

GEORGIA PACIFIC CORP
Form 10-Q
October 28, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended October 2, 2004

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
Commission File Number 1-3506

GEORGIA-PACIFIC CORPORATION

(Exact name of registrant as specified in its charter)

Georgia
(State or other jurisdiction of
incorporation or organization)

93-0432081
(I.R.S. Employer
Identification Number)

133 Peachtree Street, N.E.,
Atlanta, Georgia 30303

(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (404) 652-4000

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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 an accelerated filer (as defined in Rule 12b-2 of the Act). Yes

No "

As of the close of business on October 25, 2004, Georgia-Pacific Corporation had 258,068,006 shares of Georgia-Pacific Common Stock outstanding.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
Georgia-Pacific Corporation and Subsidiaries

| (In millions, except per share amounts) | Third Quarter | | First Nine Months | |
|--|---------------|---------|-------------------|----------|
| | 2004 | 2003 | 2004 | 2003 |
| Net sales | \$4,741 | \$5,125 | \$15,151 | \$14,446 |
| Costs and expenses: | | | | |
| Cost of sales | 3,511 | 3,966 | 11,369 | 11,334 |
| Selling and distribution | 257 | 326 | 919 | 952 |
| Depreciation, amortization and accretion | 231 | 242 | 711 | 728 |
| General and administrative | 212 | 211 | 656 | 609 |
| Interest, net | 167 | 200 | 542 | 606 |
| Other income, net | (8) | (101) | (9) | (39) |
| Total costs and expenses | 4,370 | 4,844 | 14,188 | 14,190 |

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| | | | | |
|---|-----|-----|-----|-----|
| Income from continuing operations before income taxes | 371 | 281 | 963 | 256 |
| Provision for income taxes | 132 | 97 | 352 | 69 |

| | | | | |
|--|-----|-----|-----|-----|
| Income from continuing operations | 239 | 184 | 611 | 187 |
| Income (loss) from discontinued operations, net of taxes | 1 | 8 | (4) | 8 |

| | | | | |
|--|-----|-----|-----|-----|
| Income before accounting change | 240 | 192 | 607 | 195 |
| Cumulative effect of accounting change, net of taxes | -- | -- | -- | 28 |

| | | | | |
|------------|-------|-------|-------|-------|
| Net income | \$240 | \$192 | \$607 | \$223 |
|------------|-------|-------|-------|-------|

| | | | | |
|------------------|---------|---------|---------|---------|
| Basic per share: | | | | |
| | \$ 0.93 | \$ 0.74 | \$ 2.40 | \$ 0.75 |
| | 0.01 | 0.03 | (0.02) | 0.03 |

| | | | | |
|--|--|--|--|--|
| Income from continuing operations | | | | |
| Income (loss) from discontinued operations, net of taxes | | | | |

| | | | | |
|--|---------|---------|---------|---------|
| Income before accounting change | \$ 0.94 | \$ 0.77 | \$ 2.38 | \$ 0.78 |
| Cumulative effect of accounting change, net of taxes | -- | -- | -- | 0.11 |

| | | | | |
|------------|---------|---------|---------|---------|
| Net income | \$ 0.94 | \$ 0.77 | \$ 2.38 | \$ 0.89 |
|------------|---------|---------|---------|---------|

| | | | | |
|--------------------|---------|---------|---------|---------|
| Diluted per share: | | | | |
| | \$ 0.91 | \$ 0.73 | \$ 2.33 | \$ 0.75 |
| | -- | 0.03 | (0.02) | 0.03 |

| | | | | |
|--|--|--|--|--|
| Income from continuing operations | | | | |
| Income (loss) from discontinued operations, net of taxes | | | | |

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| | | | | |
|--|---------|---------|--------|---------|
| Income before accounting change | \$ 0.91 | \$ 0.76 | \$2.31 | \$ 0.78 |
| Cumulative effect of accounting change, net of taxes | -- | -- | -- | 0.11 |

| | | | | |
|------------|---------|---------|---------|---------|
| Net income | \$ 0.91 | \$ 0.76 | \$ 2.31 | \$ 0.89 |
|------------|---------|---------|---------|---------|

| | | | | |
|-------------------------------------|-------|-------|-------|-------|
| Shares (denominator): | | | | |
| Weighted average shares outstanding | 256.0 | 250.2 | 254.9 | 250.1 |
| Dilutive securities: | | | | |
| Options and restricted stock | 7.2 | 2.1 | 7.5 | 0.7 |

| | | | | |
|---------------------------|-------|-------|-------|-------|
| Total assuming conversion | 263.2 | 252.3 | 262.4 | 250.8 |
|---------------------------|-------|-------|-------|-------|

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
Georgia-Pacific Corporation and Subsidiaries

| (In millions, except per share amount) | First Nine Months | |
|--|-------------------|--------|
| | 2004 | 2003 |
| Cash flows from operating activities | \$ 607 | \$ 223 |
| Net income | | |
| Adjustments to reconcile net income to cash provided by operations (excluding the effect of dispositions): | -- | (28) |
| Cumulative effect of accounting changes, net of taxes | (14) | (39) |
| Other income, net | 724 | 783 |
| Depreciation, amortization and accretion | 132 | (67) |
| Deferred income taxes | (481) | (282) |
| Increase in receivables | (67) | 27 |
| (Increase) decrease in inventories | 208 | 74 |
| Increase in accounts payable | 40 | 5 |
| Change in other working capital | (38) | 333 |
| | (203) | 116 |

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| | | |
|---|----------------|---------------|
| Change in taxes payable/receivable | 31 | 37 |
| Change in other assets and other long-term liabilities | | |
| Other | | |
| Cash provided by operations | 939 | 1,182 |
| Cash flows from investing activities | | |
| | (448) | (480) |
| | (23) | (2) |
| Property, plant and equipment investments | 1,416 | 27 |
| Acquisitions | (14) | (14) |
| Net proceeds from sales of assets | | |
| Other | | |
| Cash provided by (used for) investing activities | 931 | (469) |
| Cash flows from financing activities | | |
| | (5,270) | (6,318) |
| | 3,919 | 5,680 |
| Repayments of long-term debt | (14) | (48) |
| Additions to long-term debt | (35) | -- |
| Fees paid to issue debt | (15) | (54) |
| Fees paid to retire debt | (303) | 190 |
| Net decrease in bank overdrafts | 53 | 4 |
| Net (decrease) increase in short-term debt | (97) | (94) |
| Proceeds from option plan exercises | | |
| Cash dividends paid (\$0.375 per share) | | |
| Cash used for financing activities | (1,762) | (640) |
| Increase in cash | 108 | 73 |
| Balance at beginning of period | 51 | 42 |
| Balance at end of period | \$ 159 | \$ 115 |

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

CONSOLIDATED BALANCE SHEETS (Unaudited)
Georgia-Pacific Corporation and Subsidiaries

| (In millions, except shares and per share amounts) | October 2, 2004 | January 3, 2004 |
|---|--------------------|--------------------|
| ASSETS | | |
| Current assets | | |
| Cash and equivalents | \$ 159 | \$ 51 |
| Receivables, less allowances of \$29 and \$36, respectively | 1,898 | 1,542 |
| Inventories | 1,793 | 1,848 |
| Deferred income tax assets | 125 | 117 |
| Assets held for sale | -- | 739 |

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| | | |
|---|------------------|------------------|
| Other current assets | 362 | 301 |
| Total current assets | 4,337 | 4,598 |
| Property, plant and equipment | | |
| Land, buildings, machinery and equipment, at cost | 17,711 | 17,758 |
| Accumulated depreciation | (9,426) | (9,176) |
| Property, plant and equipment, net | 8,285 | 8,582 |
| Goodwill, net | 7,478 | 7,484 |
| Intangible assets, net | 689 | 716 |
| Assets held for sale | -- | 757 |
| Other assets | 2,216 | 2,268 |
| Total assets | \$ 23,005 | \$ 24,405 |

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CONSOLIDATED BALANCE SHEETS (Unaudited) (Continued)
Georgia-Pacific Corporation and Subsidiaries

| (In millions, except shares and per share amounts) | October 2, 2004 | January 3, 2004 |
|--|--------------------|--------------------|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities | | |
| Secured borrowings and other short-term notes | \$ 386 | \$ 689 |
| Current portion of long-term debt | 558 | 789 |
| Accounts payable | 1,506 | 1,404 |
| Accrued compensation | 287 | 244 |
| Liabilities held for sale | -- | 189 |
| Other current liabilities | 1,088 | 1,107 |
| Total current liabilities | 3,825 | 4,422 |
| Long-term debt, excluding current portion | 7,968 | 9,074 |
| Liabilities held for sale | -- | 206 |
| Other long-term liabilities | 3,534 | 3,826 |
| Deferred income tax liabilities | 1,647 | 1,483 |

Commitments and contingencies

| | | |
|---|------------------|------------------|
| Shareholders' equity | | |
| Preferred stock, no par value; 10,000,000 shares authorized; no shares issued or outstanding | -- | -- |
| Junior preferred stock, no par value; 25,000,000 shares authorized; no shares issued or outstanding | -- | -- |
| Common stock, par value \$0.80; 400,000,000 shares authorized; 256,370,000 and 252,980,000 shares issued and outstanding | 205 | 202 |
| Additional paid-in capital | 3,579 | 3,473 |
| Retained earnings | 2,106 | 1,596 |
| Long-term incentive plan deferred compensation | -- | (1) |
| Accumulated other comprehensive income | 141 | 124 |
| Total shareholders' equity | 6,031 | 5,394 |
| Total liabilities and shareholders' equity | \$ 23,005 | \$ 24,405 |

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
Georgia-Pacific Corporation and Subsidiaries

| (In millions) | Third Quarter | | First Nine Months | |
|---|---------------|---------------|-------------------|---------------|
| | 2004 | 2003 | 2004 | 2003 |
| Net income | \$ 240 | \$ 192 | \$ 607 | \$ 223 |
| Other comprehensive income (loss), net of tax: | | | | |
| Foreign currency translation adjustments | 54 | 3 | (11) | 127 |
| Derivative instruments: | | | | |
| Fair market value adjustments on derivatives | 2 | (1) | 2 | (4) |
| Reclassification adjustments for losses included in net income | -- | 2 | -- | 9 |
| Unrealized gain on securities | -- | -- | 26 | -- |
| Minimum pension liability adjustment | | | | |
| Comprehensive income | \$ 296 | \$ 196 | \$ 624 | \$ 359 |

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
GEORGIA-PACIFIC CORPORATION
October 2, 2004

1. **PRINCIPLES OF PRESENTATION AND ACCOUNTING POLICIES.** These consolidated financial statements include the accounts of Georgia-Pacific Corporation and subsidiaries. We prepared the consolidated financial statements following the requirements of the Securities and Exchange Commission ("SEC") for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP (accounting principles generally accepted in the United States of America) can be condensed or omitted. All significant intercompany balances and transactions were eliminated in consolidation.

Management is responsible for the unaudited financial statements included in this document. The financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of our financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in our audited financial statements for the fiscal year ended January 3, 2004 in our

Form 8-K filed with the SEC on May 20, 2004 reflecting our non-integrated pulp businesses as discontinued operations.

Certain 2003 amounts have been reclassified to conform with the 2004 presentation.

On May 7, 2004, we completed the sale of our non-integrated mills at Brunswick, Georgia, and New Augusta, Mississippi, as well as affiliated assets, to Koch Cellulose, LLC ("Koch") and its subsidiaries. These pulp businesses were reported as discontinued operations through the date of the sale and the related assets and liabilities were retroactively classified as held for sale in our January 3, 2004 balance sheet. We ceased depreciation of the related assets on February 26, 2004 (the date of the definitive agreement). These pulp businesses were previously reported in the bleached pulp and paper segment.

We classify certain shipping and handling costs as selling and distribution expenses. Shipping and handling costs included in selling and distribution expenses were \$66 million and \$250 million for the third quarter and first nine months of 2004, respectively, and \$104 million and

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\$300 million for the third quarter and first nine months of 2003, respectively.

Other income, net

The following amounts are included in Other income, net

| (In millions) | Third Quarter | | First Nine Months | |
|---|---------------|----------|-------------------|---------|
| | 2004 | 2003 | 2004 | 2003 |
| Asset impairments: | | | | |
| Bellingham | \$ -- | \$ -- | \$ 11 | \$ -- |
| Old Town | -- | -- | -- | 74 |
| White City | -- | 12 | -- | 12 |
| Other | -- | 1 | 2 | 8 |
| Adjustment to asbestos insurance | -- | (118) | -- | (118) |
| receivables | -- | -- | 53 | -- |
| Early extinguishment of debt | (16) | -- | (49) | (14) |
| Gain on asset sales, retirements and disposals, net | 8 | 4 | (26) | (1) |
| Other | | | | |
| Other income, net | \$ (8) | \$ (101) | \$ (9) | \$ (39) |

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Stock-Based Compensation

Effective December 29, 2002, we adopted Statement of Financial Accounting Standards ("SFAS") No. 148, *Accounting for Stock-Based Compensation--Transition and Disclosure* ("SFAS No. 148"), an amendment of SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS No. 123"). SFAS No. 148 provides alternative methods of transition to SFAS No. 123's fair value method of accounting for stock-based compensation and amends the disclosure provisions of SFAS No. 123. We utilized the prospective method in accordance with SFAS No. 148 and applied the expense recognition provisions of SFAS No. 123 to stock options awarded or modified in 2003 and thereafter. Prior to 2003, we accounted for our stock-based compensation plans under APB Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB No. 25"), and disclosed pro forma effects of the plans on net income and earnings per share as provided under SFAS No. 123. Because the fair market value on the date of grant was equal to the exercise price, no compensation expense had been recognized under APB No. 25 for stock options issued prior to 2003. Had compensation cost for the options issued prior to 2003 been determined based on the fair value at the grant dates consistent with the method of SFAS No. 123, the pro forma net income and earnings per share would have been as follows:

Third Quarter

First Nine Months

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| (In millions, except per share amounts) | 2004 | 2003 | 2004 | 2003 |
|---|--------|--------|--------|--------|
| Net income as reported | \$ 240 | \$ 192 | \$ 607 | \$ 223 |
| Less total stock-based employee compensation expense determined under the fair value based method, net of taxes | -- | (2) | (2) | (10) |
| Pro forma net income | 240 | 189 | 605 | 213 |
| Stock based employee compensation cost, net of taxes, included in the determination of net income as reported | 15 | 9 | 61 | 46 |
| Basic net income per share: | | | | |
| As reported | 0.94 | 0.77 | 2.38 | 0.89 |
| Pro forma | 0.94 | 0.76 | 2.37 | 0.85 |
| Diluted net income per share: | | | | |
| As reported | 0.91 | 0.76 | 2.31 | 0.89 |
| Pro forma | 0.91 | 0.75 | 2.31 | 0.85 |

Accounting Changes

In January 2003, the Financial Accounting Standards Board (the "FASB") released Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"). FIN 46 requires that all primary beneficiaries of Variable Interest Entities (VIE) consolidate that entity in their financial statements. FIN 46 is effective for VIEs created after January 31, 2003 and for VIEs in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to VIEs in which an enterprise holds a variable interest it acquired before February 1, 2003. In December 2003, the FASB published a revision to FIN 46 ("FIN 46R") to clarify some of the provisions of the interpretation and defer the effective date of implementation for certain entities. Under the guidance of FIN 46R, entities that do not have interests in structures that are commonly referred to as special purpose entities are required to apply the provisions of the interpretation in financials statements for periods ending after March 14, 2004. We do not have interests in special purpose entities that are not consolidated.

During the second quarter of 2004, we adopted FASB Staff Position ("FSP") FAS 106-2 ("the FSP"), *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*. The FSP provides specific guidance on how to account for the subsidy provided by the Medicare Prescription Drug, Improvement and Modernization Act of 2003 ("the Act"). The FSP provides for either retroactive application to the date of enactment or prospective application from the date of adoption. We have elected retroactive application to the date of enactment, the impact of which

was a reduction to net postretirement benefit cost of approximately \$4 million during the first nine months of 2004 and a reduction of the accumulated postretirement benefit obligation of approximately \$67 million.

2. **PROVISION FOR INCOME TAXES.** The effective tax rate in 2004 was higher than the statutory rate primarily because taxes related to the sale of our interest in a Brazilian pulp business and taxes related to the sale of our domestic pulp business, partially offset by lower international income tax rates. The effective tax rate in 2003 was lower than the statutory rate primarily because of lower international income tax rates and the first quarter reversal of approximately \$10 million of income tax contingency reserves no longer required in Europe.
3. **EARNINGS PER SHARE.** Basic earnings per share is computed based on net income and the weighted average number of common shares outstanding. Diluted earnings per share reflect the assumed issuance of common shares under long-term incentive stock option and stock purchase plans. The increase in dilutive securities during 2004 was due primarily to an increase in the number of shares potentially issuable under our performance awards. The computation of diluted earnings per share does not assume conversion or exercise of securities that would have an antidilutive effect on earnings per share.
4. **SUPPLEMENTAL DISCLOSURES -- CONSOLIDATED STATEMENTS OF CASH FLOWS.** The cash impact of interest and income taxes is reflected in the table below. The effect of foreign currency exchange rate changes on cash was not material in either period.

| (In millions) | First Nine Months | |
|---|-------------------|----------|
| | 2004 | 2003 |
| Total interest costs | \$ 552 | \$ 611 |
| Interest capitalized | (10) | (5) |
| Interest expense | \$ 542 | \$ 606 |
| Interest paid | \$ 558 | \$ 525 |
| Income tax paid (refunds received), net | \$ 308 | \$ (236) |
| Debt assumed by buyer in divestiture | \$ 73 | \$ -- |

Interest expense allocated to discontinued operations was \$5 million and \$11 million for the first nine months of 2004 and 2003, respectively.

5. **DIVESTITURES.**

Building Products Distribution

On May 7, 2004, we completed the sale of our building products distribution segment to a new company owned by Cerberus Capital Management L.P., a private investment firm, and members of the building products distribution business' management team (the buyer), for \$818 million. In addition, we received \$173 million in cash in June to settle an intercompany payable related to product sold to the building products distribution business prior to closing. This transaction resulted in a pre-tax gain of \$20 million (\$12 million after-tax gain), a portion of which was recognized in the third quarter upon final working capital settlement with the buyer. The gain is included in "Other income, net" on the statements of operations.

In addition, we entered into a six-year agreement for the building products distribution business to continue purchasing structural panels, lumber and other building products manufactured by us. This supply agreement contains substantially similar terms as the previous arrangement between our building products manufacturing and building products distribution businesses. Because our continuing involvement with this business via this supply agreement is considered significant, the building products distribution business is not permitted to be reported as a discontinued operation in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, *"Accounting for the Impairment and Disposal of Long-Lived Assets."* The building products distribution business was deemed to be held for sale and the related assets

and liabilities retroactively classified as such in our January 3, 2004 balance sheet. We ceased depreciation of the related assets on March 12, 2004 (the date of the definitive agreement).

The following are major classes of assets and liabilities for the building products distribution business that were held for sale at January 3, 2004:

BUILDING PRODUCTS DISTRIBUTION ASSETS AND LIABILITIES HELD FOR SALE
CONDENSED BALANCE SHEETS
(Unaudited)

(In millions)

| | |
|------------------------------------|---------------|
| ASSETS | |
| Current assets | \$ 571 |
| Property, plant and equipment, net | 201 |
| Total assets | \$ 772 |
| LIABILITIES: | |
| Current liabilities | \$ 126 |
| Deferred income tax liabilities | 3 |
| Total liabilities | \$ 129 |

| | |
|------------|--------|
| Net assets | \$ 643 |
|------------|--------|

Non-integrated Pulp Mills

On May 7, 2004, we completed the sale of our non-integrated mills at Brunswick, Georgia, and New Augusta, Mississippi, along with a short-line railroad, to Koch Cellulose, LLC ("Koch") and its subsidiaries for \$511 million in cash and a receivable of approximately \$9 million for working capital. In addition, Koch assumed \$73 million of indebtedness. This transaction resulted in a pre-tax gain of \$5 million and an after tax loss of \$13 million that was included in discontinued operations on the statements of operations. In October 2004, we received \$9 million in satisfaction of the working capital receivable.

These pulp businesses were reported as discontinued operations through the date of the sale and the related assets and liabilities were retroactively classified as held for sale in our January 3, 2004 balance sheet. We ceased depreciation of the related assets on February 26, 2004 (the date of the definitive agreement). These pulp businesses were previously reported in the bleached pulp and paper segment.

