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

FORM 10-Q

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

For the quarterly period ended March 31, 2006 **Commission File Number 1-3924**

MAXXAM INC.
(Exact name of Registrant as Specified in its Charter)

Delaware (State or other jurisdiction of incorporation or organization)	**95-2078752** (I.R.S. Employer Identification Number)
1330 Post Oak Blvd., Suite 2000 **Houston, Texas** (Address of Principal Executive Offices)	**77056** (Zip Code)

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ☒ No ☐

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 ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

Number of shares of common stock outstanding at May 4, 2006: 5,967,942

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MAXXAM INC. AND SUBSIDIARIES

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

	March 31, 2006 (Unaudited)	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 53.7	$ 72.9
Marketable securities and other short-term investments	150.3	134.6
Receivables:		
Trade net of allowance for doubtful accounts of $0.9 and $0.8, respectively	10.7	11.1
Other	4.8	5.4
Inventories:		
Lumber	6.9	7.6
Logs	9.9	18.9
Real estate inventory	14.2	12.6
Prepaid expenses and other current assets	15.8	16.4
Restricted cash and marketable securities	18.3	29.1
Total current assets	284.6	308.6
Property, plant and equipment, net of accumulated depreciation of $215.2 and $207.9, respectively	348.9	355.0
Timber and timberlands, net of accumulated depletion of $227.2 and $226.3, respectively	208.3	208.7
Real estate	39.2	43.2
Deferred income taxes	95.1	95.1
Intangible assets	2.7	2.9
Long-term receivables and other assets	26.4	26.9
Restricted cash and marketable securities	7.9	7.9
	$ 1,013.1	$ 1,048.3
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	$ 12.3	$ 11.2
Accrued interest	13.3	25.9
Accrued compensation and related benefits	18.8	20.7
Other accrued liabilities	31.8	37.0
Short-term borrowings and current maturities of long-term debt	124.0	112.5
Total current liabilities	200.2	207.3
Long-term debt, less current maturities	872.1	889.6
Accrued pension and other postretirement benefits	34.1	34.1
Losses in excess of investment in Kaiser	516.2	516.2
Other noncurrent liabilities	61.8	62.4
Total liabilities	1,684.4	1,709.6
Commitments and contingencies (see Note 7)		
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 shares issued and 668,119 shares outstanding	0.3	0.3
Common stock, $0.50 par value; 13,000,000 shares authorized; 10,063,359 shares issued; 5,967,942 shares outstanding	5.0	5.0
Additional capital	225.3	225.3
Accumulated deficit	(680.6)	(670.4)
Accumulated other comprehensive loss	(96.4)	(96.6)
Treasury stock, at cost (shares held: preferred – 845; common – 4,095,417)	(124.9)	(124.9)
Total stockholders' deficit	(671.3)	(661.3)
	$ 1,013.1	$ 1,048.3

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)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(Unaudited)	
Net sales:		
Forest products	$ 37.8	$ 47.3
Real estate	29.0	22.8
Racing	13.4	12.9
	80.2	83.0
Costs and expenses:		
Cost of sales and operations:		
Forest products	33.6	42.1
Real estate	8.3	6.8
Racing	11.2	10.6
Selling, general and administrative expenses	12.7	11.8
Gain on sales of timberlands and other assets	(0.7)	–
Depreciation, depletion and amortization	8.8	8.9
	73.9	80.2
Operating income (loss):		
Forest products	(5.5)	(2.8)
Real estate	12.9	6.7
Racing	(0.1)	(0.2)
Corporate	(1.0)	(0.9)
	6.3	2.8
Other income (expense):		
Investment and interest income	4.1	1.2
Other income	0.3	–
Interest expense	(19.6)	(17.7)
Amortization of deferred financing costs	(0.6)	(0.5)
Loss before income taxes and cumulative effect of accounting change	(9.5)	(14.2)
Benefit (provision) for income taxes	–	–
Loss before cumulative effect of accounting change	(9.5)	(14.2)
Cumulative effect of accounting change, net of tax	(0.7)	–
Net loss	$ (10.2)	$ (14.2)
Basic and diluted loss per common and common equivalent share before cumulative effect of accounting change	$ (1.59)	$ (2.38)
Basic and diluted loss per common and common equivalent share after cumulative effect of accounting change	$ (1.71)	$ (2.38)

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

MAXXAM INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions of dollars)

	Three Months Ended March 31, 2006	2005
	(Unaudited)	
Cash flows from operating activities:		
Net loss	$ (10.2)	$ (14.2)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:		
Depreciation, depletion and amortization	8.8	8.9
Non-cash stock-based compensation expense	(1.2)	(1.6)
Gains on sales of timberlands and other assets	(0.7)	–
Net gains from marketable securities	(2.6)	(0.2)
Amortization of deferred financing costs and discounts on long-term debt	0.6	0.5
Equity in loss of unconsolidated affiliates, net of dividends received	0.2	0.2
Increase (decrease) in cash resulting from changes in:		
Receivables	1.2	(2.6)
Inventories	9.3	8.5
Prepaid expenses and other assets	0.5	1.5
Accounts payable	1.2	(4.2)
Accrued and deferred income taxes	–	(0.2)
Other accrued liabilities	(7.1)	(1.3)
Accrued interest	(12.6)	(13.1)
Long-term assets and long-term liabilities	2.6	10.8
Other	–	0.1
Net cash used for operating activities	(10.0)	(6.9)
Cash flows from investing activities:		
Net proceeds from the disposition of property and investments	0.8	–
Sales and maturities of marketable securities and other investments	132.5	200.8
Purchases of marketable securities and other investments	(145.2)	(197.4)
Net proceeds from restricted cash	10.7	7.2
Capital expenditures	(1.8)	(3.3)
Other	–	(0.1)
Net cash provided by (used for) investing activities	(3.0)	7.2
Cash flows from financing activities:		
Proceeds from issuances of long-term debt	–	2.4
Redemptions and repurchases of, and principal payments on, long-term debt	(13.0)	(14.8)
Borrowings under revolving and short-term credit facilities	7.0	21.5
Incurrence of deferred financing costs	(0.2)	(0.6)
Net cash provided by (used for) financing activities	(6.2)	8.5
Net increase (decrease) in cash and cash equivalents	(19.2)	8.8
Cash and cash equivalents at beginning of the period	72.9	18.5
Cash and cash equivalents at end of the period	$ 53.7	$ 27.3
Supplemental disclosure of cash flow information:		
Interest paid, net of capitalized interest	$ 32.2	$ 30.8

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

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

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

The consolidated financial statements included herein are unaudited; however, they include all adjustments of a normal recurring nature which, in the opinion of management, are necessary for a fair presentation of the consolidated financial position of the Company at March 31, 2006, the consolidated results of operations for the three months ended March 31, 2006 and 2005, and the consolidated cash flows for the three months ended March 31, 2006 and 2005.

