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

FORM 10-K
(as amended by Amendment No. 1 thereto)

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

For the fiscal year ended December 31, 2006 **Commission File Number 1-3924**

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

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

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

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

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

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

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

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

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

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

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, as of the last business day of the Registrant's most recently completed second fiscal quarter: $67.2 million.

Number of shares of common stock outstanding at March 26, 2007: 5,255,717

DOCUMENTS INCORPORATED BY REFERENCE:

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

TABLE OF CONTENTS

Part I

Part II

Part III

Part IV

PART I

ITEM 1. BUSINESS

General

MAXXAM Inc. and its controlled subsidiaries are collectively referred to herein as the **"Company"** or **"MAXXAM"** unless otherwise indicated or the context indicates otherwise. Any reference herein to a company includes the subsidiaries of that company unless otherwise noted or the context indicates otherwise. The term **"MAXXAM Parent"** refers to the Company on a stand-alone basis without its subsidiaries. The term **"MGHI"** refers to MAXXAM Group Holdings Inc., which is the parent of MAXXAM Group Inc. (see below). Some terms used herein are defined in the Glossary of Defined Term found at the end of this document. The Company conducts the substantial portion of its operations through its subsidiaries, which operate in three principal industries:

- Forest products, through MAXXAM Group Inc. (**"MGI"**) and MGI's wholly owned subsidiaries, principally The Pacific Lumber Company (**"Palco"**), Scotia Pacific Company LLC (**"Scopac"**), Britt Lumber Co., Inc. (**"Britt"**) and Scotia Development LLC (**"SDLLC"**). MGI and its subsidiaries primarily engage in the growing and harvesting of redwood and Douglas-fir timber, the milling of logs into lumber and related operations and activities. On January 18, 2007, Palco, Scopac, Britt, SDLLC and Palco's other subsidiaries (the **"Debtors"**) filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code (the **"Bankruptcy Code"**) in the United States Bankruptcy Court for the Southern District of Texas (the **"Bankruptcy Court"**). The term **"Palco Debtors"** is used to refer to all of the Debtors other than Scopac. See Note 1, "–Reorganization Proceedings of Palco and its Subsidiaries." The proceedings of the Debtors are collectively referred to herein as the **"Bankruptcy Cases."**

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

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

The Company previously owned approximately 63% of the common stock of Kaiser Aluminum Corporation (**"Kaiser"**), which engaged in several principal aspects of the aluminum industry. In February 2002, Kaiser and certain of its subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. Kaiser's plan of reorganization, which provided for the cancellation of Kaiser's equity, including the common shares held by the Company, became effective on July 6, 2006. As a result, the Company no longer has any ownership interest in or affiliation with Kaiser. See "– Kaiser Aluminum" and Notes 1 and 10 to the Consolidated Financial Statements contained herein for further information. Except as otherwise indicated, any reference in this document to a "Note" means the Notes to the Consolidated Financial Statements contained herein.

This Annual Report on Form 10-K contains statements which constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the **"PSLRA"**). *These statements appear in a number of places (see Item 1. "Business–Forest Products Operations–Principal Assets" and "–Regulatory and Environmental Factors;" most sections under Item 3. "Legal Proceedings;" and several sections under Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations"). Such statements can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "estimates," "should," "could," "plans," "intends," "projects," "seeks," or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy. Readers are cautioned that any such forward-looking statements are not guarantees of future performance and involve significant risks and uncertainties, and that actual results may vary materially from the forward-looking statements as a result of various factors. These factors include the effectiveness of management's strategies and decisions, general economic and business conditions, developments in technology, the ability to obtain financing, new or modified statutory, environmental or regulatory requirements, litigation developments, and changing prices and market conditions. This Report identifies other factors which could cause differences between such forward-looking statements and actual results. These or other factors could cause actual results to vary materially from the forward-looking statements.*

Forest Products Operations

General

The Company engages in forest products operations and related operations and activities through MGI, Palco, and wholly owned subsidiaries of Palco, principally Scopac, Britt and SDLLC. Palco, which has been in continuous operation for over 135 years, engages in the growing and harvesting of redwood and Douglas-fir timber, the milling of logs into lumber products, and certain related operations. Scopac has experienced difficulties and delays in the approval of its timber harvesting plans (**"THPs"**) as the result of regulatory and litigation challenges. These matters have resulted in declines in actual and expected harvest levels and cash flows, significant increases in the cost of logging operations, increased costs related to timber harvest litigation, and materially adverse effects on the operations and financial condition of Palco, Scopac and Palco's other subsidiaries. As a result, on January 18, 2007, Palco, Scopac, Britt, SDLLC and Palco's other subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. See Note 1, "–Reorganization Proceedings of Palco and its Subsidiaries."

Principal Assets

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

Palco owns and manages, principally through Scopac, approximately 210,000 acres of virtually contiguous commercial timberlands located in Humboldt County along the northern California coast (the **"Palco Timberlands"**), an area which has very favorable soil and climate conditions for growing timber. Palco also owns substantially all of the assets in the town of Scotia, California, including a sawmill and other industrial use facilities, a co-generation plant, 270 homes, various commercial properties, and all of the land associated with these assets. A number of Palco employees live in Scotia. Palco also owns and operates, through Britt, a sawmill in Arcata, California.

The Palco Timberlands, which are located in close proximity to Palco's sawmills and have an extensive network of roads, contain predominantly conifer timber. As of December 31, 2006, Palco's conifers consisted (by volume) of approximately 66% redwood, 30% Douglas-fir, and 4% other conifer timber. Approximately 200,000 acres of Palco's timberlands are owned by Scopac (the **"Scopac Timberlands"**), and Scopac has the exclusive right to harvest (the **"Scopac Timber Rights"**) approximately 10,000 acres of timberlands owned by Palco and its subsidiary, Salmon Creek LLC (**"Salmon Creek"**). The timber in respect of the Scopac Timberlands and the Scopac Timber Rights is collectively referred to as the **"Scopac Timber"** and the timberlands in respect of the Scopac Timber are referred to as the **"Scopac Timber Property."** Substantially all of Scopac's assets are pledged as security for its 6.55% Series B Class A-1 Timber Collateralized Notes, 7.11% Series B Class A-2 Timber Collateralized Notes and 7.71% Series B Class A-3 Timber Collateralized Notes (the **"Scopac Timber Notes"**). The Indenture governing the Scopac Timber Notes is referred to as the **"Scopac Indenture."** Under a master purchase agreement between Palco and Scopac (the **"Master Purchase Agreement"**), Palco harvests and purchases from Scopac virtually all of the logs harvested from the Scopac Timber. See "–Relationships among the Palco Companies" below for a description of this and other relationships among Palco, Scopac and Salmon Creek.

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

Scopac's foresters, wildlife and fisheries biologists, geologists, botanists and other personnel provide a number of forest stewardship techniques, including protecting the Scopac Timber from forest fires, erosion, insects and other damage, overseeing reforestation activities, and implementing and monitoring the numerous aspects of the extensive environmental and regulatory compliance required in connection with operation of the Palco Timberlands, including the various requirements of the HCP described below. Scopac's personnel also prepare THPs and maintain and update the information contained in its geographical information system (the **"GIS"**). See "–Harvesting Practices" below for a description of the GIS updating process and the THP preparation process. Palco and Scopac engage in extensive efforts to supplement the natural regeneration of timber and increase the amount of timber on the Palco Timberlands. Scopac and Palco are required to comply with California forestry regulations regarding reforestation, which generally require that an area be reforested to specified standards within an established period of time. Palco conducts regeneration activities on the Scopac Timber Property as part of Palco's services to Scopac under the services agreement (the **"Services Agreement"**) between Palco and Scopac described below (see "–Relationships among the Palco Companies"). Reforestation of redwood timber generally is accomplished through redwood sprouts that grow from the stumps of harvested trees and the planting of redwood seedlings at levels designed to optimize growth. Douglas-fir timber is regenerated almost entirely by planting seedlings. During 2006, Palco planted an estimated 585,000 redwood seedlings.

California law requires large timberland owners, including Palco, to demonstrate that their timber operations will not decrease the sustainable productivity of their timberlands. The applicable regulations require timber companies to project timber growth and harvest on their timberlands over a 100-year planning period and to demonstrate sustained yield, i.e., that their projected average annual harvest for any decade within the 100-year planning period will not exceed the average annual growth level at the end of the 100-year planning period. A timber company may comply with this requirement by submitting a sustained yield plan to the California Department of Forestry and Fire Protection (the **"CDF"**) for review and approval. Timber companies which do not have a sustained yield plan are allowed to follow alternative procedures (see below).

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

In December 2005, a California appellate court reversed a trial court decision invalidating the SYP and the incidental take permits issued by California in connection with the Environmental Plans (the **"California Permits"**). The plaintiffs appealed the appellate court decision to the California Supreme Court, which has accepted the appeal for review. See Item 3. "Legal Proceedings–Forest Products Litigation" for further information regarding this matter. As a result of these cases, Scopac from October 2002 until March 2005 obtained review and approval of its THPs under an alternative procedure in the California forest practice rules known as "Option C." Option C is available to landowners who have submitted an "Option A" plan to the CDF for review (as was done by Palco). An approved Option A plan is an alternative to obtaining approval of a sustained yield plan. Palco's Option A plan (the **"Option A Plan"**) was approved by the CDF in March 2005. Scopac is currently relying upon the Option A Plan to obtain THP approvals.

Harvesting Practices

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

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

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

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

Production Facilities

Palco's sawmills had historically been supplied almost entirely from timber harvested from the Palco Timberlands, which are located in close proximity to the sawmills. More recently, primarily as a result of increasing regulatorily-imposed harvest limits, Palco has had to supplement its internal log supply with logs purchased from third parties. Palco has not in general been able to obtain supplies of third party logs, particularly redwood, on terms and in quantities sufficient to offset the adverse impact of these harvest limits.

Palco has over the years implemented numerous technological advances intended to increase the operating efficiency of its production facilities and the recovery of finished products from its timber. In April 2004, Palco commenced a mill improvement project, including a new sawmill located in Scotia. The new sawmill was constructed in two phases. The first phase of the project, the processing of smaller diameter second growth logs (up to 24" in diameter) is a high-speed processing line that includes advanced scanning and optimization technology intended to maximize lumber recovery. The second phase, the relocation of large log equipment from a former Palco mill, came on line in October 2005. This phase allows for processing of larger logs up to 60" in diameter. In January 2004, Palco also completed a new $5.0 million planer project in Scotia. The new planer is capable of processing rough sawn boards into finished lumber much more rapidly than the older planers at Palco's former Carlotta and Fortuna mills (see below). These technology investments have not been sufficient to overcome the adverse effects of the regulatory harvest limits.

Britt's primary business is the processing of small diameter redwood logs into fencing products for sale to retail and wholesale customers. Britt purchases, primarily from Palco but also from other timberland owners, small diameter (6 to 15 inch) redwood logs of varying lengths. Britt processes these logs at its mill into a variety of fencing products, including "dog-eared" 1" by 6" fence stock in six foot lengths, 4" by 4" fence posts in 6 through 12 foot lengths, and other lumber products in 6 through 12 foot lengths. Britt's mill and related facilities are located in Arcata, California. Britt produced approximately 69, 79 and 86 million board feet of lumber in 2006, 2005 and 2004, respectively.

Two other mills, Carlotta and Fortuna, were permanently closed in 2004 and 2005, respectively, in connection with the mill improvement project. In addition, a finishing and remanufacturing plant in Scotia was closed in 2006 as part of Palco's ongoing efforts to operate more efficiently.

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

Palco owns and operates a cogeneration power plant which is fueled by the wood residue from logging and lumber production operations. The operations of Palco and Britt supplied 53% of the fuel in 2006. The power plant is capable of producing up to 32.5 megawatts per hour and generates substantially all of the energy requirements of Scotia, California. Palco sells surplus power to Pacific Gas and Electric Company. In 2006, the sale of surplus power accounted for approximately 6% of MGI's total revenues.

Products

MGI produced 218.7, 266.8 and 298.1 million board feet of lumber in 2006, 2005 and 2004, respectively. The following table sets forth the distribution of MGI's lumber production (on a net board foot basis) and revenues by product line:

Product	Year Ended December 31, 2006			Year Ended December 31, 2005		
	% of Total Lumber Production Volume	% of Total Lumber Revenues	% of Total Revenues	% of Total Lumber Production Volume	% of Total Lumber Revenues	% of Total Revenues
Upper grade redwood lumber	2%	5%	5%	2%	5%	4%
Common grade redwood lumber	66%	76%	75%	64%	72%	61%
Total redwood lumber	68%	81%	80%	66%	77%	65%
Upper grade Douglas-fir lumber	–	–	–	–	–	–
Common grade Douglas-fir lumber	32%	19%	20%	33%	22%	19%
Total Douglas-fir lumber	32%	19%	20%	33%	22%	19%
Other grades of lumber	–	–	–	1%	1%	1%
Total lumber	100%	100%	100%	100%	100%	85%
Logs			3%			5%
Wood chips			2%			2%

In 2006, MGI sold 206.6 million board feet of lumber. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Results of Operations–Forest Products Operations" for additional information. Lumber products vary greatly by the species and quality of the timber from which they are produced. Lumber is sold not only by grade (such as "upper" grade versus "common" grade), but also by board size and the drying process associated with the lumber.

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

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

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

During 2006, MGI purchased approximately one-third of its logs (52 million board feet) from third parties. MGI does not have any significant contractual relationships with third parties relating to the purchase of logs. Palco produces softwood chips from the wood residue from its milling operations. These chips are sold to third parties for the production of wood pulp and paper products. Subject principally to economic feasibility, Palco also produces and sells to third parties wood chips from hardwood trees.

Backlog and Seasonality

MGI's backlog of sales orders at December 31, 2006 was $7.8 million, substantially all of which was shipped in the first quarter of 2007. The sales backlog at December 31, 2005, was $11.8 million, of which $5.3 million was shipped in the first quarter of 2006. MGI has historically experienced lower first quarter sales due largely to the general decline in construction-related activity during the winter months. As a consequence, MGI's results in any one quarter are not necessarily indicative of results to be expected for the full year.

Marketing

The housing, construction and remodeling markets are the primary markets for MGI's lumber products. MGI's goal is to maintain a wide geographic distribution of its products. MGI's accounts are primarily wholesale, followed by industrial end users, manufacturers, retailers and exporters. MGI's redwood and Douglas-fir lumber is sold throughout the entire United States, as well as to export markets. Common grades of redwood lumber are sold principally west of the Mississippi River, with California accounting for approximately 81% of common redwood sales in 2006. Common grades of Douglas-fir lumber are also sold primarily in California. In 2006, MGI's largest three customers accounted for approximately 13%, 9% and 7%, respectively, of MGI's total net lumber sales. Exports of lumber accounted for less than 1% of MGI's total net lumber sales in 2006. MGI markets its products through its own sales staff, which focuses primarily on domestic sales.

Competition

MGI's lumber is sold in highly competitive markets. Competition is generally based upon a combination of price, service, product availability and product quality. MGI's products compete not only with other wood products but with metals, masonry, plastic and other construction materials made from non-renewable resources. The level of demand for MGI's products is dependent on such broad factors as overall economic conditions, interest rates and demographic trends. In addition, competitive considerations, such as total industry production and competitors' pricing, as well as the price of other construction products, affect the sales prices for MGI's lumber products. Competition in the common grade redwood and Douglas-fir lumber market is intense, with MGI competing with numerous large and small lumber producers. MGI primarily competes with the northern California mills of Simpson, Redwood Empire, Sierra Pacific, Canadian cedar lumber producers, as well as other imports and non-wood alternatives.

Employees

As of March 1, 2007, MGI had approximately 475 employees.

Relationships among the Palco Companies

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

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

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

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

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

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

Regulatory and Environmental Factors

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

General

The businesses of Palco and Scopac are subject to a variety of California and federal laws and regulations, as well as the HCP, dealing with timber harvesting practices, threatened and endangered species and habitat for such species, and air and water quality. Compliance with such laws and regulations also plays a significant role in these companies' businesses. The California Forest Practice Act (the **"Forest Practice Act"**) and related regulations adopted by the California Board of Forestry and Fire Protection (the **"BOF"**) set forth detailed requirements for the conduct of timber harvesting operations in California. These requirements include the obligation of timber companies to obtain regulatory approval of detailed THPs containing information with respect to areas proposed to be harvested. See "–Harvesting Practices" above. California law also requires large timberland owners, including Palco and Scopac, to demonstrate that their proposed timber operations will result in but not exceed the maximum sustainable production of their timberlands over time. See "–Principal Assets" above.

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

Environmental Plans

In March 1999, the Palco Companies consummated their 1996 Headwaters Agreement (the **"Headwaters Agreement"**) with the United States and California. Pursuant to the Headwaters Agreement, approximately 5,600 acres of timberlands owned by the Palco Companies were transferred to the United States government in exchange for $300.0 million, approximately 7,700 acres of timberlands, and approval by the federal and state governments of the Environmental Plans. In connection with approval of the Environmental Plans, the California Permits and federal incidental take permits (the **"Federal Permits,"** and together with the California Permits, the **"Permits"**), were issued with respect to certain threatened, endangered and other species found on the timberlands covered by the Environmental Plans. The Permits were to cover the 50-year term of the HCP and allow incidental take of 17 different species covered by the HCP, including nine species which are found on the Palco Timberlands that have been listed under the ESA and/or the CESA. In October 2003, a California trial court entered a judgment invalidating the SYP and the California Permits. Palco appealed this decision and in December 2005 the appellate court reversed the trial court's ruling. See Item 3. "Legal Proceedings–Forest Products Litigation" for further information regarding this matter. The agreements which implement the Environmental Plans also provide for various remedies (including the issuance of written stop orders and liquidated damages) in the event of a breach by the Palco Companies of these agreements or the Environmental Plans.

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

The first analysis of a watershed, Freshwater, was released in June 2001. This analysis was used by the Palco Companies and the government agencies (other than the North Coast Water Board (as defined below)) to develop proposed harvesting prescriptions. Since then, watershed analysis has been completed and prescriptions approved for three additional watersheds: Van Duzen in January 2004, Lower Eel-Eel Delta in March 2004, and Elk River in November 2005. The Freshwater, Van Duzen, Lower Eel, and Elk River prescriptions each resulted in a reduction in the size of the streamside buffers set forth in the Environmental Plans and also provide for geologic reviews in order to conduct harvesting activities on some potential landslide-prone areas in lieu of no-harvest restrictions. This effectively reduced both constrained acreage and HCP-related operational restrictions in these watersheds. The analysis for a fifth watershed, Upper Eel, has been completed and the Palco Companies are awaiting final agency approval of the prescriptions.

The HCP required the Palco Companies, together with the government agencies (other than the North Coast Water Board), to establish a schedule resulting in completion of the initial watershed analysis process for all covered lands within five years. However, due largely to the number of agencies involved and the depth and complexity of the analyses, the process has required significantly more time than originally anticipated. Accordingly, the Palco Companies continue to work with the government agencies to establish appropriate timelines and to streamline watershed analyses on the remaining portions of Palco Timberlands to ensure that such studies are time and cost efficient and continue to provide scientific results necessary to evaluate potential changes to the harvesting restrictions on those lands. The Palco Companies had previously received an extension to March 2007 of the time in which the watershed analysis process must be completed. An additional request for an extension to March 2008 is in process.

The HCP contains an adaptive management provision that allows the Palco Companies to propose changes to many of the HCP prescriptions. The Palco Companies and the agencies (other than the North Coast Water Board) have previously implemented various adaptive management changes related to wildlife and rare plants, and other changes relating to roads and streamside buffers. These adaptive management changes increased the ability to conduct harvesting operations on the Palco Timberlands and/or reduced operating costs while still meeting the obligations of the Environmental Plans.

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

Water Quality

Laws and regulations dealing with water quality are impacting or have the potential to impact the Palco Companies primarily in three areas: efforts by the federal Environmental Protection Agency (the **"EPA"**) and the North Coast Regional Water Quality Control Board (the **"North Coast Water Board"**) to establish total maximum daily load limits (**"TMDLs"**) in watercourses that have been declared to be water quality impaired; actions by the North Coast Water Board imposing waste discharge reporting requirements, and various mitigation, erosion control and clean-up measures; and the development by the North Coast Water Board and its staff of special permitting requirements for the Freshwater and Elk River watersheds known as watershed-wide waste discharge requirements (**"WWDRs"**).