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The following are major classes of assets and liabilities for these discontinued operations that were held for sale at January 3, 2004:

DISCONTINUED OPERATIONS CONDENSED BALANCE SHEETS (Unaudited)

(In millions)

| | |
|------------------------------------|---------------|
| ASSETS | |
| Current assets | \$ 168 |
| Property, plant and equipment, net | 338 |
| Goodwill, net | 172 |
| Other assets | 1 |
| Total assets | \$ 679 |
| LIABILITIES: | |
| Current liabilities | \$ 63 |
| Long-term debt | 97 |
| Deferred income tax liabilities | 100 |
| Other long-term liabilities | 6 |
| Total liabilities | \$ 266 |
| Net assets | \$ 413 |

Operating results of these discontinued operations are shown below:

DISCONTINUED OPERATIONS
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

| (In millions) | Third Quarter | | First Nine Months | |
|--|---------------|--------|-------------------|--------|
| | 2004 | 2003 | 2004 | 2003 |
| Net sales | \$ -- | \$ 153 | \$ 220 | \$ 447 |
| Costs and expenses: | | | | |
| Cost of sales | 1 | 112 | 179 | 351 |
| Selling and distribution | -- | 5 | 6 | 13 |
| Depreciation, amortization and accretion | -- | 18 | 13 | 54 |
| General and administrative | -- | 3 | 4 | 9 |
| Interest, net | (3) | 4 | 5 | 11 |
| Other (income) losses, net | | 1 | (5) | 1 |
| Total costs and expenses | (2) | 143 | 202 | 439 |
| Income from discontinuing operations before income taxes | 2 | 10 | 18 | 8 |
| Provision for income taxes | 1 | 2 | 22 | -- |
| Income (loss) from discontinued operations, net of taxes | \$ 1 | \$ 8 | \$ (4) | \$ 8 |

The interest expense allocated to the discontinued operations represents the interest associated with the debt that was assumed by the buyer and interest on debt that was required to be repaid as a result of the disposal transaction.

Other Asset Sales

During the second quarter of 2004, we sold all of our interests in a Brazilian pulp business for \$71 million. This transaction resulted in a pre-tax gain of \$24 million (\$9 million after-tax gain) and was included in "Other income, net" on the statements of operations.

During the second quarter of 2004, we sold certain packaging assets and an aircraft and recognized a pre-tax gain of \$26 million (\$16 million after-tax gain). During the third quarter of 2004, we sold three hardwood lumber mills for proceeds of \$27 million and recognized a pre-tax gain of \$5 million (\$3 million after tax). These gains are included in "Other income, net" on the statements of operations.

6. ASSET IMPAIRMENT AND RESTRUCTURING.

Bellingham

In June 2004, we signed a letter of intent with the Bellingham Port Authority (the "Port") to sell our Bellingham facilities to the Port and lease back certain of those facilities. The Port will assume most of our environmental liabilities associated with the facility. In connection with this agreement, we determined that the value of the related assets were impaired. Accordingly, in the second quarter of 2004, we recorded pre-tax charges to earnings of \$11 million for asset impairments. Assuming the parties reach a formal agreement for this transaction, we expect closing to occur in the fourth quarter of 2004.

Old Town, Maine

On April 4, 2003, we announced that we would close tissue-manufacturing and converting operations at our Old Town, Maine mill. The mill's pulp and dryer operations are continuing to operate. The determination to close the tissue operations was based on excess capacity of tissue production, the mill's geographic location and high energy and fiber costs. In connection with this closure, we determined that the value of related tissue assets and certain pulp assets at this location was impaired. Accordingly, in the first quarter of 2003, we recorded a pre-tax impairment charge to earnings in the North America consumer products segment and bleached pulp and paper segment of \$25 million and \$49 million, respectively. In the third quarter of 2003, we recorded a pre-tax charge of \$7 million and \$4 million in the North American consumer products segment for related severance and business exit costs, respectively. Following the impairment charge, the carrying value of fixed assets was approximately \$75 million. The fair value of the impaired assets was determined using the present value of expected future cash flows. This impairment charge was recorded in "Other losses, net" in the accompanying consolidated statements of operations.

On May 2, 2003, the Governor of Maine announced an economic support plan that enabled us to restart one of our closed tissue machines along with eight converting lines and retain related manufacturing and support personnel. In accordance with generally accepted accounting principles, none of the impairment charge recorded in the first quarter of 2003 was reversed.

Fort James and Other

In connection with the acquisition of Fort James, we recorded liabilities totaling approximately \$78 million for employee termination costs relating to approximately 960 hourly and salaried employees. In addition, we determined that we would strategically reposition our communication papers

business to focus on faster-growing paper segments by retiring four high-cost paper machines and associated pulping facilities at our Camas, Washington mill and recorded liabilities of approximately \$26 million to exit these activities. In addition, we recorded liabilities of \$35 million primarily for lease and contract termination costs at administrative facilities that have been or will be closed in California, Connecticut, Illinois, Virginia, Wisconsin and Europe. During 2003, 2002 and 2001, approximately 940 employees were terminated and approximately \$74 million of the reserve was used to pay termination benefits. The remaining employee terminations and Camas closing activities (primarily demolition activities) are expected to be completed by the fourth quarter of 2004 due to timing of receipt of the requisite permits. The leases and contracts at the administrative facilities expire through 2012. The following table provides a rollforward of these reserves from January 3, 2004 through October 2, 2004:

| Type of Cost (In millions) | Liability Balance at January 3, 2004 | Use | Liability Balance at October 2, 2004 |
|-------------------------------|--|----------------|--|
| Employee termination | \$ 4 | \$ -- | \$ 4 |
| Facility closing costs | 30 | (10) | 20 |
| Total | \$ 34 | \$ (10) | \$ 24 |

7. **INVENTORY VALUATION.** Inventories include costs of materials, labor, and plant overhead. We use the dollar value method for computing LIFO inventories. The major components of inventories were as follows:

| (In millions) | October 2, 2004 | January 3, 2004 |
|--------------------------|--------------------|--------------------|
| Raw materials | \$ 638 | \$ 625 |
| Finished goods | 778 | 832 |
| Supplies | 503 | 489 |
| LIFO reserve | (126) | (98) |
| Total inventories | \$ 1,793 | \$ 1,848 |

8. **GOODWILL AND INTANGIBLE ASSETS.** Effective December 30, 2001, we adopted SFAS No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 141 eliminates the pooling of interests method of accounting for business combinations initiated after June 30, 2001. SFAS No. 142 requires that entities assess the fair value of the net assets underlying all acquisition-related goodwill on a reporting unit basis effective beginning in 2002. When the fair value is less than the related carrying value, entities are required to reduce the amount of goodwill. Our reporting units are: structural panels, lumber, industrial wood products, gypsum, chemical, packaging, pulp, paper, North American towel and tissue, Dixie, and international consumer products.

On May 7, 2004, we sold our non-integrated pulp mills at Brunswick, Georgia, and New Augusta, Mississippi, along with a short-line railroad to Koch. The goodwill associated with the pulp mill and the railroad was \$169 million and \$3 million, respectively, at January 3, 2004, and was included in net

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assets held for sale effective February 26, 2004 (the date of the definitive agreement)

The changes in the carrying amount of goodwill for the first nine months of 2004 are as follows:

| (In millions) | North America Consumer Products | International Consumer Products | Packaging | Building Products Manufacturing | Consolidated |
|--------------------------------------|------------------------------------|------------------------------------|-----------|------------------------------------|--------------|
| Balance as of January 3, 2004 | | \$ 987 | | | |
| Goodwill acquired during the year | \$ 5,831 | -- | \$ 630 | \$ 36 | \$ 7,484 |
| Reclassifications | -- | -- | 1 | -- | 1 |
| Foreign currency translation | 2 | -- | -- | -- | 2 |
| | -- (9) | -- | -- | -- | (9) |
| Balance as of October 2, 2004 | \$ 5,833 | \$ 978 | \$ 631 | \$ 36 | \$ 7,478 |

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Intangible Assets

The following table sets forth information for intangible assets subject to amortization:

| (In millions) | As of October 2, 2004 | | As of January 3, 2004 | |
|----------------------|--------------------------|-----------------------------|--------------------------|-----------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Trademarks | \$ 680 | \$ 58 | \$ 677 | \$ 40 |
| Patents and other | 137 | 70 | 132 | 53 |
| Total | \$ 817 | \$ 128 | \$ 809 | \$ 93 |

Aggregate Amortization

Expense:
First nine months of 2004

\$ 24
=====

Estimated Amortization
Expense:
For fiscal year 2004

\$ 29
29
20

| | |
|----------------------|----|
| For fiscal year 2005 | 20 |
| For fiscal year 2006 | 20 |
| For fiscal year 2007 | |
| For fiscal year 2008 | |

9. **ASSET RETIREMENT OBLIGATIONS.** Effective December 29, 2002, we changed our method of accounting for asset retirement obligations in accordance with SFAS No. 143. Under SFAS No. 143, we recognize asset retirement obligations in the period in which they are incurred if a reasonable estimate of the fair value can be made. When the liability is initially recorded, we capitalize the cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, we will recognize a gain or loss for any difference between the settlement amount and the liability recorded.

Our asset retirement obligations consist primarily of landfill capping and closure and post-closure costs and quarry reclamation costs. We are legally required to perform capping and closure and post-closure care on the landfills and reclamation on the quarries. In accordance with SFAS No. 143, for each landfill and quarry we recognized the fair value of a liability for an asset retirement obligation and capitalized that cost as part of the cost basis of the related asset. The related assets are being depreciated on a straight-line basis over 25-years. We have additional asset retirement obligations with indeterminate settlement dates; the fair value of these asset retirement obligations cannot be estimated due to the lack of sufficient information to estimate a range of potential settlement dates for the obligation. An asset retirement obligation related to these assets will be recognized when we know such information.

The following table describes changes to our asset retirement obligation liability:

| (In millions) | First Nine Months | |
|---|-------------------|-------|
| | 2004 | 2003 |
| Asset retirement obligation at the beginning of the year | \$ 49 | \$ 67 |
| Net transition adjustments | -- | (21) |
| Accretion expense | 3 | 3 |
| Revisions in estimated cash flow | (1) | -- |
| Payments | (1) | (1) |
| Write-offs | (1) | -- |
| Asset retirement obligation at the end of the third quarter | \$ 49 | \$ 48 |

The asset retirement obligation liability balances were as follows:

| (In millions) | October 2, 2004 | January 3, 2004 |
|---|--------------------|--------------------|
| Amounts of liability for asset retirement obligations at beginning of period | \$ 49 | \$ 46 |
| Amounts of liability for asset retirement obligations at end of period | \$ 49 | \$ 49 |

10. DEBT. Our debt decreased by \$1,736 million to \$8,912 million at October 2, 2004 from \$10,648 million at January 3, 2004. This decrease includes the effect of changes in foreign currency exchange rates of \$15 million during this time period. For the nine months ended October 2, 2004, the weighted average interest rate on our total debt, including outstanding interest rate exchange agreements, was 7.2%.

As of October 2, 2004, we had \$386 million outstanding under our \$700 million accounts receivable secured borrowing program. G-P Receivables, Inc. ("G-P Receivables") is our wholly owned subsidiary and is the special purpose entity into which some of our receivables and the receivables of participating domestic subsidiaries are sold. G-P Receivables, in turn, sells an interest in the receivables to the various banks and entities. This program is accounted for as a secured borrowing. The receivables outstanding under these programs and the corresponding debt are included as "Receivables" and "Secured borrowings and other short-term notes," respectively, in the accompanying balance sheets. As collections reduce previously pledged interests, new receivables may be pledged. G-P Receivables is a separate corporate entity and its assets will be available first and foremost to satisfy the claims of its creditors. We repurchased the receivable interest sold into the program related to the building products distribution segment and the non-integrated pulp business upon their divestiture. Those receivables were transferred to the purchasers of those businesses pursuant to the divestitures described in

Note 5. The amount of those repurchases was \$416 million and \$12 million, respectively.

On September 21, 2004, we elected to call \$250 million of our 8.25% debentures due March 1, 2023 and \$250 million of our 8.125% debentures due June 15, 2023. These debentures will be redeemed on or about October 28, 2004 using funds available under our existing credit facilities. We have classified the related debt as "Current portion of long-term debt" on the accompanying balance sheets as of October 2, 2004. In the fourth quarter of 2004, we expect to record a pretax charge of \$22 million for call premiums and to write off deferred debt issuance costs.

On July 2, 2004, we entered into a new \$2.5 billion, five-year, senior unsecured credit facility ("Senior Credit Facility") that includes a \$500 million non-amortizing term loan. This new credit facility matures July 2, 2009 and replaces a \$2.25 billion, five-year credit facility that would have matured November 3, 2005. In connection with this new facility, we recorded a pre-tax charge of approximately \$3 million to write off certain previously deferred debt issuance costs during the second quarter of 2004.

On December 11, 2003, we completed a private placement of \$500 million of 8% senior notes, due in 2024. Net proceeds from the private placement were used to pay down a portion of our five-year credit facility that would have matured in November 2005, described above. On July 1, 2004, we completed an offer to exchange these notes for new notes with substantially identical terms that are registered under the Securities Act. We paid approximately \$7 million in fees and expenses associated with these transactions. The fees are being amortized over the term of the senior notes.

On March 1, 2004, we redeemed \$243 million of our 9.875% debentures due November 1, 2021. On March 31, 2004, we also redeemed \$250 million of our 9.625% debentures due March 15, 2022. In connection with these transactions we recorded a pre-tax charge of \$26 million for call premiums and to write off deferred debt issuance costs during the first quarter of 2004. This charge for the early extinguishment of debt was included in "Other losses, net" in the accompanying statements of operations.

On April 20, 2004, we redeemed \$250 million of our 9.5% debentures due May 15, 2022. On May 6, 2004, we also redeemed \$240 million of our 9.125% debentures due July 1, 2022. In connection with these transactions, we recorded a pre-tax charge of \$24 million for call premiums and to write off deferred debt issuance costs during the second quarter of 2004. This charge for the early extinguishment of debt was included in "Other losses, net" in the accompanying statements of operations.

On April 2, 2004, we borrowed a total of \$400 million of 2.6% short-term notes which were repaid on May 7, 2004. Net proceeds from this borrowing were used to pay down a portion of our five-year credit facility that would have matured in November 2005, described above.

In connection with the sale of our non-integrated pulp mills and short-line railroad to Koch on May 7, 2004 (see

Note 5), Koch assumed \$73 million of indebtedness. In addition, we defeased an outstanding \$24 million tax-exempt bond on April 30, 2004 in order to transfer certain assets to Koch.

On July 14, 2004, Moody's Investors Service ("Moody's") upgraded our liquidity rating from SGL-3 (adequate) to SGL-2 (good). Moody's indicated that the upgrade was in response to our Senior Credit Facility that we entered into on July 2, 2004.

On May 4, 2004, Standard & Poor's Ratings Services revised its outlook on our long-term debt to 'stable' from 'negative' and affirmed its rating of BB+. Standard & Poor's Ratings Services indicated that the ratings actions reflect our improving financial profile and much better liquidity. On April 28, 2004, Fitch Ratings increased our senior unsecured long-term debt ratings to BB+ from BB and changed our rating outlook to 'stable'. Fitch Ratings indicated that this upgrade is primarily due to debt reductions resulting from expected asset sales as well as increased cash flows from operations. Additionally, on April 14, 2004, Moody's revised the outlook for our Senior Implied Ba2 debt rating to 'stable' from 'negative' citing our plans to reduce debt with proceeds from our expected asset sales.

At October 2, 2004, we had \$630 million outstanding under our new Senior Credit Facility at a weighted-average interest rate of 3.1% with a maturity date of July 2, 2009. In addition, \$559 million of borrowing capacity under this facility was committed to support outstanding letters of credit and similar instruments. Amounts outstanding under this facility are included in "Long-term debt, excluding current portion" in the accompanying consolidated balance sheets.

The amounts outstanding under our Senior Credit Facility include the following:

| (In millions) | October 2, 2004 |
|--|--------------------|
| Commitments: | |
| | \$ 2,000 |
| Revolving Loans | 500 |
| Term Loans | |
| Credit facilities available | 2,500 |
| Amounts Outstanding: | |
| | (559) |
| | (130) |
| Letters of Credit Agreements* | (500) |
| Senior Credit Facility due July 2009, average rate of 3.0% | |
| Term Loans due July 2009, average rate of 3.1% | |
| Total credit balance outstanding | (1,189) |
| Total credit available | \$ 1,311 |

* The Letters of Credit Agreements only include Standby Letters of Credit supported by the Senior Credit Facility.

Covenants in the Senior Credit Facility require a maximum leverage ratio (as defined) of 67.50% for each remaining fiscal quarter during 2004 and 65.00% thereafter, a minimum interest coverage ratio (as defined) of 2.50 to 1.00 in any quarter hereafter, and a minimum net worth (as defined) that is not less than the sum of 80% of consolidated net worth (as defined) as of the end of our fiscal year 2003 and an amount equal to 50% of consolidated net income (as defined) earned in each fiscal quarter commencing on January 4, 2004. Minimum net worth calculations follow:

| (In millions) | October 2, 2004 |
|--|--------------------|
| Adjusted Net Worth: | |
| Net worth | \$ 6,031 |
| Accumulated other comprehensive income | (141) |

Goodwill impairments --

| | |
|---|----------|
| Adjusted Net Worth | 5,890 |
| Required Net Worth: | |
| 80% of Net Worth as of January 3, 2004 | 4,216 |
| 50% of Net Income beginning first quarter 2004* | 304 |
| Required Net Worth | 4,520 |
| Adjusted Net Worth surplus | \$ 1,370 |

* Does not include quarters with net losses.

Our borrowing arrangements contain a number of financial and non-financial covenants, which restrict our activities. We were in compliance with these debt covenants as of October 2, 2004, with a leverage ratio of 60.21%, an interest coverage ratio of 3.73 to 1.00, and an adjusted net worth surplus (as defined) as shown above. In addition, certain agreements contain cross-default provisions. Our continued compliance with these restrictive covenants is dependent on a number of factors, many of which are outside of our control. Should events occur that result in noncompliance, we believe there are remedies available that are acceptable to our lenders and us.

Approximately \$62 million of our revenue bonds are supported by letters of credit that expire within one year. We have the ability and intent to refinance these revenue bonds on a long-term basis. Therefore, maturities of these obligations are reflected in accordance with their stated terms.

At October 2, 2004, we had interest rate exchange agreements (a collar) that effectively capped \$47 million of floating rate obligations to a maximum interest rate of 7.5% and established a minimum interest rate on these obligations of 5.5%. Our interest expense is unaffected by these agreements when the market interest rate falls within this range. For the nine months ended October 2, 2004, these agreements reduced interest expense by less than \$2 million. The agreements had a weighted-average maturity of approximately one

year at October 2, 2004.

The estimated fair value of our interest rate exchange agreements at October 2, 2004 was a \$2 million asset. The asset balance represents the estimated amount we would have received if these agreements were terminated on October 2, 2004. The fair value at October 2, 2004 was estimated by calculating the present value of anticipated cash flows. The discount rate used was an estimated borrowing rate for similar debt instruments with like maturities.

At October 2, 2004 we had \$1,160 million of floating rate debt outstanding, which represented approximately 13% of our total debt balance.

We currently have \$1.5 billion of debt and equity securities available for issuance under a shelf registration statement filed with the SEC in 2000.

11. **DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES.** During the third quarter of 2004, we entered into commodity swap agreements under our company-wide natural gas hedging program to reduce the risk inherent in fluctuating natural gas prices. These swap agreements are considered cash flow hedges of our natural gas purchases and differences paid and received under the swap agreements are recognized as adjustments to gas costs. These hedges are considered to be highly effective in offsetting the cash flows of our natural gas costs and therefore the changes in fair value are recorded in accumulated other comprehensive income. With each type of cash flow hedge, the settlement of the forecasted transaction will result in the reclassification into earnings of gains and losses that are reported in accumulated other comprehensive income.

At October 2, 2004, these contracts had a notional quantity 2.9 million MMBtus of natural gas and the fair market value of such contracts was an asset of \$4 million. As of October 2, 2004, \$4 million of deferred gains on these hedges included in accumulated other comprehensive income are expected to be reclassified into earnings during the next 4 months.

12. **RETIREMENT PLANS**

Defined Benefit Pension Plans

Most of our employees participate in noncontributory defined benefit pension plans. These include plans that are administered solely by us and union-administered multiemployer plans. Our funding policy for solely administered plans is based on actuarial calculations and the applicable requirements of federal law. Contributions to multiemployer plans are generally based on negotiated labor contracts.

Benefits under the majority of plans for hourly employees (including multiemployer plans) are primarily related to years of service. We have separate plans for salaried employees and officers under which benefits are primarily related to compensation and age. The officers' plan and the supplemental retirement plan for eligible executives are not funded and are nonqualified for federal income tax

purposes.