Financial Difficulties of Forest Products Entities

Status of Regulatory Matters

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. The ability to harvest ScoPac Timber 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, actions by the 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 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 WWDRs for the Freshwater and Elk River watersheds on the Palco Timberlands. As harvesting activities on the Palco Timberlands 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 "Regulatory and Environmental Factors" section of Note 7 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, which negatively impacts cash flow.

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. On May 8, 2006, the North Coast Water Board adopted WWDR's for the Freshwater and Elk River watersheds, which action has the effect of allowing harvesting in these two watersheds to begin once THPs are released by the Executive Officer of the North Coast Water Board. There can be no assurance that the THPs related to these two watersheds will ultimately be released or harvested as planned in 2006 or that the action of the North Coast Water Board will not be appealed to the State Water Board. While ScoPac continues to project that its annual harvest level over the ten-year period beginning 2006 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.

ScoPac Liquidity Update

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.

Due to regulatory constraints and adverse weather conditions during the first quarter of 2006, harvest levels were lower than planned resulting in a liquidity shortfall at ScoPac. Consequently, in January 2006 and again in April 2006, ScoPac requested and MGI approved timber purchases which provided ScoPac an aggregate of $4.4 million of additional liquidity to pay its expenses.

On the Timber Notes 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 of interest due in respect of Timber Notes held in the SAR Account). ScoPac also repaid $19.3 million of principal on the Timber Notes ($11.9 million net of principal in respect of Timber Notes held in the SAR Account), an amount equal to Scheduled Amortization, using funds held in the SAR Account.

ScoPac management estimates that its cash flows from operations, together with funds available under the ScoPac Line of Credit and other available funds, will be insufficient, by a substantial amount, to pay the entire amount of the interest due on the July 20, 2006, payment date. ScoPac also expects to incur additional interest shortfalls over at least the next several years. 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.

In an effort to address the expected shortfall on the July 20, 2006 payment date, and other future expected cash shortfalls, ScoPac has initiated the ScoPac Land Sale Program whereby ScoPac is seeking to sell certain non-timberland properties such as ranchlands and recreational areas, as well as certain timberlands. 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.

Palco Liquidity Update

Palco continues to experience liquidity shortfalls. The most recent liquidity shortfalls result primarily from a continued imbalance in the mix of log inventories, a reduction in log supply from ScoPac and operational inefficiencies related to the large log processing line at the Scotia sawmill. In the first quarter of 2006 and again in April 2006, additional liquidity was needed at Palco and Palco borrowed an aggregate of $19.0 million from MGI to meet its cash shortfalls.

As of December 31, 2005 and March 31, 2006, Palco and Britt were in default under the Palco Term Loan and the Palco Revolving Credit Facility due to financial covenant breaches. Palco estimates that, without necessary amendments to the Palco Term Loan and the Palco Revolving Credit Facility and sufficient additional working capital, it will have insufficient liquidity to fund its anticipated cash shortfalls in 2006 and its planned level of operations for the next several years. Palco is pursuing discussions with its lenders in an effort to resolve the defaults and obtain additional liquidity necessary to fund 2006 and future liquidity needs. There can be no assurance that Palco will be able to resolve the defaults and obtain additional liquidity necessary to fund future expected cash shortfalls.

In an effort to reduce its overall debt level, Palco has initiated the Palco Asset Sale Program whereby Palco is marketing certain assets, and Palco 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 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 liquidity 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 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 also have material adverse effects on the financial condition, results of operations or liquidity of the Company's forest products operations. See Note 7 for further discussion of the regulatory and environmental matters and legal proceedings affecting the Company's forest products operations.

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, 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 annuity placement interest rate assumptions as of December 31, 2005. 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, 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.

	Three Months Ended March 31, 2006
Revenues	$ 42.4
Costs and expenses	(30.6)
Operating income	11.8
MAXXAM's equity in MGI's losses	(21.0)
Other, net	(0.3)
Cumulative effect of accounting change	(0.7)
Income tax benefit	–
Net loss	$ (10.2)

	As of March 31, 2006
Current assets	$ 238.2
Property, plant and equipment (net)	239.5
Other assets	149.8
Total assets	$ 627.5
Current liabilities	43.4
Long-term debt, less current maturities	219.1
Other liabilities	63.8
Losses recognized in excess of investment in MGI and certain intercompany items	456.3
Losses recognized in excess of investment in Kaiser	516.2
Total liabilities	1,298.8
Stockholders' deficit	(671.3)
Total liabilities and stockholders' deficit	$ 627.5

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.

Kaiser Update

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 the plan is also currently under 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 which is 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.

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 and (iii) cash held in brokerage accounts from marketable securities to cash and cash equivalents in the Consolidated Balance Sheets and in the Consolidated Statements of Cash Flows.

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

2. New Accounting Standards

Accounting for Stock Options

The Company adopted SFAS No. 123(r) effective January 1, 2006. SFAS No. 123(r) requires 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. Compensation cost is required to be recognized over the period that an employee provides service in exchange for the award and these awards are required to be remeasured each reporting period. The adoption of this standard resulted in an expense of $0.7 million in the first quarter of 2006 representing the cumulative impact of awards exercisable on January 1, 2006.

Exchanges of Nonmonetary Assets

In December 2004, the FASB issued SFAS No. 153. 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. The adoption of SFAS No. 153 on January 1, 2006, did not have an impact on the Company's financial statements.

Accounting Changes and Error Corrections

In May 2005, the FASB issued SFAS No. 154, which changes the requirements applicable to 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 adoption of SFAS No. 154 on January 1, 2006, did not have an impact on the Company's financial statements.