Under the CWA, the EPA is required to establish TMDLs in watercourses that have been declared to be "water quality impaired." The EPA and the North Coast Water Board are in the process of establishing TMDLs for many northern California rivers and certain of their tributaries, including nine watercourses that flow within the Palco Timberlands. The relevant contaminant on the Palco Timberlands is simple sediment – dust, dirt and gravel – that is abundant in watercourses largely as a function of the area's normally heavy rainfall and soil that erodes easily. The Company expects the process of establishing TMDLs to continue into 2010. The EPA has issued a report dealing with TMDLs on three of the nine watercourses. The agency indicated that the requirements under the HCP would significantly address the sediment issues that resulted in TMDL requirements for these watercourses. Presently, the North Coast Water Board is in the process of establishing the TMDL requirements applicable to two other watercourses on the Palco Timberlands, Freshwater and Elk River, with a targeted completion of 2008 for these two watercourses. Scopac's scientists are actively working with North Coast Water Board staff to ensure that these TMDLs recognize and incorporate the environmental protection measures of the HCP. The final TMDL requirements applicable to the Palco Timberlands may require aquatic protection measures that are different from or in addition to those in the HCP or that result from the prescriptions to be developed pursuant to the watershed analysis process provided for in the HCP. These requirements could further restrict harvesting on the Palco Timberlands.

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

The North Coast Water Board has also issued clean up and abatement orders for the Freshwater and Elk River watersheds (the **"Water Board Orders"**), which are aimed at addressing existing sediment production sites through clean up actions. The North Coast Water Board has also initiated the process which could result in similar orders for the Bear Creek watershed, and is contemplating similar actions for the Jordan and Stitz Creek watersheds. The Water Board Orders have resulted in increased costs that could extend over a number of years. Additional orders for other watersheds (should they be issued) may also result in further cost increases.

On May 8, 2006, the North Coast Water Board adopted WWDRs for the Freshwater and Elk River. The decision allows harvesting in these two watersheds, up to approximately 50% of the applicable annual harvest limit established by the CDF for each watershed (**"CDF Harvest Limit"**), once the staff of the North Coast Water Board reviews and enrolls THPs submitted by Scopac. The North Coast Water Board's decision also allowed the enrollment of additional THPs, bringing the total to approximately 75% of the CDF Harvest Limit for these two watersheds, upon approval of a monitoring and reporting program by the Executive Officer of the North Coast Water Board staff. The monitoring and reporting program was approved on September 29, 2006, allowing enrollment by the staff of the North Coast Water Board of additional THPs for these two watersheds that were harvested in 2006. This monitoring and reporting program will also govern future THPs in these two watersheds. However, there can be no assurance that additional THPs in these two watersheds will ultimately be enrolled or harvested as planned in future years. The North Coast Water Board's adoption of these WWDRs has been appealed to the State Water Board, but the appeals are being held in abeyance pending implementation of the WWDRs. As harvesting activities on the Palco Timberlands cannot readily be moved between watersheds due to, among other things, historic harvest patterns, adjacency restrictions, and the age classes of trees, development of WWDRs and the various other matters described could result in reduced harvest levels in future years.

Effective January 1, 2004, California Senate Bill 810 provides regional water quality control boards with additional authority related to the approval of THPs on timberlands within impaired watersheds. The Company is uncertain of the operational and financial effects which will ultimately result from Senate Bill 810; however, because substantially all rivers and waterbodies on the Palco Timberlands are classified as sediment-impaired, implementation of this law could result in additional delays in obtaining approvals of THPs, lower harvest levels and increased costs and additional protection measures beyond those contained in the HCP.

Impact of Future Developments

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

Timber Operator's License

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

Real Estate Operations

General

The Company, principally through its wholly owned subsidiaries, invests in and develops residential and commercial real estate, primarily in Puerto Rico, Arizona, California, and Texas. Real estate properties and receivables as of December 31, 2006 are as follows:

			Book Value as of December 31, 2006
			(In millions)
Palmas del Mar (Puerto Rico):			
Undeveloped land and parcels held for sale	988 acres	$	30.2
Property, plant and equipment, receivables and other, net			13.3
Total			43.5
Resort operations – Palmas Country Club[(1)]			20.3
Total			63.8
Fountain Hills (Arizona):			
Residential developed lots and lots under development	135 lots		14.3
Undeveloped residential land	431 acres		4.6
Property, plant, equipment and receivables, net			1.2
Total			20.1
Mirada (California):			
Residential developed lots	5 lots		1.9
Property, plant, equipment and receivables, net			0.2
Total			2.1
Commercial lease properties:			
Property, plant and equipment, net:			
Lake Pointe Plaza (Texas)			103.4
Cooper Cameron building (Texas)			27.2
Motel 6 facilities (10 states)			40.5
Other			2.8
Total			173.9
Other, principally receivables			0.1
Total real estate properties and receivables		$	260.0

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

		Book Value as of December 31, 2006
		(In millions)
Joint Ventures:		
FireRock, LLC		
Golf course, clubhouse and other club facilities[(2)]	$	14.5
Other property, plant and equipment, net[(1)]		2.5
Total	$	17.0
Investment in FireRock, LLC[(2)]	$	1.5
RMCAL Development LP[(1)]		
Residential units under development	$	36.2
Investment in RMCAL Development LP[(2)]	$	2.4

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(1) Amounts reflect 100% of the book value of the joint venture's assets.
(2) Amounts reflect the book value of the Company's 50% interest.

Revenues from real estate operations were as follows in 2006 and 2005 (see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Results of Operations–Real Estate Operations" for additional details regarding 2006, 2005 and 2004 results):

	Years Ended December 31, 2006	Years Ended December 31, 2005
	(In millions)	
Palmas del Mar:		
Real estate sales	$ 27.6	$ 42.3
Commercial, resort operations and other	12.5	12.1
Total	40.1	54.4
Fountain Hills:		
Real estate sales	15.6	42.9
Commercial operations and other	3.7	5.4
Total	19.3	48.3
Mirada:		
Real estate sales	26.6	56.9
Commercial operations and other	0.3	0.1
Total	26.9	57.0
Commercial lease properties:		
Lake Pointe Plaza	11.1	10.9
Cooper Cameron building	2.3	2.3
Motel 6 facilities	4.8	4.8
Other	0.2	0.3
Total	18.4	18.3
Other:		
Real estate sales	–	0.1
Commercial operations and other	0.2	0.2
Total	0.2	0.3
Total	$ 104.9	$ 178.3
FireRock, LLC[(1)]:		
Real estate sales	$ –	$ –
Golf course operations	3.7	3.4
Total	$ 3.7	$ 3.4
RMCAL Development LP[(1)]:		
Real estate sales	$ 9.1	$ –

(1) Amounts reflect 100% of the joint venture's revenues.

Palmas del Mar

Palmas del Mar, a master-planned residential community and resort located on the southeastern coast of Puerto Rico near Humacao (**"Palmas"**), was acquired by a subsidiary of the Company in 1984. Originally over 2,700 acres, as of December 31, 2006, the Company now has approximately 1,000 acres of undeveloped land remaining at Palmas. The Company conducts its operations at Palmas through Palmas del Mar Properties, Inc. (**"PDMPI"**) and PDMPI's subsidiaries. PDMPI seeks developers and investors to acquire its acreage. Resort operations at Palmas include a country club with two golf courses and tennis and beach club facilities. Certain other amenities, including a hotel, marina, equestrian center and various restaurants, are owned and operated by third parties.

Fountain Hills

In 1968, a subsidiary of the Company purchased and began developing approximately 12,100 acres of real property in Fountain Hills, Arizona, which is located near Phoenix and adjacent to Scottsdale, Arizona. Development of Fountain Hills is substantially complete. Future sales are expected to consist of fully developed lots in two developments known as Eagles Nest and Adero Canyon. Eagles Nest, a 506-acre custom lot development planned to include 245 lots, commenced sales in 2004. Lots are being released in phases, with 12 lots and 78 lots having been sold in 2006 and 2005, respectively. Development plans have been formulated for Adero Canyon, a 431-acre custom lot development planned to include 171 lots. Financing of the Adero Canyon development will be accomplished either through new or existing credit facilities or joint venture arrangements.

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

Mirada

In 1991, a subsidiary of the Company acquired Mirada, a 220-acre luxury resort-residential project located in Rancho Mirage, California. Mirada is a master-planned community in the Santa Rosa Mountains, 650 feet above the Coachella Valley floor. The Company's direct development activities at the project are substantially complete. The first of the project's six parcels was a custom lot subdivision of 46 estate lots. The Ritz-Carlton Rancho Mirage Hotel, which is owned and operated by a third party, was developed on the second parcel. The third parcel is a custom lot subdivision consisting of 63 estate lots. Sales of these lots began in 2003, and as of December 31, 2006, all but 4 lots had been sold.

In April 2004, a subsidiary of the Company and a third party real estate development company formed a joint venture named RMCAL Development LP **("RMCAL"**) to develop the fourth parcel, a 27-acre residential tract. In connection with the formation of RMCAL, the Company sold a 50% interest in the parcel and contributed the remainder of the parcel to the joint venture in return for a 50% interest in the venture. RMCAL will construct and sell 46 villas to be built on the parcel. Four villas and one lot were sold in 2006. Sixteen other villas have either been completed or are under construction.

The Company's two remaining parcels encompassing approximately 39 acres, were sold in 2005.

Commercial Lease Properties

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

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

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

Marketing

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

Competition and Regulation and Other Industry Factors

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

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

Employees

As of March 1, 2007, the Company's real estate operations had approximately 225 employees.

Racing Operations

General

SHRP, Ltd. owns and operates Sam Houston Race Park, a Texas Class 1 horse racing facility located within the greater Houston metropolitan area and Valley Race Park, a greyhound racing facility located in Harlingen, Texas. In January 2004, a subsidiary of the Company, Laredo Race Park LLC (**"Laredo LLC"**), applied to the Texas Racing Commission (the **"Racing Commission"**) for an additional license to construct and operate a Class 2 horse racing facility in Laredo, Texas. Following a hearing on Laredo LLC's application and that of a competing applicant, in September 2006, two state administrative law judges recommended to the Racing Commission that Laredo LLC be awarded the license. The Racing Commission on March 20, 2007 ruled that both Laredo LLC and the competing applicant be awarded licenses for the Laredo area. The license awarded to Laredo LLC is, however, conditioned on SHRP, Ltd., by the next Racing Commission meeting on May 14, 2007, entering into an agreement satisfactory to the Racing Commission providing for the sale of Valley Race Park.

Racing Operations and Facilities

Sam Houston Race Park and Valley Race Park offer pari-mutuel wagering on live thoroughbred, quarter horse and greyhound racing during meets approved by the Racing Commission on a yearly basis and on simulcast horse and greyhound racing throughout the year. Under the Texas Racing Act and related regulations (collectively, the **"Racing Act"**), commission revenues for both facilities are a designated portion of the pari-mutuel handle. Sam Houston Race Park had 110 days of live racing in 2006 and currently has 116 days of live racing scheduled for 2007. Valley Race Park had 94 live racing days during 2006, and currently has 95 live racing days scheduled for 2007.

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

Regulation of Racing Operations

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

Marketing and Competition

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

Sam Houston Race Park competes with other forms of wagering and entertainment, including a Louisiana "racino" (horse or dog tracks with slot machines or other forms of gaming) located approximately 120 miles from Houston, casinos located approximately 140 miles from Houston, a greyhound racetrack located 55 miles away from Houston, a wide range of sporting events and other entertainment activities in the Houston area, the Texas State Lottery, and charitable bingo. Other competitive pressures include simulcast signals broadcast by racinos, which are able to offer larger purses and competitive fields, resorts with gaming, and increasing use of the Internet for horse wagering and gaming, including Internet betting services with customer incentives such as cash rebates. Sam Houston Race Park could in the future also compete with other forms of gambling in Texas, including casino gambling on Indian reservations elsewhere.

While Sam Houston Race Park believes that the location of Sam Houston Race Park is a competitive advantage over the other more distant gaming ventures mentioned above, the most significant challenges for Sam Houston Race Park are to maintain its customer base in spite of the above competitive pressures and to develop and educate new racing fans in a market where pari-mutuel wagering had been absent from the 1930's to 1994. Other competitive factors faced by Sam Houston Race Park include the allocation of sufficient live racing days by the Racing Commission and attraction of a sufficient number and quality of race horses to run at Sam Houston Race Park, particularly in view of the larger purses able to be offered by racinos. Competitive factors faced by Valley Race Park include the Texas State Lottery, charitable bingo and Internet-based gaming, as well as the attraction of sufficient greyhounds to run live racing, along with the ability of Valley Race Park to market its simulcast signal due to its brief live racing season.

The Texas Legislature convenes its regular session every other year. It is expected that this body will, during regular legislative session that began in January and lasts through May 2007, consider measures to enhance state revenues though additional forms of gaming such as video lottery terminals at existing horse and dog racing tracks, gaming on Indian reservations, and full casinos. Several measures have been introduced to date that include some form of enhanced gaming at horse and dog tracks. The Company will vigorously pursue any legislation that is favorable to it. As the measures introduced to date would require the approval of two-thirds of each legislative house and a majority of Texas voters, no assurance can be given that any such legislation will be enacted or become effective. Moreover, it is impossible to determine what the provisions of any such legislation would be or its effect on the Company.

Employees

As of March 1, 2007, the Company's racing operations had approximately 370 full and part-time employees and approximately 475 additional seasonal employees.

Kaiser Aluminum

The Company previously owned approximately 63% of the common stock of Kaiser, which engaged in several principal aspects of the aluminum industry. In February 2002, Kaiser and certain of its subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. Kaiser's plan of reorganization provided for the cancellation of Kaiser's equity, including the common shares held by the Company, without consideration or obligation. Kaiser's plan of reorganization became effective on July 6, 2006, and Kaiser emerged from bankruptcy. As a result, the Company no longer has any ownership interest in or affiliation with Kaiser. Since the Company's common stock in Kaiser was cancelled without obligation, the Company reversed the $516.2 million of losses in excess of its investment in Kaiser along with the accumulated other comprehensive losses of $85.3 million related to Kaiser, resulting in a net gain of $430.9 million, recognized in the third quarter of 2006. As a result of the cancellation of the Company's Kaiser common stock in 2006, the Company expects it will take a worthless stock deduction on its 2006 consolidated federal income tax return. However, it is uncertain whether the deduction meets certain criteria required for asset recognition purposes. Accordingly, the Company has not recorded the resulting tax asset of approximately $135.8 million in its consolidated balance sheet as of December 31, 2006.

Segment Information

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

Employees

At March 1, 2007, MAXXAM and its subsidiaries had approximately 1,570 year-round and seasonal employees none of whom are covered by a collective bargaining agreement.

Company SEC Reports

As the Company does not maintain an Internet website, the Company's filings are not available in this manner. However, the Company files electronically with the Securities and Exchange Commission (the **"SEC"**), which has an Internet website (*http://www.sec.gov*) containing the reports, proxy statements and other information that the Company electronically files with the SEC. In addition, the Company will provide these materials free of charge to any recordholder of the Company's securities or any "street name" holder that provides a brokerage or similar statement reflecting such holdings. You should send your request to MAXXAM Inc., c/o Corporate Secretary, 1330 Post Oak Boulevard, Suite 2000, Houston, Texas 77056-3058. The Company will also consider on a case-by-case basis requests for such materials by persons who do not hold Company securities.

ITEM 1A. RISK FACTORS

Risks Related to the Bankruptcy Cases

The bankruptcies of Palco and its subsidiaries, including Scopac, create significant risks and uncertainties.

On January 18, 2007, each of the Palco Debtors and Scopac filed separate voluntary petitions in the Bankruptcy Court for reorganization under Chapter 11 of the Bankruptcy Code. The filing of the Bankruptcy Cases was precipitated by liquidity shortfalls at Palco and Scopac and their resultant inability to make January 2007 interest payments on their respective debt obligations, arising from regulatory restrictions and limitations on timber harvest, increased timber harvesting costs and cyclical lumber prices.

The bankruptcies of the Debtors create significant risks and uncertainties for the Debtors and the Company, including, but not limited to, those described herein. The outcome of the Bankruptcy Cases is impossible to predict and could have a material adverse effect on the businesses of the Debtors, on the interests of creditors, and on the Company.

The Debtors may not be able to reorganize successfully, and the Company could lose some or all of is equity ownership interest.

The Debtors' overall objectives in the Bankruptcy Cases are to achieve an operational and financial restructuring of each of the Debtors' long-term debt obligations in view of estimated lower harvest levels, increased regulatory compliance costs and cyclical lumber prices, and also to continue their businesses. The Debtors may not be able to attain these objectives and achieve a successful operational and financial reorganization. If the Debtors are unsuccessful in attaining a successful operational and financial reorganization, the Debtors could be forced to surrender all or substantially all of their assets to their creditors. Many of the matters discussed elsewhere in this document could adversely affect the Debtors' ability to achieve an operational and financial restructuring.

As provided by the Bankruptcy Code, each of the Debtors generally has the exclusive right to propose a plan of reorganization for 120 days following the date of filing of the Bankruptcy Cases (the **"Exclusivity Period"**), unless certain statutory exceptions apply or the Bankruptcy Court orders otherwise. For instance, a group of holders of Scopac Timber Notes has filed a motion that, if granted, might have the effect of shortening the Exclusivity Period. There is substantial uncertainty as to when each of the Debtors will be able to file its plan. Moreover, the Debtors' efforts to obtain approval of such plan(s) by the creditors and equity holders entitled to vote on the plan(s), and to obtain confirmation by the Bankruptcy Court of such plan(s), may not be successful.

If a Debtor's creditors are not paid in full, the Bankruptcy Code provides that the Debtor's equity holder will not be entitled to retain its equity interest, unless certain exceptions apply. If the liabilities of one or more of the Debtors are ultimately found to exceed the fair value of its assets, claims of creditors could be paid at less than 100% of their face value. In that event, Palco could lose all or a material portion of its equity ownership in Scopac and Palco's other subsidiaries, MGI could lose all or a material portion of its equity ownership in Palco, or the value of such equity ownership interests could be diluted, impaired or eliminated.

The Palco Debtors and Scopac may be unable to obtain sufficient additional liquidity to continue operations and reorganize successfully under Chapter 11.

The Palco Debtors estimate that they will have liquidity shortfalls in 2007. The Palco Debtors are pursuing discussions with lenders in an effort to obtain debtor-in-possession financing (**"DIP financing"**) in order to have sufficient liquidity to fund the Palco Debtors' ongoing operating cash needs, including bankruptcy-related costs. The Palco Debtors may not be successful in obtaining the necessary additional liquidity or the necessary Bankruptcy Court approval, in which case the Palco Debtors may not be able to continue operations and reorganize successfully under Chapter 11 of the Bankruptcy Code.

Scopac has been authorized by the Bankruptcy Court to fund budgeted ongoing operating and bankruptcy-related costs using operating cash flow and, to the extent needed, funds available in Scopac's Scheduled Amortization Reserve Account (**"SAR Account"**) (subject to no more than $5.0 million in withdrawals from the SAR Account being outstanding at any given time). See Note 7, "–Scopac Timber Notes–SAR Account" for information regarding the SAR Account. If these sources of liquidity are not adequate, and if Scopac is unable to obtain additional sources of liquidity and the necessary Bankruptcy Court approval to utilize such additional sources of liquidity, Scopac may not be able to continue operations and reorganize successfully under Chapter 11 of the Bankruptcy Code.

The bankruptcies of Scopac and the Palco Debtors could result in claims against, and potential liabilities for, MAXXAM Parent and its affiliates.

The Bankruptcy Cases, and the liquidity issues being experienced by Scopac and Palco, could result in claims against and could have adverse impacts on MAXXAM Parent and its affiliates, including MGHI and/or MGI. For example, under ERISA, if Palco's pension plan were to be terminated, MAXXAM Parent and its wholly owned subsidiaries would be jointly and severally liable for any unfunded pension plan obligations. The unfunded termination obligation attributable to Palco's pension plan as of December 31, 2006, is estimated to have been approximately $23.0 million based upon annuity placement interest rate assumptions as of such date. In addition, it is possible that certain transactions could be completed in connection with a potential restructuring or reorganization of the Debtors, such as a sale of all or a portion of the equity ownership in the Debtors, a sale of a substantial portion of the Debtors' assets and/or a cancellation of some or all of the Debtors' indebtedness, which could require the utilization of all or a substantial portion of, or the loss of a significant portion of, the Company's net operating losses or other tax attributes for federal and state income tax purposes and could require tax payments. In addition, the Company may be required to establish certain deferred tax liabilities as a result of loss of control of the Debtors effective as of the Filing Date.

Risks Related to Forest Products Regulatory Matters

Regulatory and legislative actions have the power to significantly restrict and ultimately limit the harvest levels of Scopac Timber and require Scopac and Palco to incur additional costs and have other adverse consequences.