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Net periodic pension cost for our pension plans during the third quarters and first nine months of 2004 and 2003 included the following components:

| (In millions) | Third Quarter | | First Nine Months | |
|---|---------------|--------------|-------------------|---------------|
| | 2004 | 2003 | 2004 | 2003 |
| Service cost of benefits earned | \$ 34 | \$ 34 | \$ 108 | \$ 103 |
| Interest cost on projected benefit obligation | 62 | 62 | 188 | 185 |
| | (70) | (60) | (214) | (181) |
| Expected return on plan assets | 9 | 12 | 26 | 36 |
| Amortization of losses | 3 | 6 | 11 | 18 |
| Amortization of prior service cost | -- | 12 | 13 | 12 |
| Settlement and curtailment losses | 2 | 2 | 7 | 7 |
| Contributions to multiemployer pension plans | | | | |
| Net periodic pension cost | \$ 40 | \$ 68 | \$ 139 | \$ 180 |

The net periodic pension cost above includes approximately \$1 million for the third quarter of 2003 and \$1 million and \$3 million for the first nine months of 2004 and 2003, respectively, reported as discontinued operations.

Through October 2, 2004, we recognized \$139 million of pension expense. We anticipate recording an additional \$41 million of pension expense in the remainder of 2004 for a total of \$180 million, which includes settlement and curtailment losses of \$13 million related to the second-quarter 2004 sales of our building products distribution segment and our non-integrated pulp mills. The \$8 million reduction in expected expense for the year from the amount expected at the end of the second quarter is primarily related to anticipated settlement losses that were not incurred.

Through October 2, 2004, we made pension contributions of \$182 million. We presently anticipate contributing an additional \$26 million to fund our pension plans in the remainder of 2004 for a total of \$208 million for 2004.

Health Care and Life Insurance Benefits

The majority of our retiree medical plans provide prescription drug benefits that will be affected by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 ("the Act"), signed into law in December 2003. In accordance with FSP FAS 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription*

Drug, Improvement and Modernization Act of 2003, we have included the effects of the Act on our medical plans retroactively beginning in the second quarter of 2004. The reduction in our accumulated postretirement benefit obligation attributed to past service is approximately \$67 million. The impact of the subsidy on net periodic postretirement benefit cost is a reduction in the interest cost on the accumulated postretirement benefit obligation and the elimination of our requirement to amortize unrecognized gains or losses. The reduction in interest cost for the third quarter and first nine months of 2004 was approximately \$1 million and \$2 million, respectively. The required amortization for the third quarter and first nine months of 2004 would have been approximately \$1 million and \$2 million, respectively.

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Net periodic postretirement benefit cost during the third quarters and first nine months of 2004 and 2003 included the following components:

| (In millions) | Third Quarter | | First Nine Months | |
|--|---------------|-------------|-------------------|--------------|
| | 2004 | 2003 | 2004 | 2003 |
| Service cost of benefits earned | \$ 1 | \$ 1 | \$ 3 | \$ 4 |
| Interest cost on accumulated postretirement benefit obligation | 9 | 9 | 28 | 31 |
| Amortization of prior service credit | (4) | (4) | (13) | (9) |
| Amortization of unrecognized loss | - | - | 1 | - |
| Net periodic postretirement benefit cost | \$ 6 | \$ 6 | \$ 19 | \$ 26 |

Through October 2, 2004, we made contributions of \$64 million for the payment of benefits. We presently anticipate contributing an additional \$16 million for the payment of benefits from our retiree medical plans in the remainder of 2004 for a total of \$80 million for 2004.

13. **COMMITMENTS AND CONTINGENCIES.** We are involved in various legal proceedings incidental to our business and are subject to a variety of environmental and pollution control laws and regulations in all jurisdictions in which we operate. As is the case with other companies in similar industries, Georgia-Pacific faces possible liabilities, and defense costs, from actual or potential claims and legal proceedings involving a wide variety of issues.

ENVIRONMENTAL MATTERS

We are involved in environmental remediation activities at approximately 173 sites, both owned by us and owned by others, where we have been notified that we are or may be a potentially responsible party ("PRP") under the United States Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") or similar state "superfund" laws. Of the known sites in which we are involved, we estimate that approximately 43% are being investigated, approximately 21% are being remediated and approximately 36% are being monitored (an activity

that occurs after either site investigation or remediation has been completed). The ultimate costs to us for the investigation, remediation and monitoring of many of these sites cannot be predicted with certainty, due to the often unknown nature and magnitude of the pollution or the necessary cleanup, the varying costs of alternative cleanup methods, the amount of time necessary to accomplish the cleanups, the evolving nature of cleanup technologies and governmental regulations, and the inability to determine our share of multiparty cleanups or the extent to which contribution will be available from other parties, all of which factors are taken into account to the extent possible in estimating our liabilities. We have established reserves for environmental remediation costs for these sites that we believe are probable and reasonably able to be estimated. To the extent that we are aware of unasserted claims, consider them probable, and can estimate their potential costs, we include appropriate amounts in the reserves.

Based on analyses of currently available information and previous experience with respect to the cleanup of hazardous substances, we believe it is reasonably possible that costs associated with these sites may exceed current reserves by amounts that may prove insignificant or that could range, in the aggregate, up to approximately \$130 million. This estimate of the range of reasonably possible additional costs is less certain than the estimates upon which reserves are based, and in order to establish the upper limit of this range, assumptions least favorable to us among the range of reasonably possible outcomes were used. In estimating both our current reserve for environmental remediation and the possible range of additional costs, we have not assumed we will bear the entire cost of remediation of every site to the exclusion of other known PRPs who may be jointly and severally liable. The ability of other PRPs to participate has been taken into account, based generally on their financial condition and probable contribution on a per-site basis.

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Presented below is the activity in our environmental liability account for the last three fiscal years and first nine months of 2004 and 2003.

| In millions | First Nine Months | | Fiscal Year Ended | | |
|--|-------------------|--------|-------------------|--------|--------|
| | 2004 | 2003 | 2003 | 2002 | 2001 |
| Beginning balance | \$ 230 | \$ 306 | \$ 306 | \$ 318 | \$ 121 |
| Expense (income) included in earnings: | | | | | |
| Related to previously existing matters | 2 | -- | (64) | 14 | 2 |
| Related to new matters | 5 | -- | 1 | -- | 15 |
| Amounts related to acquisitions: | | | | | |
| Purchase price allocations | -- | -- | -- | -- | 207 |
| Reclassification of reserves | 7 | (3) | (4) | -- | -- |
| Payments | (5) | (6) | (9) | (26) | (27) |
| Ending balance | \$ 239 | \$ 297 | \$ 230 | \$ 306 | \$ 318 |

KALAMAZOO RIVER SUPERFUND SITE

We are currently implementing an Administrative Order by Consent ("AOC") entered into with the Michigan Department of Natural Resources and the United States Environmental Protection Agency ("United States EPA") regarding an investigation of the Kalamazoo River Superfund Site. The Kalamazoo River Superfund Site is comprised of 35 miles of the Kalamazoo River, three miles of Portage Creek and a number of operable units in the form of landfills, waste disposal areas and impoundments. We became a PRP for the site in December 1990 by signing the AOC. There are two other named PRPs at this time. The contaminant of concern is polychlorinated biphenyls ("PCBs") in the river sediments and residuals in the landfills and waste disposal areas.

A draft Remedial Investigation/Feasibility Study ("RI/FS") for the Kalamazoo River was submitted to the State of Michigan on October 30, 2000 by us and other PRPs. The draft RI/FS evaluated five remedial options ranging from no action to total dredging of the river and off-site disposal of the dredged materials. In February 2001, the PRPs, at the request of the State of Michigan, also evaluated 9 additional potential remedies. The cost for these remedial options ranges from \$0 to \$2.5 billion. The draft RI/FS recommends a remedy involving stabilization of over twenty miles of riverbank and long-term monitoring of the riverbed. The total cost for this remedy is approximately \$73 million. It is unknown over what timeframe these costs will be paid out. The United States EPA has taken over management of the RI/FS and is evaluating the proposed remedy. We cannot predict what impact or change will result from the United States EPA's assuming management of the site.

We are paying 45% of the costs for the river portion of the RI/FS investigation based on an interim allocation. This 45% interim allocation includes the share assumed by Fort James prior to its acquisition by us. Several other companies have been identified by government agencies as PRPs, and all but one is believed to be financially viable.

As part of implementing the AOC, we have investigated the closure of two disposal areas which are contaminated with PCBs. The cost to remediate one of the disposal areas, the King Highway Landfill, was approximately \$9 million. The remediation of that area is essentially complete and we are waiting for final approval of the closure from the State of Michigan. A 30-year post-closure care period will begin upon receipt of closure approval, and over that period we will make expenditures accrued for post-closure care. We are solely responsible for closure and post-closure care of the King Highway Landfill.

It is anticipated that the cost for closure of the second disposal area, the Willow Boulevard/A Site landfill, will be approximately \$8 million. The State of Michigan has drafted a new RI/FS for this landfill and we are in the process of preparing comments on that document. The new draft RI/FS evaluates the same remedies proposed by the PRPs. The decision as to the actual remedy will be made by the United States

EPA after the RI/FS is finalized, which is expected to be this year. We believe the United States EPA will require a remedy for this landfill similar to the King Highway landfill closure. It is anticipated

these costs will be paid out over the next five years, and costs for post-closure care for 30 years following certification of the closure. We are solely responsible for closure and post-closure care of the Willow Boulevard portion of the landfill, and are sharing investigation costs for the A Site portion of the landfill with Millennium Holdings on an equal basis. A final determination as to how closure and post-closure costs for the A Site will be allocated between us and Millennium Holdings has not been made; however, our share should not exceed 50%.

We have spent approximately \$34.7 million on the Kalamazoo River Superfund Site through October 2, 2004 broken down as follows:

| <u>Site</u> | <u>(in millions)</u> |
|--------------|----------------------|
| River | \$ 20.2 |
| King Highway | 9.4 |
| A Site | 2.1 |
| Willow Blvd. | <u>3.0</u> |
| | <u>\$ 34.7</u> |

All of these amounts were charged to earnings.

The reserve for the Kalamazoo River Superfund Site is based on the assumption that the bank stabilization remedy will be selected as the final remedy by the United States EPA and the State of Michigan, and that the costs of the remedy will be shared by several other PRPs.

FOX RIVER SUPERFUND SITE

The Fox River site in Wisconsin is comprised of 39 miles of the Fox River and Green Bay. The site was nominated by the United States EPA (but never finally designated) as a Superfund site due to contamination of the river by PCBs through wastewater discharged from the recycling of carbonless copy paper from 1953-1971. We became a PRP through our acquisition of Fort James.

In late July of 2003, the Wisconsin Department of Natural Resources ("WDNR") and the United States EPA issued a Record of Decision ("ROD") for Operable Units ("OU") 3, 4 and 5 of the Fox River. OU 3 is the section of the Fox River running downstream from Little Rapids to the De Pere dam, and Operable Unit 4 runs from the De Pere dam downstream to the mouth of the Fox River at Green Bay. Operable Unit 5 is Green Bay. The Fort James facility, which potentially discharged PCBs, is located in OU 4 approximately 3 miles downstream from the De Pere dam.

The ROD calls for the removal by dredging of all sediments in OUs 3 and 4 containing PCBs above one part per million. The amount of sediment estimated to contain PCBs above one part per million is 586,800 cubic yards in OU 3 and 5,880,000 cubic yards in OU 4. The ROD also calls for monitored natural recovery for OU 5. The ROD estimates the dredging remedy for OUs 3 and 4 and the monitored natural recovery for OU 5 will cost \$324 million. However, the ROD does allow for capping as an alternative remedy to dredging in certain areas of OUs 3 and 4 if capping would be less costly than dredging and provide the same level of protection as dredging. The WDNR estimated that approximately 40% of the total volume of contaminated sediments in OUs 3 and 4 would be eligible for capping based upon the capping criteria defined in the ROD. The allowance for capping in the

ROD represents a major change from the proposed remedial action plan issued by WDNR in 2001, which did not provide or allow for capping in any areas of OUs 3 and 4.

Six other companies have been identified by the governments as PRPs. Under an interim allocation agreement, we were paying 30% of costs incurred by the PRPs in analyzing and responding to all of the governmental documents which preceded the issuance of the ROD. With the issuance of the ROD, we do not anticipate that the PRPs will be engaged in any further formal remedial investigation work as a group.

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We believe that all of the PRPs are liable for some portion of the costs of remediating OUs 4 and 5, and that our ultimate liability will be less than 30% of the total estimated cost of remediating the Fox River site.

Following issuance of the ROD we analyzed its remedial provisions as well as the relevant facts impacting our potential liability. We concluded that we will be able to utilize the capping remedy to the extent permitted by the ROD. We also concluded that there are geographic limitations on our potential liability, and that we can limit our responsibility for the removal and capping of PCBs to the part of OU 4 immediately adjacent to and downstream from the Fort James facility in Green Bay, Wisconsin. We share liability for any appropriate monitoring in OU 5 with all of the PRPs. Based on these considerations we determined that we would not be required to utilize all of the reserve previously established for this site, and in December, 2003 reduced such reserve by approximately \$66 million.

We have spent approximately \$38 million from 1995 to October 2, 2004 on the Fox River site, some of which was spent by Fort James prior to its acquisition by us.

Along with another PRP, we have entered into an Administrative Order on Consent ("AOC") to prepare the remedial design for OUs 3, 4 and 5. We are presently developing a work plan for the design effort and conducted pre-design sampling in OUs 3, 4 and 5 in the summer of 2004.

In 2002, we entered into an agreement with the WDNR and the United States Fish and Wildlife Service to settle claims for natural resource damages under CERCLA, the Federal Water Pollution Control Act and state law for approximately \$12 million, and to date have paid approximately \$9 million of this amount. The agreement was entered by the Federal District Court in Wisconsin on March 19, 2004 and is now effective. The \$12 million to be paid under this agreement is separate and apart from any costs related to remediation of the Fox River site.

In 1999 we and Chesapeake Corporation formed a joint venture to which a Chesapeake subsidiary, Wisconsin Tissue Mills, Inc., contributed tissue mills and other assets located along the Fox River. Wisconsin Tissue is one of the PRPs for the Fox River site. Chesapeake and Wisconsin Tissue specifically retained all liabilities arising from Wisconsin Tissue's status as a PRP, and indemnified

the joint venture and us against these liabilities. In 2001, we (having acquired all of Chesapeake's interest) sold this joint venture to Svenska Cellulosa Aktiebolaget (publ) ("SCA") and indemnified SCA and the joint venture against all environmental liabilities (including all liabilities arising from the Fox River site for which Wisconsin Tissue is ultimately responsible) arising prior to the closing of the SCA sale. As part of the agreement pursuant to which we acquired Chesapeake's interest in the joint venture, Chesapeake specifically agreed that we would retain Chesapeake's prior indemnification for these liabilities.

WHATCOM WATERWAY SUPERFUND SITE

The Whatcom Waterway is a Federal channel located adjacent to our facilities in Bellingham, Washington. The State of Washington declared the Whatcom Waterway a Superfund site due to historical contamination of sediments with woody debris, phenolics and mercury. On March 6, 1995, the Washington Department of Ecology named us as a Potentially Liable Party ("PLP") in the case.

We completed an RI/FS and identified a preferred remedial alternative comprised of a combination of dredging, capping and habitat restoration with a total estimated cost of \$23 million. It is anticipated these costs will be paid out over the next 5 to 10 years. We have completed interim remedial action and habitat restoration of a portion of the site. Environmental monitoring of this portion of the site is ongoing. The reserve for the Whatcom Waterway site is based on the assumptions that the \$23 million proposed remedy involving limited dredging and capping will be selected by the State of Washington as the final remedy and that the cost of the remedy will be shared among a small group of PLPs. We have spent approximately \$4 million through October 2, 2004 on the Whatcom Waterway site, all of which was charged to earnings.

In June of 2004, we signed a letter of intent with the Bellingham Port Authority (the "Port") to sell our Bellingham facilities to the Port and lease back certain of those facilities. The Port will assume most of our environmental liabilities associated with the facility and Whatcom Waterway. Assuming the parties reach a formal agreement for this transaction, closing could occur in the fourth quarter of 2004.

OTHER

The United States EPA issued a "Finding of Violation" ("FOV") to the Company on December 4, 2003, alleging violations of certain air regulations at one of our Green Bay, Wisconsin paper mills.

The FOV alleged two types of violation, one concerning a coal-fired boiler at the plant and the other concerning certain industrial refrigeration equipment. EPA has recently informed the Company of its initial penalty calculation of \$231,000 to settle the refrigerant issues. The Company is continuing its negotiations with EPA and believes it will settle those issues for less than the EPA-calculated amount.

ASBESTOS LITIGATION

We and many other companies are defendants in suits brought in various courts around the nation by plaintiffs who allege that they have suffered personal injury as a result of exposure to asbestos-containing products. Our asbestos liabilities relate primarily to joint systems products manufactured by Bestwall Gypsum Company and our gypsum business that contained small amounts of asbestos fiber. We acquired Bestwall in 1965, and discontinued using asbestos in the manufacture of these products in 1977.

Pending Claims

These suits allege a variety of lung and other diseases based on alleged exposure to our products. In many cases, the plaintiffs are unable to demonstrate that they have suffered any compensable loss as a result of such exposure, or that any injuries they have incurred did in fact result from exposure to our products. Virtually all asbestos suits involve multiple defendants and seek money damages. We are unable to provide any meaningful disclosure about the total amount of such damages, for the following reasons:

We do not track this data in any form since we do not consider the amount of damages, if any, alleged in the initial complaint relevant in assessing our exposure to asbestos liabilities;

In the past, we estimated that less than 15% of the claims then pending against us contained any specific demand for damages, as opposed to a general demand for such damages as the plaintiff may prove at trial, or a demand which was stated as being in excess of the minimum jurisdictional limit of a particular court;

Those complaints which did contain a specific damage demand nearly always involved multiple defendants (anywhere from 30 to over 100), most of which never manufactured joint systems products. In this review, we did not identify any complaint which stated a specific demand for money damages solely from us;

Claims which did allege specific damages often alleged the same amount of damages regardless of the specific disease a plaintiff may have had. In addition, in many such cases no specific disease was alleged, and thus the damages alleged were meaningless because the ultimate settlement value of any claim is significantly influenced by the actual disease the plaintiff is able to prove; and

Because we do not track this data and do not consider the amount of damages, if any, alleged in the initial complaint relevant in assessing our exposure to asbestos liabilities, we have not updated this analysis and do not intend to do so in the future.

The following table presents information about the approximate number of our asbestos claims during the past three fiscal years and the first nine months of each of 2004 and 2003:

| | <u>First Nine Months</u> | | <u>Fiscal Year Ended</u> | | |
|------------------------------------|--------------------------|-------------|--------------------------|-------------|-------------|
| | <u>2004</u> | <u>2003</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
| Claims Filed ¹ | 22,800 | 34,100 | 39,000 | 41,700 | 39,700 |
| Claims Resolved ² | 27,300 | 35,900 | 43,500 | 35,100 | 30,900 |
| Claims Unresolved at End of Period | 59,800 | 67,000 | 64,300 | 68,800 | 62,200 |

-
- 1 Claims Filed includes all asbestos claims for which service has been received and/or a file has been opened by us and each such claim represents a plaintiff who is pursuing an asbestos claim against us.
- 2 Claims resolved include asbestos claims which have been settled or dismissed or which are in the process of being settled or dismissed based upon agreements or understandings in place with counsel for the claimants.

In addition, Fort James Corporation, one of our wholly-owned subsidiaries, currently is defending approximately 771 asbestos premises liability claims.

Asbestos Liabilities

From the commencement of this litigation through October 2, 2004, we either had settled, had dismissed or were in the process of settling a total of approximately 340,500 asbestos claims. For this same period our asbestos payments, for liability, defense and administration, before insurance recoveries and tax benefits, totaled approximately \$775 million. We generally settle asbestos claims for amounts we consider reasonable given the facts and circumstances of each claim.

In the fourth quarter of 2001, we recorded a pre-tax charge to earnings of \$350 million to cover the probable and reasonably estimable asbestos liabilities and defense costs we believed we would pay through 2011, net of expected insurance recoveries during this same period. The charge was based on projections prepared by National Economic Research Associates (NERA) and Navigant Consulting (formerly known as Peterson Consulting), nationally recognized firms with expertise in asbestos liability and insurance coverage matters, and contained many assumptions. NERA's projection of our future asbestos liabilities assumed that beginning in 2001 the number of new claims filed against us for asbestos-related injuries would decline at a fairly constant rate each year through 2011. It also assumed that we would pay about \$105 million for our asbestos liabilities and defense costs in 2002 (compared to about \$84 million in 2001), with such payments then declining at varying rates over the period through 2011.