3. Segment Information and Other Items

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

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

	Reportable Segments				
	Forest Products	Real Estate	Racing	Corporate	Consolidated Total
Depreciation, depletion and amortization for the three months ended:					
March 31, 2006	$ 4.8	$ 3.6	$ 0.3	$ 0.1	$ 8.8
March 31, 2005	4.9	3.6	0.4	–	8.9
Total assets as of:					
March 31, 2006	395.0	352.1	37.4	228.6	1,013.1
December 31, 2005	421.4	345.3	36.4	245.2	1,048.3

4. Debt

Palco Credit Agreements

At December 31, 2005 and March 31, 2006, Palco and Britt 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 their other rights and remedies under the Palco Term Loan, Palco Revolving Credit Facility and related security agreements. 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 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. As of March 31, 2006, $34.6 million was outstanding under the Palco Term Loan and $12.7 million was outstanding under the Palco Revolving Credit Facility. As waivers of the defaults have not been obtained, amounts outstanding under the Palco Term Loan and the Palco Revolving Credit Facility have been classified as a current liability in the consolidated balance sheets.

Palco borrowed an aggregate of $6.0 million from MGI in 2005. During the first quarter of 2006, Palco borrowed an aggregate additional $11.0 million from MGI, and in April 2006, borrowed an aggregate additional $9.0 million from MGI, of which $8.0 million has been utilized. Palco used these loan proceeds to fund liquidity shortfalls. Each of the additional borrowings required an amendment to the Palco Term Loan and Palco Revolving Credit Facility.

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 3%, 2% and 1% payable in connection with any prepayment of the Palco Term Loan that occurs during the 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 would in the future determine or be able to make any such investment in whole or part.

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. On June 20, 2003, the ScoPac Line of Credit was extended to July 7, 2006. ScoPac has requested an extension of the ScoPac Line of Credit, but there can be no assurance that the ScoPac Line of Credit will be extended. If not extended, ScoPac may draw upon the full amount available. The amount drawn would, to the extent of available funds, 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 March 31, 2006, the maximum availability under the ScoPac Line of Credit was $54.1 million, and outstanding borrowings were $49.6 million.

ScoPac Timber Notes

On the Timber Notes 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 of interest due in respect of Timber Notes held in the SAR Account). ScoPac also repaid $19.3 million of principal on the Timber Notes ($11.9 million net of principal in respect of Timber Notes held in the SAR Account), an amount equal to Scheduled Amortization, using funds held in the SAR Account.

As discussed further in Note 1, ScoPac is experiencing financial difficulties due to regulatory restrictions on harvesting and other factors. As a result, ScoPac management estimates that its cash flows from operations, together with funds available under the ScoPac Line of Credit and other available funds, will be insufficient, by a substantial amount, to pay the entire amount of interest due on the July 20, 2006, payment date. Such an event would constitute an event of default under the Indenture. 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. If such accelerations of Timber Notes and/or advances under the ScoPac Line of Credit occur, the Trustee may exercise all rights under the 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 Indenture and all advances under the ScoPac Line of Credit 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.

U.S. Bank, the Trustee under the Indenture resigned effective May 1, 2006. ScoPac has appointed Deutsche Bank National Trust Company as successor Trustee under the Indenture, which appointment was accepted and became effective May 1, 2006.

At March 31, 2006, the SAR Account balance was $57.9 million (consisting of $44.8 million of Timber Notes held in the SAR Account and $13.1 million in cash), all of which is restricted for future principal payments on the Timber Notes. Such cash is sufficient to cover Scheduled Amortization in 2006, but will not be sufficient to cover the Scheduled Amortization on the January 20, 2007, Timber Notes payment date and beyond. Accordingly, ScoPac's ability to make 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.

Letters of Credit

As a result of 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 to satisfy certain liability insurance policy requirements.

5. Income Taxes

The Company generated a loss before income taxes of $10.2 million for the first quarter of 2006; however, the Company has not recorded any tax provision or benefit during this period as the Company anticipates an effective tax rate of zero for the year ended December 31, 2006. Each period, the Company evaluates appropriate factors in determining the realizability of the deferred tax assets attributable to losses and credits generated in that period and those being carried forward. Based on this evaluation, the Company provided valuation allowances with respect to the deferred tax assets attributable to the losses and credits generated during the three months ended March 31, 2006. These valuation allowances were in addition to the valuation allowances which were provided in prior years.

6. Employee Benefit Plans

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

	Pension Benefits		Medical/Life	
	Three Months Ended March 31,			
	2006	2005	2006	2005
Components of net periodic benefit costs:				
Service cost	$ –	$ 0.9	$ 0.1	$ 0.1
Interest cost	1.3	1.4	0.1	0.2
Expected return on assets	(1.4)	(1.3)	–	–
Amortization of prior service costs	–	–	–	(0.1)
Recognized net actuarial loss	0.1	0.2	–	–
Net periodic benefit costs	$ –	$ 1.2	$ 0.2	$ 0.2

7. Regulatory and Environmental Factors and Contingencies

Regulatory and Environmental Factors

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 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 would not exceed the average annual growth level at the end of the 100-year planning period. These regulations 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, although an appellate court reversed that decision in December 2005. As a result of an earlier stay order 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 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 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 EPA and the North Coast Water Board to establish TMDLs in watercourses that have been declared to be water quality impaired; actions by the North Coast Water Board to impose waste discharge reporting requirements in respect of watersheds on the 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 Palco

Timberlands. 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 is in 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 Palco Timberlands may require aquatic protection measures that are different from or in addition to those in the HCP or that result from the prescriptions to be developed pursuant to the watershed analysis process provided for in the HCP.

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 to 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 the Elk River Orders, which are aimed at addressing existing sediment production sites through clean up actions. The North Coast Water Board has also initiated the process that 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 Orders have resulted in increased costs to Palco that could extend over a number of years. Additional orders for other watersheds (should they be issued) may also result in further cost increases.

The North Coast Water Board in December 2003 directed its staff to formulate WWDRs for the Freshwater and Elk River watersheds on the Palco Timberlands. As harvesting activities on the Palco Timberlands 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.