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

- The North Coast Water Board has adopted WWDRs for the Freshwater and Elk River watersheds. This decision allows harvesting in these two watersheds once THPs are reviewed and enrolled by the staff of the North Coast Water Board. In addition, the Executive Officer of the North Coast Water Board has approved a monitoring and reporting program, which has the effect of allowing enrollment by the staff of the North Coast Water Board of additional THPs for these two watersheds. There can be no assurance that THPs for these two watersheds will ultimately be enrolled or harvested as planned in 2007 or in future years. If there are delays in the enrollment of these THPs, there could be a further significant adverse impact on current and future harvest levels and the cash flows of both Palco and Scopac.

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

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

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

- The Company is uncertain of the operational and financial effects that will ultimately result from Senate Bill 810, which provides regional water quality control boards with additional authority related to the approval of THPs within impaired watersheds. Implementation of this law could, however, result in delays in obtaining approvals of THPs, lower harvest levels, and increased costs.

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

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

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

Palco and Scopac were involved in a variety of pending legal proceedings as of the date the Bankruptcy Cases were filed. While these legal proceedings are in general stayed as against the Debtors while the companies are in bankruptcy, such proceedings could be continued as against the Debtors if the stay is modified by the Bankruptcy Court, if the Bankruptcy Cases are dismissed, or in certain circumstances, upon the emergence of the companies from bankruptcy. Were such legal proceedings to then be decided against the companies, there could be an adverse effect upon them, which effect could under certain circumstances be materially adverse to their financial condition, results of operations, or liquidity. Moreover, additional legal proceedings could be filed against Palco, Scopac, the other Debtors, the Company and their affiliates, further increasing litigation costs and subjecting the companies to potential adverse decisions. See Item 3. "Legal Proceedings–Forest Products Litigation."

Other Risks Related to Our Forest Products Operations

Scopac's estimate of its future harvest levels is subject to significant uncertainty.

Scopac has estimated that its average annual harvest level over the ten-year period that began in 2006 is not likely to exceed approximately 95 million board feet per year. This revised estimated harvest level reflects Scopac's further analysis of the cumulative impact of ongoing regulatory limitations, watershed prescriptions, the requirements of the HCP and other matters, and is based on a number of assumptions that may or may not prove to be accurate. Actual harvest levels are expected to vary significantly from year to year. Moreover, the average harvest level over the ten-year period could be even lower due to, among other things, the various matters discussed elsewhere in this document.

Palco may not be able to obtain enough logs to operate efficiently.

The ability of Palco to operate its mills efficiently depends in large part on its ability to obtain logs from Scopac at the estimated harvest level indicated above. Should these harvest levels not materialize, Palco would be adversely affected, perhaps materially. In addition, Palco expects that to operate at profitable levels, it will in the future be required to purchase a significant portion of its logs from third parties. These purchases may not be available, or may be available on terms that are not acceptable or are significantly adverse to Palco. In addition, given its liquidity problems, Palco may not have sufficient liquidity to undertake such purchases.

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

Although it is currently contemplated that all or substantially all of Scopac's revenues will be derived from the sale of logs to Palco, should Palco be unable to continue purchasing all of Scopac's logs, Scopac would need to seek third party purchasers. Such purchasers may not be available or, if available, such purchasers may not acquire sufficient quantities of logs at prices and on terms that would allow Scopac to generate cash flow equivalent to what sales to Palco would have generated due to, among other things, other mills in the area generally being farther away from the Scopac Timber Property than Palco's mills.

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

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

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

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

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

Decreases in the level of residential construction activity or repair and remodeling activity generally reduce demand for logs and wood products. In addition, timber owners generally increase production volumes for logs and products during favorable price environments. Such increased production, however, when coupled with declines in demand for these products in general, could lead to oversupply and lower prices. By way of example, Douglas-fir lumber prices have recently declined significantly, and redwood lumber prices have also recently declined, although to a lesser extent than Douglas-fir prices. This has adversely affected the cash flows of both Palco and Scopac.

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

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

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

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

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

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

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

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

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

Palco has one customer that accounted for 12.5% of its revenues in 2006. The loss of key customers would adversely impact Palco's cash flows.

Risks Related to Our Real Estate Operations

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

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

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

The real estate development industry is cyclical and is significantly affected by changes in general and local economic conditions, including, but not limited to:

- employment levels and population growth and shifts;
- interest rates and the availability of financing;
- consumer confidence; and
- changes in the desirability of residential and commercial areas.

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

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

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

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

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

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

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

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

Risks Related to Our Racing Operations

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

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

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

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

Other Risk Factors

Claims could arise from prior acquisitions.

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

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

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

Uninsured claims and litigation could adversely impact our operating results.

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

We depend on our management and employees.

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

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

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

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

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

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

Charles E. Hurwitz, the Company's Chairman of the Board, controls a majority of the Company's common stock (the **"Common Stock"**) and 79.5% of the Company's total combined voting power. As a result, Mr. Hurwitz is able to control the election of the Company's Board of Directors and controls the vote on virtually all matters which might be submitted to a vote of our stockholders.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

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

ITEM 3. LEGAL PROCEEDINGS

General

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

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

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

MAXXAM Inc. Litigation

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

OTS Contingency and Related Matters

In December 1995, the United States Department of Treasury's Office of Thrift Supervision (the **"OTS"**) initiated a formal administrative proceeding (the ***"OTS action"***) against the Company and others alleging, among other things, misconduct by the Company and certain of its affiliated persons (the **"Respondents"**) and others with respect to the failure of United Savings Association of Texas (the **"USAT"**). The OTS sought damages ranging from $326.6 million to $821.3 million under various theories. Following 110 days of proceedings before an administrative law judge during 1997-1999, and over two years of post-trial briefing, on September 12, 2001, the administrative law judge issued a recommended decision in favor of the Respondents on each claim made by the OTS. On October 17, 2002, the *OTS action* was settled for $0.2 million with no admission of wrongdoing on the part of the Respondents.

As a result of the dismissal of the *OTS action*, a related civil action, alleging damages in excess of $250 million, was subsequently dismissed. This action, entitled *Federal Deposit Insurance Corporation, as manager of the FSLIC Resolution Fund v. Charles E. Hurwitz* (the ***"FDIC action"***), was originally filed by the Federal Deposit Insurance Corporation (the **"FDIC"**) in August 1995 against Mr. Charles E. Hurwitz (Chairman and Chief Executive Officer of the Company).

In May 2000, the Respondents filed a counterclaim to the *FDIC action* in the U.S. District Court in Houston, Texas (No. H95-3956). In November 2002, the Respondents filed an amended counterclaim and an amended motion for sanctions (collectively, the **"Sanctions Motion"**). The Sanctions Motion states that the FDIC illegally paid the OTS to bring the *OTS action* against the Respondents and that the FDIC illegally sued for an improper purpose (i.e., in order to acquire timberlands held by a subsidiary of the Company). The Respondents are seeking as a sanction to be made whole for the attorneys' fees they have paid (plus interest) in connection with the *OTS* and *FDIC actions*. As of December 31, 2006, such fees were in excess of $40.9 million. On August 23, 2005, the District Court ruled on the Sanctions Motion, ordering the FDIC to pay the Respondents $72.3 million. The FDIC has appealed the District Court decision to the U.S. Fifth Circuit Court of Appeals. The U.S. District Court award has not been accrued as of December 31, 2006. There can be no assurance that the Company will ultimately collect this award.

Forest Products Reorganization Proceedings

On January 18, 2007, Palco and its five wholly owned subsidiaries, including Scopac, filed separate voluntary petitions for reorganization under Chapter 11 of the Bankruptcy Code. See Note 1, "–Reorganization Proceedings of Palco and its Subsidiaries" for further information regarding the bankruptcy proceedings of Palco and its subsidiaries, including potential adverse impacts on MAXXAM Parent and its affiliates. Also see Item 1A. "Risk Factors–Risks Related to the Bankruptcy Cases" and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Financial Condition and Investing and Financing Activities–Forest Products Operations."

Forest Products Litigation

Various pending judicial and administrative proceedings could adversely affect the ability of the Palco Companies to implement the HCP, implement certain approved THPs, or carry out other operations, as discussed below. The Services Agreement generally requires Palco to prepare and file on behalf of Scopac (at Palco's cost) all pleadings and motions, and otherwise diligently pursue, appeals of any denial, and defense of any challenge to approval, of any THP or the Environmental Plans or similar plan or permit and related matters.

In March 1999, an action entitled *Environmental Protection Information Association, Sierra Club v. California Department of Forestry and Fire Protection, California Department of Fish and Game, The Pacific Lumber Company, Scotia Pacific Company LLC, Salmon Creek Corporation, et al.* (the ***"EPIC-SYP/Permits lawsuit"***) was filed in Superior Court in Humboldt County, California (No. CV-990445). This action alleged, among other things, various violations of the CESA and the CEQA, and challenged, among other things, the validity and legality of the SYP and the California Permits and sought, among other things, to prevent implementation of THPs approved in reliance upon these documents. In March 1999, a similar action, entitled *United Steelworkers of America, AFL-CIO, CLC, and Donald Kegley v. California Department of Forestry and Fire Protection, The Pacific Lumber Company, Scotia Pacific Company LLC* *and Salmon Creek Corporation* (the **"*USWA lawsuit*"**), was filed in Humboldt County Superior Court (No. CV-990452) challenging the validity and legality of the SYP. The *EPIC-SYP/Permits* and *USWA lawsuits* were consolidated for trial.

Following the trial, the Court in October 2003 entered a judgment invalidating the SYP and the California Permits and in September 2004 granted the plaintiffs' request for reimbursement of an aggregate of $5.8 million in attorneys' fees and other expenses. The Palco Companies and the State of California appealed both decisions. In December 2005, the appellate court reversed the trial court's decision invalidating the SYP and the California Permits. The plaintiffs have appealed the appellate court's decision to the California Supreme Court, which has accepted the appeal for review. The defendants' appeal of the trial court's award of attorneys fees and expenses is still pending at the appellate court. Due to the Bankruptcy Cases, both the California Supreme Court and the appellate court have entered orders staying the proceedings pending before each court.

In July 2001, an action entitled *Environmental Protection Information Association v. Pacific Lumber, Scotia Pacific Company LLC* (No. C01-2821) (the **"*Bear Creek lawsuit*"**) was filed in the U.S. District Court for the Northern District of California, and later amended to add the EPA as a defendant. The lawsuit alleges that harvesting and other forestry activities under certain of Scopac's THPs will result in discharges of pollutants in violation of the CWA. The plaintiff asserts that the CWA requires the defendants to obtain a permit from the North Coast Water Board before beginning timber harvesting and road construction activities and is seeking to enjoin these activities until such permit has been obtained. The plaintiff also seeks civil penalties of up to $27,500 per day for the alleged continued violation of the CWA. In October 2003, the Court upheld the validity of an EPA regulation that exempts harvesting and other forestry activities from certain discharge requirements. Both state and federal agencies, along with Palco and other timber companies, have relied upon this regulation for more than 25 years. However, the Court interpreted the regulation in such a way as to narrow the forestry operations that are exempted, thereby limiting the regulation's applicability and subjecting culverts and ditches to permit requirements. This ruling has widespread implications for the timber industry in the United States. The case is not yet final as the trial has not yet been held, and there are many unresolved issues involving interpretation of the Court's decision and its application to actual operations. On June 30, 2006, the plaintiff filed a motion for partial summary judgment seeking to establish the Palco Companies' liability and the Palco Companies filed a motion for summary judgment asserting that the plaintiff lacks standing to maintain the lawsuit. A hearing on these motions was held on October 3, 2006, and the Court took the matter under submission. Due to the Bankruptcy Cases, the Court has entered an order staying this matter.

Should the Court's October 2003 decision ultimately become final and be held to apply to all of the timber operations of Palco and Scopac, it may have some or all of the following effects: imposing additional permitting requirements, delaying approvals of THPs, increasing harvesting costs, and adding water protection measures beyond those contained in the HCP. The Company believes that civil penalties should not be awarded for operations that occurred prior to the Court's decision due to timber companies' historical reliance on the regulation and Palco's belief that the requirements under the HCP are adequate to ensure that sediment and pollutants from harvesting activities on the Palco Timberlands will not reach levels harmful to the environment. While the impact of a conclusion to this case that upholds the October 2003 ruling may be adverse, the Company does not believe that such an outcome should have a material adverse impact on the Company's consolidated financial condition, results of operations or liquidity. Nevertheless, due to the numerous ways in which the Court's interpretation of the regulation could be applied to actual operations, there can be no assurance that this will be the case.

On November 20, 2002, two similar actions entitled *Alan Cook, et al. v. Gary Clark, et al.* (the **"*Cook action*"**) and *Steve Cave, et al. v. Gary Clark, et al.* (the **"*Cave action*"**) were filed in Humboldt County Superior Court (Nos. DR020718 and DR020719, respectively), which also name Palco and certain affiliates as defendants. The *Cook action* alleges, among other things, that defendants' logging practices have contributed to an increase in flooding along Freshwater Creek (which runs through the Palco Timberlands), resulting in personal injury and damage to the plaintiffs' properties. Plaintiffs further allege that in order to have THPs approved in the affected areas, the defendants engaged in certain unfair business practices. The plaintiffs seek, among other things, compensatory and exemplary damages, injunctive relief, and appointment of a receiver to ensure that the watershed is restored. The *Cave action* contains similar allegations and requests similar relief with respect to the Elk River watershed (a portion of which is contained on the Palco Timberlands). On October 13, 2005, an action entitled *Edyth Johnson, et.al v. Charles E. Hurwitz, an individual; MAXXAM Inc. et al.* (No. DR040720) was filed in Humboldt County Superior Court (the **"*Johnson action*"**) and contains allegations similar to the *Cave* and *Cook actions*. The Company does not believe the resolution of these actions should result in a material adverse effect on its consolidated financial condition, results of operations or liquidity. Notices have been filed with the Court to stay these matters due to the Bankruptcy Cases.

On February 25, 2003, the District Attorney of Humboldt County filed a civil suit entitled *The People of the State of California v. The Pacific Lumber Company, Scotia Pacific Holding Company and Salmon Creek Corporation* in the

Humboldt County Superior Court (No. DR030070) (the ***"Humboldt DA action"***). The suit was filed under California's unfair competition law and alleges that the Palco Companies used certain unfair business practices in connection with completion of the Headwaters Agreement, and that this resulted in the harvest of significantly more trees than would have otherwise been the case. The suit seeks a variety of remedies including a civil penalty of $2,500 for each additional tree that has been or will be harvested due to this alleged increase in harvest, as well as restitution and an injunction in respect of the additional timber harvesting allegedly being conducted. On June 14, 2005, the Court dismissed this matter in its entirety. On September 19, 2005, the District Attorney appealed this decision, however, the Company believes that the dismissal ruling has substantially diminished the exposure of the Palco Companies with respect to this matter. Due to the Bankruptcy Cases, the Court has entered an order staying this matter.

In December 2005, Palco and Scopac filed a claim (the **"Claim"**) with the California Victim Compensation and Government Claims Board (the **"Claims Board"**) against the North Coast Water Board, the State Water Board and the State of California (Claim No. G558159). The Claim alleges that the defendants have substantially impaired the contractual and legal rights of Palco and Scopac under the Headwaters Agreement and the related permits, authorizations and approvals. The Claim also alleges that the actions of the defendants have caused the companies substantial damages, but does not specify an amount. While the Claims Board has indicated that it is investigating the matter, it failed to approve or deny the claim by the statutory deadline. As a result, the Claim is by operation of law treated as having been denied, and Palco could then file a suit for damages in California state court. This suit was filed by Palco and Scopac on December 20, 2006 in Superior Court in Fresno, California (No. CECG 0422).

While the above-described legal proceedings are, in general, stayed as against the Debtors while the companies are in bankruptcy, such proceedings could be dismissed as against the Debtors as the stay is modified by the Bankruptcy Court, if the Bankruptcy Cases are dismissed, or in certain circumstances, upon the emergence of the companies from bankruptcy. Also see Item 1A. "Risk Factors–Risk Factors Related to Forest Products Regulatory Matters."

Other Matters

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

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

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

Not applicable.

PART II

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

Common Stock and Related Stockholder Matters

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

	2006		2005	
	High	Low	High	Low
First quarter	$ 35.60	$ 31.77	$ 33.80	$ 28.50
Second quarter	33.00	26.75	28.89	21.21
Third quarter	28.50	27.00	35.25	23.00
Fourth quarter	29.27	25.20	36.24	30.11

As of March 26, 2007, there were 2,517 recordholders of the Company's Common Stock. The Company has not declared any cash dividends on its capital stock and has no present intention to do so.

Issuer Purchases of Equity Securities

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

Equity Compensation Plan Information

The following table sets forth information, as of December 31, 2006, concerning securities that have been, or are available to be, issued under the various equity compensation plans of the Company.

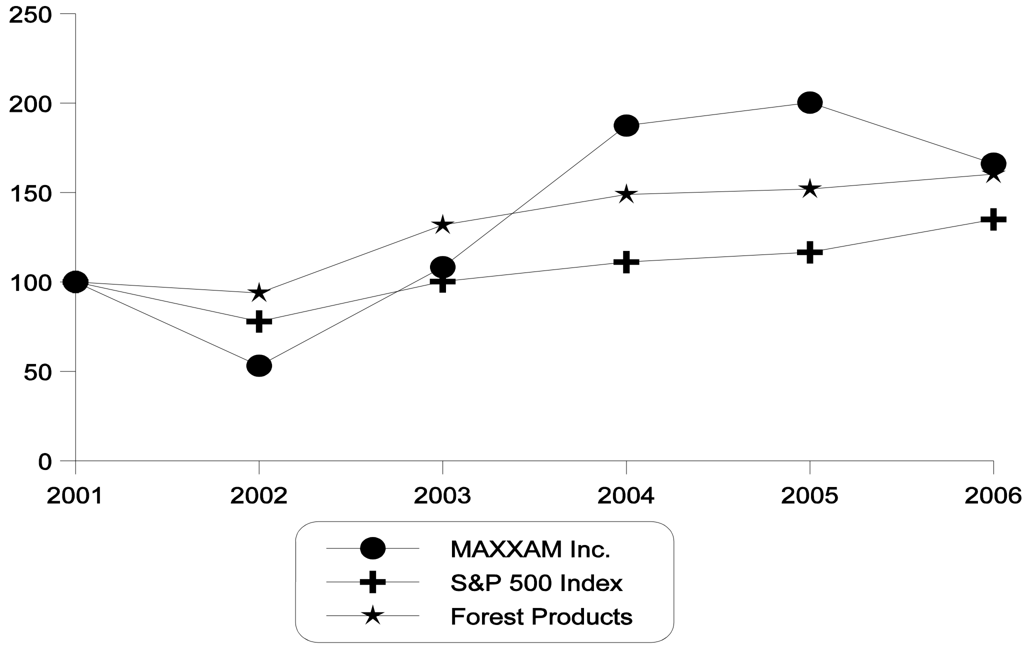
Plan Category	(a) Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders [(1)]:			
Common Stock	1,081,853	$25.51	161,587[(2)]
Preferred Stock	–	–	70,000[(2)]
Equity compensation plans not approved by security holders	–	–	–
Total	1,081,853	$25.51	231,587[(2)]

(1) Does not include securities issuable pursuant to the Company's Executive Bonus Plan (**"Executive Plan"**) as there are no securities set aside for issuance thereunder. However, it is possible that securities of the Company could in the future be issued pursuant to the Executive Plan.

(2) Includes (a) 148,687 shares of Common Stock and 70,000 shares of Class A $0.05 Non-Cumulative Participating Convertible Preferred Stock (the **"Class A Preferred Stock"**) available for issuance under the Company's 2002 Omnibus Employee Incentive Plan (the **"2002 Omnibus Plan"**), and (b) 12,900 shares of Common Stock available for issuance under the Company's Non-Employee Director Stock Plan (the **"Director Plan"**). Awards under the 2002 Omnibus Plan may be made in the form of incentive or non-qualified stock options, stock appreciation rights, performance units or shares, and restricted and unrestricted stock.

Performance Graph

The following performance graph compares the cumulative total stockholder return on the Company's Common Stock for the last five fiscal years with the cumulative total returns for the same period of (a) the S&P 500 Stock Index, and (b) a peer group consisting of companies included by S&P in its published indices for the Forest Products Industry. The graph assumes that the value of the investment in the Company's Common Stock and each index was $100 at December 31, 2001, and that all dividends were reinvested. The data points indicate the value of each such investment as of the last trading day for each year indicated (calculated as indicated above).



In addition to its forest products operations, the Company is involved in the real estate and racing industries. However, the real estate and racing units of the Company have generally accounted for less than 30% and 15%, respectively, of the Company's consolidated revenues over the past several years. Accordingly, a line-of-business index for each such industry has not been utilized.