In fact, during 2002 the number of new claims filed against us increased somewhat and our total asbestos liabilities and defense costs were approximately \$75 million more than NERA's projection had assumed. This result was due principally to higher settlement costs in 2002 for claims involving mesothelioma, which represent a very small percentage of our total asbestos claims but accounted for well over half of our total asbestos liabilities in 2002. In addition, during 2001 a number of other manufacturers of asbestos-containing products, including one of our principal competitors in the manufacture of joint systems products, filed for bankruptcy. During 2002 many plaintiff

lawyers increased their settlement demands on us, principally in mesothelioma cases, to compensate for these bankruptcies. As a result, at the end of 2002 NERA increased its original estimate of our asbestos liabilities and defense costs over the period through 2011, and extended the projection through 2012, to a total of slightly less than \$1.2 billion, before any insurance recoveries and ignoring possible tax benefits. In the fourth quarter of 2002 we recorded an additional pre-tax charge to earnings of \$315 million which, when added to amounts remaining from the charges recorded in 2001, we believed were sufficient to cover our projected asbestos liabilities and defense costs, net of expected insurance recoveries, through 2012.

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During 2003 we observed a number of developments involving our asbestos litigation, including the following:

The total number of new claims filed in 2003 was slightly below 2002 levels; the rate of such filings peaked in the third quarter and then declined sharply in the third and fourth quarters. The peak in the third quarter was due primarily to the passage of tort reform legislation in Mississippi, which became effective at the end of 2002 and which resulted in a large number of claims being filed in Mississippi by plaintiff's lawyers seeking to ensure their claims would be governed by the law in effect prior to passage of tort reform.

The United States Senate Judiciary Committee passed a bill that would establish a trust fund to pay future asbestos-related disease claims and remove such cases from federal and state courts, with industry and insurers funding the trust with payments estimated to total about \$114 billion over a 50-year period; the legislation reflected widespread concern over the inability of courts to deal fairly and efficiently with asbestos claims and the fact that 50-60% of total asbestos payments in the United States represent legal fees and related costs.

Tort reform legislation was enacted in Arkansas, Mississippi, Ohio, Texas and West Virginia, which are states that together account for a significant number of the asbestos claims pending against us; the effect of such legislation cannot be assessed yet.

For 2003, our total payments for asbestos liabilities and defense costs (before insurance and tax benefits) were \$189 million. NERA has reviewed our 2003 asbestos liability and defense cost payments and compared them to the revised estimate it made at the end of 2002. Based on this review, NERA concluded that the 2003 payments were in line with its revised estimate and that the assumptions it used in that estimate remain valid. Accordingly, the only adjustment to our asbestos reserve in 2003 was to accrue an additional amount equal to payments we anticipate making in 2013 for asbestos liabilities and defense costs, so that the reserve remains a ten-year reserve. NERA estimated this amount to be \$54 million (before insurance and tax benefits). Accordingly, in the fourth

quarter of 2003 we recorded a pre-tax charge of \$54 million to record this additional accrual. We believe that NERA's projection for 2004 through 2013 represents the best estimate of the reasonably estimable asbestos costs we will incur based upon currently available information.

Insurance

In 2001, 2002 and again in 2003, we, with advice from legal counsel and Navigant Consulting, also reviewed our existing insurance policies, analyzed publicly available information bearing on the creditworthiness of our various insurers, and employed insurance allocation methodologies which we and our advisors considered appropriate to ascertain the amount of probable insurance recoveries from our insurers for our present and future asbestos liabilities. Assumptions were made about self-insurance reserves, policy exclusions, liability caps and gaps in our coverage, the resolution of allocation issues among various layers of insurers, as well as insolvencies of certain of our insurance carriers and the continued solvency of our other insurers. Based on this analysis, Navigant Consulting projected our expected insurance recoveries for asbestos liabilities and costs over the period through 2013.

During 2003 we entered into agreements with several of our insurers to confirm amounts payable by them under applicable policies. These agreements generally provide that we will be able to recover more insurance than we had assumed when we were projecting our insurance receivables in 2001 and 2002. During 2003 we revised our insurance receivable to include recoveries under these agreements, to account for favorable negotiations and other recoveries from certain other insurers, to change our allocation methodology for remaining solvent insurers consistent with these agreements, and to reflect possible insolvencies at two of our insurers. The net effect of these changes was to increase our total insurance receivable by \$156 million during 2003. All of our available insurance is included in our insurance receivable.

The insurance receivables recorded by us do not assume any recovery from insolvent carriers, and assume that those carriers which are currently solvent will continue to be solvent. However, there can be no assurances that these assumptions will be correct. Substantially all of the insurance recoveries deemed probable are from insurance companies rated A- (excellent) or better by A.M. Best Company. No more than 33% of such insurance recoveries are from any one company, though several of the insurers are under common control.

In the fourth quarter of 2003, we sold without recourse approximately \$156 million of our insurance receivables, representing claims already paid by us to a third party, for approximately \$147 million in cash.

Key Assumptions

The analyses and projections of NERA and Navigant Consulting are based on their professional judgment. The more important assumptions in NERA's projection of the number of claims that will be filed against us include the population potentially exposed to asbestos-containing products manufactured by us, the expected occurrence of various diseases in these potentially exposed

populations, the rate at which these potentially exposed populations actually file claims, and activities of the asbestos plaintiffs bar designed to maximize its profits from such claims. The cost of settling claims is driven by these same assumptions, as well as by prevailing judicial and social environments in the jurisdictions in which claims are filed, the rulings by judges and the attitudes of juries in respect to the value of each such claim, the insolvencies of other defendants to a particular claim, and the impact of verdicts against other defendants on settlement demands against us.

Generally, NERA's projections assume:

That the number of new claims to be filed against us each year through 2013 will decline at a fairly constant rate each year beginning in 2003;

That the percentage of claims settled by us will be about three-quarters of the total number of claims resolved (whether by settlement or dismissal) each year through 2013;

That the average estimated per case settlement costs are anticipated to decrease slightly over the period through 2013; and

That the total amount paid by us in settlements, and in defense and administrative costs, will decline at varying rates over the period through 2013

Among the more important assumptions made by Navigant Consulting in projecting our future insurance recoveries are the resolution of allocation issues among various layers of insurers, the application of particular theories of recovery based on decided cases, and the continuing solvency of various insurance companies.

Given these assumptions and the uncertainties involved in each of them, our actual asbestos liabilities, defense costs and insurance recoveries could be higher or lower than those currently projected and/or recorded. However, these assumptions are only some of those contained in the NERA and Navigant Consulting projections, and all of such assumptions are only one aspect of the overall projections made by those firms. Changes in the foregoing assumptions, or others, whether from time to time or over the period covered by such projections, may or may not affect the validity of the overall projections. With the assistance of our outside advisors, we are monitoring our accrued asbestos liabilities, defense costs and insurance recoveries against these overall projections, and will make adjustments to such accruals as required by generally accepted accounting principles.

Summary of Accruals

In the fourth quarter of 2003 we recorded a net pre-tax charge to earnings of \$16 million, which when added to our existing reserves are estimated to cover the probable and reasonably estimable asbestos liabilities and defense costs we believe we will pay through 2013, net of expected

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insurance recoveries during this same period. The following table summarizes accruals to, and payments from, our reserve for our total asbestos personal injury liabilities, receipts from our insurance carriers, including the monetization of a part of such receivables in 2003 as described above, and other changes to our expected insurance receivables, for the last three fiscal years and first nine months of each of 2004 and 2003 (dollars in millions):

| | First Nine Months | | Fiscal Year End | | |
|-----------------------------|-------------------|-----------------|-----------------|-----------------|---------------|
| | 2004 | 2003 | 2003 | 2002 | 2001 |
| Asbestos Liabilities | | | | | |
| | \$ 1,027 | \$ 1,162 | \$ 1,162 | \$ 836 | \$ 136 |
| | -- | -- | 54 | 507 | 784 |
| Beginning Balance | | | (189) | (181) | (84) |
| Accruals | | | | | |
| Payments | (145) | (134) | | | |
| Ending Balance | \$ 882 | \$ 1,028 | \$ 1,027 | \$ 1,162 | \$ 836 |
| Insurance Receivable | | | | | |
| | \$ 576 | \$ 670 | \$ 670 | \$ 527 | \$ 172 |
| | -- | 118 | 156 | 192 | 421 |
| Beginning Balance | (26) | (77) | (250) | (49) | (66) |
| Accruals | | | | | |
| Receipts | | | | | |
| Ending Balance | \$ 550 | \$ 711 | \$ 576 | \$ 670 | \$ 527 |

The amounts accrued for asbestos liabilities are recorded under "Other current liabilities" and "Other long-term liabilities," and the amounts accrued for insurance receivables are reflected under "Other current assets" and "Other assets," in the accompanying consolidated balance sheets.

During the first nine months of 2004 the number of new asbestos claims filed against us decreased 33% compared to the first nine months of 2003. Our payments to settle pending asbestos cases were approximately equal to our projections for the period and equal to the amount paid in the first nine months of 2003. However, we are spending significantly more money to defend these cases than we had projected, and we expect defense costs will remain at their current level for an unknown period of time. Defense costs have increased as we have undertaken more discovery with regard to the medical condition and allegations of causation of plaintiffs. Additionally, we have taken more cases to trial. With the assistance of our outside advisors, we are monitoring the amount of future defense costs we expect to incur, and the potential impact of such costs on our settlement projections and the asbestos reserves.

There can be no assurance that our currently accrued asbestos liabilities will be sufficient to cover our payments for such liabilities and related defense costs, or that our accrued insurance recoveries will be realized, through 2013. We believe that it is reasonably possible that we will incur additional charges for our asbestos liabilities and defense costs in the future which could exceed our existing reserves, but cannot estimate such excess amount at this time. We also believe that it is reasonably possible that such excess liabilities could be material to our operating results in any given quarter or year but, based on the information available to us at present, do not believe that it is reasonably possible that such excess

liabilities would have a material adverse effect on our long-term results of operations, liquidity or consolidated financial position.

OTHER LITIGATION

In 2003, we settled a class action antitrust lawsuit filed against us and other manufacturers of containerboard. However, a significant number of plaintiffs opted out of the class and brought suit against the same defendants, making substantially the same allegations. During the first nine months of 2004, we recorded a pre-tax charge of \$11 million for the settlement of these lawsuits. We have resolved all of these opt out cases.

In August 1995, Fort James, at the time a publicly-held corporation, transferred certain assets and liabilities of its communications paper and food packaging businesses to two newly formed companies, Crown Vantage, Inc. ("CV"), (a wholly-owned subsidiary of Fort James) and CV's subsidiary Crown Paper Co. ("CP"). CP then entered into a \$350 million credit facility with certain banks and issued \$250 million face amount of senior subordinated notes. Approximately \$483 million in proceeds from these financings were transferred to Fort James in payment for the transferred assets and other consideration. CV also issued to Fort James a pay-in-kind note with a face amount of \$100 million. CV shares were then spun off to the Fort James shareholders and CV operated these businesses as a stand-alone company beginning in August 1995.

In March 2001, CP and CV filed for bankruptcy. Various creditors have alleged that the borrowings made by CP and CV, and the payments to Fort James for the assets transferred to CV and CP, caused those companies to become insolvent, and that the transfer of these assets therefore was a fraudulent conveyance. In April 2001, Fort James filed suit against CP and CV in Federal Bankruptcy Court in Oakland, California seeking a declaratory judgment that the transactions did not involve any fraudulent conveyance and that other parties and actions were the cause of the bankruptcy of CV and CP. In September 2001, CV filed suit in Federal District Court in San Francisco against Fort James asserting, among other claims, that the transactions described above constituted fraudulent conveyances and seeking unspecified damages. Early in July 2004 that court in San Francisco dismissed a number of these claims, and continued proceedings with respect to two remaining claims. The court had earlier lifted an injunction imposed by the Federal Bankruptcy Court in Oakland which prevented us from proceeding with an action we filed in Delaware that asserts that a 1998 agreement released all claims by CV and CP against Fort James. CV and CP have appealed these rulings. Fort James does not believe that any of its actions in establishing CV or CP involved a fraudulent conveyance or caused the bankruptcy of those companies, and it intends to defend itself vigorously.

Although the ultimate outcome of these and other environmental matters and legal proceedings cannot be determined with certainty, based on presently available information management believes that adequate reserves have been established for probable losses with respect thereto. Management further believes that the ultimate outcome of these and other environmental matters and legal proceedings could be material to operating results in any given quarter or year but will not have a material adverse effect on our long-term results of operations, liquidity or consolidated financial

position.

GUARANTEES AND INDEMNIFICATIONS

Georgia-Pacific is a party to contracts in which it is common for us to agree to indemnify third parties for certain liabilities that arise out of or relate to the subject matter of the contract. In some cases, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by gross negligence or willful misconduct. We cannot estimate the potential amount of future payments under these indemnities until events arise that would trigger a liability under the indemnities.

We are a 50% partner in a joint venture ("GA-MET") with Metropolitan Life Insurance Company ("Metropolitan"). GA-MET owns and operates our main office building in Atlanta, Georgia. We account for the investment in GA-MET under the equity method. At October 2, 2004, GA-MET had an outstanding mortgage loan payable to Metropolitan in the amount of \$123 million. The note bears interest at 9.5%, requires monthly payments of principal and interest through 2011, and is secured by the land and building

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owned by the joint venture. In the event of foreclosure, each partner has severally guaranteed payment of one-half of any shortfall of collateral value to the outstanding secured indebtedness. Based on present market conditions and building occupancy, the likelihood of any obligation to us with respect to this guarantee is considered remote.

Additionally, in connection with the sale of assets and the divestiture of businesses, we may agree to indemnify the buyer of the assets and related parties for certain losses or liabilities incurred by the buyer with respect to (i) the representations and warranties made by us to the buyer in connection with the sale and (ii) liabilities related to the pre-closing operations of the assets sold. Indemnities related to pre-closing operations generally include environmental liabilities, tax liabilities, and other liabilities not assumed by the buyer in the transaction.

Indemnities related to the pre-closing operations of sold assets normally do not represent additional liabilities to us, but simply serve to protect the buyer from potential liability associated with our obligations existing at the time of the sale. As with any liability, we have previously accrued for those pre-closing obligations that are considered probable and reasonably estimable. We have not accrued any additional amounts as a result of the indemnities summarized below, which result from significant asset sales and divestitures in recent years.

- SCA

-- In connection with the sale of our away-from-home tissue manufacturing assets to SCA, we agreed to indemnify SCA with respect to certain losses resulting from breaches of our representations and warranties contained in the sale agreement. We are not required to pay under this general indemnification obligation until claims against us, on a cumulative basis, exceed \$2 million. Upon exceeding this \$2 million threshold, we generally are obligated to provide indemnification for any losses in excess of \$1 million, up to a limit of \$425 million. The majority of these general indemnification obligations expired on March 2, 2003, and SCA has asserted some claims under these provisions. However, we remain subject to certain claims by SCA for various environmental claims until early 2009. Unlike our \$425 million limit on liability with respect to general claims, our liability with respect to certain environmental claims made by SCA is capped at \$850 million, less the amount of any indemnification payments previously made under our general indemnification obligations.

- Domtar Inc.

-- In connection with the sale of certain of our paper and pulp mills to Domtar, we agreed to indemnify Domtar for certain losses resulting from breaches of our representations and warranties contained in the sale agreement. We are not required to pay under this general indemnification obligation until claims against us, on a cumulative basis, exceed \$16 million. Upon exceeding this \$16 million threshold, we generally are obligated to provide indemnification for any losses in excess of \$16 million, up to a limit of \$500 million. The majority of these general indemnification obligations expired on March 31, 2003, and Domtar has asserted some claims under these provisions. However, we remain subject to certain claims by Domtar for various environmental liabilities assumed by it until mid-2011. Our liability with respect to these environmental claims is capped at \$100 million, and is subject to the \$16 million threshold discussed above.

- Plum Creek

-- In connection with the merger of our timberlands business into Plum Creek, we agreed to indemnify Plum Creek with respect to certain losses resulting from breaches of limited representations and warranties contained in the separation agreement. This indemnity generally is not capped at a maximum potential liability and does not expire, but we believe we have very limited exposure under it.

- Unisource

-- In connection with the sale of 60% of our Unisource paper distribution subsidiary to an affiliate of Bain Capital Partners, LLC, we agreed to indemnify Unisource for certain losses resulting from breaches of our representations and warranties contained in the sale agreement. We are not required to pay under this general indemnification obligation until claims against us, on a cumulative basis, exceed \$8 million. Upon exceeding this \$8 million threshold, we are generally obligated to provide indemnification for any losses in excess of \$8 million, up to a limit of \$150 million. This general indemnification obligation expires on May 2, 2005, provided that Unisource may make certain claims with respect to various (i) tax and employee benefit matters until the expiration of the applicable statute of limitations and (ii) environmental matters until late 2007.

- Norampac, Inc.

-- As part of an asset exchange with Norampac, we agreed to indemnify Norampac with respect to any losses resulting from (i) the breach of limited representations and warranties contained in the asset exchange agreement, (ii) any pre-exchange liabilities related to the exchanged facility not assumed by Norampac, and (iii) any environmental liability related to the pre-exchange operations of the exchanged facility. We are not required to pay under this general indemnification obligation until claims against us, on a cumulative basis, exceed \$500,000. Upon exceeding this threshold, we generally are obligated to provide indemnification for any losses in excess of \$500,000, up to a limit of \$10 million. The majority of these general indemnification obligations and the environmental liability indemnity expire in April 2006.

- Genessee & Wyoming Inc.

-- In connection with the sale of the assets of certain of our railroads to Genessee & Wyoming Inc. ("GWI"), we agreed to indemnify GWI for certain losses suffered as a result of our breaches of certain representations, warranties and covenants contained in the sale agreement. We are generally not required to pay under the indemnities until claims against us, on a cumulative basis, exceed \$500,000. Upon exceeding this threshold, we are generally obligated to provide indemnification for losses in excess of \$500,000, up to a limit of \$20 million for general indemnities. With respect to our environmental indemnities generally, we are obligated to provide indemnification for 80% of losses in excess of \$500,000 and GWI is responsible for the remaining 20%, up to a total cap of \$2 million. In the event environmental liabilities exceed \$2 million, we are obligated to pay 100% of any such excess up to a limit of \$15 million. The majority of these general indemnification obligations expire in June 2005, while the environmental liability indemnity expires in December 2008.

- Sale of Insurance Receivables.

-- In 2003, we sold, without recourse, approximately \$156 million of asbestos insurance receivables to a trust established for the purpose of securitizing the receivables. We have retained no interests in the trust or the receivables. According to the sale agreement, the Certificate of Claims Qualification and Qualified Payments have been transferred to the purchaser. Our continuing involvement is limited to our agreement to indemnify the trust for any losses resulting from our breach of any representation or warranty we made in agreements associated with the sale, or any claims brought by the insurance companies.

- Building Products Distribution

- In connection with the sale of our building products distribution business to Cerberus Capital Management L.P. ("Cerberus") in 2004, we agreed to indemnify Cerberus for certain losses incurred as a result of breaches of certain representations, warranties and covenants made by us contained in the sale agreement. We are generally not required to pay under the indemnities until claims against us, on a cumulative basis, exceed \$7 million. Upon exceeding this threshold, we are generally obligated to provide indemnification for losses up to an aggregate of 15 percent of the purchase price or approximately \$120 million. The majority of these indemnities expire in May 2006 while some expire in May 2010. We have also agreed to indemnify Cerberus for certain pre-closing environmental and product liability claims, without the application of deductibles or caps. Although our indemnity for these pre-closing environmental and product liability claims does not expire, we believe we

have limited exposure under this indemnity.

- Non-integrated Pulp Mills

- In May 2004, we sold our non-integrated pulp mills at Brunswick, Georgia, and New Augusta, Mississippi, to Koch Cellulose, LLC and its subsidiaries ("Koch"). In connection with the sale, we agreed to indemnify Koch for certain losses incurred as a result of breaches of certain representations, warranties and covenants made by us contained in the sale agreement. Additionally, we agreed to indemnify Koch for any losses related to pre-closing environmental liabilities. The environmental liability indemnity is subject to a deductible of \$5 million and limited to a cap of \$75 million. The indemnity expires in May 2011. The indemnities related to our representations, warranties and covenants are subject to a deductible of \$2 million and a cap of \$225 million. Most of these indemnities have terms ranging from 18 months to 10 years after the closing date and certain of such indemnities have no expiration date, however we believe exposure to the latter indemnities is limited.