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 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 issued the 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 had 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 May 8, 2006, the North Coast Water Board adopted WWDR's for the Freshwater and Elk River watersheds, which action has the effect of allowing harvesting in these two watersheds to begin once THPs are released by the Executive Officer of the North Coast Water Board. There can be no assurance that the THPs related to these two watersheds will ultimately be released or harvested as planned in 2006 or that the action of the North Coast Water Board will not be appealed to the State Water Board. While ScoPac continues to project that its annual harvest level over the ten-year period beginning 2006 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 July 14, 2005, Palco and ScoPac filed the *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 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. The Court issued a ruling on April 27, 2006, granting Palco's writ, thus requiring the State Water Board to set aside its June 16, 2005 order. The Court remanded the matter to the State Water Board to reconsider whether the North Coast Water Board's enrollment of additional THPs was proper. Further proceedings before the State Board have yet to be scheduled. A hearing on whether to stay the North Coast Water Board's enrollments until the State Water Board reconsiders the merits of the enrollments is currently scheduled for May 15, 2006.

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 Palco Timberlands 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.

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

Various 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, the *EPIC-SYP/Permits lawsuit* was filed. 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. A similar action, the *USWA lawsuit*, was filed on the same day, and the two actions 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. On December 12, 2005, an appellate court reversed the trial court's decision invalidating the SYP. The plaintiffs have appealed the appellate court's decision to the California Supreme Court, which has indicated it will review the matter. The defendants' appeal of the trial court's award of attorneys' fees and expenses is still pending at the appellate court. There can be no assurance that this appeal will be successful.

In July 2001, the *Bear Creek lawsuit* was filed and later amended to add the EPA as a defendant. The lawsuit alleges that harvesting and other forestry activities under certain of 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 grounds 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. On April 28, 2006, the Court denied both motions and the litigation is proceeding.

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 Palco Timberlands 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, the *Cook action* and the *Cave action* were filed, which 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, the *Johnson action* was filed 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 the *Humboldt DA action*. The suit was filed under California's unfair competition law and alleges that the Palco Companies used certain unfair business practices in connection with completion of the Headwaters Agreement, and that this resulted in 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 and prior rulings of the Court substantially diminished the exposure of the Palco Companies with respect to this matter.

In December 2005, Palco and ScoPac filed the *California Headwaters action*. The *California Headwaters action* 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 *California Headwaters action* 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 *California Headwaters action* is by operation of law treated as having been denied, and Palco and ScoPac 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 OTS initiated the *OTS action* against the Company and others alleging, among other things, misconduct by the Respondents and others with respect to the failure of USAT. The OTS sought damages ranging from $326.6 million to $821.3 million under various theories. Following 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, the *FDIC action*, alleging damages in excess of $250 million, was subsequently dismissed. The *FDIC action* was originally filed by the FDIC in August 1995 against Mr. Charles E. Hurwitz (Chairman and Chief Executive Officer of the Company).

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

Circuit Court of Appeals. The U.S. District Court award has not been accrued as of December 31, 2005 or March 31, 2006. There can be no assurance that the Company will ultimately collect this award.

On January 16, 2001, the *Kahn lawsuit* was filed. The plaintiff purports to bring this action as a stockholder of the Company derivatively on behalf of the Company. The lawsuit concerns the *OTS* and *FDIC actions*, and the Company's advancement of fees and expenses on behalf of Federated and certain of the Company's directors in connection with these actions. It alleges that the defendants have breached their fiduciary duties to the Company, and 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 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 and MGI entered into an amendment to the Administrative Consent Order substituting the new owner for the original property owner. MGI 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.

8. Stock-Based Compensation Plans

Under the Company's share-based compensation plans, stock options and similar instruments may be granted to employees and outside directors at no less than the fair market value of the Company's Common Stock on the date of grant. Grants generally vest ratably over a five-year period for grants to employees and over a four-year period for grants to outside directors and expire ten years after the grant date. Grants have generally been settled in cash upon exercise.

Grants issued to employees and outside directors were previously accounted for under the intrinsic value method of accounting as defined by APB Opinion No. 25 and related interpretations. Effective January 1, 2006, the Company prospectively adopted the fair value based method of accounting for stock-based employee compensation as prescribed by SFAS No. 123(r) and recognized a $0.7 million charge in January 2006, representing the cumulative effect of the accounting change.

The fair value of grants is determined using a Black-Scholes option-pricing model. The following assumptions apply to the options granted through the periods presented.

	Three Months Ended March 31,	
	2006	2005
Expected volatility	38%	40%
Expected dividends	–	–
Expected term (in years)	6.44	6.63
Risk-free rate	4.82%	4.18%

Expected volatilities are based on historical volatility of the Company's Common Stock. The dividend yield on the Company's Common Stock is assumed to be zero since the Company has not paid dividends in the past five years and has no current plans to do so in the future. The Company uses historical experience regarding exercises of grants to determine the grants' expected term. The expected term represents the period of time that the options granted are expected to remain outstanding. The risk-free interest rate is based on the U.S. Treasury yield curve in effect for the expected term of the option at the reporting date.

A summary of activity under the Company's plans as of March 31, 2006 is presented below:

	Balance at March 31, 2006	
	Outstanding	Exercisable
Grants	1,114,306	696,154
Weighted average exercise price	$ 25.06	$ 26.05
Weighted average remaining contractual term (years)	6.06	4.92
Aggregate intrinsic value (amount in millions)	$ 11.7	$ 7.7

No grants were issued, exercised, forfeited or expired during the three months ended March 31, 2006. Total compensation cost for share-based payment arrangements recognized in income for the three months ended March 31, 2006 was ($1.2) million. Total compensation related to non-vested grants not yet recognized is $7.3 million and the weighted average period over which it is expected to be recognized is 1.8 years as of March 31, 2006. There can be no assurance that the Company will be obligated to pay the non-vested grants.

The following table illustrates the pro forma effect on net loss and loss per share for the three months ended March 31, 2005, had the Company accounted for its grants under the fair value method of accounting (in millions, except per share information).

	Three Months Ended March 31, 2005
Net loss, as reported	$ (14.2)
Add: Non-cash stock-based employee compensation benefit included in reported net loss, net of related tax effects	(1.6)
Deduct: Total stock-based employee compensation benefit determined under the fair value method for all awards, net of related tax effects	1.7
Pro forma loss	$ (14.1)
Basic and diluted loss per share:	
As reported	$ (2.38)
Pro forma loss	(2.35)

9. Per Share Information

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

	Three Months Ended March 31,	
	2006	2005
Weighted average shares outstanding:		
Common Stock	5,967,942	5,976,530
Effect of dilution:		
Class A Preferred Stock [1]	–	–
Weighted average number of common and common equivalent shares - Basic	5,967,942	5,976,530
Effect of dilution:		
Stock options [1]	–	–
Weighted average number of common and common equivalent shares - Diluted	5,967,942	5,976,530

[1] The Class A Preferred Stock and options were not included in the computation of basic or diluted earnings per share because the Company had a loss for the three months ended March 31, 2006 and 2005, respectively.

