1-9204)
10.35	Tax Allocation Agreement , dated March 23, 1993, among Palco, Scotia Pacific Holding Company, Salmon Creek Corporation and the Company (**"Palco Tax Allocation Agreement"**) (incorporated herein by reference to Exhibit 10.1 to Amendment No. 3 to the Registration Statement on Form S-1 of Scotia Pacific Holding Company; Registration No. 33-55538)
10.36	Amendment of Palco Tax Allocation Agreement, dated December 31, 2001 (incorporated herein by reference to Exhibit 10.7 to the MGHI 2001 Form 10-K)
10.37	Tax Allocation Agreement, dated February 9, 2004, among Britt, Palco, MGI and the Company (incorporated herein by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)
10.38	[Reserved]

Exhibit Number	Description
10.39	New Master Purchase Agreement, dated July 20, 1998, between ScoPac and Palco (incorporated herein by reference to Exhibit 10.1 to MGHI's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998; File No. 333-18723; **"MGHI June 1998 Form 10-Q"**)
10.40	New Services Agreement, dated July 20, 1998, between Palco and ScoPac (incorporated herein by reference to Exhibit 10.2 to the MGHI June 1998 Form 10-Q)
10.41	New Additional Services Agreement, dated July 20, 1998, between ScoPac and Palco (incorporated herein by reference to Exhibit 10.3 to the MGHI June 1998 Form 10-Q)
10.42	New Reciprocal Rights Agreement, dated July 20, 1998, among Palco, ScoPac and Salmon Creek Corporation (incorporated herein by reference to Exhibit 10.4 to the MGHI June 1998 Form 10-Q)
10.43	New Environmental Indemnification Agreement, dated July 20, 1998, between Palco and ScoPac (incorporated herein by reference to Exhibit 10.5 to the MGHI June 1998 Form 10-Q)
10.44	Implementation Agreement with Regard to Habitat Conservation Plan for the Properties of Palco, ScoPac and Salmon Creek Corporation, dated March 1, 1999, by and among the United States Fish and Wildlife Service, the National Marine Fisheries Service, the CDFG, the CDF, Palco, Salmon Creek Corporation and ScoPac (incorporated herein by reference to Exhibit 99.3 to ScoPac's Report on Form 8-K dated March 19, 1999; File No. 333-63825; **"ScoPac March 19, 1999 Form 8-K"**)
10.45	Agreement Relating to Enforcement of AB 1986, dated February 25, 1999, by and among the California Resources Agency, CDFG, CDF, the California Wildlife Conservation Board, Palco, Salmon Creek Corporation and ScoPac (incorporated herein by reference to Exhibit 99.4 to the ScoPac March 19, 1999 Form 8-K)
10.46	Habitat Conservation Plan, dated March 1, 1999, for the Properties of Palco, ScoPac and Salmon Creek Corporation (incorporated herein by reference to Exhibit 99.5 to the ScoPac March 19, 1999 Form 8-K)
10.47	Letter, dated February 25, 1999, from the CDF to Palco (incorporated herein by reference to Exhibit 99.8 to the ScoPac March 19, 1999 Form 8-K)
10.48	Letter, dated March 1, 1999, from the CDF to Palco (incorporated herein by reference to Exhibit 99.9 to the ScoPac March 19, 1999 Form 8-K)
10.49	Letter, dated March 1, 1999, from the U.S. Department of the Interior Fish and Wildlife Service and the U.S. Department of Commerce National Oceanic and Atmospheric Administration to Palco, Salmon Creek Corporation and ScoPac (incorporated herein by reference to Exhibit 99.10 to the ScoPac March 19, 1999 Form 8-K)
10.50	[Reserved]
	Executive Compensation Plans and Arrangements
10.51	MAXXAM 2002 Omnibus Employee Incentive Plan (incorporated hereby reference to Exhibit 99 to the Company's Schedule 14A dated April 30, 2002)
10.52	Form of Stock Option Agreement under the MAXXAM 2002 Omnibus Employee Incentive Plan (incorporated herein by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K for the year ended December 31, 2002)
10.53	MAXXAM 1994 Omnibus Employee Incentive Plan (incorporated herein by reference to Exhibit 99 to the Company's Schedule 14A dated April 29, 1994)
10.54	Form of Stock Option Agreement under the MAXXAM 1994 Omnibus Employee Incentive Plan (incorporated herein by reference to Exhibit 10.30 to the Company's Annual Report on Form 10-K for the year ended December 31, 1994)
10.55	MAXXAM Amended and Restated Non-Employee Director Stock Plan (incorporated herein by reference to Exhibit 99.1 to the Company's Schedule 14A dated April 20, 2004)