We do not believe that any amounts that we may be required to pay under the indemnities set forth in the agreements relating to the divestitures summarized above will be material to our results of operations, financial position, or liquidity. We will accrue a liability related to a specific indemnity when future payment is probable and the amount is reasonably estimable.

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14. CONDENSED CONSOLIDATING INFORMATION Fort James is an issuer of certain securities registered under the Securities Act of 1933, thus subjecting it to reporting requirements under Section 15(d) of the Securities Exchange Act of 1934. Fort James guaranteed our \$500 million and \$1.5 billion senior notes offerings (see

Note 10), which were completed on June 3, 2003 and January 30, 2003, respectively. Fort James Operating Company, a subsidiary of Fort James, guarantees the \$500 million senior notes and the securities issued by Fort James. Similarly, certain of our domestic subsidiaries guarantee our Senior Credit Facility. Each subsidiary issuer or subsidiary guarantor is 100% owned by us and all guarantees are full and unconditional.

Included in Other Non-Guarantor Subsidiaries is our wholly owned subsidiary G-P Receivables, a special purpose entity into which some of our receivables and the receivables of participating domestic subsidiaries are sold. G-P Receivables bought these receivables at a significant discount during the first nine months of 2004 resulting in G-P Receivables recognizing a credit to general and administrative expense of \$581 million, and the Corporation, Fort James Guarantor Subsidiary, and Other Non-Guarantor Subsidiaries recognizing a corresponding charge to general and administrative expense of \$522 million, \$5 million and \$53 million, respectively. Prior to December 2003, G-P Receivables purchased the receivables at face value; accordingly, no such income or loss was recognized in the nine months of 2003. At the end of the second quarter of 2004, the transfer agreement between G-P Receivables and our participating domestic subsidiaries was amended whereby the discount factor has been substantially reduced for all future purchases beginning with the third quarter. As a result, the credit to general and administrative expenses to be recognized by G-P Receivables will continue to be significantly less in subsequent periods.

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Certain assets and liabilities are administered by us, and, accordingly, are maintained at the Corporation and thus are not reflected on the balance sheets of our subsidiaries. The statements of operations properly reflect all results of operations of each respective entity. The following condensed consolidating financial information is presented in lieu of consolidated financial statements for Fort James and Fort James Operating Company because the securities issued by Fort James are fully and unconditionally guaranteed by us:

CONSOLIDATING STATEMENTS OF INCOME
THIRD QUARTER 2004

| In millions | Georgia-Pacific Corp. | Fort James Corp. | Fort James Guarantor Subsidiary | Fort James Non-Guarantor Subsidiaries | Other Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Amounts |
|--|-----------------------|------------------|---------------------------------|---------------------------------------|----------------------------------|---------------------------|----------------------|
| Net sales | \$ 2,396 | \$ -- | \$ 1,206 | \$ 537 | \$ 1,183 | \$ (581) | \$ 4,741 |
| Costs and expenses | 1,908 | -- | 833 | 399 | 952 | (581) | 3,511 |
| Cost of sales | 79 | -- | 108 | 47 | 23 | -- | 257 |
| Selling and distribution | 101 | -- | 61 | 33 | 36 | -- | 231 |
| Depreciation, amortization and accretion | 141 | -- | 41 | 26 | 4 | -- | 212 |
| General and administrative | 111 | 4 | 91 | (61) | 22 | -- | 167 |
| Interest, net | (210) | (106) | 5 | 1 | 3 | 299 | (8) |
| Other (income) losses, including equity income in affiliates | | | | | | | |
| Total costs and expenses | 2,130 | (102) | 1,139 | 445 | 1,040 | (282) | 4,370 |
| (Loss) income from continuing operations before income taxes | 266 | 102 | 67 | 92 | 143 | (299) | 371 |
| (Benefit) provision for income taxes | 29 | (2) | 25 | 28 | 52 | -- | 132 |
| Income (loss) from continuing | 237 | 104 | 42 | 64 | 91 | (299) | 239 |

| | | | | | | | |
|--|--------|--------|-------|-------|-------|----------|--------|
| operations | 3 | -- | -- | -- | (2) | -- | 1 |
| Income (loss) | | | | | | | |
| from discontinued operations, net of taxes | | | | | | | |
| Net income (loss) | \$ 240 | \$ 104 | \$ 42 | \$ 64 | \$ 89 | \$ (299) | \$ 240 |

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CONSOLIDATING STATEMENTS OF INCOME
THIRD QUARTER 2003

| In millions | Georgia-Pacific Corp. | Fort James Corp. | Fort James Guarantor Subsidiary | Fort James Non-Guarantor Subsidiaries | Other Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Amounts |
|--|-----------------------|------------------|---------------------------------|---------------------------------------|----------------------------------|---------------------------|----------------------|
| Net sales | \$ 2,944 | \$ - | \$ 1,186 | \$ 512 | \$ 1,079 | \$ (596) | \$ 5,125 |
| Costs and expenses | 2,453 | - | 818 | 367 | 924 | (596) | 3,966 |
| Cost of sales | 140 | - | 115 | 43 | 28 | - | 326 |
| Selling and distribution | 113 | - | 61 | 30 | 38 | - | 242 |
| Depreciation, amortization and accretion | 124 | - | 36 | 39 | 12 | - | 211 |
| General and administrative | 127 | 5 | 104 | (59) | 23 | - | 200 |
| Interest, net | (246) | (100) | - | (1) | 16 | 230 | (101) |
| Other losses (income), including equity income in affiliates | | | | | | | |
| Total costs and expenses | 2,711 | (95) | 1,134 | 419 | 1,041 | (366) | 4,844 |
| (Loss) income from continuing operations before income taxes | 233 | 95 | 52 | 93 | 38 | (230) | 281 |
| (Benefit) | 32 | (2) | 19 | 26 | 22 | -- | 97 |

provision for
income taxes

| | | | | | | | |
|--|--------|-------|-------|-------|-------|----------|--------|
| Income (loss) from continuing operations | 201 | 97 | 33 | 67 | 16 | (230) | 184 |
| (Loss) income from discontinued operations, net of taxes | (9) | -- | -- | -- | 17 | -- | 8 |
| Net (loss) income | \$ 192 | \$ 97 | \$ 33 | \$ 67 | \$ 33 | \$ (230) | \$ 192 |

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CONSOLIDATING STATEMENTS OF INCOME
FIRST NINE MONTHS 2004

| In millions | Georgia-Pacific Corp. | Fort James Corp. | Fort James Guarantor Subsidiary | Fort James Non-Guarantor Subsidiaries | Other Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Amounts |
|---|--------------------------|------------------------|---------------------------------------|---|--|------------------------------|-------------------------|
| Net sales | \$ 8,284 | \$ -- | \$ 3,556 | \$ 1,667 | \$ 3,412 | \$ (1,768) | \$ 15,151 |
| Costs and expenses | 6,606 | | 2,521 | 1,198 | 2,812 | (1,768) | 11,369 |
| Cost of sales | 344 | | 349 | 144 | 82 | -- | 919 |
| Selling and distribution | 317 | | 185 | 100 | 109 | -- | 711 |
| Depreciation, amortization and accretion | 932 | | 125 | 83 | (484) | -- | 656 |
| General and administrative | 354 | 21 | 283 | (184) | 68 | -- | 542 |
| Interest, net | (801) | (289) | 7 | (25) | 6 | 1,093 | (9) |
| Other (income) losses, including equity income in affiliates | | | | | | | |
| | 7,752 | (268) | 3,470 | 1,316 | 2,593 | (675) | 14,188 |

Total costs and expenses

| | | | | | | | |
|--|--------|--------|-------|--------|--------|------------|--------|
| (Loss) income from continuing operations before income taxes | 532 | 268 | 86 | 351 | 819 | (1,093) | 963 |
| (Benefit) provision for income taxes | (85) | (8) | 33 | 115 | 297 | -- | 352 |
| Income (loss) from continuing operations | 617 | 276 | 53 | 236 | 522 | (1,093) | 611 |
| (Loss) income from discontinued operations, net of taxes | (10) | -- | -- | -- | 6 | -- | (4) |
| Net (loss) income | \$ 607 | \$ 276 | \$ 53 | \$ 236 | \$ 528 | \$ (1,093) | \$ 607 |

CONSOLIDATING STATEMENTS OF INCOME
FIRST NINE MONTHS 2003

| In millions | Georgia-Pacific Corp. | Fort James Corp. | Fort James Guarantor Subsidiary | Fort James Non-Guarantor Subsidiaries | Other Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Amounts |
|--|-----------------------|------------------|---------------------------------|---------------------------------------|----------------------------------|---------------------------|----------------------|
| Net sales | \$ 7,961 | \$ - | \$ 3,609 | \$ 1,546 | \$ 3,119 | \$ (1,789) | \$ 14,446 |
| Costs and expenses | 6,835 | - | 2,561 | 1,101 | 2,626 | (1,789) | 11,334 |
| Cost of sales | 385 | - | 349 | 135 | 83 | - | 952 |
| Selling and distribution | 339 | - | 189 | 86 | 114 | - | 728 |
| Depreciation, amortization and accretion | 339 | - | 113 | 116 | 41 | - | 609 |
| General and | 386 | 14 | 317 | (179) | 68 | - | 606 |
| | (484) | (235) | 75 | (1) | 18 | 588 | (39) |

| | | | | | | | | |
|--|--------|--------|-------|--------|--------|----------|--------|--|
| administrative Interest, net Other (income) losses, including equity income in affiliates | | | | | | | | |
| Total costs and expenses | 7,800 | (221) | 3,604 | 1,258 | 2,950 | (1,201) | 14,190 | |
| (Loss) income from continuing operations before income taxes | 161 | 221 | 5 | 288 | 169 | (588) | 256 | |
| (Benefit) provision for income taxes | (82) | (5) | 2 | 78 | 76 | - | 69 | |
| Income (loss) from continuing operations | 243 | 226 | 3 | 210 | 93 | (588) | 187 | |
| (Loss) income from discontinued operations, net of taxes | (23) | -- | -- | -- | 31 | -- | 8 | |
| Income (loss) before accounting change | 220 | 226 | 3 | 210 | 124 | (588) | 195 | |
| Cumulative effect of accounting change, net of taxes | 3 | 2 | 22 | - | 1 | - | 28 | |
| Net (loss) income | \$ 223 | \$ 228 | \$ 25 | \$ 210 | \$ 125 | \$ (588) | \$ 223 | |

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FIRST NINE MONTHS 2004

| In millions | Georgia-Pacific Corp. | Fort James Corp. | Fort James Guarantor Subsidiary | Fort James Non-Guarantor Subsidiaries | Other Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Amounts |
|--|-----------------------|------------------|---------------------------------|---------------------------------------|----------------------------------|---------------------------|----------------------|
| Cash (used for) provided by operating activities | \$ (39) | \$ 26 | \$ 299 | \$ 367 | \$ 286 | \$ -- | \$ 939 |
| Cash flows from investing activities: | | | | | | | |
| Property, plant and equipment investments | (203) | -- | (134) | (51) | (60) | -- | (448) |
| Acquisitions | (20) | -- | (3) | -- | -- | -- | (23) |
| Net proceeds from sales of assets | 1,046 | -- | 3 | 71 | 296 | -- | 1,416 |
| Other | (3) | (13) | 13 | 7 | (18) | -- | (14) |
| Cash provided by (used for) investing activities | 820 | (13) | (121) | 27 | 218 | -- | 931 |
| Cash flows from financing activities: | | | | | | | |
| Net decrease in debt | (719) | (672) | (18) | (28) | (232) | -- | (1,669) |
| Net change in intercompany payable/invested equity | 28 | 659 | (161) | (251) | (275) | -- | -- |
| Fees paid to issue debt | (14) | -- | -- | -- | -- | -- | (14) |
| Fees paid to retire debt | (35) | -- | -- | -- | -- | -- | (35) |
| Proceeds from option plan exercises | 53 | -- | -- | -- | -- | -- | 53 |
| Cash dividends paid | (97) | -- | -- | -- | -- | -- | (97) |
| Cash used for financing activities | (784) | (13) | (179) | (279) | (507) | -- | (1,762) |
| (Decrease) increase in cash | (3) | -- | (1) | 115 | (3) | -- | 108 |

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| | | | | | | | |
|--------------------------------|--------|-------|-------|--------|---------|-------|--------|
| Balance at beginning of period | 1 | -- | 1 | 25 | 24 | -- | 51 |
| Balance at end of period | \$ (2) | \$ -- | \$ -- | \$ 140 | \$ (21) | \$ -- | \$ 159 |

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CONSOLIDATING STATEMENTS OF CASH FLOWS
FIRST NINE MONTHS 2003

| In millions | Georgia-Pacific Corp. | Fort James Corp. | Fort James Guarantor Subsidiary | Fort James Non-Guarantor Subsidiaries | Other Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Amounts |
|--|-----------------------|------------------|---------------------------------|---------------------------------------|----------------------------------|---------------------------|----------------------|
| Cash provided by (used for) operating activities | \$ 522 | \$ 5 | \$ 152 | \$ 428 | \$ 75 | \$ - | \$ 1,182 |
| Cash flows from investing activities: | | | | | | | |
| Property, plant and equipment investments | (169) | - | (203) | (35) | (73) | - | (480) |
| Acquisitions | (2) | - | - | - | - | - | (2) |
| Net proceeds from sales of assets | 21 | - | 2 | 4 | - | - | 27 |
| Other | (14) | - | - | - | - | - | (14) |
| Cash (used for) provide by investing activities | (164) | - | (201) | (31) | (73) | - | (469) |
| Cash flows from financing activities: | | | | | | | |
| Net (decrease) increase in debt | (674) | 18 | (21) | (19) | 194 | - | (502) |
| Net change in intercompany payable/invested equity | 451 | (23) | 71 | (308) | (191) | - | - |
| | (47) | - | - | - | (1) | - | (48) |
| | 4 | - | - | - | - | - | 4 |
| | (94) | - | - | - | - | - | (94) |

| | | | | | | | | |
|--|-------|------|------|-------|-------|------|--|--------|
| Fees paid to issue debt | | | | | | | | |
| Proceeds from option plan exercises | | | | | | | | |
| Cash dividends paid | | | | | | | | |
| Cash provided by (used for) financing activities | (360) | (5) | 50 | (327) | 2 | - | | (640) |
| (Decrease) increase in cash | (2) | - | 1 | 70 | 4 | - | | 73 |
| Balance at beginning of period | 3 | - | - | 18 | 21 | - | | 42 |
| Balance at end of period | \$ 1 | \$ - | \$ 1 | \$ 88 | \$ 25 | \$ - | | \$ 115 |

CONSOLIDATING BALANCE SHEETS
AS OF OCTOBER 2, 2004

| In millions | Georgia-Pacific Corp. | Fort James Corp. | Fort James Guarantor Subsidiary | Fort James Non-Guarantor Subsidiaries | Other Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Amounts |
|----------------------------------|-----------------------|------------------|---------------------------------|---------------------------------------|----------------------------------|---------------------------|----------------------|
| ASSETS | | | | | | | |
| Current assets | | | | | | | |
| Cash and equivalents | \$ (2) 19 | \$ -- | \$ -- | \$ 140 535 | \$ 21 1,344 | \$ -- | \$ 159 1,898 |
| Receivables, less allowances | 553 178 | -- | 626 (39) | 285 16 | 329 (30) | -- | 1,793 125 |
| Inventories | 590 | 30 | -- | 21 | 93 | (734) | -- |
| Deferred income tax assets | 230 | -- | 29 | 54 | 73 | (24) | 362 |
| Intercompany interest receivable | | | | | | | |
| Other current assets | | | | | | | |

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| | | | | | | | |
|--|-----------|-----------|-----------|----------|----------|-------------|-----------|
| Total current assets | 1,568 | 30 | 616 | 1,051 | 1,830 | (758) | 4,337 |
| Total property, plant and equipment, net | 2,645 | -- | 3,089 | 1,160 | 1,391 | -- | 8,285 |
| Goodwill, net | 491 | -- | 5,827 | 984 | 176 | -- | 7,478 |
| Intercompany note receivable | | | | | | | -- |
| | 2,350 | 1,964 | -- | 3,786 | 236 | (8,336) | |
| Other assets | 10,877 | 9,320 | 478 | 292 | 860 | (18,922) | 2,905 |
| Total assets | \$ 17,931 | \$ 11,314 | \$ 10,010 | \$ 7,273 | \$ 4,493 | \$ (28,016) | \$ 23,005 |

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CONSOLIDATING BALANCE SHEETS (continued)
AS OF OCTOBER 2, 2004

| In millions | Georgia-Pacific Corp. | Fort James Corp. | Fort James Guarantor Subsidiary | Fort James Non-Guarantor Subsidiaries | Other Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Amounts |
|---|-----------------------|------------------|---------------------------------|---------------------------------------|----------------------------------|---------------------------|----------------------|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | | |
| Current liabilities | \$ 524 | \$ 16 | \$ 7 | \$ 12 | \$ 385 | \$ -- | \$ 944 |
| Short-term debt | 589 | -- | 195 | 484 | 239 | (1) | 1,506 |
| Accounts payable | | | | | | | |
| Intercompany interest payable | 93 | 262 | 35 | -- | 344 | (734) | -- |
| Other current liabilities | 866 | 6 | 178 | 206 | 143 | (24) | 1,375 |
| Total current liabilities | 2,072 | 284 | 415 | 702 | 1,111 | (759) | 3,825 |
| Long-term debt, excluding current portion | 7,132 | 417 | 248 | 63 | 108 | -- | 7,968 |
| Other long-term liabilities | 2,027 | -- | 570 | 154 | 879 | (96) | 3,534 |
| Deferred income tax liabilities | 433 | -- | 681 | 46 | 487 | -- | 1,647 |
| | 236 | 928 | 5,007 | 77 | 2,090 | (8,338) | -- |

Intercompany note
payable

| | | | | | | | |
|--|-----------|-----------|-----------|----------|----------|------------|-----------|
| Shareholders'/invested equity | 6,031 | 9,685 | 3,089 | 6,231 | (182) | (18,823) | 6,031 |
| Total liabilities and shareholders' equity | \$ 17,931 | \$ 11,314 | \$ 10,010 | \$ 7,273 | \$ 4,493 | \$(28,016) | \$ 23,005 |

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CONSOLIDATING BALANCE SHEETS
AS OF JANUARY 3, 2004

| In millions | Georgia-Pacific Corp. | Fort James Corp. | Fort James Guarantor Subsidiary | Fort James Non-Guarantor Subsidiaries | Other Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Amounts |
|---|-----------------------|------------------|---------------------------------|---------------------------------------|----------------------------------|---------------------------|----------------------|
| ASSETS | | | | | | | |
| Current assets | | | | | | | |
| Cash and equivalents | \$ -- | \$ -- | \$ 1 | \$ 25 | \$ 25 | \$ -- | \$ 51 |
| Receivables, less allowances | (16) | -- | -- | 541 | 1,017 | -- | 1,542 |
| Inventories | 618 | -- | 629 | 285 | 316 | -- | 1,848 |
| Deferred income tax assets | 174 | -- | (39) | 16 | (34) | -- | 117 |
| Intercompany interest receivable | 488 | 8 | -- | 7 | 91 | (594) | -- |
| Assets held for sale | 290 | -- | -- | -- | 449 | -- | 739 |
| Other current assets | 148 | -- | 12 | 64 | 126 | (49) | 301 |
| Total current assets | 1,702 | 8 | 603 | 938 | 1,990 | (643) | 4,598 |
| Total property, plant and equipment, net | 2,663 | -- | 3,226 | 1,215 | 1,477 | 1 | 8,582 |
| Goodwill, net | 491 | -- | 5,824 | 994 | 176 | (1) | 7,484 |
| Intercompany note receivable | 2,289 | 1,964 | (1) | 3,772 | 204 | (8,228) | -- |

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| | | | | | | | |
|----------------------|-----------|-----------|-----------|----------|----------|-------------|-----------|
| Assets held for sale | 218 | -- | -- | 45 | 494 | -- | 757 |
| Other assets | 10,883 | 9,531 | 496 | 342 | 848 | (19,116) | 2,984 |
| Total assets | \$ 18,246 | \$ 11,503 | \$ 10,148 | \$ 7,306 | \$ 5,189 | \$ (27,987) | \$ 24,405 |

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CONSOLIDATING BALANCE SHEETS (continued)
AS OF JANUARY 3, 2004

| In millions | Georgia-Pacific Corp. | Fort James Corp. | Fort James Guarantor Subsidiary | Fort James Non-Guarantor Subsidiaries | Other Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Amount |
|---|-----------------------|------------------|---------------------------------|---------------------------------------|----------------------------------|---------------------------|---------------------|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | | |
| Current liabilities | \$ 47 | \$ 714 | \$ 7 | \$ 13 | \$ 698 | \$ (1) | \$ 1,478 |
| Short-term debt | 511 | -- | 181 | 505 | 208 | -- | 1,405 |
| Accounts payable | | | | | | | |
| Intercompany interest | 91 | 212 | 8 | 1 | 282 | (594) | -- |
| payable | 128 | -- | -- | -- | 61 | -- | 189 |
| Liabilities held for sale | 891 | 24 | 172 | 146 | 167 | (50) | 1,350 |
| Other current liabilities | | | | | | | |
| Total current liabilities | 1,668 | 950 | 368 | 665 | 1,416 | (645) | 4,422 |
| Long-term debt, excluding current portion | 8,225 | 404 | 254 | 91 | 100 | -- | 9,074 |
| Other long-term liabilities | 2,266 | -- | 587 | 179 | 834 | (40) | 3,826 |
| Deferred income tax liabilities | 388 | (27) | 655 | 42 | 425 | -- | 1,483 |
| Liabilities held for sale | 101 | -- | -- | -- | 165 | (60) | 206 |
| Intercompany note payable | 204 | 928 | 5,006 | 77 | 2,014 | (8,229) | -- |
| | 5,394 | 9,248 | 3,278 | 6,252 | 235 | (19,013) | 5,394 |

Shareholders'/invested
equity

| | | | | | | | |
|---|-----------|-----------|-----------|----------|----------|-------------|-----------|
| Total liabilities and shareholders' equity | \$ 18,246 | \$ 11,503 | \$ 10,148 | \$ 7,306 | \$ 5,189 | \$ (27,987) | \$ 24,405 |
|---|-----------|-----------|-----------|----------|----------|-------------|-----------|

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15. OPERATING SEGMENT INFORMATION. We have six reportable operating segments: North America consumer products, international consumer products, packaging, bleached pulp and paper, building products manufacturing, and building products distribution. The following represents selected operating data for each reportable segment for the three and nine months ended September 2004 and 2003.