10. Comprehensive Loss

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

	Three Months Ended March 31,	
	2006	2005
Net loss:	$ (10.2)	$ (14.2)
Other comprehensive loss:		
Unrealized gain (loss) on available-for-sale investments	0.2	(0.1)
Total comprehensive loss	$ (10.0)	$ (14.3)

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

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

This Quarterly Report on Form 10-Q contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. These statements appear in a number of places in this section and in Part II, Item 1 "Legal Proceedings." Such statements can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "estimates," "will," "should," "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, new or modified statutory, environmental or regulatory requirements, litigation developments, and changing prices and market conditions. This Form 10-Q and the Form 10-K identify other factors which could cause differences between such forward-looking statements and actual results. No assurance can be given that these are all of the factors that could cause actual results to vary materially from the forward-looking statements.

Results of Operations

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

The Company 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 undergoing Chapter 11 reorganization. See Note 1 for information regarding the deconsolidation of Kaiser's financial results, the status of Kaiser's Chapter 11 proceedings, and the accounting treatment of the Company's investment in Kaiser. 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 periods indicated for the Company's consolidated operations.

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Net sales	$ 80.2	$ 83.0
Costs and expenses	(73.9)	(80.2)
Operating income	6.3	2.8
Other income, net	4.4	1.2
Interest expense	(20.2)	(18.2)
Loss before income taxes and cumulative effect of accounting change	$ (9.5)	$ (14.2)

Overview of Consolidated Results of Operations

Net Sales

Consolidated net sales for the three months ended March 31, 2006, declined $2.8 million, as compared to the comparable period in the prior year. Real estate sales increased $6.2 million during the quarter due to increased lot sales at Mirada and deferred profit recognized at Palmas, offset by a reduction in the number of lots sold at Fountain Hills. The increase in real estate sales was offset by a $9.5 million decline in sales at the Company's forest products segment primarily as a result of a 23.3% decline in lumber shipments from the prior year period.

Operating Income

Consolidated operating income for the first quarter of 2006, totaled $6.3 million compared to an operating income of $2.8 million for the same quarter in 2005. Operating income for the real estate segment increased $6.2 million, primarily as a result of increased real estate sales, as discussed above. Operating losses for the forest products segment increased $2.7 million, primarily as a result of lower sales volume during the first quarter of 2006 partially offset by lower spending due to administrative staffing reductions. The forest products segment's operating losses for the first quarter of 2005 include a one-time benefit related to a $3.1 million insurance settlement.

Other Income, net

Consolidated other income, net for the first quarter of 2006 was impacted favorably by higher returns on marketable securities and other short-term investments.

Forest Products Operations

Industry Overview and Selected Financial and Operating Data

The Company's forest products operations are conducted through MGI and its wholly owned subsidiaries, principally Palco, ScoPac and Britt. The segment's business has become increasingly unpredictable due to continued regulatory constraints, ongoing litigation challenges and other factors. Additionally, the segment's business is somewhat seasonal, with 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" and Item 1A. "Risk Factors" of the Form 10-K and Note 7 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.

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 the ScoPac 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, Timber Notes payment date.

Palco and Britt are in default under the $35.0 million Palco Term Loan and the $30.0 million asset-based Palco Revolving Credit Facility. Palco estimates that without necessary amendments to these credit agreements and sufficient additional working capital, it will have insufficient liquidity to fund anticipated cash shortfalls in 2006 and its planned 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 liquidity 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 (see "–Financial Condition and Investing and Financing Activities–Forest Products Operations") 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 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 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," and Item 3. "Legal Proceedings–Forest Products Operations" of the Form 10-K and Note 7 ("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.

Since 2001, comprehensive external and internal reviews have been conducted of Palco's business operations. Those reviews were conducted in an effort to identify ways in which Palco could operate on a more efficient and cost-effective basis. Palco has implemented a number of changes, including: consolidating its sawmill operations; 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 continues 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. Palco also completed a new 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 $28.2 million through March 31, 2006, on the new sawmill and planer project and estimates additional expenditures of $4.5 million related to the project in 2006.

The following table presents selected operational and financial information for the periods indicated, for the Company's forest products operations.

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(In millions of dollars, except shipments and prices)	
Shipments:		
Timber harvest [(1)]	14.2	33.1
Lumber: [(2)]		
Redwood upper grades	0.6	2.4
Redwood common grades	37.0	43.1
Douglas-fir upper grades	–	0.3
Douglas-fir common grades	23.1	33.0
Other	0.4	0.8
Total lumber	61.1	79.6
Cogeneration power [(3)]	27.9	40.7
Average sales price:		
Lumber: [(4)]		
Redwood upper grades	$ 1,344	$ 1,183
Redwood common grades	633	610
Douglas-fir upper grades	–	895
Douglas-fir common grades	364	367
Cogeneration power [(5)]	66	63
Net sales:		
Lumber, net of discount	$ 32.5	$ 41.4
Logs	2.0	1.5
Cogeneration power	1.9	2.6
Wood chips	0.7	1.1
Other [(6)]	0.7	0.7
Total net sales	$ 37.8	$ 47.3
Operating loss	$ (5.5)	$ (2.8)
Loss before income taxes and cumulative effect of accounting change	$ (21.0)	$ (16.3)

(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) The Company realized a gain of $0.7 million on the sale of certain Palco Timberlands in the first quarter of 2006.

Net Sales

Total net sales for forest products operations decreased to $37.8 million for the first quarter of 2006, as compared to $47.3 million for the first quarter of 2005. The $9.5 million decrease in net sales was due to a 23.3% decline in lumber shipments as a result of adverse weather and a lower log supply from ScoPac during the first quarter of 2006.

Operating Income (loss)

Operating losses for forest products operations increased by $2.7 million for the first quarter of 2006, as compared to the same period in 2005, primarily due to lower sales volumes during the first quarter of 2006, partially offset by lower spending due to administrative staffing reductions. Operating losses for the first quarter of 2005 include a one-time benefit related to a $3.1 million insurance settlement.