ITEM 6. SELECTED FINANCIAL DATA

The following summary of consolidated financial information for each of the five years ended December 31, 2006 is not reported upon herein by independent public accountants and should be read in conjunction with the Consolidated Financial Statements and the Notes thereto which are contained in Item 8 herein.

	Years Ended December 31,				
	2006	2005	2004	2003	2002[1]
	(In millions of dollars, except per share amounts)				
Consolidated statement of operations:					
Net sales	$ 291.5	$ 406.4	$ 347.5	$ 336.6	$ 366.7
Income (loss) before income taxes, minority interests and cumulative effect of accounting change[2]	370.9	(4.1)	(46.9)	(10.6)	(96.0)
Income (loss) from continuing operations	375.1	(4.0)	(46.6)	(11.6)	(81.4)
Cumulative effect of accounting change	(0.7)	–	–	–	(2.6)
Net income (loss)	374.4	(4.0)	(46.6)	(11.6)	(84.0)
Consolidated balance sheet at end of period:					
Total assets	1,009.9	1,048.3	1,015.2	1,060.8	1,107.3
Long-term debt, less current maturities	885.4	889.6	912.0	953.5	982.3
Stockholders' deficit	(211.8)	(661.3)	(657.1)	(601.9)	(582.5)
Per share information:					
Basic net income (loss) per share before cumulative effect of accounting change	$ 67.77	$ (0.66)	$ (7.79)	$ (1.79)	$ (12.87)
Basic net income (loss) after cumulative effect of accounting change	67.64	(0.66)	(7.79)	(1.79)	(12.87)
Diluted net income (loss) before cumulative effect of accounting change	59.82	(0.66)	(7.79)	(1.79)	(12.87)
Diluted net income (loss) after cumulative effect of accounting change	59.71	(0.66)	(7.79)	(1.79)	(12.87)

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

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

- 2006 includes a $430.9 million reversal of net investment in Kaiser (see Notes 1 and 10), a $11.6 million gain from the sale of certain properties as part of the Scopac Land Sale Program and a $1.5 million charge for employee severance and benefit costs at Palco and Scopac.
- 2005 includes a $0.7 million charge for employee severance and benefit costs at Palco (see Note 3), a $1.9 million charge in connection with an environmental matter associated with a former subsidiary of the Company (see Note 3), a $3.1 million gain from an insurance settlement, a $4.6 million asset impairment charge at Palco (see Note 5), and a $4.3 million benefit to correct the cumulative effect of an overstatement of intercompany interest from 1995 to 2000.
- 2004 includes a $1.4 million charge for employee severance and benefit costs at Palco (see Note 3), and a $1.9 million charge in connection with an environmental matter associated with a former subsidiary of the Company (see Note 3).
- 2003 includes a gain on the sale of timberlands of $16.8 million, $8.0 million of insurance recoveries related to the *OTS* and *FDIC actions*, and a $1.4 million charge to write-down the Company's casino-related assets to estimated fair value.
- 2002 includes other items of $0.5 million attributable to Kaiser for the period from January 1, 2002, through February 11, 2002.

MAXXAM Inc. did not declare or pay any cash dividends during the five-year period ended December 31, 2006.

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

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

Results of Operations

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

The Company operates in three industries: forest products and related operations and activities, through MGI and its wholly owned subsidiaries, principally Palco, Scopac, Britt and SDLLC; real estate investment and development, through various subsidiaries and joint ventures; and racing operations through SHRP, Ltd. MGHI owns 100% of MGI and is a wholly owned subsidiary of the Company. Any reference herein to a company includes the subsidiaries of that company unless otherwise noted or the context indicates otherwise.

In addition to the above, the Company previously owned 50,000,000 common shares (the **"Kaiser Shares"**) of Kaiser, which represented approximately 63% of Kaiser's common stock. In July 2006, the Kaiser Shares were cancelled as part of Kaiser's Chapter 11 plan of reorganization. As a result, the Company no longer has any ownership interest in or affiliation with Kaiser.

On January 18, 2007, Palco, Scopac, Britt, SDLLC and Palco's other subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. See Note 1, "–Reorganization Proceedings of Palco and its Subsidiaries" and "–Financial Condition and Investing and Financing Activities–Forest Products Operations" for further discussion.

Consolidated Operations

Selected Operational Data

The following table presents selected financial information for the years ended December 31, 2006, 2005 and 2004 for the Company's consolidated operations.

	Years Ended December 31,		
	2006	2005	2004
	(In millions of dollars)		
Net sales	$ 291.5	$ 406.4	$ 347.5
Costs and expenses	(285.0)	(351.2)	(333.3)
Reversal of net investment in Kaiser	430.9	–	–
Gains on sales of timberlands and other assets	11.6	0.3	0.1
Operating income	449.0	55.5	14.3
Other income	9.6	18.6	12.8
Interest expense	(87.7)	(78.2)	(74.0)
Income (loss) before income taxes and cumulative effect of accounting change	370.9	(4.1)	(46.9)
Benefit (provision) for income taxes	4.2	0.1	0.3
Income (loss) before cumulative effect of accounting change	$ 375.1	$ (4.0)	$ (46.6)
Cumulative effect of accounting change, net of tax	(0.7)	–	–
Net income (loss)	$ 374.4	$ (4.0)	$ (46.6)
Revenues by segment as a percentage of total:			
Forest products	48.0 %	44.7 %	58.2%
Real estate	36.0 %	43.9 %	27.3%
Racing	16.0 %	11.4 %	14.5%
	100.0 %	100.0 %	100.0%

Overview of Consolidated Results of Operations

Reversal of Net Investment in Kaiser

In February 2002, Kaiser and certain of its subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. Kaiser's plan of reorganization provided for the cancellation of Kaiser's equity, including common shares held by the Company, without consideration or obligation. Kaiser's plan of reorganization became effective on July 6, 2006, and Kaiser emerged from bankruptcy. As a result, the Company no longer has any ownership interest in or affiliation with Kaiser. Since the Company's Kaiser Shares were cancelled without obligation, the Company reversed the $516.2 million of losses in excess of its investment in Kaiser along with the accumulated other comprehensive losses of $85.3 million related to Kaiser, resulting in a net gain of $430.9 million, recognized in the third quarter of 2006. As a result of the cancellation of the Company's Kaiser Shares in 2006, the Company expects it will take a worthless stock deduction on its 2006 consolidated federal income tax return. However, it is uncertain whether the deduction meets certain criteria required for asset recognition purposes. Accordingly, the Company has not recorded the resulting tax asset of approximately $135.8 million in its consolidated balance sheet as of December 31, 2006.

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

Net Sales

Net sales for 2006 totaled $291.5 million, compared to $406.4 million in 2005. The decline in net sales was the result of lower lot and acreage sales at the real estate segment and reduced throughput at the forest products segment, resulting primarily from reduced harvest levels as the result of regulatory restrictions and limitations. Sales at the Company's real estate segment were $104.9 million in 2006, as compared to $178.3 million in 2005. This substantial decrease in sales was due primarily to reduced acreage sales at Palmas and Mirada and a reduction in the number of lots sold at Fountain Hills, partially offset by increased lot sales at Mirada and higher deferred profit recognized at Palmas. In addition to the decline in sales for the real estate segment, there was a $41.8 million decline in net sales for the Company's forest products segment. This decline was due to a decrease in product volume attributable to reduced harvesting caused by regulatory restrictions and limitations, as well as an unfavorable shift in lumber sold from redwood to lower-priced, common grade Douglas-fir lumber.

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

Operating Income (Loss)

Operating income was $449.0 million in 2006, as compared to $55.5 million in 2005. This substantial change resulted primarily from the reversal of the Company's net investment in Kaiser (discussed above), reduced sales volumes at the Company's real estate segment and increased operating losses at the Company's forest products segment. Operating income for the real estate segment declined $51.6 million, primarily as a result of a decline in real estate sales, as discussed above. The Company's forest products segment incurred operating losses of $9.1 million in 2006, net of gains on sales of timberlands of $11.6 million. The forest products operating losses were the result of reduced harvest levels and operational inefficiencies at Palco's Scotia sawmill.

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

Loss Before Income Taxes

The Company's consolidated income before income taxes was $370.9 million in 2006 as compared to $4.1 million loss in 2005. This significant improvement is primarily the result of the net gain of $430.9 million from the reversal of the Company's net investment in Kaiser (discussed above), offset by the decline in real estate operations (discussed above).

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

Forest Products Operations

Industry Overview and Selected Financial and Operating Data

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

The Company's forest products business segment has become increasingly unpredictable due to regulatory constraints and ongoing litigation challenges and harvest levels have declined significantly.

On January 18, 2007, the Debtors (Palco and its five wholly owned subsidiaries, including Scopac) filed the Bankruptcy Cases, separate voluntary petitions for reorganization under Chapter 11 of the Bankruptcy Code, in the Bankruptcy Court (the United States Bankruptcy Court for the Southern District of Texas). The six companies that filed for voluntary protection were Scopac and the Palco Debtors – Palco, Britt, SDLLC, Salmon Creek and Scotia Inn Inc. (**"Scotia Inn"**). The term **"Filing Date"** shall mean January 18, 2007. The Bankruptcy Cases are being jointly administered (Case No. 07-20027-C-11), with the Debtors managing their business in the ordinary course as debtors-in-possession subject to the control and supervision of the Bankruptcy Court.

The filing of the Bankruptcy Cases was precipitated by liquidity shortfalls at Palco and Scopac and their resultant inability to make January 2007 interest payments on their respective debt obligations, arising from regulatory restrictions and limitations on timber harvest, increased timber harvesting costs and cyclical lumber prices. Both Scopac and Palco undertook various efforts in 2006 to generate additional liquidity to satisfy their respective debt service obligations; however, the cash generated from their efforts, together with their cash flows from operations, was not sufficient to cover their respective interest payment shortfalls in January 2007. See "–Financial Condition and Investing and Financial Activities–Forest Product Operations" for further discussion.

During 2001, comprehensive external and internal reviews were conducted of Palco's business operations. These reviews were conducted in an effort to identify ways in which Palco could operate on a more efficient and cost-effective basis. Since 2001, Palco has implemented a number of changes, including: closing four of its five sawmills; eliminating certain of its operations, including its company-staffed logging operations (now relying exclusively on contract loggers), its soil amendment and concrete block activities, and its Scotia finishing and remanufacturing plant; and adopting various cost saving measures. Palco has continued to examine ways in which to achieve cost savings. In April 2004, Palco commenced a mill improvement project, including a new sawmill located in Scotia, California. The new sawmill was constructed in two phases. The first phase of the project, the processing of smaller diameter second growth logs (up to 24" in diameter) is a high-speed processing line that includes advanced scanning and optimization technology intended to maximize lumber recovery. The second phase, the relocation of large log equipment from the Carlotta mill, came on line in October 2005. This phase allows for processing of larger logs up to 60" in diameter. Palco also completed a new $5.0 million planer project in Scotia in January 2004. The new planer is capable of processing rough sawn boards into finished lumber more rapidly. These improvements have not been sufficient to overcome the adverse effects of regulatory harvest limits.

The following table presents selected operational and financial information for the years ended December 31, 2006, 2005 and 2004 for the Company's forest products operations.

	Years Ended December 31,		
	2006	2005	2004
	(In millions of dollars, except shipments and prices)		
Timber harvest[1]	99.6	145.5	144.1
Shipments:			
Lumber:[2]			
Redwood upper grades	3.4	6.4	17.4
Redwood common grades	136.5	178.8	209.2
Douglas-fir upper grades	–	0.6	2.5
Douglas-fir common grades	66.7	92.6	61.6
Other	–	3.6	6.2
Total lumber	206.6	282.0	296.9
Cogeneration power [3]	111.3	164.0	162.0
Average sales price:			
Lumber: [4]			
Redwood upper grades	$ 1,671	$ 1,243	$ 1,352
Redwood common grades	678	620	613
Douglas-fir upper grades	549	914	980
Douglas-fir common grades	351	373	408
Cogeneration power [5]	73	65	65
Net sales:			
Lumber, net of discount	$ 121.6	$ 155.9	$ 179.2
Logs	3.5	8.2	6.1
Cogeneration power	8.5	10.9	10.8
Wood chips	2.7	3.5	3.1
Other	3.7	3.3	2.9
Total net sales	$ 140.0	$ 181.8	$ 202.1
Operating income (loss)[6][7]	$ (9.1)	$ (13.4)	$ 5.4
Loss before income taxes	$ (78.0)	$ (69.9)	$ (49.3)

(1) Timber harvest is expressed in millions of board feet, net Scribner scale.
(2) Lumber shipments are expressed in millions of board feet.
(3) Power deliveries are expressed in thousands of megawatt hours.
(4) Dollars per thousand board feet.
(5) Dollars per megawatt hour.
(6) Operating losses for 2006 and 2005 include a $0.7 million and $4.6 million, respectively, of impairment charges related to the write-down to estimated salvage value of certain long-lived assets.
(7) Operating losses for 2006 includes a $11.6 million gain on sales of timberlands.

Net Sales

Net sales for the forest products segment in 2006 were $41.8 million below the prior year's net sales. The decline was due primarily to a reduction in total lumber shipments, compounded by an unfavorable shift in lumber sold from redwood lumber to lower-priced, common grade Douglas-fir lumber. Sales of logs, power and other products, which accounted for 13.1% of the segment's sales product mix in 2006, decreased $7.5 million compared to the prior year.

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

Operating Income (Loss)

The forest products segment incurred operating losses of $9.1 million in 2006, net of gains on sales of timberlands of $11.6 million, as compared to operating losses of $13.4 million in 2005. The forest products operating losses were the result of reduced harvest levels and operational inefficiencies at Palco's Scotia sawmill.

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

Loss Before Income Taxes

The loss before income taxes of $78.0 million, as compared to $69.9 million of losses in 2005, reflects the effects of the factors discussed above compounded by additional interest expense related to higher debt levels.

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

Real Estate Operations

Industry Overview and Selected Operational Data

The Company, through its wholly owned subsidiaries and joint ventures, invests in and develops residential and commercial real estate primarily in Puerto Rico, Arizona, California, and Texas. Results of operations between periods for the Company's real estate operations are generally not comparable due to the timing of individual real estate transactions and cash collections. The following table presents selected financial and operating information for the years ended December 31, 2006, 2005 and 2004, respectively, for the Company's real estate operations.

	Years Ended December 31,		
	2006	2005	2004
	(In millions of dollars)		
Net sales:			
Real estate:			
Fountain Hills	$ 15.6	$ 42.9	$ 12.7
Mirada	26.6	56.9	16.1
Palmas	27.6	42.3	30.9
Other	–	0.1	–
Total	69.8	142.2	59.7
Resort, commercial and other:			
Fountain Hills	3.7	5.4	6.7
Mirada	0.3	0.1	0.1
Palmas	12.5	12.1	10.9
Commercial lease properties	18.4	18.3	17.2
Other	0.2	0.2	0.2
Total	35.1	36.1	35.1
Total net sales	$ 104.9	$ 178.3	$ 94.8
Operating income (loss):			
Fountain Hills	$ 6.6	$ 23.3	$ 4.1
Mirada	14.6	35.9	6.0
Palmas	8.2	22.6	13.3
Commercial lease properties	9.4	8.3	7.2
Other	(1.4)	(1.1)	(0.9)
Total operating income	$ 37.4	$ 89.0	$ 29.7
Investment, interest and other income (expense), net:			
Equity in earnings (losses) from real estate joint ventures	$ (0.4)	$ (1.0)	$ 2.8
Other	5.5	3.4	5.3
	$ 5.1	$ 2.4	$ 8.1
Income before income taxes	$ 25.2	$ 74.0	$ 19.5

Net Sales

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

Net sales for the real estate segment decreased $73.4 million in 2006 from the year-ago period. The substantial decrease was due primarily to reduced acreage sales at Palmas and Mirada and a reduction in the number of lots sold at Fountain Hills, partially offset by increased lot sales at Mirada and deferred profit recognized at Palmas.

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

Operating Income (Loss)

Operating income decreased $51.6 million from $89.0 million in 2005 to $37.4 million in 2006 due to the decline in sales discussed above. Operating income increased $59.3 million from $29.7 million in 2004 to $89.0 million in 2005 due to increased sales, as discussed above.

Income Before Income Taxes

The segment's income before income taxes decreased to $25.2 million in 2006, from $74.0 million in 2005, due to the decline in sales discussed above, offset by higher interest income and joint venture earnings from RMCAL. The segment's income before income taxes increased to $74.0 million in 2005, from $19.5 million in 2004, due to the higher operating results discussed above offset by a reduction in equity earnings from the Company's investment in FireRock, LLC due to the sell-out of lots in 2004.

Racing Operations

Industry Overview and Selected Operational Data

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

The following table presents selected operational and financial information for the years ended December 31, 2006, 2005 and 2004, respectively, for the Company's racing operations.

	Years Ended December 31,		
	2006	2005	2004
	(In millions of dollars)		
Number of live racing days:[1]			
Sam Houston Race Park	110	120	167
Valley Race Park	94	89	110
Handle:			
Sam Houston Race Park:			
On-track handle	$ 132.0	$ 126.6	$ 137.0
Off-track handle	132.7	140.9	173.7
Total	$ 264.7	$ 267.5	$ 310.7
Valley Race Park:			
On-track handle	$ 18.2	$ 19.0	$ 19.4
Off-track handle	3.4	2.5	3.6
Total	$ 21.6	$ 21.5	$ 23.0
Net sales:			
Sam Houston Race Park:			
Gross pari-mutuel commissions	$ 32.8	$ 32.1	$ 34.9
Other revenues	8.5	8.8	10.0
Total	41.3	40.9	44.9
Valley Race Park:			
Gross pari-mutuel commissions	4.3	4.4	4.6
Other revenues	1.0	1.0	1.1
Total	5.3	5.4	5.7
Total net sales	$ 46.6	$ 46.3	$ 50.6
Operating loss:			
Sam Houston Race Park	$ (3.7)	$ (3.5)	$ (2.1)
Valley Race Park	(0.9)	(0.6)	(1.0)
Total operating loss	$ (4.6)	$ (4.1)	$ (3.1)
Loss before income taxes	$ (4.4)	$ (4.1)	$ (3.1)

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

Net Sales

Total net sales for the racing segment increased $0.3 million in 2006, as compared to the prior year, primarily due to an increase in simulcast wagering, partially offset by a decline in simulcast wagering at Valley Race Park. Total net sales for the racing segment declined $4.3 million in 2005, as compared to the prior year, primarily due to a decrease in the number of live racing days from 2004.

Operating Loss and Income Before Income Taxes

Racing operations' operating loss and loss before income taxes for 2006 increased from 2005, principally due to increased operating costs at Sam Houston Race Park and Valley Race Park. Racing operations' operating loss and loss before income taxes for 2005 increased from 2004, principally due to lower net sales, partially offset by lower operating costs associated with the reduced number of live racing days at Sam Houston Race Park.

Other Items Not Directly Related to Industry Segments

	Years Ended December 31,		
	2006	2005	2004
	(In millions of dollars)		
Operating income (loss), including reversal of net investment in Kaiser	$ 425.3	$ (16.0)	$ (17.7)
Income (loss) before income taxes	428.1	(4.1)	(14.0)

Operating Loss

The Corporate segment's operating losses represent general and administrative expenses that are not specifically attributable to the Company's segments, including stock-based compensation expense and the Company's investment in Kaiser.

Kaiser's plan of reorganization under Chapter 11 of the Bankruptcy Code, which provided for the cancellation of the Company's Kaiser Shares without consideration or obligation, became effective on July 6, 2006. Since the Company's Kaiser Shares were cancelled without obligation in the third quarter of 2006, the Company reversed its net investment in Kaiser, resulting in a net gain of $430.9 million in that reporting period.

The Corporate segment's selling, general and administrative expenses were significantly lower in 2006, as compared to 2005 and 2004, primarily due to changes in stock-based compensation expense. For the years ended December 31, 2006, 2005 and 2004, stock-based compensation expense was $(2.0) million, $3.7 million and $6.1 million, respectively. Also included in Corporate selling, general and administrative expenses for 2005 and 2004 is a $1.9 million charge in connection with an environmental matter associated with a former subsidiary of the Company. See Note 11 for further information.

Income (Loss) Before Income Taxes

Income (loss) before income taxes includes operating losses, investment, interest and other income (expense) and interest expense, which are not attributable to the Company's segments. Results for 2006 include approximately $2.5 million of investment, interest and other income, a $5.5 million decrease from 2005, as well as a net gain of $430.9 million from the reversal of net investment in Kaiser (see Notes 1 and 10).