CONSOLIDATED SELECTED OPERATING SEGMENT DATA (Unaudited)
Georgia-Pacific Corporation and Subsidiaries

| (Dollar amounts in millions) | Third Quarter 2004 | | Third Quarter 2003 | |
|--|--------------------|-------------|--------------------|-------------|
| NET SALES TO UNAFFILIATED CUSTOMERS | | | | |
| North America consumer products | \$ 1,439 | 30% | \$ 1,369 | 27% |
| International consumer products | 498 | 11 | 474 | 9 |
| Packaging | 755 | 16 | 657 | 13 |
| Bleached pulp and paper | 419 | 9 | 389 | 8 |
| Building products manufacturing | 1,628 | 34 | 1,050 | 20 |
| Building products distribution | -- | -- | 1,185 | 23 |
| Other | 2 | -- | 1 | -- |
| Total net sales to unaffiliated customers | \$ 4,741 | 100% | \$ 5,125 | 100% |
| INTERSEGMENT SALES | | | | |
| North America consumer products | \$ (1) | | \$ -- | |
| International consumer products | -- | | -- | |
| Packaging | 27 | | 30 | |
| Bleached pulp and paper | 165 | | 125 | |
| Building products manufacturing | 180 | | 529 | |
| Building products distribution | -- | | 2 | |

| | | |
|---------------------------------|---------------|---------------|
| Other ¹ | (371) | (686) |
| Total intersegment sales | \$ -- | \$ -- |
| TOTAL NET SALES | | |
| North America consumer products | \$ 1,438 30% | \$ 1,369 27% |
| International consumer products | 498 11 | 474 9 |
| Packaging | 782 16 | 687 13 |
| Bleached pulp and paper | 584 12 | 514 10 |
| Building products manufacturing | 1,808 38 | 1,579 31 |
| Building products distribution | -- -- | 1,187 23 |
| Other ¹ | (369) (7) | (685) (13) |
| Total net sales | \$ 4,741 100% | \$ 5,125 100% |

1 Includes elimination of intersegment sales.

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CONSOLIDATED SELECTED OPERATING SEGMENT DATA (Unaudited)
Georgia-Pacific Corporation and Subsidiaries

| (Dollar amounts in millions) | Third Quarter 2004 | Third Quarter 2003 |
|---|--------------------|--------------------|
| OPERATING PROFITS (LOSSES) | | |
| North America consumer products | \$ 206 38% | \$ 164 34% |
| International consumer products | 39 7 | 41 9 |
| Packaging | 100 19 | 77 16 |
| Bleached pulp and paper ² | 20 4 | 4 1 |
| Building products manufacturing | 282 52 | 156 32 |
| Building products distribution | 13 3 | 52 11 |
| Other ³ | (122) (23) | (13) (3) |
| Total operating profits | 538 100% | 481 100% |
| Interest expense | (167) | (200) |
| Income from continuing operations before income taxes | 371 | 281 |
| Provision for income taxes | (132) | (97) |
| Income from continuing operations | 239 | 184 |
| Income from discontinued operations, net of taxes | 1 | 8 |

| | | |
|------------|--------|--------|
| Net income | \$ 240 | \$ 192 |
|------------|--------|--------|

2 Amount in 2004 and 2003 includes an operating loss of \$4 million and \$7 million, respectively, from our 40% minority interest in Unisource.

3 Includes some miscellaneous businesses, unallocated corporate operating expenses and the elimination of profit on intersegment sales.

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CONSOLIDATED SELECTED OPERATING SEGMENT DATA (Unaudited)
Georgia-Pacific Corporation and Subsidiaries

| (Dollar amounts in millions) | First Nine Months 2004 | | First Nine Months 2003 | |
|--|------------------------|-------------|------------------------|-------------|
| NET SALES TO UNAFFILIATED CUSTOMERS | | | | |
| North America consumer products | \$ 4,207 | 28% | \$ 4,029 | 28% |
| International consumer products | 1,549 | 10 | 1,444 | 10 |
| Packaging | 2,119 | 14 | 1,987 | 14 |
| Bleached pulp and paper | 1,206 | 8 | 1,121 | 8 |
| Building products manufacturing | 4,181 | 28 | 2,776 | 19 |
| Building products distribution | 1,883 | 12 | 3,087 | 21 |
| Other | 6 | | 2 | |
| | - | | - | |
| Total net sales to unaffiliated customers | \$ 15,151 | 100% | \$ 14,446 | 100% |
| INTERSEGMENT SALES | | | | |
| North America consumer products | \$ -- | | \$ 2 | |
| International consumer products | -- | | -- | |
| Packaging | 79 | | 87 | |
| Bleached pulp and paper | 461 | | 409 | |
| Building products manufacturing | 1,161 | | 1,475 | |
| Building products distribution | 3 | | 6 | |
| Other ¹ | (1,704) | | (1,979) | |
| Total intersegment sales | \$ -- | | \$ -- | |
| TOTAL NET SALES | | | | |
| North America consumer products | \$ 4,207 | 28% | \$ 4,031 | 28% |
| International consumer products | 1,549 | 10 | 1,444 | 10 |
| Packaging | 2,198 | 15 | 2,074 | 14 |
| Bleached pulp and paper | 1,667 | 11 | 1,530 | 11 |
| Building products manufacturing | 5,342 | 35 | 4,251 | 29 |
| Building products distribution | 1,886 | 12 | 3,093 | 21 |
| Other ¹ | (1,698) | (11) | (1,977) | (13) |
| Total net sales | \$ 15,151 | 100% | \$ 14,446 | 100% |

1 Includes elimination of intersegment sales.

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CONSOLIDATED SELECTED OPERATING SEGMENT DATA (Unaudited)
Georgia-Pacific Corporation and Subsidiaries

| (Dollar amounts in millions) | First Nine Months 2004 | | First Nine Months 2003 | |
|--|------------------------|------------|------------------------|------------|
| OPERATING PROFITS (LOSSES) | | | | |
| North America consumer products | \$ | 476 32% | \$ | 434 50% |
| International consumer products | | 135 9 | | 123 14 |
| Packaging | | 227 15 | | 236 27 |
| Bleached pulp and paper ² | | 27 2 | | (40) (4) |
| Building products manufacturing | | 911 60 | | 178 21 |
| Building products distribution | | 111 7 | | 76 9 |
| Other ³ | | (382) (25) | | (145) (17) |
| Total operating profits | | 1,505 100% | | 862 100% |
| | | === | | === |
| Interest expense | | (542) | | (606) |
| Income from continuing operations before income taxes | | 963 | | 256 |
| (Provision for income taxes) | | (352) | | (69) |
| Income from continuing operations | | 611 | | 187 |
| (Loss) income from discontinued operations, net of taxes | | (4) | | 8 |
| Income before accounting changes | | 607 | | 195 |
| Cumulative effect of accounting changes, net of taxes | | -- | | 28 |
| Net income | \$ | 607 | \$ | 223 |

2 Amount in 2004 and 2003 includes an operating loss of \$17 million and \$20 million, respectively, from our 40% minority interest in Unisource.

3 Includes some miscellaneous businesses, unallocated corporate operating expenses and the elimination of profit on intersegment sales.

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Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Our strategy is to improve our portfolio of businesses by investing in businesses that are high value-added and that position us closer to consumers, and by divesting or exiting non-strategic businesses. A key component of that strategy is improving our bath tissue, paper towel and napkin business, which is commonly referred to as the tissue business. We believe that our acquisition of Fort James Corporation in late 2000 directly facilitated that strategy. In our other paper and forest products businesses, we are focused on maximizing cash returns by differentiating our products and partnering with our customers to improve supply chain efficiencies.

During the second quarter of 2004, we completed the sales of our non-integrated mills at Brunswick, Georgia, and New Augusta, Mississippi, along with a short-line railroad; our building products distribution segment; and all of our interests in a Brazilian pulp business.

In addition to our strategic initiatives, the primary issues that affect us are economic conditions in the United States and Europe, the levels of supply and demand in the paper and forest product industry, our debt and liquidity, and uncertainty about our total asbestos liability.

Industry Conditions

Most of our businesses experienced weak industry conditions during 2001, 2002 and 2003. Industry productive capacity generally exceeded demand in those periods, resulting in cyclically low prices and declining operating results for our consumer products, packaging and bleached pulp and paper businesses. The following factors negatively impacted the industry supply/demand balance:

- sluggish economic growth in the U.S. and export markets,
- increased paper and forest product production capacity outside the United States,
- weak employment conditions,
- lower U.S. industrial output as production shifted to other regions of the world,
- a decline in U.S commercial construction, and
- increased energy and wastepaper costs.

During those periods, we shut down a number of facilities and machines in an effort to maximize the efficiency of our manufacturing and logistics systems, resulting in asset impairment charges and severance costs.

Industry conditions have improved over the past five quarters. In particular, our building products manufacturing and distribution businesses experienced significantly improved market conditions in the second half of 2003, driven by very strong demand for building materials and low industry inventories. This positive momentum continued through the first nine months of 2004. However, plywood and oriented-strand board ("OSB") prices fell sharply in October to their lowest levels of the year. During 2004, particularly in the second half of the year, market conditions improved for our consumer products businesses in North America, as well as our bleached pulp and paper, and packaging businesses, driven by improving economic and employment conditions in the U.S. Market conditions in Europe have remained sluggish during 2004, as we continued to experience declining prices in local currencies with flat sales volumes.

Our strategic initiative to move away from the commodity end of our product spectrum toward more consumer products and value-added services is intended to mitigate, to some extent, the impact of commodity cycles on our

business and increase our profit margins. Over the past four years, we have introduced a number of new and improved specialty products with qualities that are designed to differentiate them from industry commodities, provide additional value to customers and consumers, and sell at a premium. We have also focused on developing supply chain solutions, which reduce the costs of warehousing, transportation, handling and waste, and are able to share these savings with our customers.

Debt and Liquidity

Our senior management has established the parameters of our financial policies, which have been approved by our board of directors. These include balancing our debt and equity to keep our weighted average cost of capital low while retaining the flexibility needed to ensure that we can meet our financial obligations when or before they come due and to finance attractive business opportunities. Historically, we set debt targets based on our cash generating capability under various business scenarios. We experience variances in cash flow from period to period and various methods are utilized to reasonably estimate possible deviations in estimated future cash flows.

We maintain a high portion of our debt as long-term at fixed interest rates. We intend to manage the maturities of our long-term debt (excluding bank debt) so that generally no more than \$500 million matures in any one year and if it does then the sum of the maturities of any two consecutive years does not significantly exceed \$1 billion. Our current maturities are in substantial compliance with these guidelines. Generally, we seek to have 75% of our aggregate debt at fixed rates so as to minimize exposure to fluctuating interest rates. Currently we have approximately 87% of our aggregate debt at fixed rates. The previously announced redemption of \$500 million in fixed-rate debentures on October 28, 2004 will be funded by additional borrowings under our existing credit facilities, which have variable interest rates. Additionally, we are planning to enter into interest rate swaps to convert fixed-rate debt of approximately \$500 million to variable rate debt. These two transactions will reduce the percentage of our fixed-rate debt to approximately 75% of our aggregate debt.

Short-term debt is used in modest proportions and generally for seasonal working capital variations and/or financing some of our accounts receivable. We utilize bank credits for temporary short- and/or intermediate-term financing usually bridging known or expected events. Additionally, we maintain committed, available borrowing capacity to allow for seasonal, timing or unexpected needs. In an effort to further manage the maturities of our debt, we entered into a new \$2.5 billion, five-year, Senior Credit Facility that includes a \$500 million non-amortizing term loan. The Senior Credit Facility matures on July 2, 2009 and replaces a \$2.25 billion, five-year credit facility that would have matured November 3, 2005. As of October 2, 2004, unused capacity under our Senior Credit Facility was \$1,311 million. For further discussion of the unused capacity, see

Note 10.

We are focused on reducing the amount of debt that we carry and minimizing the interest costs on that debt. During the first nine months of 2004, our total debt level has been reduced by \$1.7 billion using proceeds from asset sales and operating cash flows.

In an effort to minimize the interest costs on the debt that we carry, during the first nine months of 2004 we called \$243 million of our 9.875% debentures due November 1, 2021, \$250 million of our 9.625% debentures due March 15, 2022, \$250 million of our 9.5% debentures due May 15, 2022 and \$240 million of our 9.125%

debentures due July 1, 2022. We used funds available under a credit facility that would have matured November 2005 to redeem these debentures. We have also announced that we will call \$250 million of our 8.125% debentures due June 15, 2023, and \$250 million of our 8.25% debentures due March 1, 2023 during the fourth quarter of 2004.

We continuously review our financing objectives to determine the appropriate level of debt to employ in our capital structure to provide the necessary flexibility to finance future growth and investment opportunities.

Asbestos

We, and many other companies, are defendants in suits brought in various courts around the nation by plaintiffs who allege that they have suffered personal injury as a result of exposure to asbestos-containing products. Our asbestos liabilities relate primarily to joint systems products manufactured by Bestwall Gypsum Company and our gypsum business that contained small amounts of asbestos fiber. We acquired Bestwall in 1965, and discontinued using asbestos in the manufacture of these products in 1977. These suits allege a variety of lung and other diseases based on alleged exposure to our products. In many cases, the plaintiffs are unable to demonstrate that they have suffered any compensable loss as a result of such exposure, or that any injuries they have incurred did in fact result from exposure to our products. Virtually all asbestos suits involve multiple claimants seeking money damages and virtually all asbestos suits involve multiple defendants. Historically, the vast majority of claims against us have been resolved either by settlement or a dismissal, rather than by jury verdicts.

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Beginning in 2001, and again at the end of 2002 and 2003, we retained nationally recognized consultants in asbestos liability and insurance to work with us to estimate the amounts, net of insurance, that we would pay for our asbestos-related liabilities and defense costs for the following 10-year periods. At the end of 2001 we recorded an initial liability of \$350 million to cover the projected asbestos liabilities and defense costs, net of expected insurance recoveries, we expected to pay through 2011. At the end of 2002, we increased our reserve net of expected insurance recoveries by \$315 million to increase our estimated liability for years 2003 through 2012 based on our actual costs in 2002, which were higher than expected and to add the estimated net cost for 2012.

Our actual 2003 claims experience was in line with the underlying assumptions we used to determine our projected asbestos liability at the end of 2002. Also during the year, we completed agreements with two insurers of our asbestos liabilities which generally provide that we will be able to recover more insurance from those carriers than we had assumed when we were projecting our insurance receivables in 2002. After adjusting our estimated receivables and adding an estimate of our net costs for 2013, our total 10-year net liability at the end of 2003 was \$451 million, compared with \$492 million at the end of 2002. The following table details the activity in our asbestos liability and receivable balances during the first nine months of 2004:

| Asbestos Liabilities | (in millions) |
|----------------------|------------------|
| Beginning Balance | \$ 1,027 |
| Accruals | -- |

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| | |
|----------------------|---------------|
| Payments | <u>(145)</u> |
| Ending Balance | \$ <u>882</u> |
| | |
| Insurance Receivable | |
| Beginning Balance | \$ 576 |
| Accruals | -- |
| | |
| Receipts | <u>(26)</u> |
| Ending Balance | \$ <u>550</u> |
| Net Liability | \$ <u>332</u> |

During the first nine months of 2004 the number of new asbestos claims filed against us decreased 33% compared to the first nine months of 2003. Our payments to settle pending asbestos cases were approximately equal to our projections for the period and equal to the amount paid in the first nine months of 2003. However, defense costs over the past several quarters were significantly higher than projected, and are expected to remain at their current level for an unknown period of time. Defense costs have increased as we have undertaken more discovery with regard to the medical condition and allegations of causation of plaintiffs who allege malignant conditions. Additionally, we have taken more cases to trial. With the assistance of our outside advisors, we are monitoring the amount of future defense costs projected to be incurred and the potential impact of such costs on our settlement projections and the asbestos reserves.

We expect insurance proceeds to be lower in 2004 than in previous years because we monetized \$156 million of the receivables in the fourth quarter of 2003, and we have entered the third layer of our insurance coverage, which has more insolvent carriers. As a result, we expect our insurance receipts over the next two years to be less than 50% of our asbestos liability payments until we exhaust this layer and move to upper layers with fewer insolvencies.

In recent years federal and state legislators have considered proposals for tort reform generally, and to deal with asbestos litigation in particular. Tort reform legislation has been enacted in some states where large numbers of claims have been filed against us, but because this legislation is relatively new, we are not able to assess its effect as yet. In the U.S. Senate, the Fairness in Asbestos Injury Resolution Act was introduced in 2003, and approved by the Senate Judiciary Committee. The Act would create a national trust fund, to be funded by companies and insurers which have asbestos liability; the fund would pay claims of asbestos victims and generally end litigation alleging personal injury caused by asbestos in federal and

state courts. There have been further negotiations among industry, insurers, labor unions and other interested parties but no action on such legislation is expected this year.

For further information regarding our asbestos matters, see

Note 13 of the Notes to Consolidated Financial Statements.

THIRD QUARTER 2004 COMPARED WITH THIRD QUARTER 2003

During the third quarter of 2004 we reported consolidated net sales of \$4.7 billion, compared with net sales of \$5.1 billion for the third quarter of 2003. The decrease in sales resulted from the divestiture of our building products distribution business in the second quarter of 2004. This divestiture also explains the year-over-year reduction in selling and distribution expenses.

Interest expense decreased \$33 million to \$167 million in the third quarter of 2004 compared with \$200 million in the third quarter of 2003, principally as a result of lower debt levels that were slightly offset by higher average interest rates. Interest expense allocated to discontinued operations was \$4 million in the third quarter of 2003.

Income from continuing operations before income taxes was \$371 million and we reported an income tax provision of \$132 million for the third quarter of 2004, compared with income from continuing operations before income taxes of \$281 million and an income tax provision of \$97 million for the third quarter of 2003. The effective tax rates for the third quarters of 2004 and 2003 were slightly lower than the statutory rate primarily because of lower international income tax rates.

The remaining discussion refers to the "Consolidated Selected Operating Segment Data" table (included in Note 15 to the Consolidated Financial Statements).

NORTH AMERICA CONSUMER PRODUCTS

Net sales and operating profits for the North America consumer products segment were \$1,438 million and \$206 million, respectively, for the third quarter of 2004. Third quarter 2004 operating profit included a \$6 million charge for employee termination costs and asset write offs primarily related to a restructuring in our Dixie business. Third quarter 2003 net sales and operating profits were \$1,369 million and \$164 million, respectively.