Loss Before Income Taxes and Cumulative Effect of Accounting Change

Forest products operations' loss before income taxes and cumulative effect of accounting change increased by $4.7 million for the first quarter of 2006, as compared to the same 2005 period, primarily due to the decline in operating results discussed above and higher 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 quarterly periods for the Company's real estate operations are generally not comparable due to the timing of individual real estate sales transactions and cash collections. Accordingly, results for any one quarter are not necessarily indicative of results to be expected for the full year. The following table presents selected operational and financial information for the three months ended March 31, 2006 and 2005, for the Company's real estate operations.

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(In millions of dollars)	
Net sales:		
Real estate:		
Fountain Hills	$ 2.1	$ 6.7
Mirada	9.1	2.6
Palmas	8.6	4.6
Total	19.8	13.9
Resort, commercial and other:		
Fountain Hills	1.0	1.4
Palmas	3.4	2.9
Commercial lease properties	4.6	4.5
Other	0.2	0.1
Total	9.2	8.9
Total net sales	$ 29.0	$ 22.8
Operating income (loss):		
Fountain Hills	$ 0.4	$ 2.6
Mirada	4.8	0.8
Palmas	5.9	1.8
Commercial lease properties	2.1	1.5
Other	(0.3)	–
Total operating income	$ 12.9	$ 6.7
Investment, interest and other income (expense), net:		
Equity in earnings (losses) from real estate joint ventures	$ (0.2)	$ (0.2)
Other	1.2	0.6
	$ 1.0	$ 0.4
Income before income taxes and cumulative effect of accounting change	$ 9.5	$ 2.7

Net Sales

Total net sales for the real estate operations for the first quarter of 2006 increased by $6.2 million, as compared to the same period in 2005, primarily due to increased lot sales at Mirada and deferred profit recognized at Palmas, offset by a reduction in the number of lots sold at Fountain Hills.

Operating Income and Income Before Income Taxes and Cumulative Effect of Accounting Change

Operating income increased by $6.2 million for the first quarter of 2006 as compared to the same period of 2005, primarily as a result of the increased sales noted above. The segment's income before income taxes and cumulative effect of accounting change increased by $6.8 million for the first quarter 2006, as compared to the same period in 2005, primarily due to improved the operating results noted above.

Racing Operations

Industry Overview and Selected Operational Data

The Company owns SHRP, Ltd., which owns and operates Sam Houston Race Park, a Class 1 horse racing facility in Houston, Texas, and Valley Race Park, a greyhound racing facility located in Harlingen, Texas. Results of operations between quarterly periods are generally not comparable for these facilities due to the timing, varying lengths and types of racing meets held. Accordingly, results for any one quarter are not necessarily indicative of results to be expected for the full year. 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 first quarter ended March 31, 2006 and 2005, for the Company's racing operations.

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(In millions of dollars)	
Number of live race days:		
Sam Houston Race Park	42	42
Valley Race Park	62	63
Handle:		
Sam Houston Race Park:		
On-track handle	$ 33.1	$ 31.8
Off-track handle	77.1	73.1
Total	$ 110.2	$ 104.9
Valley Race Park:		
On-track handle	$ 5.9	$ 5.6
Off-track handle	2.4	1.5
Total	$ 8.3	$ 7.1
Net sales:		
Sam Houston Race Park:		
Gross pari-mutuel commissions	$ 9.5	$ 9.2
Other revenues	2.0	1.9
Total	11.5	11.1
Valley Race Park:		
Gross pari-mutuel commissions	1.5	1.4
Other revenues	0.4	0.4
Total	1.9	1.8
Total net sales	$ 13.4	$ 12.9
Operating loss:		
Sam Houston Race Park	$ –	$ –
Valley Race Park	(0.1)	(0.2)
Total operating loss	$ (0.1)	$ (0.2)
Loss before income taxes and cumulative effect of accounting change	$ (0.1)	$ (0.2)

Net Sales

Total net sales for racing operations increased slightly in the first quarter 2006 compared to the prior year period, principally due to increased average daily attendance at both Sam Houston Race Park and Valley Race Park improved slightly.

Operating Loss and Loss Before Taxes and Cumulative Effect of Accounting Change

Racing operations' operating loss and loss before taxes and cumulative effect of accounting change for the first quarter of 2006 improved slightly from the comparable period in 2005, principally due to the higher net sales noted above.

Other Items Not Directly Related to Industry Segments

	Three Months Ended March 31,	
	2006	**2005**
	(In millions of dollars)	
Operating loss	$ (1.0)	$ (0.9)
Income (loss) before cumulative effect of accounting change	2.1	(0.4)

Operating Loss

Corporate operating losses represent general and administrative expenses that are not attributable to the Company's industry segments. The first quarter of 2005 included a non-recurring severance expense of $0.5 million and an additional $0.4 million credit for stock-based compensation than in the first quarter of 2006.

Income (Loss) Before Income Taxes and Cumulative Effect of Accounting Change

In the first quarter of 2006, the Company realized higher returns on marketable securities and other short-term investments.

Financial Condition and Investing and Financing Activities

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

Overview

The Company conducts its operations primarily through its subsidiaries. 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. 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)				
Indebtedness (excluding intercompany notes)								
Short-term borrowings and current maturities of long-term debt:								
March 31, 2006	$ 72.3 [2]	$ 47.4 [3]	$ –	$ 4.2	$ 0.1	$ –	$ –	$ 124.0
December 31, 2005	49.4	58.9	–	4.1	0.1	–	–	112.5
Long-term debt, excluding current maturities:								
March 31, 2006	$ 653.1	–	–	$ 218.8	$ 0.2	$ –	$ –	$ 872.1
December 31, 2005	669.6	$ –	$ –	219.7	0.3	–	–	889.6
Cash, cash equivalents, marketable securities and other investments and availability of lender credit								
March 31, 2006:								
Cash and cash equivalents	$ 0.7	$ 0.6	$ –	$ 33.1	$ 4.4	$ –	$ 14.9	$ 53.7
Marketable securities and other investments	1.1	–	–	29.5	–	–	119.7	150.3
Current restricted cash and marketable securities	13.1	–	2.0	2.3	0.9	–	–	18.3
Long-term restricted amounts	2.5	2.4	–	3.0	–	–	–	7.9
	$ 17.4	$ 3.0	$ 2.0	$ 67.9	$ 5.3	$ –	$ 134.6	$ 230.2
Unused and available credit	4.5	–	–	1.2	–	–	–	5.7
	$ 21.9 [1]	$ 3.0	$ 2.0	$ 69.1	$ 5.3	$ –	$ 134.6	$ 235.9