Exhibit Number	Description
10.56	Form of Stock Option Agreement under the Amended and Restated Non-Employee Director Plan (incorporated herein by reference to Exhibit 10.27 to the Company's Annual Report on Form 10-K for the year ended December 31, 2004)
10.57	Form of deferred fee agreement for Company directors (incorporated herein by reference to Exhibit 10.26 to the Company's Annual Report on Form 10-K for the year ended December 31, 1996)
10.58	MAXXAM 1994 Executive Bonus Plan (Amended and Restated 2003) (incorporated herein by reference to Exhibit 99 to the Company's Schedule 14A dated April 5, 2004)
10.59	MAXXAM Revised Capital Accumulation Plan of 1988, as amended December 12, 1988 (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995)
10.60	MAXXAM Supplemental Executive Retirement Plan (incorporated herein by reference to Exhibit 10(ii) to MGI's Registration Statement on Form S-4 on Form S-2; Registration No. 33-42300)
10.61	Form of Company deferred compensation agreement (incorporated herein by reference to Exhibit 10.35 to the Company's Annual Report on Form 10-K for the year ended December 31, 1995)
10.62	[Reserved]
10.63	Executive Employment Agreement, dated April 1, 2005, between the Company and M. 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; **"April 1, 2005 Form 8-K"**)
10.64	Restricted Stock Agreement, dated December 13, 1999, between the Company and Charles E. Hurwitz (**"Restricted Stock Agreement"**) (incorporated herein by reference to Exhibit 10.53 to the Company's Annual Report on Form 10-K for the year ended December 31, 1999)
10.65	Amendment, dated December 16, 2003, to the Restricted Stock Agreement (incorporated herein by reference to Exhibit 10.35 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)
10.66	Consulting Agreement, dated December 30, 2004, between Diane Dudley and the Company (incorporated herein by reference to Exhibit 10.1 the Company's Current Report on Form 8-K dated December 30, 2004)
10.67	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)
10.68	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)
10.69	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)
10.70	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)
*21.1	List of the Company's Subsidiaries
*23.1	Consent of Deloitte & Touche LLP
*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

Glossary of Defined Terms

Set forth below is a list of all terms used and defined in this Report (other than the Exhibit Index) and the Consolidated Financial Statements

1994 Director Plan: The MAXXAM 1994 Non-Employee Director Plan

1994 Omnibus Plan: The MAXXAM 1994 Employee Incentive Omnibus Plan

2002 Omnibus Plan: The MAXXAM 2002 Employee Incentive Omnibus Plan

Acquiring Person: A person or group of affiliated or associated persons who acquire beneficial ownership, or the right to acquire beneficial ownership, of 15% or more of the Company's Common Stock (or announces a tender offer which would have this result)

Alpart: Alumina Partners of Jamaica

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

APB Opinion No. 29: Accounting Principles Board Opinion 29, "Accounting for nonmonetary transactions"

Bankruptcy Code: The United States Bankruptcy Code

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

Beltway Assets: Beltway Assets LLC, an indirect wholly owned subsidiary of the Company

Beltway Notes: The 6.08% notes of Beltway Assets due in November 2024

BOF: California Board of Forestry and Fire Protection

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

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

CDF Harvest Limit: Annual harvest limit established by the CDF

CDFG: California Department of Fish and Game

CEQA: California Environmental Quality Act

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

COSO: Committee of Sponsoring Organizations of the Treadway Commission

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 of the Palco/Britt Revolving Credit Agreement and Palco Term Loan which, among other things, excludes the results of ScoPac

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

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

ESA: The Federal Endangered Species Act

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 Giddeon Holdings, Inc.