Operating margins continued to improve in the third quarter of 2004, driven by higher selling prices for retail tissue, which more than offset the impacts from cost inflation and slightly lower volumes. In retail channels, we successfully implemented price increases across all product categories, lead by our recently re-launched Brawny® paper towels and Quilted Northern® bathroom tissue. Manufacturing and distribution costs continued to trend upward, driven by fiber, energy, resins and fuel-related costs, although these impacts were mitigated by product reconfigurations and other spending controls.

During the fourth quarter of 2004, we expect pricing conditions in our retail channels to remain strong, with further strengthening in commercial channels as we execute announced price increases. Inflationary costs pressures are expected to continue.

INTERNATIONAL CONSUMER PRODUCTS

During the third quarter of 2004, the international consumer products segment reported net sales and operating profits of \$498 million and \$39 million, respectively, compared with \$474 million and \$41 million of net sales and operating profits, respectively, in the prior year. Included in the 2004 operating profits is a \$5 million charge primarily related to our Athens (Greece) converting facility closure and a fire at our facility in Russia. These comparisons were impacted by a weaker U.S. dollar relative to the Euro in the 2004 period, which benefited reported net sales by approximately \$45 million and benefited reported operating profits by approximately \$4 million. Excluding favorable impacts from the weaker U.S. dollar and the effect of the \$5 million charge, third quarter operating profits were flat year-over-year with declines in local currency selling prices being offset by cost reduction initiatives. For the remainder of 2004, business conditions in Europe are expected to remain competitive.

PACKAGING

The packaging segment reported net sales of \$782 million and operating profits of \$100 million in the third quarter of 2004, compared with net sales of \$687 million and operating profits of \$77 million in the third quarter of 2003. Operating margins improved significantly during the third quarter of 2004 due to improved pricing for containerboard and boxes coupled with higher box shipments. These positive factors offset the impacts of higher costs for natural gas, maintenance and old corrugated containers ("OCC").

During the fourth quarter of 2004, we expect continued strong pricing for containerboard with some further price increase realization on boxes following announced price increases. Inflationary cost pressures from natural gas and secondary fiber are expected to continue.

BLEACHED PULP AND PAPER

The bleached pulp and paper segment reported net sales and operating profits of \$584 million and \$20 million, respectively, in the third quarter of 2004. The third quarter 2004 results include a \$2 million reduction of the gain on the sale of our interests in a Brazilian pulp business. For the same period in 2003, the segment reported net sales of \$514 million and operating profits of \$4 million. In the third quarters 2004 and 2003, operating profits included a loss from our investment in Unisource of \$4 million and \$7 million, respectively. The increase in operating profits was driven by price increases for paper, bleached board and kraft coupled with improved demand for bleached board and cost reduction efforts at our mills. Reduced sales volumes in our paper and kraft businesses negatively impacted these profit improvements.

The outlook for the fourth quarter is positive, as previous price commitments to customers expire and demand remains strong, but with continued pressure from energy and fuel costs.

BUILDING PRODUCTS MANUFACTURING

During the third quarter of 2004, the building products manufacturing segment reported net sales of \$1,808 million and operating profits of \$282 million. In the third quarter of 2003, the segment reported net sales and operating

profits of \$1,579 million and \$156 million, respectively. Included in the 2003 results is a charge of approximately \$20 million primarily related to severance costs and asset impairments. Demand for building materials has been exceptionally strong since the third quarter of 2003, driven by a robust housing market. During July and August of 2004, housing starts and non-residential spending were 8% higher than last year.

Third quarter 2004 average selling prices for plywood, softwood lumber, particleboard, oriented strand board and gypsum increased 11%, 17%, 33%, 4% and 21%, respectively, compared with the same period last year. Sales volumes were also significantly higher for gypsum. Manufacturing costs were up year-over-year driven by wood and natural gas.

Operating profits are expected to decline sharply in the fourth quarter of 2004. Plywood and OSB prices fell dramatically during October to their lowest levels of the year. Housing starts remain at historically high levels, although new home inventories have grown approximately 20% since last year and approximately 8% since June 2004. Mortgage applications have declined approximately 26% since last year and approximately 5% over the last quarter.

BUILDING PRODUCTS DISTRIBUTION

As stated above, we sold our building products distribution segment on May 7, 2004 and therefore operating profits for the third quarter of 2004 consisted solely of a \$13 million gain on the divestiture of the business as a result of the final working capital adjustment. During the third quarter of 2003, the segment reported net sales and operating profits of \$1,187 million and \$52 million, respectively.

OTHER

The operating loss in the "Other" segment, which includes some miscellaneous businesses, unallocated corporate operating expenses and the elimination of profit on intersegment sales was \$122 million in 2004 and \$13 million in the 2003 third quarter. The third quarter 2004 loss included \$24 million of stock-based compensation expenses; \$13 million of compensation expenses which vary based on the company's financial performance; and \$5 million of net foreign currency transaction losses associated with foreign borrowings. Included in the third quarter 2003 results are \$11 million of stock-based compensation expenses and \$11 million of variable compensation expenses. Also included in the 2003 results was a credit of \$118 million to increase the estimated amount that we will receive from asbestos liability insurance, offset by a charge of \$21 million to settle a class action lawsuit, a \$13 million charge associated with our captive insurance subsidiary and a charge of \$12 million for pension settlement costs.

YEAR-TO-DATE 2004 COMPARED WITH YEAR-TO-DATE 2003

During the first nine months of 2004 we reported consolidated net sales of \$15.2 billion, compared with net sales of \$14.4 billion for the first nine months of 2003.

Interest expense decreased \$64 million to \$542 million in the first nine months of 2004 compared with \$606 million in the first nine months of 2003, principally as a result of lower debt levels offset somewhat by higher average interest rates. Interest expense allocated to discontinued operations was \$5 million and \$11 million in the

first nine months of 2004 and 2003, respectively.

During the first nine months of 2004, we reported income from continuing operations before income taxes of \$963 million and an income tax provision of \$352 million, compared with income from continuing operations before income taxes and accounting changes of \$256 million and an income tax provision of \$69 million for the first nine months of 2003. The effective tax rate in 2004 was higher than the statutory rate primarily because of taxes related to the sale of our interest in a Brazilian pulp business and the sale of our non-integrated pulp mills, partially offset by lower international income tax rates. The effective tax rate in 2003 was different from the statutory rate primarily because of lower international income tax rates, utilization of state tax credits and the first quarter reversal of approximately \$10 million of income tax contingency reserves no longer required in Europe.

On December 29, 2002, we adopted SFAS No. 143. SFAS No. 143 requires that entities record the fair value of an asset retirement obligation in the period in which it was incurred. The cumulative effect of adopting SFAS No. 143 was an after-tax credit of \$28 million effective at the beginning of 2003 (see

Note 9 of the Notes to Financial Statements).

The remaining discussion refers to the "Consolidated Selected Operating Segment Data" table (included in

Note 15 to the Consolidated Financial Statements).

NORTH AMERICA CONSUMER PRODUCTS

Net sales and operating profits for the North America consumer products segment were \$4.2 billion and \$476 million, respectively, for the first nine months of 2004, and \$4.0 billion and \$434 million, respectively, for the first nine months of 2003. Included in the 2004 results was a \$27 million pre-tax charge for employee termination costs, asset impairments and asset write-offs primarily related to restructurings in the Dixie business and at the Green Bay, Wisconsin and Bellingham, Washington paper mills. Included in the 2003 operating results were pre-tax charges related to the partial shutdown of tissue-manufacturing and converting operations at our Old Town, Maine facility (see

Note 6 of the Notes to Financial Statements) of \$25 million for asset impairments and \$9 million for severance and business exit costs. Third quarter 2003 operating results also included a pre-tax charge of \$3 million related to our Norwalk office closure.

Operating margins were slightly higher for the first nine months of 2004 due primarily to higher selling prices for retail tissue and Dixie products. These pricing improvements were partially offset by higher costs for waste paper, purchased pulp, natural gas, electricity, resin and transportation. Advertising costs were also higher, driven by the re-launch of our Brawny® paper towels and Quilted Northern® bathroom tissue in first quarter 2004. Case shipments were modestly higher in 2004, as market conditions were competitive in all businesses.

INTERNATIONAL CONSUMER PRODUCTS

During the first nine months of 2004, the international consumer products segment reported net sales and operating profits of \$1.5 billion and \$135 million, respectively, compared with \$1.4 billion and \$123 million of net sales and operating profits, respectively, in the prior year. Included in the 2004 results is a \$5 million charge primarily related to our Athens (Greece) converting facility closure and a fire at our Russian facility, offset by a \$4 million reversal of severance accruals. These comparisons were impacted by a weaker U.S. dollar relative to the Euro in the 2004 period, which benefited reported net sales by approximately \$155 million and benefited reported operating profits by approximately \$14 million. Excluding favorable impacts from the weaker U.S. dollar, operating profits were relatively flat year over year. Competitive market conditions in most countries caused our

sales volumes to remain flat, while selling prices declined in local currencies. We experienced higher costs for purchased pulp in the first nine months of 2004, but were able to offset these negative impacts through cost reduction efforts in other areas of our business.

PACKAGING

The packaging segment reported net sales of \$2.2 billion and operating profits of \$227 million in the first nine months of 2004, compared with net sales of \$2.1 billion and operating profits of \$236 million in the first nine months of 2003. Included in the operating results of both 2004 and 2003 were gains of \$18 million on the sale of some packaging assets, net of associated severance. 2004 operating profits were impacted by a 24% increase in OCC costs. Average costs for wood and natural gas were also higher in the 2004 period. These costs were largely offset by 4% higher sales volumes for containerboard and boxes.

BLEACHED PULP AND PAPER

The bleached pulp and paper segment reported net sales of \$1.7 billion and operating profits of \$27 million during the first nine months of 2004. For the same period in 2003, the segment reported net sales of \$1.5 billion and an operating loss of \$40 million. Included in the 2004 operating results is a pre-tax gain of \$24 million related to sale of our interests in a Brazilian pulp business and a \$17 million loss from our minority interest in Unisource. Included in the 2003 operating results is an impairment charge of \$49 million related to the partial shutdown of tissue-manufacturing and converting operations at our Old Town, Maine mill (see

Note 6) and a \$20 million loss from the company's minority interest in Unisource. Sales volumes for the first nine months of 2004 were above 2003 levels, due to a strengthening U.S. economy and a weaker U.S. dollar, which improved export conditions for the industry. In spite of these improving conditions, average selling price levels in the 2004 period were slightly lower than 2003 for paper, with a 3% decrease for bleached board and kraft grades. Average cost levels in the first nine months of 2004 for wastepaper, natural gas, electricity and transportation were also above 2003 levels.

BUILDING PRODUCTS MANUFACTURING

During the first nine months of 2004, the building products manufacturing segment reported net sales of \$5.3 billion and operating profits of \$911 million. In the first nine months of 2003, the segment reported net sales and operating profits of \$4.3 billion and \$178 million, respectively. Demand for building materials has been exceptionally strong since the third quarter of 2003, resulting in significantly higher selling prices and volumes in 2004 when compared with the first nine months of 2003. Average selling prices for plywood, softwood lumber, particleboard, oriented strand board and gypsum increased 37%, 19%, 28%, 58% and 15%, respectively, when compared with the same period in 2003. Sales volumes for plywood, oriented strand board, gypsum, and softwood lumber increased 3%, 6%, 14% and 11%, respectively. Particleboard volumes were relatively flat year over year. Average wood costs were higher in the first nine months of 2004, as were natural gas costs.

BUILDING PRODUCTS DISTRIBUTION

As stated above, we sold our building products distribution segment on May 7, 2004 and therefore our 2004 operating results for this segment represent four months of operations compared with nine months in 2003. Net sales and operating profits for the building products distribution segment were \$1.9 billion and \$111 million, respectively, for the first nine months of 2004. During the same period in 2003, the segment reported net sales and operating profits of \$3.1 billion and \$76 million, respectively. Included in the 2004 operating results is a \$20 million pre-tax gain on the sale of the distribution business. The increase in operating profits is a result of increased

selling prices for plywood, oriented strand board and lumber.

OTHER

The operating loss in the "Other" segment, which includes some miscellaneous businesses, unallocated corporate operating expenses and the elimination of profit on intersegment sales was \$382 million in 2004 and \$145 million in the first nine months of 2003. The results for the first nine months of 2004 included a \$53 million loss from early extinguishment of debt; \$97 million of stock-based compensation expenses; \$40 million of compensation expenses which vary based on the company's financial performance; and \$8 million of net foreign currency transaction gains associated with foreign borrowings. Included in the results for the first nine months of 2003 results are \$21 million of stock-based compensation expenses and \$16 million of compensation expenses which vary based on the company's financial performance. Also included in the 2003 results was a credit of \$118 million to increase the estimated amount that we will receive from asbestos liability insurance, a charge of \$21 million to settle a class action lawsuit, a \$13 million charge associated with our captive insurance subsidiary and a charge of \$12 million for pension settlement costs.

LIQUIDITY AND CAPITAL RESOURCES

During the first nine months of 2004, debt decreased by approximately \$1.7 billion to \$8.9 billion. We expect our cash flow from operations and financing activities will be sufficient to fund planned capital investments, pay dividends and make scheduled debt repayments for the foreseeable future. The following discussion provides further details of our liquidity and capital resources.

OPERATING ACTIVITIES For the first nine months of 2004 we generated cash from operations of \$939 million compared to \$1,182 million a year ago. Cash provided by operations in 2003 was unusually high because of a \$354 million income tax refund received in April 2003.

During the first nine months of 2004, we experienced a seasonal working capital increase of \$340 million compared to an increase of \$181 million in the same period last year. Approximately 75% of this increase represents working capital growth in our building products distribution business prior to its being sold on May 7, 2004.

Accounts receivable increased by \$481 million in the 2004 period compared with a \$282 million seasonal increase during the first nine months of 2003. The current year increase in accounts receivable reflects significantly higher sales levels in our building products manufacturing and distribution businesses, as well as sales growth in our North America consumer products and packaging segments. Inventories increased by \$67 million compared with a decrease during the first nine months of 2003 by \$27. Excluding modest growth in building products distribution inventories prior to the sale of that business in early May, inventories were relatively flat in the first nine months of 2004. Accounts payable increased by \$208 million during the first nine months of 2004, reflecting generally increased business levels as well as cost inflation for energy, fiber and transportation, compared with a \$74 million increase in the comparable 2003 period.

INVESTING ACTIVITIES. Capital expenditures for property, plant and equipment for the first nine months of 2004 were \$448 million, which included \$149 million in the North America consumer products segment, \$48 million in the international consumer products segment, \$100 million in the packaging segment, \$42 million in the

bleached pulp and paper segment, \$66 million in the building products manufacturing segment, \$9 million in sold business units and \$34 million in the other segment. Capital expenditures for property, plant and equipment in the first nine months of 2003 were \$480 million. Our full-year capital spending outlook for 2004 is approximately \$700 million. This includes a new oriented strand board facility in Hosford, Florida, which will start up in the first half of 2005. We are also evaluating energy savings projects at mills that have high natural gas consumption.

In February 2004, the United States EPA finalized two new maximum achievable control technology (MACT) requirements that establish new air emission limits for plywood and composite panel facilities (PCWP MACT) and for boilers at both wood products and pulp and paper facilities (Boiler MACT). Compliance with these standards will be required by mid 2007. We currently estimate compliance cost for the PCWP MACT standard to be approximately \$80 million at 40 plants and approximately \$50 million to install emission control technology on 38 boilers at various manufacturing locations. The bulk of the capital spending will occur in 2005 and 2006 to be funded from operating cash flows.

During the second quarter of 2004, we sold all of our interests in a Brazilian pulp business for \$71 million. This transaction resulted in a pre-tax gain of \$24 million and was included in "Other (income) losses, net" on the statements of operations.

On May 7, 2004, we completed the sale of our non-integrated mills at Brunswick, Georgia, and New Augusta, Mississippi, along with a short-line railroad, to Koch Cellulose, LLC ("Koch") and its subsidiaries for \$511 million in cash and a receivable of approximately \$9 million for working capital, which was received on October 5, 2004. In addition, Koch assumed \$73 million of indebtedness. This transaction resulted in a pre-tax gain of \$5 million and an after tax loss of \$13 million that was included in discontinued operations on the statements of operations.

On May 7, 2004, we completed the sale of our building products distribution segment to a new company owned by Cerberus Capital Management L.P., a private investment firm, and members of the building products distribution business' management team for \$818 million. In addition, we received \$173 million in cash in June to settle an intercompany payable related to product sold to the building products distribution business prior to closing. This transaction resulted in a pre-tax gain of \$20 million (\$12 million after-tax gain) and was included in "Other income, net" on the statements of operations.

During the second quarter of 2004, we purchased certain packaging assets in Ontario, California and Harrington, Delaware for approximately \$20 million. Also during the second quarters of both 2004 and 2003, we sold certain packaging assets and recorded pre-tax gains, net of related severance, of \$18 million in both quarters. These gains were reflected in "Other income, net" in the accompanying statements of operations. During the third quarter of 2004, we sold three hardwood lumber mills for proceeds of \$27 million.

In the second quarter of 2003, we received approximately \$193 million of income tax refund from the sale of a 60% controlling interest in our Unisource paper distribution business.

FINANCING ACTIVITIES. Our debt decreased by \$1,736 million to \$8,912 million at October 2, 2004 from \$10,648 million at January 3, 2004. This decrease includes the effect of changes in foreign currency exchange rates of \$15 million during this time period. For the nine months ended October 2, 2004, the weighted average interest rate on our total debt, including outstanding interest rate exchange agreements, was 7.2%. The following table details the activity in our short and long-term debt balances in 2004:

| (in millions) | Short-term | Long-term* | Total |
|---|------------|------------|-----------|
| Beginning balances: | \$ 689 | \$ 9,959 | \$ 10,648 |
| Maturities: | | | |
| Eurobond | -- | (363) | (363) |
| Industrial revenue bonds | -- | (30) | (30) |
| Money markets | (400) | -- | (400) |
| Notes | -- | (320) | (320) |
| Assumed by buyer | -- | (73) | (73) |
| Repayments** | (947) | (4,551) | (5,498) |
| Borrowings** | 1,044 | 3,919 | 4,963 |
| Other: | | | |
| Effect of foreign currency exchange rates | -- | (15) | (15) |
| Ending balances | \$ 386 | \$ 8,526 | \$ 8,912 |

* Includes current portion of long-term debt of \$558 million.

** Includes repayments and re-borrowings of our Senior Credit Facility of \$3,487 million and \$3,867 million, respectively.

For a detailed discussion of our current debt position and the current year activity, refer to

Note 10.

Our borrowing arrangements contain a number of financial and non-financial covenants, which restrict our activities. The more significant financial covenants are mentioned in

Note 10. In addition, certain agreements contain cross-default provisions. Our continued compliance with these restrictive covenants is dependent a number of factors, many of which are outside of our control. Should events occur that result in noncompliance, we believe there are remedies available that are acceptable to our lenders and us.