Provision for Income Taxes

Texas House Bill 3, signed into law in May 2006, eliminates the taxable capital and earned surplus components of the existing Texas franchise tax and replaces these components with a margin-based franchise tax. There will be no impact on the Company's 2006 Texas state income taxes as the new law is effective for reports due on or after January 1, 2008 (based on business activity during 2007). The Company is required to include in income for the period that includes the date of enactment the impact of the tax law change on its deferred state income taxes. This tax law change resulted in a reduction in the Company's deferred state income taxes in the amount of $4.1 million, net of federal benefit, and the net tax benefit was recognized in the second quarter of 2006.

The Company generated a loss before income taxes of $4.1 million for 2005 and $60.0 million for 2006 (excluding the reversal of the net investment in Kaiser); however, the Company has recorded a full valuation allowance to offset the tax benefit associated with the tax losses for these periods. Each period, the Company evaluates the appropriate factors in determining the realizability of the deferred tax assets attributable to losses and credits generated in the current period and those being carried forward. These factors are discussed further in Note 8. Based on this evaluation, the Company provided full valuation allowances with respect to the deferred tax assets attributable to losses and credits generated during 2005 and 2006.

Financial Condition and Investing and Financing Activities

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

Overview

The Company conducts its operations primarily through its subsidiaries. Accordingly, creditors of subsidiaries of the Company have priority with respect to the assets and earnings of such subsidiaries over the claims of the creditors of the Company. Certain of the Company's subsidiaries, principally Palco and Scopac, are restricted by their various debt instruments as to the amount of funds that can be paid in the form of dividends or loaned to affiliates. Scopac is highly leveraged and has significant debt service requirements. Palco is also highly leveraged and has significant debt service obligations.

On January 18, 2007, Palco, Scopac and Palco's other subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. The Bankruptcy Cases are being jointly administered, with the Debtors managing their business in the ordinary course as debtors-in-possession subject to the control and supervision of the Bankruptcy Court. The filing of the Bankruptcy Cases was precipitated by liquidity shortfalls at Palco and Scopac and their resultant inability to make

January 2007 interest payments on their respective debt obligations, arising from regulatory restrictions and limitations on timber harvest, increased timber harvesting costs and cyclical lumber prices. Both Scopac and Palco undertook various efforts in 2006 to generate additional liquidity to satisfy their respective debt service obligations; however, the cash generated from their efforts, together with their cash flows from operations, was not sufficient to cover their respective interest payment shortfalls in January 2007. See "–Financial Condition and Investing and Financial Activities-Forest Product Operations" for further discussion.

Cash Flow

As a result of the commencement of the Bankruptcy Cases, the operative documents provide that the outstanding principal of, and accrued interest on, all debt obligations of the Debtors became immediately due and payable. However, the vast majority of the claims in existence at the Filing Date (including claims for principal and accrued interest on the Debtors' indebtedness and substantially all legal claims) are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession. The automatic stay provisions of Chapter 11 of the Bankruptcy Code make it unnecessary to reclassify prepetition long-term liabilities as of the Filing Date even though prepetition creditors might demand payment or there is violation of a covenant in the debt agreement. Accordingly, the Debtors' long-term obligations, except for the Palco Term Loan, where the Borrowers' did not meet the required minimum EBITDA maintenance covenant for the three months ended December 31, 2006, have been classified in accordance with their contractual terms in the Company's consolidated financial statements and in the cash flow table below.

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

	Forest Products							
	Scopac	Palco and Other	MGI	Real Estate	Racing	MGHI	MAXXAM Parent	Total
				(In millions of dollars)				
Debt and credit facilities (excluding intercompany notes)								
Short-term borrowings and current maturities of long-term debt:								
December 31, 2006	$ 67.4 [1]	$ 108.4 [5]	$ –	$ 4.7	$ 0.2	$ –	$ –	$ 180.7
Long-term debt, excluding current maturities and discounts:								
December 31, 2006	$ 669.5	$ 0.4	$ –	$ 215.3	$ 0.2	$ –	$ –	$ 885.4
Cash, cash equivalents, marketable securities and other investments								
December 31, 2006:								
Current restricted amounts	$ 39.5 [4]	$ 0.1	$ –	$ 0.9	$ 2.6	$ –	$ –	$ 43.1
Other current amounts	1.6	0.5	0.7	17.9	3.6	–	136.7	161.0
	41.1	0.6	0.7	18.8	6.2	–	136.7	204.1
Long-term restricted amounts	$ 2.5	$ 2.4	$ –	$ 3.3	$ –	$ –	$ –	$ 8.2
	$ 43.6	$ 3.0	$ 0.7	$ 22.1	$ 6.2	$ –	$ 136.7	$ 212.3

Table and Notes continued on next page

	Forest Products							
	Scopac	Palco and Other	MGI	Real Estate	Racing	MGHI	MAXXAM Parent	Total
				(In millions of dollars)				
Changes in cash and cash equivalents								
Capital expenditures:								
December 31, 2006	$ 6.6	$ 6.7	$ –	$ 1.7	$ 0.6	$ –	$ –	$ 15.6
December 31, 2005	6.5	8.2	–	1.2	3.4	–	0.4	19.7
December 31, 2004	7.8	22.0	–	2.4	0.2	–	0.3	32.7
Net proceeds from dispositions of property and investments:								
December 31, 2006	$ 13.1	$ 2.8	$ –	$ –	$ –	$ –	$ –	$ 15.9
December 31, 2005	–	0.1	–	–	–	–	–	0.1
December 31, 2004	–	0.3	–	–	–	–	–	0.3
Borrowings (repayments) of debt and credit facilities, net of financing costs:								
December 31, 2006	$ 17.0	$ 40.6	$ –	$ (3.8)	$ –	$ –	$ –	$ 53.8
December 31, 2005	(2.5)	42.0	–	(4.6)	(0.1)	–	–	34.8
December 31, 2004	1.0	12.0	–	(21.5)	–	–	–	(8.5)
Dividends, advances including interest paid and tax sharing payments received (paid):								
December 31, 2006	$ 1.6	$ 31.0 [2]	$ 2.8 [3]	$ (58.8)	$ 1.0	$ (1.7)	$ 24.1	$ –
December 31, 2005	–	8.0	1.7	(66.2)	9.3	0.1	47.1	–
December 31, 2004	–	0.1	0.3	(29.5)	–	0.1	29.0	–

(1) Includes borrowings outstanding under the Scopac Line of Credit (see below) of $36.2 million and the current portion of Scheduled Amortization (see below) on the Scopac Timber Notes of $31.2 million.

(2) Reflects $21.0 million of intercompany loans from MGI to Palco used to fund Palco's liquidity shortfalls and $10.0 million of additional intercompany loans from MGI required in connection with the closing of the Palco Term Loan and the Palco Revolving Credit Facility in July 2006.

(3) Advances of $8.1 million were used by MGI to fund timber/log purchases from Scopac during 2006. At December 31, 2006, $1.6 million of timber log purchases had not been settled.

(4) Includes $30.2 million of net proceeds from the sale of Scopac Timber Notes held in the SAR Account.

(5) At December 31, 2006, Palco's and Britt's credit facilities were classified as short-term borrowings since the Borrowers' did not meet the required minimum EBITDA maintenance covenant for the three months ended December 31, 2006.

Operating Activities

Net cash used for operating activities of $74.4 million for the year ended December 31, 2006, resulted primarily from operating cash shortfalls at the Company's forest products segment. Net cash provided by operating activities of $53.3 million for the year ended December 31, 2005 was primarily the result of higher real estate sales, partially offset by operating cash shortfalls at the Company's forest products segment.

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

Investing Activities

Net cash provided by investing activities of $5.0 million for the year ended December 31, 2006, primarily reflects net proceeds from the Scopac Land Sale Program (see below), offset by capital expenditures at the Company's forest products segment. Net cash used for investing activities of $33.5 million for the year ended December 31, 2005, reflects the liquidation of certain short-term investments and the use of restricted cash for debt service payments, offset by capital expenditures in respect of Palco's sawmill project, infrastructure requirements at Scopac and Fountain Hills, and capital expenditures at the Company's horse racing facility.

Net cash used for investing activities of $10.9 million for the year ended December 31, 2004 principally reflects capital expenditures of $32.7 million, $20.5 million of which were related to Palco's new sawmill project, offset by net proceeds from restricted cash of $13.0 million and the sale of marketable securities and other short-term investments of $5.8 million.

Financing Activities

The $31.3 million of net cash provided by financing activities for the year ended December 31, 2006, principally reflects the net proceeds of the Palco refinancing that occurred in July 2006 (see below), offset by treasury stock purchases of $22.5 million by MAXXAM Parent . Net cash provided by financing activities of $34.6 million for the year ended December 31, 2005 principally reflects the net proceeds from a Palco refinancing that occurred in April 2005.

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

MAXXAM Parent

MAXXAM Parent has in the past provided, and may from time to time in the future, either directly or through subsidiaries and under appropriate circumstances, provide various forms of financial assistance to its subsidiaries, or enter into financing or other transactions with its subsidiaries, including secured or unsecured loans, or asset purchases. There can be no assurance that such subsidiaries will have sufficient liquidity in the future to repay intercompany loans.

Although there are no restrictions on the Company's ability to pay dividends on its capital stock, the Company has not paid any dividends for a number of years and has no present intention to do so. Additionally, the Company may from time to time purchase additional shares of its Common Stock on national exchanges or in privately negotiated transactions. During 2006, MAXXAM Parent purchased 710,345 shares of its Common Stock for an aggregate cost of $22.5 million.

At December 31, 2006, MAXXAM Parent had unrestricted cash, cash equivalents and marketable securities and other investments of $136.7 million and MAXXAM Parent did not have any external debt. MAXXAM Parent believes that its existing resources will be sufficient to fund its working capital requirements for the next year. With respect to long-term liquidity, MAXXAM Parent believes that its existing cash and cash resources, together with future distributions from the real estate segment, will be sufficient to meet its long-term working capital requirements. See Note 1, "–Potential Impact on Registrant and Certain Related Entities" regarding potential adverse impacts upon MAXXAM Parent as a result of the Bankruptcy Cases.

Forest Products Operations

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

On January 18, 2007, Palco and its five wholly owned subsidiaries, including Scopac, filed for reorganization under Chapter 11 of the Bankruptcy Code. The Bankruptcy Cases are being jointly administered, with the Debtors managing their business in the ordinary course as debtors-in-possession subject to the control and supervision of the Bankruptcy Court.

The filing of the Bankruptcy Cases was precipitated by liquidity shortfalls at Palco and Scopac and their resultant inability to make January 2007 interest payments on their respective debt obligations, arising from regulatory restrictions and limitations on timber harvest, increased timber harvesting costs and cyclical lumber prices. Both Scopac and Palco undertook various efforts in 2006 to generate additional liquidity to satisfy their respective debt service obligations; however, the cash generated from their efforts, together with their cash flows from operations, was not sufficient to cover their respective interest payment shortfalls in January 2007.

Scopac's indebtedness consists of the Scopac Timber Notes, the 6.55% Class A-1, 7.11% Class A-2 and 7.71% Class A-3 Timber Collateralized Notes due 2028 ($713.8 million principal outstanding as of December 31, 2006), and the Scopac Line of Credit, a line of credit with a group of banks pursuant to which Scopac was permitted to borrow to pay interest on the Scopac Timber Notes (the **"Scopac Line of Credit")** ($36.2 million principal outstanding as of December 31, 2006), and each being secured by (i) Scopac's timber, timberlands and timber rights, (ii) certain contract rights and other assets, (iii) the proceeds of the foregoing and (iv) the funds held by the Trustee under the Scopac Indenture (the **"Trustee"**) in various accounts related to the Scopac Timber Notes. Annual interest obligations related to Scopac's debt facilities were approximately $55.4 million as of December 31, 2006. See Note 7 for further information regarding Scopac's debt obligations.

Palco's indebtedness consists of a five-year $85.0 million secured term loan (the **"Palco Term Loan"**) ($84.3 million principal outstanding as of December 31, 2006) and a five-year $60.0 million secured asset-based revolving credit facility (the **"Palco Revolving Credit Facility"**) ($24.1 million of borrowings outstanding and $13.7 million of letters of credit issued as of December 31, 2006). These facilities are secured by a security interest in the stock of Palco held by MGI, and substantially all of the assets of the Palco Debtors (other than Palco's equity interest in Scopac). Annual interest obligations related to Palco's long-term debt obligations were approximately $17.1 million as of December 31, 2006. See Note 7 for further information regarding Palco's debt obligations.

The Debtors' overall objectives in the Bankruptcy Cases are to achieve an operational and financial restructuring of each of the Debtors' long-term debt obligations in view of estimated lower harvest levels, increased regulatory compliance costs, cyclical lumber prices, and also to continue their businesses. See "– Financial Difficulties of the Forest Products Entities" below. There can be no assurance that the Debtors will be able to attain these objectives and achieve a successful operational and financial reorganization. In the event the Debtors are unsuccessful in attaining a successful operational and financial reorganization, the Debtors could be forced to surrender all or substantially all of their assets to their creditors. Many of the matters discussed elsewhere in this document could adversely affect the Debtors' ability to achieve an operational and financial restructuring. The outcome of the Bankruptcy Cases is impossible to predict and could have a material adverse effect on the businesses of the Debtors, on the interests of creditors, and on the Company.

As provided by the Bankruptcy Code, each of the Debtors generally has the exclusive right to propose a plan of reorganization during the Exclusivity Period, a 120 day period following the date of filing of the Bankruptcy Cases, unless certain statutory exceptions apply or the Bankruptcy Court orders otherwise. For instance, a group of holders of Scopac Timber Notes has filed a motion that, if granted, might have the effect of shortening the Exclusivity Period. Palco and Scopac have each engaged The Blackstone Group (**"Blackstone"**) to serve as its financial advisor and assist in the development of a plan of reorganization for each of Palco and Scopac. If the Debtors fail to file such plan(s) of reorganization during the Exclusivity Period or any extension thereof, or such plan(s) are not accepted by the requisite number of creditors and equity holders entitled to vote on the plan(s), other parties in interest in the Bankruptcy Cases may be permitted to propose their own plan(s) of reorganization for the Debtors.

As a result of the commencement of the Bankruptcy Cases, operative documents provide that the outstanding principal of, and accrued interest on, all long-term debt of the Debtors became immediately due and payable. However, the vast majority of the claims in existence at the Filing Date (including claims for principal and accrued interest on the Debtors' indebtedness, and substantially all legal proceedings) are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession. The automatic stay provisions of Chapter 11 of the Bankruptcy Code make it unnecessary to reclassify prepetition long-term liabilities as of the Filing Date even though prepetition creditors might demand payment or there is a violation of a debt covenant in the debt agreement. Accordingly, the Debtors' long-term debt obligations, except for the Palco Term Loan, where the Borrowers' did not meet the required minimum EBITDA maintenance covenant for the three months ended December 31, 2006, have been classified in accordance with their contractual terms in the accompanying consolidated financial statements. The Bankruptcy Court has, however, upon motion by the Debtors, permitted the Debtors to pay or otherwise honor certain unsecured pre-Filing Date claims, including employee wages and benefits and customary claims in the ordinary course of business, subject to certain limitations. The Debtors also have the right to assume or reject executory contracts, subject to Bankruptcy Court approval and certain other limitations. In this context, "assumption" means that the Debtors agree to perform their obligations and cure certain existing defaults under an executory contract and "rejection" means that the Debtors are relieved from their obligations to perform further under an executory contract and are subject only to a claim for damages due to the breach thereof. Any claim for damages resulting from the rejection of an executory contract is treated as a general unsecured claim in the Bankruptcy Cases.

The Debtors anticipate that substantially all liabilities of the Debtors as of the Filing Date will be resolved under one or more plans of reorganization to be proposed and voted on in the Bankruptcy Cases and in accordance with the provisions of the Bankruptcy Code. However, there can be no assurance that the liabilities of the Debtors will not be ultimate ly found to exceed the fair value of their assets. If a Debtor's creditors are not paid in full, the Bankruptcy Code provides that a Debtor's equity holder will not be entitled to retain its equity interest, unless certain exceptions apply. If the liabilities of one or more of the Debtors are ultimately found to exceed the fair value of its assets, claims of creditors could be paid at less than 100% of their face value. In that event, Palco could lose all or a material portion of its equity ownership in Scopac and Palco's other subsidiaries, MGI could lose all or a material portion of its equity ownership in Palco, or the value of such equity ownership interests could be diluted, impaired or eliminated. There is substantial uncertainty as to when the Debtors will be able to file such plan(s). Moreover, the Debtors' efforts to obtain approval of such plan(s) by the creditors and equity holders entitled to vote on the plan(s), and to obtain confirmation by the Bankruptcy Court of such plan(s), may not be successful.

The financial information of the Debtors contained herein and consolidated with the Company's results has been prepared on a "going concern" basis, which contemplates the realization of assets and the liquidation of liabilities in the ordinary course of business; however, as a result of the commencement of the Bankruptcy Cases, such realization of assets and liquidation of liabilities are subject to a significant number of uncertainties. Specifically, but not all-inclusive, the financial information of the Debtors for the year ended December 31, 2006, contained herein does not present: (a) the realizable value of assets on a liquidation basis, (b) the estimated costs and expenses associated with the Bankruptcy Cases, (c) the amount that will ultimately be paid to settle liabilities and contingencies which may be allowed in the Bankruptcy Cases, or (d) the effect of any changes that may be made in connection with the Company's investment in the Debtors or with the Debtors' operations resulting from a plan of reorganization. Because of the ongoing nature of the Bankruptcy Cases, the discussions and financial information of the Debtors contained herein are subject to material uncertainties.

Financial Difficulties of Forest Products Entities

Future Harvest Levels

Scopac has conducted extensive reviews and analyses of its assets, operations and future prospects. As a result of these extensive reviews and analyses Scopac has concluded that, in the absence of significant regulatory relief and accommodations, its future annual timber harvest levels and cash flows from operations for the foreseeable future will be substantially below both historical harvest levels and the minimum levels necessary to allow Scopac to satisfy the principal and interest payments specified by the Scopac Indenture. Scopac has estimated that its average annual harvest level over the ten-year period that began in 2006 is not likely to exceed approximately 95 million board feet per year. This revised estimated harvest level reflects Scopac's further analysis of the cumulative impact of ongoing regulatory limitations, watershed prescriptions, the requirements of the HCP and other matters, and is based on a number of assumptions that may or may not prove to be accurate. Actual harvest levels are expected to vary substantially from year to year. Moreover, the average annual harvest level over the ten-year period could be even lower due to, among other things, the various matters discussed elsewhere in this document.

Regulatory Matters

Regulatory and environmental matters as well as legal actions have had and are expected to continue to have a significant adverse effect on the Company's forest products operations and liquidity. The ability to harvest Scopac Timber depends in large part upon Scopac's ability to obtain regulatory approval of its THPs. Scopac has experienced difficulties and delays in the approval of its THPs as the result of regulatory and litigation challenges and expects these challenges to persist. The foregoing matters have resulted in declines in actual and expected harvest levels and cash flows, significant increases in the cost of logging operations and increased costs related to timber harvest litigation, all of which have severely impacted the historical cash flows of both Palco and Scopac. These adverse effects are expected to continue.

Scopac Liquidity

As noted above, in the absence of significant regulatory relief and accommodations, Scopac's annual timber harvest levels and cash flows from operations will, for the foreseeable future, be substantially below both historical levels and the minimum levels necessary to allow Scopac to satisfy the principal and interest payments specified by the Scopac Indenture.

In an effort to address expected future interest payment shortfalls, Scopac in 2005 initiated a program to sell certain timberland properties, as well as various non-timberland properties, such as ranchlands and recreational areas (the **"Scopac Land Sale Program"**). The Scopac Land Sale Program generated proceeds of $13.1 million during 2006, however, the proceeds generated from the Scopac Land Sale Program, together with other available liquidity, were not sufficient to cover the expected interest payment shortfall on the January 20, 2007, Scopac Timber Notes payment date.

Scopac experienced liquidity shortfalls during 2006. On the Scopac Timber Notes payment date in January 2006, Scopac used its existing cash resources, all of the remaining funds available under the Scopac Line of Credit, and the additional funds made available from a $2.3 million timber/log purchase by MGI, to pay all of the $27.7 million of interest due ($25.8 million net of interest due in respect of the Scopac Timber Notes held in the SAR Account). Using funds held in the SAR Account, Scopac also repaid $19.3 million of principal on the Scopac Timber Notes ($11.9 million net of principal in respect of the Scopac Timber Notes held in the SAR Account) in accordance with Scheduled Amortization. **"Scheduled Amortization"** is the amount of principal that Scopac must pay (on a cumulative basis) through any Scopac Timber Notes payment date in order to avoid prepayment or deficiency premiums. See Note 7, "–Scopac Timber Notes" for further information regarding Scheduled Amortization.

In April 2006, Scopac and MGI consummated a timber/log purchase that provided Scopac $2.1 million of additional liquidity to pay its operating expenses.