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

Forest Practice Act: The California Forest Practice Act

Fountain Hills: Fountain Hills, a master-planned residential community located in Fountain Hills, Arizona

GIS: ScoPac's Geographical information system

GPS: ScoPac's Global Positioning System

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, ScoPac, 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

Headwaters Timberlands: Approximately 5,600 acres of Palco timberlands transferred to the United States government as part of the Headwaters Agreement

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

Johnson action: An action entitled *Edyth Johnson, et al. v. Charles E. Hurwitz, an individual, MAXXAM Inc., et al.* (No. DR040720) filed in the Superior Court of Humboldt County, California

Junior Preferred Stock: $0.50 par value Class B Junior Participating Preferred Stock of the Company

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

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

KJBC: Kaiser Jamaica Bauxite Company

Lakepointe Assets: Lakepointe Assets Holdings LLC, an indirect wholly owned subsidiary of the Company

Lakepointe Notes: The 7.56% notes of Lakepointe Assets and its subsidiaries' due June 8, 2021

LIBOR: London Inter Bank Offering Rate

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

MAXXAM: MAXXAM Inc., including its subsidiaries

MAXXAM Parent: MAXXAM Inc., excluding its subsidiaries

Mead Facility: Kaiser's Mead facility and certain related property

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

MGHI Notes: 12% Senior Secured Notes of MGHI

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

Mirada: The Company's luxury resort-residential project located in Rancho Mirage, California

mmbf: Million board feet

Moody's: Moody's Investors Service

Motel Assets: Motel Assets Holdings LLC, an indirect wholly owned subsidiary of the Company

Motel Notes: The 7.03% notes of Motel Assets and its subsidiaries' due May 1, 2018

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

Old growth: Trees which have been growing for approximately 200 years or longer

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

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 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.

Palco Revolving Credit Facility: 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

Palco Companies: Palco, ScoPac and Salmon Creek, collectively

Palco Asset Sale Program: Palco's process for marketing certain of its assets

Palco Timberlands: The ScoPac Timber Property 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

Palmas Notes: The 7.12% notes due December 20, 2030 of Palmas Country Club Inc., an indirect wholly owned subsidiary of the Company

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

Prior Palco Credit Agreement: January 2004 Palco Revolving Credit Facility between Palco and a bank which provided for borrowings up to $30.0 million, which facility was terminated in connection with the closing of the Palco Revolving Credit Facility and Palco Term Loan

PSLRA: Private Securities Litigation Reform Act of 1995

QAL: Queensland Alumina Limited

Racing Act: The Texas Racing Act and related regulations

Racing Commission: Texas Racing Commission

Required Liquidity Amount: One year's interest on the aggregate outstanding balance of the Timber Notes

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

Rights: The Series A and B Rights

RMCAL: A 50% owned joint venture formed to construct and sell 47 villas on a parcel in the Company's Mirada development

S&P: Standard & Poor's Rating Service

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

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

Sanctions Motion: An amended 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 ScoPac must pay through each Timber Note payment date in order to avoid prepayment or deficiency premiums

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

ScoPac Land Sale Program: ScoPac's program pursuant to which it is seeking to sell certain timberland and non-timberland properties

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

ScoPac Timber: The timber in respect of the ScoPac Timber Property and the ScoPac Timber Rights

ScoPac Timber Property: Approximately 204,000 acres of timberlands owned by ScoPac

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

SEC: The Securities and Exchange Commission

second growth: Trees that have been growing for less than 200 years

Series A Right: The Company's Series A Preferred Stock Purchase Right

Series B Right: The Company's Series B Preferred Stock Purchase Right

Services Agreement: Agreement between ScoPac and Palco under which Palco provides certain operational, management and related services to ScoPac with respect to the ScoPac Timber Property

SFAS: Statement of Financial Accounting Standards

SFAS No. 5: SFAS No. 5, “Accounting for Contingencies”

SFAS No. 66: SFAS No. 66, “Accounting for Sales of Real Estate”

SFAS No. 123(R): SFAS No. 123 (revised 2004), “Share-Based Payments”

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

SFAS No. 154: SFAS No. 154, “Accounting Changes and Error Correction”

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

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

State Water Board: California State Water Resources Control Board

State Water Board Order: Order issued by the State Water Board on June 16, 2005

SYP: The sustained yield plan approved in March 1999 as part of the Headwaters Agreement, and later invalidated by a California state court

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

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: ScoPac’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

Trustee: The trustee under the Timber Notes Indenture

TMDLs: Total maximum daily load limits

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

Valco: Volta Aluminium Company Limited

Valley Race Park: The Company’s greyhound racing facility located in Harlingen, Texas

WWDRs: Watershed-wide discharge requirements

young growth: Trees which have been growing for less than 200 years