The following table presents principal (or notional) amounts and related weighted average interest rates by year of expected maturity for our debt obligations and interest rate exchange agreements as of October 2, 2004. For obligations with variable interest rates, the tables set forth payout amounts based on weighted average rates for the year ended October 2, 2004, and do not attempt to project future interest rates.

| <u>(in millions)</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> |
|------------------------|---------------|--------------|---------------|---------------|
| Debt | | | | |
| Secured borrowings | \$ 386 | -- | -- | -- |
| Average interest rates | 2.0% | -- | -- | -- |
| Credit facilities | -- | -- | -- | -- |
| Average interest rate | -- | -- | -- | -- |
| Notes and debentures | \$ 516* | -- | \$ 607 | \$ 300 |
| Average interest rates | 8.0% | -- | 7.4% | 6.9% |
| Revenue bonds | -- | \$ 22 | \$ 1 | \$ 29 |
| Average interest rates | -- | 5.6% | 5.7% | 4.9% |
| Capital leases | \$ 2 | \$ 13 | \$ 14 | \$ 17 |
| Average interest rates | 8.8% | 8.8% | 8.8% | 9.6% |
| European debt | \$ 9 | \$ 11 | \$ 9 | \$ 5 |
| Average interest rates | 4.5% | 4.6% | 4.7% | 3.9% |
| Other loans | \$ 5 | \$ 4 | -- | -- |
| Average interest rates | 2.8% | 2.9% | -- | -- |
| Subtotal | \$ 918 | \$ 50 | \$ 631 | \$ 351 |

| | | | | |
|--|----|-------|----|----|
| Notional amount of interest rate exchange agreements (rate collar) | -- | \$ 47 | -- | -- |
| Average interest rate cap | -- | 7.5% | -- | -- |
| Average interest rate floor | -- | 5.5% | -- | -- |

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| <u>(In millions)</u> | <u>2008</u> | <u>Thereafter</u> | <u>Total</u> | <u>Fair value</u> <u>October 2,</u> <u>2004</u> |
|------------------------|-------------|-------------------|--------------|---|
| Debt | | | | |
| Secured borrowings | -- | -- | \$ 386 | \$ 386 |
| Average interest rates | -- | -- | 2.0% | 2.0% |
| Credit facilities | -- | \$ 630 | \$ 630 | \$ 630 |

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|---------------------------------|--------|----------|----------|----------|
| Average interest rates | -- | 3.1% | 3.1% | 3.1% |
| Notes and debentures | \$ 350 | \$ 5,069 | \$ 6,842 | \$ 7,648 |
| Average interest rates | 7.4% | 8.4% | 8.2% | 6.1% |
| Revenue bonds | \$ 21 | \$ 666 | \$ 739 | \$ 735 |
| Average interest rates | 5.0% | 5.4% | 5.2% | 5.5% |
| Capital leases | \$ 22 | \$ 199 | \$ 267 | \$ 317 |
| Average interest rates | 9.0% | 8.1% | 8.4% | 5.6% |
| European debt | \$ 5 | \$ 36 | \$ 75 | \$ 75 |
| Average interest rates | 3.5% | 3.5% | 3.9% | 3.9% |
| Other loans | -- | -- | \$ 9 | \$ 9 |
| Average interest rates | -- | -- | 2.8% | 3.0% |
| Subtotal | \$ 398 | \$ 6,600 | \$ 8,948 | |
| Less: unamortized debt discount | | | (36) | |
| Total debt balance | | | \$ 8,912 | |

| | | | | |
|--|----|----|-------|------|
| Notional amount of interest rate exchange agreements (rate collar) | -- | -- | \$ 47 | \$ 2 |
| Average interest rate cap | -- | -- | 7.5% | 7.5% |
| Average interest rate floor | -- | -- | 5.5% | 5.5% |

*Amount includes the two \$250 million debentures to be redeemed during the 4th quarter of 2004.

Approximately \$62 million of our revenue bonds are supported by letters of credit that expire within one year. We have the ability and intent to refinance these revenue bonds on a long-term basis. Therefore, maturities of these obligations are reflected in accordance with their stated terms.

The following table presents commitment amounts by year of expected expiration for our standby letter of credit agreements.

| <u>(In millions)</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>Thereafter</u> | <u>Total</u> |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|-------------------|--------------|
| Standby Letters of Credit** | -- | -- | -- | -- | -- | \$ 21 | \$ 21 |

** Standby letters of credit not included in

Note 10 under the credit facilities.

We intend to renew the standby letters of credit where appropriate as they mature, therefore, the obligations do not have a definitive maturity date.

On July 14, 2004, Moody's Investors Service (Moody's) upgraded our liquidity rating from SGL-3 (adequate) to SGL-2 (good). Moody's indicated that the upgrade was in response to our Senior Credit Facility that we entered into on July 2, 2004.

On May 4, 2004, Standard & Poor's Ratings Services revised its outlook on our long-term debt to 'stable' from 'negative' and affirmed its rating of BB+. Standard & Poor's Ratings Services indicated that the ratings actions reflect our improving financial profile and much better liquidity. On April 28, 2004, Fitch Ratings increased our senior unsecured long-term debt ratings to BB+ from BB and changed our rating outlook to 'stable'. Fitch Ratings indicated that this upgrade is primarily due to debt reductions resulting from expected asset sales as well as increased cash flows from operations. Additionally, on April 14, 2004, Moody's revised the outlook for our Senior Implied Ba2 debt rating to 'stable' from 'negative' citing our plans to reduce debt with proceeds from our expected asset sales.

On September 21, 2004, we elected to call \$250 million of our 8.25% debentures due March 1, 2023 and \$250 million of our 8.125% debentures due June 15, 2023. These debentures will be redeemed on or about October 28, 2004 using funds available under our existing credit facilities. We have classified the related debt as "Current portion of long-term debt" on the accompanying balance sheets as of October 2, 2004. In the fourth quarter of 2004, we expect to record a pretax charge of \$22 million for call premiums and to write off deferred debt issuance costs.

At October 2, 2004, we had interest rate exchange agreements (a collar) that effectively capped \$47 million of floating rate obligations to a maximum interest rate of 7.5% and established a minimum interest rate on these obligations of 5.5%. Our interest expense is unaffected by this agreement when the market interest rate falls within this range. As of October 2, 2004, these agreements decreased interest expense by less than \$2 million. The agreements had a weighted-average maturity of approximately one year at October 2, 2004.

The estimated fair value of our interest rate exchange agreements at October 2, 2004 was a \$2 million asset. The liability balance represents the estimated amount we would be paid if the agreements were terminated on October 2, 2004. The fair value at October 2, 2004 was estimated by calculating the present value of anticipated cash flows. The discount rate used was an estimated borrowing rate for similar debt instruments with like maturities.

At October 2, 2004, we had \$1,160 million of floating rate debt outstanding, which represented approximately 13% of our total debt balance. The call of our 8.25% debentures and 8.125% debentures described above, along with our planned use of interest rate swaps to convert approximately \$500 million of fixed-rate debt to variable rate debt during the fourth quarter, will increase our percentage of variable-rate debt to approximately 25% of our aggregate debt. Generally, we seek to have no more than 25% of our aggregate debt at variable rates to minimize our exposure to fluctuating interest rates.

As of October 2, 2004, we had \$1.5 billion of debt and equity securities available for issuance under a shelf registration statement filed with the Securities and Exchange Commission in 2000.

During the first nine months of 2004 and 2003, we paid dividends totaling \$97 million and \$94 million, respectively.

OTHER. We employ approximately 55,000 people, including approximately 23,000 who are members of unions. We consider our relationship with our employees to be good. Forty-six union contracts are subject to negotiation and renewal in 2004, including ten at major facilities. Thirty-seven of these contracts were renewed during the first nine months of 2004.

Critical Accounting Policies

The following are accounting policies that management believes are most important to the portrayal of our financial condition and results and require management's most difficult, subjective, or complex judgments.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Judgments and assessments of uncertainties are required in applying our accounting policies in many areas. For example, key assumptions are particularly important when determining amounts allocated to identifiable intangible assets in a business combination and in developing our projected liabilities for pension and other postretirement benefits.

Environmental and Legal Matters

Other areas in which significant uncertainties exist include, but are not limited to, projected costs to be incurred in connection with environmental and legal matters, including our asbestos liabilities. The more important assumptions in assessing our asbestos liability are the projection of the number of claims that will be filed against us in the future, which are influenced by the population potentially exposed to asbestos-containing products manufactured by us, the expected occurrence of various diseases in these potentially exposed populations, the rate at which these potentially exposed populations actually file claims, and activities of the asbestos plaintiffs' bar designed to maximize its profits from such claims. The cost of settling claims is driven by these same assumptions, as well as by prevailing judicial and social environments in the jurisdictions in which claims are filed, the rulings by judges and the attitudes of juries in those jurisdictions, the demands of the asbestos plaintiffs' bar with respect to the value of each such claim, the insolvencies of other defendants to a particular claim, and the impact of verdicts against or settlements by other defendants on settlement demands against us. The unique nature of our asbestos claims and the calculation of the liability does not lend itself to a sensitivity analysis.

We recognize a liability for environmental remediation and legal indemnification and defense costs when we believe it is probable a liability has been incurred and the amount can be reasonably estimated. The liabilities are developed based on currently available information and reflect the participation of other potentially responsible parties, depending on the parties' financial condition and probable contribution. The accruals are recorded at undiscounted amounts and are reflected as liabilities on the accompanying consolidated balance sheets. We also have insurance that covers a substantial part of our asbestos liabilities and defense costs and losses on certain environmental claims. We record insurance recoveries as a receivable to the extent that the realization of the insurance is deemed probable. Such receivables are recorded at an undiscounted amount and are reflected as an asset in the accompanying consolidated balance sheets.

Environmental remediation costs are generally expensed. Environmental compliance costs are generally capitalized when the costs improve the condition of the property or prevent or mitigate future contamination.

Goodwill and Long-Lived Assets

In addition, management uses judgment in assessing goodwill and other long-lived assets for impairment. In accordance with the transition provisions of SFAS No. 142, we have assessed the recoverability of our goodwill. Goodwill totaled \$7.5 billion at October 2, 2004 and represented 32% of our total assets. We review the recorded value of our goodwill annually at the beginning of the third fiscal quarter of each year, or sooner if events or changes in circumstances indicate that the carrying amount may exceed fair value. Recoverability is determined by comparing the estimated fair value of the reporting unit to which the goodwill applies to the carrying value, including goodwill, of that reporting unit. We utilize the present value of expected net cash flows to determine the estimated fair value of our reporting units. This present value model requires management to estimate future net cash flows, the timing of these cash flows, and a discount rate (or weighted average cost of capital) representing the time value of money and the inherent risk and uncertainty of the future cash flows. The discount rate, adjusted for inflation, is based on independently calculated beta risks for a composite group of consumer products companies and forest products peer companies, our target capital mix, and an estimated market risk premium. The assumptions used in estimating future cash flows were consistent with the reporting unit's internal planning. If the estimated fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not impaired. If the carrying amount of the reporting unit exceeds its estimated fair value, the implied fair value of the reporting unit goodwill is compared to the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. If the discount rate used to estimate the fair value of each reporting unit were increased by 100 basis points, the fair value would continue to exceed the carrying value for all of our reporting units.

We assess our long-lived assets other than goodwill for impairment whenever facts and circumstances indicate that the carrying amount may not be fully recoverable. To analyze recoverability, we project undiscounted net future cash flows over the remaining life of the assets. If these projected cash flows are less than the carrying amount, an impairment would be recognized, resulting in a write-down of assets with a corresponding charge to earnings. The impairment loss is measured based upon the difference between the carrying amount and the fair value of the assets.

Accounting Changes

During the second quarter of 2004, we adopted FASB Staff Position FAS 106-2 ("the FSP"), *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*. The FSP provides specific guidance on how to account for the subsidy provided by the Medicare Prescription Drug, Improvement and Modernization Act of 2003 ("the Act"). The FSP provides for either retroactive application to the date of enactment or prospective application from the date of adoption. We have elected retroactive application to the date of enactment, the impact of which was a reduction to net postretirement benefit cost of approximately \$2 million in the second quarter of 2004 and a reduction of the accumulated postretirement benefit obligation of approximately \$67 million.

In January 2003, the FASB released FIN 46. FIN 46 requires that all primary beneficiaries of Variable Interest Entities (VIE) consolidate that entity in their financial statements. FIN 46 is effective for VIEs created after January 31, 2003 and for VIEs in which an enterprise obtains an interest after that date. It applies in the first fiscal

year or interim period beginning after June 15, 2003, to VIEs in which an enterprise holds a variable interest it acquired before February 1, 2003. In December 2003, the FASB published a revision to FIN 46 ("FIN 46R") to clarify some of the provisions of the interpretation and defer the effective date of implementation for certain entities. Under the guidance of FIN 46R, entities that do not have interests in structures that are commonly referred to as special purpose entities are required to apply the provisions of the interpretation in financial statements for periods ending after March 14, 2004. We do not have interests in special purpose entities that are not consolidated.

CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. Some of the matters discussed in this Form 10-Q concerning, among other things, the business outlook, anticipated financial and operating results, strategies, contingencies and our contemplated transactions, constitute forward-looking statements and are based upon management's expectations and beliefs concerning future events. There can be no assurance that these events will occur or that our results will be as estimated. In some cases, the forward-looking statements contained in this Form 10-Q can be identified by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "believes," or "estimates," or the negative of these terms or other comparable terminology.

Forward-looking statements are only predictions. Therefore, readers are cautioned not to place undue reliance on these forward-looking statements, which are based on information known today and speak only as of the date of the filing of this Form 10-Q. Moreover, in the future, we, through our senior management team, may make additional or different forward-looking statements about the matters described in this document. We undertake no obligation to publicly revise any of these forward-looking statements to reflect changes in the facts or information on which they are based or any events or circumstances occurring after the date hereof. Actual events or future results may differ materially as a result of the following factors, as well as other factors described elsewhere in this Form 10-Q, and in our other SEC filings, including our Form 10-K for our fiscal year-ended January 3, 2004, which are incorporated herein by this reference.

Forward-looking statements also involve risks and uncertainties, which could cause actual results to differ materially from those contained in any forward-looking statement. Many of these factors are beyond our ability to control or predict. In addition to the risks, uncertainties and assumptions discussed elsewhere herein, factors that could cause or contribute to actual results differing materially from such forward-looking statements include the following:

the realization of announced price increases for many of our products, continued strength in new home building and home renovation, the effect of general economic conditions on the demand for consumer products, building products, and pulp and paper, the corresponding level of demand for and cost of wood fiber, wastepaper, energy and other costs, the success of the branding and marketing strategies we are pursuing for our consumer products, the effect of changes in the productive capacity of manufacturers of competitive products, unanticipated expenditures with respect to environmental, safety and health laws, our ability to continue to reduce debt, actions taken or to be taken by the United States or other governments as a result of the situation in Iraq and acts or threats of terrorism, and other risks, uncertainties and assumptions discussed in our periodic filings with the Securities and Exchange Commission.

Risk Factors

The following factors, which we caution are not exclusive, are described in accordance with the provisions of the Private Securities Litigation Reform Act of 1995, which encourages companies to disclose these factors.

Substantial Indebtedness

As described in this Form 10-Q, we have substantial indebtedness. Our ability to meet our debt service obligations and to repay our outstanding indebtedness will depend in part on cash from operations. There can be no assurance that our businesses will be able to generate sufficient cash flows from operations, as they are subject to general economic, business, financial, competitive, legislative, regulatory and other factors beyond our control.

Competition and Business Volatility

We face intense competition from both large international and small domestic producers in most of our businesses.

In our consumer products businesses, we believe we have a strong competitive position with low-cost operations, manufacturing expertise, and strong brands in North America as well as most countries in Europe. We do face competition from established, global consumer products competitors. Aggressive actions by these competitors can lead to decreased pricing and/or increased advertising and promotional spending by us in order to maintain market share. In order to achieve and/or maintain leadership positions in key product categories, we must continue to develop brand recognition and loyalty through the development and introduction of new products and product line extensions; continue to enhance product quality and performance; and continue to develop our marketing and distribution capabilities to serve our customers.

Operating results in our building products, packaging and bleached pulp and paper businesses are typically more volatile than in our consumer products businesses. Most of the products in these businesses are commodities, where selling price tends to be the principal competitive factor. We cannot control such factors as decreasing demand from customers or increasing supply from competitors, both of which may cause rapid price decreases for such products and in turn adversely affect our net sales, operating income and cash flows.

Costs Associated with Environmental Compliance and Remediation

Our operations are subject to significant regulation by federal, state and local environmental and safety authorities. The costs of compliance with existing and new regulatory schemes could require significant capital expenditures that would decrease the amount of funds available for investment in other areas of our operations. For example, the United States Environmental Protection Agency has recently issued new air emission regulations, known as "MACT" or Maximum Achievable Control Technology regulations, as described in "Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources." The costs of compliance with these regulations, and additional or supplementary regulations, cannot be quantified in all cases, and there can be no assurance that the costs of such compliance will not be material to our results of operations in certain reporting periods. In addition, the costs of remediating known environmental sites, as described in

Note 13, in some instances has been significant and remediation of future sites could also be significant. There can be no assurance that the final remediation costs will equal currently estimated costs or that additional sites will not require significant remediation expenses.

Litigation

We are subject to significant asbestos litigation liabilities and costs, as discussed below, and to other litigation risks that are similar to other corporations of our size and complexity in an increasingly litigious environment.

While we do not believe that any of these matters will be material to our long-term financial status, certain litigation-related matters may be material to our results of operations in certain reporting periods.

As of October 2, 2004, we have recorded reserves totaling \$882 million for asbestos liabilities and defense costs, and insurance receivables of \$550 million, which reflects our expected payments and receipts through 2013. Projecting liabilities for asbestos litigation is subject to a number of important risks and uncertainties, including the possibility that the number of asbestos claims filed against us in the future will be greater than projected; the risk that the cost of defending and settling current and future asbestos claims will be higher than projected, resulting in more rapid depletion of available insurance coverage and higher out-of-pocket costs; the possibility of additional insolvencies among insurance carriers; the risk that final resolution of allocation, coverage or other issues affecting available insurance coverage will result in lower insurance recoveries than forecast; the possibility that adverse jury verdicts could require us to pay damages in amounts greater than the amounts for which we now settle cases; and the risk that bankruptcies of other asbestos defendants may increase our costs in the future.

These or other factors could cause our actual liabilities to be materially higher, and our insurance recoveries to be materially lower, than those projected and recorded to date. If these or other factors cause us to determine that the assumptions used to project our asbestos liabilities and defense costs, and insurance recoveries, through 2013 are no longer reasonable, or if we determine that our asbestos liabilities net of insurance recoveries for years after 2013 will be material, we may have to establish additional reserves relating to asbestos beyond the charges already taken, and the amount of these reserves may be material. We cannot estimate the amount of any such additional reserves at this time.

The reader should not place undue reliance on any forward-looking statements, which are based on current expectations. See the Cautionary Statement above.

For a discussion of commitments and contingencies refer to

Note 13 of the Notes to Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to commodity price risk related to the use of natural gas in many of our facilities. During the third quarter of 2004, we entered into commodity swap agreements under our company-wide natural gas hedging program to reduce the risk inherent in fluctuating natural gas prices. These swap agreements are considered cash flow hedges of our natural gas purchases and differences paid and received under the swap agreements are recognized as adjustments to gas costs. These hedges are considered to be highly effective in offsetting the cash flows of our natural gas costs and therefore the changes in fair value are recorded in accumulated other comprehensive income. With each type of cash flow hedge, the settlement of the forecasted transaction will result in the reclassification into earnings of gains and losses that are reported in accumulated other comprehensive income.

At October 2, 2004, these contracts had a notional quantity of 2.9 million MMBtus of natural gas and the fair market value of such contracts was an asset of \$4 million. As of October 2, 2004, \$4 million of deferred gains on these hedges included in accumulated other comprehensive income are expected to be reclassified into earnings during the next four months.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures which, by their nature, can provide only reasonable assurance regarding management's control objectives.

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer along with our Chief Financial Officer, on the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14 as of the end of the period covered by this Quarterly Report on Form 10-Q. Based upon that evaluation, each of our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to Georgia-Pacific Corporation (including its consolidated subsidiaries) required to be included in our Exchange Act reports. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out our evaluation.

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PART II - OTHER INFORMATION

GEORGIA-PACIFIC CORPORATION

October 2, 2004

Item 1. Legal Proceedings.

The information contained in

Note 13 "Commitments and Contingencies" of the Notes to Consolidated Financial Statements filed as part of this Quarterly Report on Form 10-Q is incorporated herein by reference.

Item 6. Exhibits.

| | |
|-----------------------|--|
| <u>Exhibit 23.1</u> - | Consent of National Economic Research Associates (NERA). (1) |
| <u>Exhibit 23.2</u> - | Consent of Navigant Consulting. (1) |
| <u>Exhibit 31.1</u> - | Certification by Alston D. Correll, as Chairman and Chief Executive Officer of Georgia-Pacific Corporation, pursuant to § 302 of the |

Sarbanes-Oxley Act of 2002 (15 U.S.C. § 7241).
(1)

Exhibit 31.2 - Certification by Danny W. Huff, as Executive Vice President-Finance and Chief Financial Officer of Georgia-Pacific Corporation, pursuant to § 302 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. § 7241). (1)

Exhibit 32.1 - Certification by Alston D. Correll, as Chairman and Chief Executive Officer of Georgia-Pacific Corporation, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350). (1)

Exhibit 32.2 - Certification by Danny W. Huff, as Executive Vice President-Finance and Chief Financial Officer of Georgia-Pacific Corporation, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350). (1)

(1) Filed herewith via EDGAR.

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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.

Date: October 28, 2004

GEORGIA-PACIFIC CORPORATION

(Registrant)

by /s/ Danny W. Huff
Danny W. Huff,
Executive Vice President - Finance
and Chief Financial Officer

by /s/ Robert P. Nelson
Robert P. Nelson,
Vice President and Controller

GEORGIA-PACIFIC CORPORATION
INDEX TO EXHIBITS
FILED WITH THE QUARTERLY REPORT
ON FORM 10-Q FOR THE
NINE MONTHS ENDED OCTOBER 2, 2004

| <u>Exhibit No.</u> | <u>Sequentially Numbered Description</u> |
|--------------------|---|
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