On the Scopac Timber Notes payment date in July 2006, Scopac used its existing cash resources, all of the remaining funds available under the Scopac Line of Credit, $10.2 million of funds from the Scopac Land Sale Program, a $3.7 million timber/log purchase by MGI, and a $2.1 million early log payment by Palco to pay all of the $27.1 million of interest due ($25.4 million net of interest due in respect of Scopac Timber Notes held in the SAR Account). Using funds held in the SAR account, Scopac also repaid $10.0 million of principal on the Scopac Timber Notes ($6.2 million net of principal in respect of Scopac Timber Notes held in the SAR Account), an amount equal to Scheduled Amortization.

As the January 2007 Scopac Timber Notes payment date approached, it became apparent to Scopac that it would not have sufficient liquidity to make the interest payment. The failure of Scopac to pay all of the interest on the Scopac Timber Notes when due constitutes an event of default under Scopac Indenture. In the event of a failure to pay interest on the Scopac Timber Notes in full when due, the Trustee under the Scopac Indenture or the holders of at least 25% of the aggregate outstanding principal amount of the Scopac Timber Notes were entitled to cause all principal, interest and other amounts related to the Scopac Timber Notes to become immediately due and payable. In the event of any such acceleration, the Agent under the Scopac Line of Credit was also entitled to accelerate the advances then outstanding thereunder. If such accelerations of Scopac Timber Notes and/or advances under the Scopac Line of Credit were to occur, the Trustee would be entitled to exercise all rights under the Scopac Indenture and related security documents, including applying funds to pay accelerated amounts, and selling the Scopac Timberlands, Scopac Timber Rights and Scopac's other assets and using the proceeds thereof to pay accelerated amounts. Based upon a review of its alternatives under the circumstance and consultation with its legal advisors, on January 18, 2007, Scopac elected to file for voluntary protection under Chapter 11 of the Bankruptcy Code. As a result of the commencement of the Bankruptcy Cases, lender claims are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession.

Scopac has been authorized by the Bankruptcy Court to fund budgeted ongoing operating and bankruptcy-related costs using operating cash flow and, to the extent needed, funds available in the SAR Account (subject to no more than $5.0 million in withdrawals from the SAR Account being outstanding at any given time). If these sources of liquidity are not adequate, and if Scopac is unable to obtain additional sources of liquidity and the necessary Bankruptcy Court approval to utilize such additional sources of liquidity, Scopac may not be able to continue operations and reorganize successfully under Chapter 11 of the Bankruptcy Code.

Palco Liquidity

As of December 31, 2005, and June 30, 2006, Palco and Britt were in default under the prior Palco-Britt term loan and prior Palco-Britt revolving credit facility (the **"Prior Palco-Britt Facilities"**) due to financial covenant breaches. In the first half of 2006, additional liquidity was needed at Palco and Palco borrowed an aggregate of $20.0 million from MGI to meet its cash shortfalls.

On July 18, 2006, Palco and Britt, as Borrowers, closed on the Palco Term Loan, a five-year $85.0 million secured term loan, and the Palco Revolving Credit Facility, a five-year $60.0 million secured asset-based revolving credit facility, and terminated the Prior Palco-Britt Facilities. The Palco Term Loan was fully funded at closing. The Palco Term Loan and the Palco Revolving Credit Facility required MGI to provide a $10.0 million subordinated loan to the Borrowers, which was also funded at closing. The Borrowers used approximately $56.5 million of the Palco Term Loan to pay off the Prior Palco-Britt Facilities and cash collateralize previously-existing letters of credit; and $6.0 million to pay transaction costs. The remaining $32.5 million of loan proceeds were used for general corporate purposes. As of December 31, 2006, $84.3 million was outstanding under the Palco Term Loan, and $24.1 million of borrowings were outstanding and $13.7 million of letters of credit were issued under the Palco Revolving Credit Facility.

The Borrowers did not meet the required minimum EBITDA maintenance covenant for the three-month period ended September 30, 2006, due to an unplanned severance charge and a legal settlement. On November 20, 2006, MGI made a loan to Palco, enabling the Borrowers to exercise their cure right under the two debt facilities. The Borrowers also notified the lenders that changing market conditions and other factors would likely adversely affect the Borrowers' ability to comply with the financial covenants at December 31, 2006 and in future periods.

The Borrowers did not meet the required minimum EBITDA maintenance covenant for the three-month period ended December 31, 2006. Accordingly, the Palco Term Loan has been reclassified as a current liability in the Company's consolidated balance sheet.

In January 2007, Palco did not have sufficient liquidity to pay all of the interest due on the Palco Term Loan. Based upon a review of its alternatives under the circumstances, and consultation with its legal advisors, in January 18, 2007, Palco elected to file for voluntary protection under Chapter 11 of the Bankruptcy Code. As a result of the commencement of the Bankruptcy Cases, lender claims are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession.

The liquidity shortfalls experienced by Palco throughout 2005 and 2006 resulted primarily from reduced log supply from Scopac and operational inefficiencies related to Palco's Scotia sawmill. Additional liquidity shortfalls are expected in 2007. Additionally, in 2006, Palco initiated an asset sale program (**"Palco Asset Sale Program"**), including real property associated with Palco's former Fortuna and Carlotta sawmills and Palco-owned homes in Scotia, California, with the objective of reducing Palco's overall debt levels. The Palco Asset Sale Program did not generate any cash flow in 2006 and is not expected to generate liquidity in 2007 as, among other things, a substantial portion of the properties must be subdivided and/or rezoned before such properties can be sold.

The Palco Debtors estimate that they will have liquidity shortfalls in 2007. The Palco Debtors are pursuing discussions with lenders in an effort to obtain DIP financing in order to have sufficient liquidity to fund the Palco Debtors' ongoing operating cash needs and bankruptcy-related costs. The Palco Debtors may not be successful in obtaining additional liquidity or the necessary Bankruptcy Court approval, in which case the Palco Debtors may not be able to continue operations and reorganize successfully under Chapter 11 of the Bankruptcy Code.

Real Estate Operations

Real estate management believes that the existing cash and credit facilities are sufficient to fund the segment's working capital and capital expenditure requirements for 2007. With respect to the segment's long-term liquidity, real estate management believes that the ability to generate cash from the sale of existing assets, together with the ability to obtain financing and joint venture partners, should provide sufficient funds to meet its working capital and capital expenditure requirements.

Capital expenditures and real estate improvements and development costs are expected to be approximately $15.0 million to $19.0 million in 2007. The Company expects that these expenditures will be funded by existing cash and available credit facilities. Subject to available resources, the Company's real estate segment may purchase additional properties and/or seek other investment ventures from time to time as appropriate opportunities arise.

Racing Operations

During 2006, SHRP, Ltd. borrowed $1.1 million from MAXXAM Parent to fund its 2006 capital expenditures and improve its working capital position. SHRP, Ltd.'s management expects that SHRP, Ltd. will require additional advances from MAXXAM Parent to fund its operations and capital expenditures in the future. SHRP, Ltd. is experiencing strong competition from Internet wagering and racinos in surrounding states. These factors will also play a role in the long-term liquidity of SHRP, Ltd.

Capital expenditures are expected to be approximately $0.4 million in 2007. Subject to available resources, the Company's racing segment may purchase additional properties and/or seek to expand its operations as appropriate opportunities arise.

Off-Balance Sheet Arrangements

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

Contractual Obligations

As a result of the commencement of the Bankruptcy Cases, the operative documents provide that the outstanding principal of, and accrued interest on, all debt obligations became immediately due and payable. However, the vast majority of the claims in existence at the Filing Date (including claims for principal and accrued interest on the Debtors' indebtedness and substantially all legal claims) are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession. The automatic stay provisions of Chapter 11 of the Bankruptcy Code make it unnecessary to reclassify prepetition long-term liabilities as of the Filing Date even though prepetition creditors might demand payment or there is violation of a covenant in the debt agreement. Accordingly, the Debtors' long-term obligations, except for the Palco Term Loan, where the Borrowers' did not meet the required minimum EBITDA maintenance covenant for the three months ended December 31, 2006, have been classified in accordance with their contractual terms in the Company's consolidated financial statements and in the contractual obligations table below.

The following table presents information with respect to the Company's contractual obligations as of December 31, 2006 (in millions).

		Payments Due by Period					
Contractual Obligations	**Total**	**2007**	**2008**	**2009**	**2010**	**2011**	**Thereafter**
Debt obligations[1]	$ 1,079.2	$ 183.5	$ 35.6	$ 29.5	$ 33.6	$ 38.4	$ 758.6
Interest due on long-term debt obligations	620.7	89.4	81.3	79.3	77.3	75.1	218.3
Operating lease obligations	10.6	3.1	2.7	1.9	0.8	0.7	1.4
Pension funding obligations	15.0	4.4	2.9	1.8	1.8	1.8	2.3
Other long-term liabilities reflected on the Company's balance sheet[2][3][4][5]	5.6	3.1	2.5	–	–	–	–
Total	$ 1,731.1	$ 283.5	$ 125.0	$ 112.5	$ 113.5	$ 116.0	$ 980.6

1) The Scopac Indenture provides that a Scopac Timber Note does not cease to be outstanding because Scopac holds the instrument. Accordingly, the amounts shown in the table above reflect total amounts outstanding, including amounts related to Scopac Timber Notes held in the SAR Account.

(2) Excludes liabilities for litigation, environmental remediation, self-insurance claims, and other contingent liabilities due to uncertainty as to when cash payments will be required.

(3) Includes $1.7 million in 2007 under the terms of various executive compensation agreements.

(4) Includes $2.1 million in 2008 for PDMPI's cost sharing agreement with the Puerto Rico Power Authority for the construction of an electrical substation that will provide capacity to new projects within PDMPI.

(5) Includes $1.4 million in 2007 and $0.4 million in 2008 for contractual amounts owed under agreements with various professional firms (principally audit and tax compliance fees).

Trends

Forest Products Operations

The forest products operations have become increasingly unpredictable due to regulatory constraints and ongoing litigation challenges and harvest levels have declined significantly. Regulatory and environmental matters as well as legal actions have had and are expected to continue to have a significant adverse effect on the Company's forest products operations and liquidity. These matters have resulted in declines in actual and expected harvest levels and cash flows, significant increases in the cost of logging operations and increased costs related to timber harvest litigation, all of which have severely impacted the historical cash flows of both Palco and Scopac. These adverse effects are expected to continue. Additionally, the Debtors expect to incur substantial legal and advisor fees as a result of the Bankruptcy Cases.

Real Estate Operations

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

Racing Operations

The Company has in the past and intends to continue to vigorously pursue Texas gaming legislation favorable to it. As some legislation may require the approval of two-thirds of each legislative house and a majority of the Texas voters, no assurance can be given that any such legislation will be enacted or become effective. Moreover, it is impossible to determine what the provisions of any such legislation would be or its effect on the Company.

In January 2004, a subsidiary of the Company, Laredo LLC, applied to the Racing Commission for an additional license to construct and operate a Class 2 horse racing facility in Laredo, Texas. Following a hearing on Laredo LLC's application and that of a competing applicant, in September 2006, two state administrative law judges recommended to the Racing Commission that Laredo LLC be awarded the license. The Racing Commission on March 20, 2007 ruled that both Laredo LLC and the competing applicant be awarded licenses for the Laredo area. The license awarded to Laredo LLC is, however, conditioned on SHRP, Ltd., by the next Racing Commission meeting on May 14, 2007, entering into an agreement satisfactory to the Racing Commission providing for the sale of Valley Race Park.

Critical Accounting Policies and Estimates

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

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

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

Principles of Consolidation

Under generally accepted accounting principles for entities consolidated through voting interests, consolidation is generally required for investments of more than 50% of the outstanding voting stock of an investee, except when control is not held by the majority owner. Under these rules, legal reorganization or bankruptcy represent conditions which can preclude consolidation in instances where control rests with the bankruptcy court, rather than the majority owner.

Financial Reporting by Entities in Reorganization under the Bankruptcy Code

Under generally accepted accounting principles, entities in reorganization proceedings under the Bankruptcy Code generally continue to apply the financial reporting principles they applied before filing petitions; accordingly, these consolidated financial statements do not reflect changes in the Debtors' financial condition that may result from the Bankruptcy Cases. The automatic stay provisions of Chapter 11 of the Bankruptcy Code make it unnecessary to reclassify prepetition long-term liabilities as of the Filing Date even though prepetition creditors might demand payment or there is a violation of a covenant in the debt agreement. Additionally, debt discounts, as well as debt issuance costs on debts that are not subject to compromise, such as fully secured claims, should not be adjusted. Accordingly, the Debtors' long-term debt obligations, except for the Palco Term Loan, where the Borrowers' did not meet the required minimum EBITDA maintenance covenant for the three months ended December 31, 2006, have been classified according to their contractual terms in the accompanying consolidated financial statements and there have been no adjustments made to debt discounts or debt issuance costs as a result of the reorganization proceedings.

Deconsolidation of Kaiser

On February 12, 2002, Kaiser and certain of its subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. As a result, the Company discontinued consolidating Kaiser's financial results beginning February 12, 2002, and began reporting its investment in Kaiser using the cost method, under which the investment was reflected as a single amount on the Company's consolidated balance sheet and the recording of earnings or losses from Kaiser was discontinued after February 11, 2002.

Kaiser's plan of reorganization provided for the cancellation of Kaiser's equity, including the Company's Kaiser Shares, without consideration or obligation. Kaiser's plan of reorganization became effective on July 6, 2006, and Kaiser emerged from bankruptcy. As a result, the Company no longer has any ownership interest in or affiliation with Kaiser. Since the Company's Kaiser Shares were cancelled without obligation, the Company reversed the $516.2 million of losses in excess of its investment in Kaiser along with the accumulated other comprehensive losses of $85.3 million related to Kaiser, resulting in a net gain of $430.9 million, recognized in the third quarter of 2006. As a result of the cancellation of the Company's Kaiser Shares in 2006, the Company expects it will take a worthless stock deduction on its 2006 consolidated federal income tax return. However, it is uncertain whether the deduction meets certain criteria required for asset recognition purposes. Accordingly, the Company has not recorded the resulting tax asset of approximately $135.8 million in its consolidated balance sheet as of December 31, 2006.

Gain and Loss Contingencies

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

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

Income Taxes

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

Deferred Tax Asset Valuation Allowances

As of December 31, 2006, the Company had $131.6 million of deferred tax assets (net of $125.1 million in valuation allowances) and $41.7 million of deferred tax liabilities. The deferred tax assets and liabilities reported in the Company's consolidated balance sheet reflect the amount of taxes that the Company has prepaid or for which it will receive a tax benefit (an asset) or will have to pay in the future (a liability) because of temporary differences that result from differences in timing of revenue recognition or expense deductibility between generally accepted accounting principles and the Internal Revenue Code. Accounting rules require that a deferred tax asset be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50%) that all or some portion of the deferred tax asset will not be realized. The Company considers all available evidence, both positive and negative, to determine whether a valuation allowance is needed. The need for a valuation allowance ultimately depends on the existence of sufficient taxable income to realize the benefit of a future deductible amount.

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

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

Pension and Other Postretirement Benefit Plan Obligations and Expenses

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

The projected benefit obligation for the Company's pension plans and the accumulated postretirement benefit obligation for the Company's other postretirement benefit plans was determined using a discount rate of 6.0% at December 31, 2006, and 5.625% at December 31, 2005. As the pension plans were frozen December 31, 2005, there is no assumed weighted average long-term rate of compensation. The assumed weighted average long-term rate of return on the assets of the plans is 8.75%. The assets of the plans consist principally of common stocks and U.S. government and other fixed-income obligations.

The estimated impact of a 1% decrease in the discount rate (from 6.0% to 5.0%) would increase the Company's consolidated projected pension benefit obligation by approximately $14.5 million, while the estimated impact of a 1% increase in the discount rate (from 6.0% to 7.0%) would decrease the Company's consolidated projected benefit obligation by approximately $11.6 million.

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

Impairment of Noncurrent Assets

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

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

New Accounting Standards

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to changes in interest rates primarily under the Scopac Line of Credit and the Palco Term Loan and Palco Revolving Credit Facility, as well as certain other debt facilities used to finance real estate development activities. These facilities bear interest at either the prime interest rate or LIBOR, plus specified percentage point spreads. The Company's objective in maintaining its other variable rate borrowings is flexibility in borrowing funds and making repayments without penalties. As of December 31, 2006, there were $144.6 million in borrowings outstanding under all variable rate facilities. Based on the amount of borrowings outstanding under these facilities during 2006, a 2.0% change in interest rates effective from the beginning of the year would have resulted in an increase or decrease in annual interest expense of $3.6 million.

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of MAXXAM Inc. and subsidiaries (collectively the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of operations, cash flows, and stockholders' deficit for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedules listed in the Index at Item 15(a)(2). These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedules based on our audits. We did not audit the financial statements of Sam Houston Race Park, Ltd. (a subsidiary), which statements reflect total revenue constituting 16.0 percent, 11.4 percent and 14.5 percent of the Company's consolidated total revenues for the years ended December 31, 2006, 2005, and 2004, respectively. Such financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Sam Houston Race Park, Ltd., is based solely on the report of such other auditors.

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

In our opinion, based on our audits and the report of other auditors, such consolidated financial statements present fairly, in all material respects, the financial position of MAXXAM Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, based on our audits and (as to the amounts included for Sam Houston Race Park, Ltd.) the report of other auditors, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

The accompanying consolidated financial statements have been prepared assuming that MAXXAM Inc., and its subsidiaries will continue as going concerns. As discussed in Note 1 to the consolidated financial statements, on January 18, 2007, MAXXAM Inc.'s wholly owned subsidiary, The Pacific Lumber Company ("Palco") and its five wholly owned subsidiaries, including Scotia Pacific Company LLC ("Scopac"), filed separate voluntary petitions in the United States Bankruptcy Court for the Southern District of Texas for reorganization under Chapter 11 of the Bankruptcy Code. The six companies that filed for voluntary protection are as follows: Palco, Britt Lumber Co., Inc. ("Britt"), Scotia Development LLC, Salmon Creek LLC, Scotia Inn Inc. and Scopac (the "Debtors"). The proceedings of the Debtors are collectively referred to as the "Bankruptcy Cases." The filing of the Bankruptcy Cases was precipitated by liquidity shortfalls at Palco and Scopac and their resultant inability to make January 2007 interest payments on their respective debt obligations, arising from regulatory restrictions and limitations on timber harvest, increased timber harvesting costs and cyclical lumber prices. Additionally, Palco and Britt did not meet the minimum required EBIDTA maintenance covenant required by their debt facilities for the three month period ended December 31, 2006. Management's plans concerning these matters are also discussed in Note 1 to the consolidated financial statements. The Bankruptcy Cases raise substantial doubts about Palco's and Scopac's ability to continue as going concerns. Further, the Bankruptcy Cases raise substantial doubt about the ability of MAXXAM Inc. and subsidiaries to realize their timber-related assets and discharge their timber-related liabilities in the normal course of business and to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 30, 2007 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

DELOITTE & TOUCHE LLP

Houston, Texas
March 30, 2007

MAXXAM INC. AND SUBSIDIARIES

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

	December 31, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 34.8	$ 72.9
Marketable securities and other short-term investments	126.2	134.6
Receivables:		
Trade, net of allowance for doubtful accounts of $0.7 and $0.8, respectively	9.9	11.1
Other	9.7	5.4
Inventories:		
Lumber	16.3	7.6
Logs	25.5	18.9
Real estate inventory	5.8	12.6
Prepaid expenses and other current assets	16.2	16.4
Restricted cash and marketable securities	43.1	29.1
Total current assets	287.5	308.6
Property, plant and equipment, net of accumulated depreciation of $234.5 and $207.9, respectively	337.0	355.0
Timber and timberlands, net of accumulated depletion of $232.2 and $226.3, respectively	200.3	208.7
Real estate	46.0	43.2
Deferred income taxes	97.5	95.1
Intangible assets	2.0	2.9
Long-term receivables and other assets	31.4	26.9
Restricted cash and marketable securities	8.2	7.9
	$ 1,009.9	$ 1,048.3
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	$ 10.0	$ 11.2
Accrued interest	28.8	25.9
Accrued compensation and related benefits	13.8	20.7
Other accrued liabilities	26.3	37.0
Short-term borrowings and current maturities of long-term debt	180.7	112.5
Total current liabilities	259.6	207.3
Long-term debt, less current maturities and discount	885.4	889.6
Accrued pension and other postretirement benefits	20.8	34.1
Losses in excess of investment in Kaiser	–	516.2
Other noncurrent liabilities	55.9	62.4
Total liabilities	1,221.7	1,709.6
Commitments and contingencies (see Note 11)		
Stockholders' deficit:		
Preferred stock, $0.50 par value; $0.75 liquidation preference; 2,500,000 shares authorized; Class A $0.05 Non-Cumulative Participating Convertible Preferred Stock; 668,964 shares issued; 668,119 shares outstanding	0.3	0.3
Common stock, $0.50 par value; 13,000,000 shares authorized; 10,063,359 shares issued; 5,257,657 and 5,967,942 outstanding, respectively	5.0	5.0
Additional capital	225.3	225.3
Accumulated deficit	(296.0)	(670.4)
Accumulated other comprehensive income (loss)	1.0	(96.6)
Treasury stock, at cost (shares held: preferred – 845; common – 4,805,702 and 4,095,417, respectively)	(147.4)	(124.9)
Total stockholders' deficit	(211.8)	(661.3)
	$ 1,009.9	$ 1,048.3