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:								
March 31, 2006	$ 1.1	$ 0.4	$ –	$ 0.2	$ 0.1	$ –	$ –	$ 1.8
March 31, 2005	2.2	0.5	–	0.2	0.1	–	0.3	3.3
Net proceeds from dispositions of property and investments:								
March 31, 2006	$ 0.8	$ –	$ –	$ –	$ –	$ –	$ –	$ $0.8
March 31, 2005	–	–	–	–	–	–	–	–
Borrowings (repayments) of debt and credit facilities, net of financing costs:								
March 31, 2006	$ 6.3	$ (11.6)	$ –	$ (0.8)	$ (0.1)	$ –	$ –	$ ($6.2)
March 31, 2005	11.6	(1.3)	–	(1.8)	–	–	–	$8.5
Dividends, advances including interest paid and tax sharing payments received (paid):								
March 31, 2006	$ 2.4	$ 11.0	$ 2.5	$ (1.4)	$ 1.0	$ –	$ (15.5)	$ –
March 31, 2005	–	–	2.4	(2.2)	4.5	–	(4.7)	–

(1) Excludes Timber Notes held in the SAR Account that ScoPac intends to sell before the January 20, 2007, Timber Notes payment date. See Note 4.
(2) Includes outstanding borrowings under the ScoPac Line of Credit of $49.6 million and the current portion of Timber Notes Scheduled Amortization of $22.7 million.
(3) Includes outstanding borrowings under the Palco Revolving Credit Facility of $12.7 million and the Palco Term Loan of $34.6 million.

Operating Activities

Net cash used for operating activities of $10.0 million for the three months ended March 31, 2006, increased by $3.1 million as compared to the three months ended March 31, 2005. The increase is due primarily to the reduced net loss and offsetting changes in long-term assets and long-term liabilities.

Investing Activities

Net cash used for investing activities of $3.0 million for the three months ended March 31, 2006, primarily reflects net purchases of short-term investments and net proceeds from restricted cash. Net cash provided by investing activities of $7.2 million for the three months ended March 31, 2005, reflected net proceeds from restricted cash.

Financing Activities

The $6.2 million of net cash used for financing activities for the three months ended March 31, 2006, principally reflects repayments on long-term debt partially offset by additional borrowings to fund forest products operations. Net cash provided by financing activities of $8.5 million for the three months ended March 31, 2005, principally reflects additional borrowings to fund the Company's forest products operations.

MAXXAM Parent

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. There can be assurances that MAXXAM Parent's subsidiaries will have sufficient liquidity in the future to repay intercompany loans. Additionally, the Company may from time to time purchase shares of its Common Stock on national exchanges or in privately negotiated transactions.

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 March 31, 2006, MAXXAM Parent had unrestricted cash, cash equivalents and marketable securities and other investments of $134.5 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 Note 1, "–Potential Impact on Registrant and Certain Related Entities" 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. The ability to harvest ScoPac Timber 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, actions by the 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 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 WWDRs for the Freshwater and Elk River watersheds on the Palco Timberlands. As harvesting activities on the Palco Timberlands 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 "Regulatory and Environmental Factors" section of Note 7 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, which negatively impacts cash flow.

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. On May 8, 2006, the North Coast Water Board adopted WWDR's for the Freshwater and Elk River watersheds, which action has the effect of allowing harvesting in these two watersheds to begin once THPs are released by the Executive Officer of the North Coast Water Board. There can be no assurance that the THPs related to these two watersheds will ultimately be released or harvested as planned in 2006 or that the action of the North Coast Water Board will not be appealed to the State Water Board. While ScoPac continues to project that its annual harvest level over the ten-year period beginning 2006 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.

ScoPac Liquidity Update

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 Item 1A. "Risk Factors," of the Form 10-K and Note 7), 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" of the Form 10-K) 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 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.

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.

Due to regulatory constraints and adverse weather conditions during the first quarter of 2006, harvest levels were lower than planned resulting in a liquidity shortfall at ScoPac. Consequently, in January 2006 and again in April 2006, ScoPac requested and MGI approved timber purchases which provided ScoPac an aggregate of $4.4 million of additional liquidity to pay its expenses.

On the Timber Notes 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 of interest due in respect of Timber Notes held in the SAR Account). ScoPac also repaid $19.3 million of principal on the Timber Notes ($11.9 million net of principal in respect of Timber Notes held in the SAR Account), an amount equal to Scheduled Amortization, using funds held in the SAR Account.

ScoPac management estimates that its cash flows from operations, together with funds available under the ScoPac Line of Credit and other available funds, will be insufficient, by a substantial amount, to pay the entire amount of the interest due on the July 20, 2006, payment date. ScoPac also expects to incur additional interest shortfalls over at least the next several years. 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.

In an effort to address the expected shortfall on the July 20, 2006 payment date, and other future expected cash shortfalls, ScoPac has initiated the ScoPac Land Sale Program whereby ScoPac is seeking to sell certain non-timberland properties such as ranchlands and recreational areas, as well as certain timberlands. 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.

Palco Liquidity Update

Palco continues to experience liquidity shortfalls. The most recent liquidity shortfalls result primarily from a continued imbalance in the mix of log inventories, a reduction in log supply from ScoPac and operational inefficiencies related to the large log processing line at the Scotia sawmill. In the first quarter of 2006 and again in April 2006, additional liquidity was needed at Palco and Palco borrowed an aggregate of $19.0 million from MGI to meet its cash shortfalls.

As of December 31, 2005 and March 31, 2006, Palco and Britt were in default under the Palco Term Loan and the Palco Revolving Credit Facility due to financial covenant breaches. Palco estimates that, without necessary amendments to the Palco Term Loan and the Palco Revolving Credit Facility and sufficient additional working capital, it will have insufficient liquidity to fund its anticipated cash shortfalls in 2006 and its planned level of operations for the next several years. Palco is pursuing discussions with its lenders in an effort to resolve the defaults and obtain additional liquidity necessary to fund 2006 and future liquidity needs. There can be no assurance that Palco will be able to resolve the defaults and obtain additional liquidity necessary to fund future expected cash shortfalls.