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

MAXXAM INC. AND SUBSIDIARIES

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

	Years Ended December 31, 2006	2005	2004
Net sales:			
Forest products	$ 140.0	$ 181.8	$ 202.1
Real estate	104.9	178.3	94.8
Racing	46.6	46.3	50.6
	291.5	406.4	347.5
Cost and expenses:			
Cost of sales and operations:			
Forest products	117.1	146.3	150.1
Real estate	36.4	52.0	31.7
Racing	40.9	40.1	42.7
Selling, general and administrative expenses	56.3	72.3	71.7
Gains on sales of timberlands and other assets	(11.6)	(0.3)	(0.1)
Impairment of assets	0.7	4.6	–
Depreciation, depletion and amortization	33.6	35.9	37.1
Reversal of net investment in Kaiser	(430.9)	–	–
	(157.5)	350.9	333.2
Operating income (loss):			
Forest products	(9.1)	(13.4)	5.4
Real estate	37.4	89.0	29.7
Racing	(4.6)	(4.1)	(3.1)
Corporate, including reversal of net investment in Kaiser	425.3	(16.0)	(17.7)
	449.0	55.5	14.3
Other income (expense):			
Investment and interest income	7.4	17.5	8.6
Other income	2.2	1.1	4.2
Interest expense	(81.1)	(74.4)	(71.8)
Amortization of deferred financing costs	(6.6)	(3.8)	(2.2)
Income (loss) before income taxes and cumulative effect of accounting change	370.9	(4.1)	(46.9)
Benefit for income taxes	4.2	0.1	0.3
Income (loss) before cumulative effect of accounting change	375.1	(4.0)	(46.6)
Cumulative effect of accounting change	(0.7)	–	–
Net income (loss)	$ 374.4	$ (4.0)	$ (46.6)
Basic income (loss) per common and common equivalent share before cumulative effect of accounting change	$ 67.77	$ (0.66)	$ (7.79)
Cumulative effect of accounting change	(0.13)	–	–
Basic income (loss) per common and common equivalent shares after cumulative effect of accounting change	$ 67.64	$ (0.66)	$ (7.79)
Diluted income (loss) per common and common equivalent share before cumulative effect of accounting change	$ 59.82	$ (0.66)	$ (7.79)
Cumulative effect of accounting change	(0.11)	–	–
Diluted income (loss) per common and common equivalent share after cumulative effect of accounting change	$ 59.71	$ (0.66)	$ (7.79)

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

MAXXAM INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions of dollars)

	Years Ended December 31, 2006	2005	2004
Cash flows from operating activities:			
Net income (loss)	$ 374.4	$ (4.0)	$ (46.6)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:			
Reversal of net investment in Kaiser	(430.9)	–	–
Depreciation, depletion and amortization	33.6	35.9	37.1
Non-cash stock-based compensation (benefit) expense	(2.0)	3.7	6.1
Non-cash impairment charge	0.7	4.6	–
Gains on sales and/or disposals of timberlands and other assets	(11.6)	(0.3)	(0.1)
Net losses (gains) on marketable securities	(2.2)	(6.6)	2.2
Amortization of deferred financing costs and discounts on long-term debt	6.6	3.8	2.2
Equity in loss (earnings) of unconsolidated affiliates, net of dividends received	0.4	1.0	(0.4)
Increase (decrease) in cash resulting from changes in:			
Receivables	(2.8)	5.4	(0.8)
Inventories	(15.3)	(1.1)	4.4
Prepaid expenses and other assets	7.0	0.5	1.5
Accounts payable	(1.2)	(3.4)	2.5
Accrued and deferred income taxes	(6.5)	0.2	0.2
Other accrued liabilities	(14.7)	8.1	1.6
Accrued interest	2.9	1.0	(0.9)
Long-term assets and long-term liabilities	(12.8)	4.6	17.7
Other	–	(0.1)	0.2
Net cash provided by (used for) operating activities	(74.4)	53.3	26.9
Cash flows from investing activities:			
Net proceeds from dispositions of property and investments	15.9	0.1	0.3
Sales and maturities of marketable securities and other investments	627.9	708.3	778.6
Purchases of marketable securities and other investments	(625.4)	(728.4)	(772.6)
Net proceeds from restricted cash	2.2	5.2	13.0
Capital expenditures	(15.6)	(19.7)	(32.7)
Return of investment in joint venture	–	0.8	2.1
Other	–	0.2	0.4
Net cash provided by (used for) investing activities	5.0	(33.5)	(10.9)
Cash flows from financing activities:			
Proceeds from issuances of long-term debt	–	38.0	5.4
Proceeds from sale of Scopac Timber Notes held in the SAR Account	31.8	–	–
Principal payments on long-term debt	(67.9)	(32.1)	(48.1)
Principal payments on Scopac Timber Notes held in the SAR Account	11.1	9.5	5.0
Borrowings under revolving and short-term credit facilities	89.4	23.0	30.0
Incurrence of deferred financing costs	(10.6)	(3.6)	(0.8)
Treasury stock purchases	(22.5)	(0.2)	–
Net cash provided by (used for) financing activities	31.3	34.6	(8.5)
Net increase (decrease) in cash and cash equivalents	(38.1)	54.4	7.5
Cash and cash equivalents at beginning of year	72.9	18.5	11.0
Cash and cash equivalents at end of year	$ 34.8	$ 72.9	$ 18.5

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

MAXXAM INC. AND SUBSIDIARIES

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

	Years Ended December 31,		
	2006	2005	2004
Preferred Stock ($.50 Par)			
Balance at beginning and end of year	$ 0.3	$ 0.3	$ 0.3
Common Stock ($.50 Par)			
Balance at beginning and end of year	$ 5.0	$ 5.0	$ 5.0
Additional Capital			
Balance at beginning and end of year	$ 225.3	$ 225.3	$ 225.3
Accumulated Deficit			
Balance at beginning of year	$ (670.4)	$ (666.4)	$ (619.8)
Net income (loss)	374.4	(4.0)	(46.6)
Balance at end of year	$ (296.0)	$ (670.4)	$ (666.4)
Accumulated Other Comprehensive Income (Loss)			
Minimum pension liability adjustment, net of taxes	$ 11.1	$ 0.1	$ (6.9)
Reversal of other comprehensive income related to Kaiser	85.3	–	–
Other	(0.1)	–	–
Unrealized gains (losses) on available-for-sale investments	1.3	(0.1)	(1.7)
Other comprehensive income (loss)	97.6	–	(8.6)
Accumulated other comprehensive loss at beginning of year	(96.6)	(96.6)	(88.0)
Accumulated other comprehensive income (loss) at end of year	$ 1.0	$ (96.6)	$ (96.6)
Treasury Stock			
Balance at beginning of year	$ (124.9)	$ (124.7)	$ (124.7)
Treasury stock purchases	(22.5)	(0.2)	–
Balance at end of year	$ (147.4)	$ (124.9)	$ (124.7)
Comprehensive Income (Loss)			
Net income (loss)	$ 374.4	$ (4.0)	$ (46.6)
Other comprehensive income (loss)	97.6	–	(8.6)
Total comprehensive income (loss)	$ 472.0	$ (4.0)	$ (55.2)

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

MAXXAM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Index of Notes

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

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

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

- Forest products, through MAXXAM Group Inc. (**"MGI"**) and MGI's wholly owned subsidiaries, principally The Pacific Lumber Company (**"Palco"**), Scotia Pacific Company LLC (**"Scopac"**), Britt Lumber Co., Inc. (**"Britt"**) and Scotia Development LLC (**"SDLLC"**). MGI and its subsidiaries engage primarily in the growing and harvesting of redwood and Douglas-fir timber, the milling of logs into lumber and related operations and activities. A substantial portion of the Company's consolidated assets, liabilities, revenues and results of operations are attributable to the forest products subsidiaries. On January 18, 2007, Palco, Scopac, Britt, SDLLC and Palco's other subsidiaries (the **"Debtors"**) filed for reorganization under Chapter 11 of the United States Bankruptcy Code (the **"Bankruptcy Code"**). See "–Reorganization Proceedings of Palco and its Subsidiaries" below for further information.

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

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

In addition to the above, the Company previously owned 50,000,000 common shares (the **"Kaiser Shares"**) of Kaiser Aluminum Corporation (**"Kaiser"**), which represented approximately 63% of Kaiser's common stock. In July 2006, the Kaiser Shares were cancelled as part of Kaiser's Chapter 11 plan of reorganization. As a result, the Company no longer has any ownership interest in or affiliation with Kaiser. See the "Deconsolidation of Kaiser" below and Note 10 for further information regarding this matter.

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

Principles of Consolidation

Under generally accepted accounting principles for entities consolidated through voting interests, consolidation is generally required for investments of more than 50% of the outstanding voting stock of an investee, except when control is not held by the majority owner. Under these rules, legal reorganization or bankruptcy represent conditions which can preclude consolidation in instances where control rests with the bankruptcy court, rather than the majority owner.

Financial Reporting by Entities in Reorganization under the Bankruptcy Code

On January 18, 2007 (the **"Filing Date"**), the Debtors (Palco and its subsidiaries) filed for reorganization under Chapter 11 of the Bankruptcy Code. As a result, the Company expects to discontinue consolidating the Debtors' financial results beginning January 18, 2007, and begin reporting its net investment in the Debtors using the cost method. See the "Reorganization Proceedings of Palco and its Subsidiaries" section below for further information regarding the status of the Debtors' reorganization proceedings.

Under generally accepted accounting principles, entities in reorganization proceedings under the Bankruptcy Code generally continue to apply the financial reporting principles they applied before filing petitions; accordingly, these consolidated financial statements do not reflect changes in the Debtors' financial condition that may result from the Bankruptcy Cases. The automatic stay provisions of Chapter 11 of the Bankruptcy Code make it unnecessary to reclassify prepetition long-term liabilities as of the Filing Date even though prepetition creditors might demand payment or there is a violation of a covenant in the debt agreement. Additionally, debt discounts as well as debt issuance costs on debts that are not subject to compromise, such as fully secured claims, should not be adjusted. Accordingly, the Debtors' long-term debt obligations, except for the Palco Term Loan (as defined below), where the Borrowers' did not meet the required minimum EBITDA maintenance covenant for the three months ended December 31, 2006, have been classified according to their contractual terms in the accompanying consolidated financial statements and there have been no adjustments made to debt discounts, or debt issuance costs as a result of the reorganization proceedings.

Deconsolidation of Kaiser

On February 12, 2002, Kaiser and certain of its subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. As a result, the Company discontinued consolidating Kaiser's financial results beginning February 12, 2002, and began reporting its investment in Kaiser using the cost method, under which the investment was reflected as a single amount on the Company's consolidated balance sheet and the recording of earnings or losses from Kaiser was discontinued after February 11, 2002.

Kaiser's plan of reorganization provided for the cancellation of Kaiser's equity, including the Company's Kaiser Shares, without consideration or obligation. Kaiser's plan of reorganization became effective on July 6, 2006, and Kaiser emerged from bankruptcy. As a result, the Company no longer has any ownership interest in or affiliation with Kaiser. Since the Company's Kaiser Shares were cancelled without obligation, the Company reversed the $516.2 million of losses in excess of its investment in Kaiser along with the accumulated other comprehensive losses of $85.3 million related to Kaiser, resulting in a net gain of $430.9 million, recognized in the third quarter of 2006. As a result of the cancellation of the Company's Kaiser Shares in 2006, the Company expects it will take a worthless stock deduction on its 2006 consolidated federal income tax return. However, it is uncertain whether the deduction meets certain criteria required for asset recognition purposes. Accordingly, the Company has not recorded the resulting tax asset of approximately $135.8 million in its consolidated balance sheet as of December 31, 2006.

Reorganization Proceedings of Palco and its Subsidiaries (subsequent event)

On January 18, 2007, Palco and its five wholly owned subsidiaries, including Scopac, filed separate voluntary petitions in the United States Bankruptcy Court for the Southern District of Texas (the **"Bankruptcy Court"**) for reorganization under Chapter 11 of the Bankruptcy Code. The six companies that filed for voluntary protection are Palco, Britt, SDLLC, Salmon Creek LLC (**"Salmon Creek"**) and Scotia Inn (**"Scotia Inn"**) (the **"Palco Debtors"**) and Scopac. The proceedings of the Debtors are collectively referred to as the **"Bankruptcy Cases."** For purposes of these financial statements, the term **"Filing Date"** shall mean January 18, 2007. The Bankruptcy Cases are being jointly administered, with the Debtors managing their business in the ordinary course as debtors-in-possession subject to the control and supervision of the Bankruptcy Court.

The filing of the Bankruptcy Cases was precipitated by liquidity shortfalls at Palco and Scopac and their resultant inability to make January 2007 interest payments on their respective debt obligations, arising from regulatory restrictions and limitations on timber harvest, increased timber harvesting costs and cyclical lumber prices. Both Scopac and Palco undertook various efforts in 2006 to generate additional liquidity to satisfy their respective debt service obligations; however, the cash generated from their efforts, together with their cash flows from operations, was not sufficient to cover their respective interest payment shortfalls in January 2007.

Scopac's indebtedness consists of its 6.55% Class A-1, 7.11% Class A-2 and 7.71% Class A-3 Timber Collateralized Notes due 2028 (the **"Scopac Timber Notes"**) ($713.8 million principal outstanding as of December 31, 2006) and a line of credit with a group of banks pursuant to which Scopac was permitted to borrow to pay interest on the Scopac Timber Notes (the **"Scopac Line of Credit"**) ($36.2 million principal outstanding as of December 31, 2006), and each being secured by (i) Scopac's timber, timberlands and timber rights, (ii) certain contract rights and other assets, (iii) the proceeds of the foregoing and (iv) the funds held by the Trustee in various accounts related to the Scopac Timber Notes. Annual interest obligations related to Scopac's debt facilities were approximately $55.4 million as of December 31, 2006. See Note 7 for further information regarding Scopac's debt obligations.

Palco's indebtedness consists of a five-year $85.0 million secured term loan (the **"Palco Term Loan"**) ($84.3 million principal outstanding as of December 31, 2006) and a five-year $60.0 million secured asset-based revolving credit facility (the **"Palco Revolving Credit Facility"**) ($24.1 million of borrowings outstanding and $13.7 million of letters of credit issued as of December 31, 2006). These facilities are secured by the stock of Palco held by MGI, and substantially all of the assets of the Palco Debtors (other than Palco's equity interest in Scopac). Annual interest obligations related to Palco's long-term debt obligations were approximately $17.1 million as of December 31, 2006. See Note 7 for further information regarding Palco's debt obligations.

The Debtors' overall objectives in the Bankruptcy Cases are to achieve an operational and financial restructuring of each of the Debtors' long-term debt obligations in view of estimated lower harvest levels, increased regulatory compliance costs, cyclical lumber prices, and also to continue their businesses. There can be no assurance that the Debtors will be able to attain these objectives and achieve a successful operational and financial reorganization. In the event the Debtors are unsuccessful in attaining a successful operational and financial reorganization, the Debtors could be forced to surrender all or substantially all of their assets to their creditors. Many of the matters discussed elsewhere in this document could adversely affect the Debtors' ability to achieve an operational and financial restructuring. The outcome of the Bankruptcy Cases is impossible to predict and could have a material adverse effect on the businesses of the Debtors, on the interests of creditors, and on the Company.

As provided by the Bankruptcy Code, each of the Debtors generally has the exclusive right to propose a plan of reorganization the Exclusivity Period, a 120 day period following the date of filing of the Bankruptcy Cases, unless certain statutory exceptions apply to the Bankruptcy Court orders otherwise. For instance, a group of holders of Scopac Timber Notes has filed a motion that, if granted, might have the effect of shortening the Exclusivity Period. Palco and Scopac have each engaged The Blackstone Group (**"Blackstone"**) to serve as its financial advisor and assist in the development of a plan of reorganization for each of Palco and Scopac. If the Debtors fail to file such plan(s) of reorganization during the Exclusivity Period or any extension thereof, or such plan(s) are not accepted by the requisite number of creditors and equity holders entitled to vote on the plan(s), other parties in interest in the Bankruptcy Cases may be permitted to propose their own plan(s) of reorganization for the Debtors.

As a result of the commencement of the Bankruptcy Cases, the outstanding principal of, and accrued interest on, all long-term debt of the Debtors became immediately due and payable. However, the vast majority of the claims in existence at the Filing Date (including claims for principal and accrued interest on the Debtors' indebtedness, and substantially all legal proceedings) are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession. Accordingly, the Debtors' long-term debt obligations, except for the Palco Term Loan, where the

Borrowers' did not meet the required minimum EBITDA maintenance covenant for the three months ended December 31, 2006, have been classified in accordance with their contractual terms in the accompanying consolidated financial statements. The Bankruptcy Court has, however, upon motion by the Debtors, permitted the Debtors to pay or otherwise honor certain unsecured pre-Filing Date claims, including employee wages and benefits and customary claims in the ordinary course of business, subject to certain limitations. The Debtors also have the right to assume or reject executory contracts, subject to Bankruptcy Court approval and certain other limitations. In this context, "assumption" means that the Debtors agree to perform their obligations and cure certain existing defaults under an executory contract and "rejection" means that the Debtors are relieved from their obligations to perform further under an executory contract and are subject only to a claim for damages and the breach thereof. Any claim for damages resulting from the rejection of an executory contract is treated as a general unsecured claim in the Bankruptcy Cases.

The Debtors anticipate that substantially all liabilities of the Debtors as of the Filing Date will be resolved under one or more plans of reorganization to be proposed and voted on in the Bankruptcy Cases and in accordance with the provisions of the Bankruptcy Code. However, there can be no assurance that the liabilities of the Debtors will not be ultimately found to exceed the fair value of its assets. If a Debtor's creditors are not paid in full, the Bankruptcy Code provides that a Debtor's equity holder will not be entitled to retain its equity interest, unless certain exceptions apply. If the liabilities of one or more of the Debtors are ultimately found to exceed the fair value of their assets, claims of creditors could be paid at less than 100% of their face value. In that event, Palco could lose all or a material portion of its equity ownership in Scopac and Palco's other subsidiaries, MGI could lose all or a material portion of its equity ownership in Palco, or the value of such equity ownership interests could be diluted, impaired or eliminated. There is substantial uncertainty as to when the Debtors will be able to file such plan(s), and the Debtors' efforts to obtain approval of such plan(s) by the creditors and equity holders entitled to vote on the plan(s), and to obtain confirmation by the Bankruptcy Court of such plan(s), may not be successful.

The financial information of the Debtors contained herein and consolidated with the Company's results has been prepared on a "going concern" basis, which contemplates the realization of assets and the liquidation of liabilities in the ordinary course of business; however, as a result of the commencement of the Bankruptcy Cases, such realization of assets and liquidation of liabilities are subject to a significant number of uncertainties. Specifically, but not all-inclusive, the financial information of the Debtors for the year ended December 31, 2006, contained herein does not present: (a) the realizable value of assets on a liquidation basis, (b) the estimated costs and expenses associated with the Bankruptcy Cases, (c) the amount that will ultimately be paid to settle liabilities and contingencies which may be allowed in the Bankruptcy Cases, or (d) the effect of any changes that may be made in connection with the Company's investment in the Debtors or with the Debtors' operations resulting from a plan of reorganization. Because of the ongoing nature of the Bankruptcy Cases, the discussions and financial information of the Debtors contained herein are subject to material uncertainties.

Financial Difficulties of Forest Products Entities

Future Harvest Levels

Scopac has conducted extensive reviews and analyses of its assets, operations and future prospects. As a result of these extensive reviews and analyses Scopac has concluded that, in the absence of significant regulatory relief and accommodations, its future annual timber harvest levels and cash flows from operations for the foreseeable future will be substantially below both historical harvest levels and the minimum levels necessary to allow Scopac to satisfy the principal and interest specified by the Scopac Indenture. Scopac has estimated that its average annual harvest levels over the ten-year period that began in 2006 is not likely to exceed approximately 95 million board feet per year. This revised estimated harvest level reflects Scopac's further analysis of the cumulative impact of ongoing regulatory limitations, watershed prescriptions, the requirements of its comprehensive multi-species habitat conservation plan (the **"HCP"**) and other matters, and is based on a number of assumptions that may or may not prove to be accurate. Actual harvest levels are expected to vary significantly from year to year. Moreover, the average annual harvest level over the ten-year period could be even lower due to, among other things, the various matters discussed elsewhere in this document.