In an effort to reduce its overall debt level, Palco has initiated the Palco Asset Sale Program whereby Palco is marketing certain assets, and Palco 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 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 liquidity 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 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 also have material adverse effects on the financial condition, results of operations or liquidity of the Company's forest products operations. See Note 7 for further discussion of the regulatory and environmental matters and legal proceedings affecting the Company's forest products operations.

Capital expenditures for Palco and ScoPac were $1.5 million for the first quarter of 2006 and are expected to be between $13.0 million and $14.0 million for the remainder of 2006, subject to available cash. Palco's pension funding was $0.4 million in the first quarter of 2006 and is expected to be $8.2 million for the remainder of 2006.

Real Estate Operations

Capital expenditures and real estate improvements and development costs were $2.1 million for the first quarter of 2006 and are expected to be between approximately $21.0 million to $26.0 million for the remainder of 2006, primarily for infrastructure construction obligations at Fountain Hills. The Company expects that these expenditures will be funded by cash flows from operations, 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 and investments in new ventures were $0.1 million for the first quarter of 2006 and an additional $0.2 million is expected for the remainder of 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 the first quarter of 2006, SHRP, Ltd. borrowed $1.0 million from MAXXAM Parent to 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.

Off-Balance Sheet Arrangements

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

Trends

Forest Products 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 for at least the next several years 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 or that Palco will be successful in securing sufficient additional liquidity.

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.

Racing Operations

A special session of the Texas Legislature was called in April 2006 and its next regular session will begin in January of 2007. The Company has in the past and intends to continue to vigorously pursue gaming legislation favorable to it. 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.

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. 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 concluded in March 2006 and the Company is awaiting a decision.

Contractual Obligations

There has been no material changes to the Company's contractual obligations provided in the Form 10-K.

Critical Accounting Policies and Estimates

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

New Accounting Pronouncements

See Note 2 for a discussion of new accounting pronouncements and their impact on the Company's financial statements.

ITEM 3. 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 Revolving Credit Facility and Palco Term Loan, as well as certain other debt facilities used to finance real estate development activities. As of March 31, 2006, there were $96.9 million in borrowings outstanding under all variable rate facilities. Based on the amount of borrowings outstanding under these facilities during the three months ended March 31, 2006, a 1.0% change in interest rates effective from the beginning of the year would have resulted in an increase or decrease in interest expense for the period of $0.2 million.

ITEM 4. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief

Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, the Company has investments in certain unconsolidated entities. As the Company does not control or manage these entities, its disclosure controls and procedures with respect to such entities are necessarily substantially more limited than those it maintains with respect to its consolidated subsidiaries.

As of the end of the period covered by this report, our management carried out an evaluation, under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on the evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of March 31, 2006.

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth in Note 7 is incorporated herein by reference.

ITEM 1A. RISK FACTORS

Part I, Item 1A of the Company's Form 10-K contains important risk factors that could cause the Company's actual results to differ materially from those projected in any forward-looking statement. The Company has amended and restated the first item under "Risk Factors–Risks Related to Forest Products Regulatory Matters" to read as follows:

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 staff of the North Coast Water Board has adopted WWDRs for the Freshwater and Elk River watersheds, which action has the effect of allowing harvesting in these two watersheds to begin once THPs are released by the Executive Officer of the North Coast Water Board. There can be no assurance that the THPs related to these two watersheds will ultimately be released or harvested as planned in 2006 or that the action of the North Coast Water Board will not be appealed to the State Water Board. If there are further delays in the release of these THPs, there could be a further significant adverse impact on current and future harvest levels and the cash flows of both Palco and ScoPac.

- The final TMDL requirements applicable to the Palco Timberlands 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 Palco Timberlands. 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 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.

This risk factor and those set forth in the Form 10-K do not represent a comprehensive list of factors that could cause our results to differ from those that are currently anticipated and should be read together with the risk factors set forth in the Form 10-K and in the Company's other filings with the Securities and Exchange Commission.

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

The Company may from time to time purchase shares of its Common Stock on national exchanges or in privately negotiated transaction.

ITEM 6. EXHIBITS

a. Exhibits:

* 31.1 Section 302 Certification of Chief Executive Officer

* 31.2 Section 302 Certification of Chief Financial Officer

* 32.1 Section 906 Certification of Chief Executive Officer

* 32.2 Section 906 Certification of Chief Financial Officer

* Included with this filing

SIGNATURES

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

MAXXAM INC.

Date: May 10, 2006

By: /S/ JOHN H. KARNES
John H. Karnes
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

Date: May 10, 2006

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

APPENDIX A

Glossary of Defined Terms

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

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

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

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 Headwaters Action: The claim filed by Palco and ScoPac with the Claims Board against the North Coast Water Board, the State Water Board and the State of California (Claim No. G558159) alleging that the defendants have substantially impaired their contractual and legal rights under the Headwaters Agreement

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

Claims Board: The California Victim Compensation and Government Claims Board

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

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

Company: MAXXAM Inc., including its subsidiaries

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

CWA: Federal Clean Water Act

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

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)

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

FASB: Financial Accounting Standards Board

FDIC: Federal Deposit Insurance Corporation

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

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

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

Form 10-K: Annual Report on Form 10-K of the Company for the fiscal year ended December 31, 2005

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

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

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

Indenture: The indenture governing the Timber Notes

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

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

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

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

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

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

NJDEP: New Jersey Department of Environmental Protection

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

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

Palco Companies: Palco, ScoPac and Salmon Creek, collectively

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

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

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

PSLRA: Private Securities Litigation Reform Act of 1995

Racing Commission: Texas Racing Commission

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

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

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

SFAS: Statement of Financial Accounting Standards

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 Water Board: California State Water Resources Control Board

State Water Board action: An action entitled *The Pacific Lumber Company and Scotia Pacific Company LLC v. State Water Resources Control Board, at al.* (No. CV050516) in Humboldt County Superior Court appealing the State Water Board Order

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

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

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

Trustee: The trustee under the 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

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

WWDRs: Watershed-wide discharge requirements