Regulatory Matters

Regulatory and environmental matters as well as legal actions have had and are expected to continue to have a significant adverse effect on the Company's forest products operations and liquidity. The ability to harvest Scopac Timber (as defined below) depends in large part upon Scopac's ability to obtain regulatory approval of its timber harvest plans (**"THPs"**). Scopac has experienced difficulties and delays in the approval of its THPs as the result of regulatory and litigation challenges and expects these challenges to persist. The foregoing matters have resulted in declines in actual and expected harvest levels and cash flows, significant increases in the cost of logging operations and increased costs related to timber harvest litigation, all of which have severely impacted the historical cash flows of both Palco and Scopac. These adverse effects are expected to continue. The timber on the timberlands owned by Scopac (the **"Scopac**

Timberlands”) and the timber that Scopac has the exclusive right to harvest (**“Scopac Timber Rights”**) is collectively referred to as the **“Scopac Timber”**. The timberlands in respect of the Scopac Timber are referred to as the **“Scopac Timber Property”**. The Scopac Timber Property and the timberlands owned by Palco and Salmon Creek are referred to as the **“Palco Timberlands.”**

Scopac Liquidity

As noted above, in the absence of significant regulatory relief and accommodations, Scopac's annual timber harvest levels and cash flows from operations will, for the foreseeable future, be substantially below both historical levels and the minimum levels necessary to allow Scopac to satisfy the principal and interest payments specified by the Scopac Indenture.

In an effort to address expected future interest payment shortfalls, Scopac in 2005 initiated a program to sell certain timberland properties, as well as various non-timberland properties, such as ranchlands and recreational areas (the **“Scopac Land Sale Program”**). The Scopac Land Sale Program generated proceeds of $13.1 million during 2006, however, the proceeds generated from the Scopac Land Sale Program, together with other available liquidity, were not sufficient to cover the expected interest payment shortfall on the January 20, 2007, Scopac Timber Notes payment date.

Scopac experienced liquidity shortfalls during 2006. On the Scopac Timber Notes payment date in January 2006, Scopac used its existing cash resources, all of the remaining funds available under the Scopac Line of Credit, and the additional funds made available from a $2.3 million timber/log purchase by MGI, to pay all of the $27.7 million of interest due ($25.8 million net of interest due in respect of Scopac Timber Notes held in the Scheduled Amortization Reserve Account; **“SAR Account”**). Using funds held in the SAR Account, Scopac also repaid $19.3 million of principal on the Scopac Timber Notes ($11.9 million net of principal in respect of Scopac Timber Notes held in the SAR Account) in accordance with Scheduled Amortization. **“Scheduled Amortization”** is the amount of principal that Scopac must pay (on a cumulative basis) through any Scopac Timber Notes payment date in order to avoid prepayment or deficiency premiums. See Note 7, “–Scopac Timber Notes” for further information regarding Scheduled Amortization and the SAR Account.

In April 2006, Scopac and MGI consummated a timber/log purchase that provided Scopac $2.1 million of additional liquidity to pay its operating expenses.

On the Scopac Timber Notes payment date in July 2006, Scopac used its existing cash resources, all of the remaining funds available under the Scopac Line of Credit, $10.2 million of funds from the Scopac Land Sale Program, a $3.7 million timber/log purchase by MGI, and a $2.1 million early log payment by Palco to pay all of the $27.1 million of interest due ($25.4 million net of interest due in respect of Scopac Timber Notes held in the SAR Account). Scopac also repaid $10.0 million of principal on the Scopac Timber Notes ($6.2 million net of principal in respect of Scopac Timber Notes held in the SAR Account), an amount equal to Scheduled Amortization, using funds held in the SAR Account.

As the January 2007 Scopac Timber Notes payment date approached, it became apparent to Scopac that it would not have sufficient liquidity to make the interest payment. The failure of Scopac to pay all of the interest on the Scopac Timber Notes when due constitutes an event of default under the indenture governing the Scopac Timber Notes (**“Scopac Indenture”**). In the event of a failure to pay interest on the Scopac Timber Notes in full when due, the trustee under the Scopac Indenture (the **“Trustee”**) or the holders of at least 25% of the aggregate outstanding principal amount of the Scopac Timber Notes were entitled to cause all principal, interest and other amounts related to the Scopac Timber Notes to become immediately due and payable. In the event of any such acceleration, the Agent under the Scopac Line of Credit was also entitled to accelerate the advances then outstanding thereunder. If such accelerations of Scopac Timber Notes and/or advances under the Scopac Line of Credit were to occur, the Trustee was entitled to exercise all rights under the Scopac Indenture and related security documents, including applying funds to pay accelerated amounts, and selling the Scopac Timberlands, the Scopac Timber Rights and Scopac's other assets and using the proceeds thereof to pay accelerated amounts. Based upon a review of its alternatives under the circumstance and consultation with its legal advisors, on January 18, 2007, Scopac elected to file for voluntary protection under Chapter 11 of the Bankruptcy Code. As a result of the commencement of the Bankruptcy Cases, lender claims are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession.

Scopac has been authorized by the Bankruptcy Court to fund budgeted ongoing operating and bankruptcy-related costs using operating cash flow and, to the extent needed, funds available in the SAR Account (subject to no more than $5.0 million in withdrawals from the SAR Account being outstanding at any given time). If these sources of liquidity are not adequate, and if Scopac is unable to obtain additional sources of liquidity and the necessary Bankruptcy Court approval to utilize such additional sources of liquidity, Scopac may not be able to continue operations and reorganize successfully under Chapter 11 of the Bankruptcy Code.

Palco Liquidity

As of December 31, 2005, and June 30, 2006, Palco and Britt were in default under the prior Palco-Britt term loan and prior Palco-Britt revolving credit facility (the **"Prior Palco-Britt Facilities"**) due to financial covenant breaches. In the first half of 2006, additional liquidity was needed at Palco and Palco borrowed an aggregate of $20.0 million from MGI to meet its cash shortfalls.

On July 18, 2006, Palco and Britt, as **Borrowers**, closed on the Palco Term Loan, a five-year $85.0 million secured term loan (the **"Palco Term Loan"**), and the Palco Revolving Credit Facility, a five-year $60.0 million secured asset-based revolving credit facility (the **"Palco Revolving Credit Facility"**), and terminated the Prior Palco-Britt Facilities. The Palco Term Loan was fully funded at closing. The Palco Term Loan and the Palco Revolving Credit Facility required MGI to provide a $10.0 million subordinated loan to the Borrowers, which was also funded at closing. The Borrowers used approximately $56.5 million of the Palco Term Loan to pay off the Prior Palco-Britt Facilities and cash collateralize previously-existing letters of credit; and $6.0 million to pay transaction costs. The remaining $32.5 million of loan proceeds were used for general corporate purposes. As of December 31, 2006, $84.3 million was outstanding under the Palco Term Loan, and $24.1 million of borrowings were outstanding and $13.7 million of letters of credit were issued under the Palco Revolving Credit Facility.

The Borrowers did not meet the required minimum EBITDA maintenance covenant for the three-month period ended September 30, 2006, due to an unplanned severance charge and a legal settlement. On November 20, 2006, MGI made a loan to Palco, enabling the Borrowers to exercise their cure right under the two debt facilities. The Borrowers also notified the lenders that changing market conditions and other factors would likely adversely affect the Borrowers' ability to comply with the financial covenants at December 31, 2006 and in future periods.

The Borrowers did not meet the required minimum EBITDA maintenance covenant for the three-month period ended December 31, 2006. Accordingly, the Palco Term Loan has been reclassified as a current liability in the Company's consolidated balance sheet.

In January 2007, Palco did not have sufficient liquidity to pay all of the interest due on the Palco Term Loan. Based upon a review of its alternatives under the circumstance, and consultation with its legal advisors, on January 18, 2007, Palco elected to file for voluntary protection under Chapter 11 of the Bankruptcy Code. As a result of the commencement of the Bankruptcy Cases, lender claims are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession.

The liquidity shortfalls experienced by Palco throughout 2005 and 2006 resulted primarily from reduced log supply from Scopac and operational inefficiencies related to Palco's Scotia sawmill. Additional liquidity shortfalls are expected in 2007. Additionally, in 2006, Palco initiated an asset sale program (**"Palco Asset Sale Program"**), including real property associated with Palco's former Fortuna and Carlotta sawmills and Palco-owned homes in Scotia, California with the objective of reducing Palco's overall debt levels. The Palco Asset Sale Program did not generate any cash flow in 2006 and is not expected to generate liquidity in 2007 as, among other things, a substantial portion of the properties must be subdivided and/or rezoned before such properties can be sold.

The Palco Debtors estimate that they will have liquidity shortfalls in 2007. The Palco Debtors are pursuing discussions with lenders in an effort to obtain debtor-in-possession financing in order to have sufficient liquidity to fund the Palco Debtors' ongoing operating cash needs, including bankruptcy-related costs. The Palco Debtors may not be successful in obtaining additional liquidity or the necessary Bankruptcy Court approval, in which case the Palco Debtors may not be able to continue operations and reorganize successfully under Chapter 11 of the Bankruptcy Code.

Potential Impact on Registrant and Certain Related Entities

The Bankruptcy Cases, and the liquidity issues being experienced by Scopac and Palco, could result in claims against and could have adverse impacts on MAXXAM Parent and its affiliates, including MGHI and/or MGI. For example, under ERISA, if Palco's pension plan were to be terminated, MAXXAM Parent and its wholly owned subsidiaries would be jointly and severally liable for any unfunded pension plan obligations. The unfunded termination obligation attributable to Palco's pension plan as of December 31, 2006, is estimated to have been approximately $23.0 million based upon annuity placement interest rate assumptions as of such date. In addition, it is possible that certain transactions could be completed in connection with a potential restructuring or reorganization of the Debtors, such as a sale of all or a portion of the equity ownership in the Debtors, a sale of a substantial portion of the Debtors' assets and/or a cancellation of some or all of the Debtors' indebtedness, which could require the utilization of all or a substantial portion of, or the loss of a significant portion of, the Company's net operating losses or other tax attributes for federal and state income tax purposes and could require tax payments. In addition, the Company may be required to establish certain deferred tax liabilities as a result of loss of control of the Debtors effective as of the Filing Date.

The following condensed pro forma financial information reflects the results of operation of the Company, excluding the Debtors, for the period presented (in millions):

	Year Ended December 31, 2006
Revenues	$ 151.5
Costs and expenses	(140.4)
Reversal of net investment in Kaiser	430.9
Operating income (loss)	442.0
Debtors' loss	(79.0)
Other income (expenses), net	7.9
Cumulative effect of accounting change	(0.7)
Income tax benefit	4.2
Net income	$ 374.4

The following condensed pro forma financial data reflects the deconsolidation of the Debtors, as of the date presented (in millions):

	As of December 31, 2006
Current assets	$ 183.4
Property, plant, and equipment, net	228.8
Other assets	158.6
Total assets	$ 570.8
Current liabilities	36.0
Long-term debt, less current maturities	215.5
Other liabilities	12.8
Net investment in Debtors[1]	518.3
Total liabilities	782.6
Stockholder's deficit	(211.8)
Total liabilities and stockholder's deficit	$ 570.8

[1] This amount represents the net book value of the Debtors' assets minus liabilities stated in accordance with generally accepted accounting principles.

Use of Estimates and Assumptions

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

Risks and uncertainties are inherent with respect to the ultimate outcome of Bankruptcy Cases and the matters discussed in Note 11. Scopac's estimate of its future harvest levels is based on a number of assumptions that may or may not prove to be accurate and, accordingly, is subject to significant uncertainty. The results of a resolution of such uncertainties could have a material effect on the Company's consolidated financial position, results of operations or liquidity. In addition, uncertainties related to the projection of future taxable income could affect the realization of the Company's deferred tax assets discussed in Note 8. Estimates of future benefit payments used to measure the

Company's pension and other postretirement benefit obligations discussed in Note 9 are subject to a number of assumptions about future experience, as are the estimated future cash flows projected in the evaluation of long-lived assets for possible impairment. To the extent there are material differences between these estimates and actual results, the Company's consolidated financial position, results of operations and/or liquidity could be affected.

Reclassifications

Certain reclassifications totaling $0.9 million have been made to prior years' consolidated financial statements to be consistent with the current year's presentation.

Summary of Significant Accounting Policies

Concentrations of Credit Risk

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

Available-for-Sale Securities

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

Investments in Limited Partnerships

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

Inventories

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

Real Estate

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

Timber Harvest and Other Long-Term Assets

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

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

	December 31,		
	2006	2005	2004
SYP/HCP	$ 8.3	$ 8.3	$ 8.3
Less: Accumulated amortization	(6.3)	(5.4)	(4.5)
	$ 2.0	$ 2.9	$ 3.8

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

Amortization of intangible assets for the years ended December 31, 2006, 2005 and 2004, was $0.9 million per year. The estimated amortization expense for 2007 and 2008 is $0.9 million per year, and $0.2 million for 2009. Estimated amortization will change if events or circumstances warrant the revision of estimated useful lives.

Timber and Timberlands

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

Capital expenditures related to Scopac's timber properties were $1.9 million, $2.4 million and $3.0 million for the years ended December 31, 2006, 2005 and 2004, respectively. Depletion expense for the years ended December 31, 2006, 2005 and 2004, was $5.8 million, $6.1 million and $8.2 million, respectively.

Revenue Recognition

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

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

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

Deferred Financing Costs

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

Long-Lived Assets

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

The Company classifies long-lived assets as held-for-sale when the following conditions are satisfied: (i) management commits to a plan to sell a long-term operating asset, (ii) the asset is available for immediate sale, (iii) an active effort to locate a buyer is underway, and (iv) it is probable that the sale will be completed within one year. The assets classified as held-for-sale at December 31, 2006 and 2005 related primarily to real estate properties that are expected to be sold within a year.

Gain and Loss Contingencies

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

Environmental Remediation Obligations

In 2001, Palco recorded an environmental remediation charge of $3.4 million (of which $1.4 million is accrued at December 31, 2006). The environmental accrual represents Palco's estimate of costs reasonably expected to be incurred based on presently enacted laws and regulations, currently available facts, existing technology, and Palco's assessment of the likely remediation actions to be taken. Palco incurred $0.1 million, $0.2 million and $0.4 million of costs related to this remediation liability during 2006, 2005 and 2004, respectively. Based on management's best estimates given the current facts and circumstances, $1.0 million is expected to be incurred in 2007 and the remaining $0.4 million in future years.

Income Taxes

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

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

Stock-Based Compensation

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

Grants issued to employees and outside directors were previously accounted for under the intrinsic value method of accounting as defined by APB Opinion No. 25 and related interpretations. Effective January 1, 2006, the Company prospectively adopted the fair value-based method of accounting for stock-based employee compensation as prescribed by SFAS No. 123(R), *Share Based Payments* (**"SFAS No. 123(R)"**) issued by the Financial Accounting Standards Board (**"FASB"**), and recognized a $0.7 million charge in January 2006, representing the cumulative effect of the accounting change. For the year ended December 31, 2006, the Company recognized a benefit of $2.0 million for stock based compensation and for the years ended December 31, 2005 and 2004, the Company recognized stock compensation expense of $3.7 million and $6.1 million, respectively. The 2006 benefit is the result of a decline in the market value of the Company's Common Stock. The 2005 expense is primarily the impact of additional options vesting during the fourth quarter of 2005, while the 2004 expense is the result of additional options vesting and an increase in the market value of the Company's Common Stock. Stock compensation expense is adjusted as the market value of the Company's Common Stock changes and awards vest. Included in the Consolidated Balance Sheet at December 31, 2006 is a liability for stock compensation of $7.2 million.

The following table illustrates the pro forma effect on net loss and loss per share for the years ended December 31, 2005 and 2004, respectively, had the Company accounted for its grants under the fair value method of accounting (in millions, except per share information).

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

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

	Years Ended December 31, 2005	Years Ended December 31, 2004
Expected volatility	38%	41%
Expected dividends	–	–
Expected term (in years)	6.44	6.63
Risk-free rate	4.35%	3.63%
Weighted average fair value	$ 15.40	$ 13.47

Per Share Information

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

	2006	2005	2004
Weighted average number of common shares outstanding-basic	5,534,981	5,972,180	5,976,467
Effect of dilution[1]:			
Conversion of Class A Convertible Preferred Stock	668,119	–[1]	–[1]
Exercise of stock options	67,104	–[1]	–[1]
Weighted average number of common shares outstanding-diluted	6,270,204	5,972,180	5,976,467

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

Accumulated Other Comprehensive Income (loss)

Accumulated Other Comprehensive Income (loss) (**"AOCI"**) consists of the following (in millions):

	December 31, 2006	December 31, 2005
AOCI related to Kaiser	$ –	$ (85.3)
Minimum pension liability, net of related income tax effects of $2.9 million	0.8	(10.3)
Unrealized gains (losses) on available-for-sale investments	0.6	(0.7)
Other	(0.4)	(0.3)
	$ 1.0	$ (96.6)

2. New Accounting Standards

Accounting for Stock Options

The Company adopted SFAS No. 123(R) effective January 1, 2006. SFAS No. 123(R) requires compensation costs related to share-based payments to be determined by the fair value of the equity or liability instruments issued on the grant date. Compensation cost is required to be recognized over the period that an employee provides service in exchange for the award and these awards are required to be re-measured each reporting period. The adoption of this standard resulted in an expense of $0.7 million in the first quarter of 2006 representing the cumulative impact of awards exercisable on January 1, 2006.

Exchanges of Nonmonetary Assets

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29* (**"SFAS No. 153"**). SFAS No. 153 is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The adoption of SFAS No. 153 on January 1, 2006, did not have an impact on the Company's consolidated financial statements.

Accounting Changes and Error Corrections

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (**"SFAS No. 154"**) which changes the requirements applicable to accounting for, and reporting of, a change in accounting principle. SFAS No. 154 requires retrospective application of a change in accounting principle to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 on January 1, 2006, did not have an impact on the Company's consolidated financial statements.

Accounting for Uncertainty in Income Taxes

In June 2006, the FASB issued FASB Interpretation No. 48, *"Accounting for Uncertainty in Income Taxes"* (**"FIN No. 48"**), which clarifies the accounting for uncertainty in income tax positions. FIN 48 requires that a company recognize in its consolidated financial statements the impact of a tax position that will more likely than not be sustained upon examination based on the technical merits of the position. FIN 48 is effective for the Company's calendar year beginning January 1, 2007. Any cumulative effect recorded as a result of adopting FIN 48 will be recorded as an adjustment to opening retained earnings. The Company does not expect the impact of adoption of this statement to have a material impact on its consolidated financial statements.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("**SFAS No. 157**"), which is intended to increase consistency and comparability in fair value measurements by defining fair value, establishing a framework for measuring fair value, and expanding disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will adopt SFAS No. 157 on January 1, 2008, and has not yet determined the impact, if any, on its consolidated financial statements.

Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ("**SFAS No. 158**"), which requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position, and to recognize through comprehensive income changes in the funded status in the year in which the changes occur. Additionally, it requires an employer to measure the funded status of a plan as of the date of its fiscal year-end, with limited exceptions. SFAS 158 is effective as of the end of fiscal years ending after December 15, 2006; however, the requirement to measure plan assets and benefit obligations as of the fiscal year-end is not effective until fiscal years ending after December 15, 2008. The Company adopted all requirements of SFAS 158 on December 31, 2006 and recognized a $2.1 million reduction of its liability.

The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115* ("**SFAS No. 159**"). SFAS No. 159 permits entities to measure eligible assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS No. 159 on January 1, 2008, and has not yet determined the impact, if any, on its consolidated financial statements.

3. Segment Information and Other Items

Reportable Segments

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

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

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

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

	December 31,	Reportable Segments: Forest Products	Reportable Segments: Real Estate	Reportable Segments: Racing	Corporate	Consol-idated Total
Selling, general and administrative expenses	2006	$ 24.4 [1]	$ 17.7	$ 8.8	$ 5.4 [2]	56.3
	2005	24.8 [3]	23.1	8.6	15.8 [2]	72.3
	2004	26.1 [4]	19.4	9.3	16.9 [2]	71.7
Investment, interest and other income (expense), net	2006	1.7 [5]	5.1	0.2	2.6 [6]	9.6
	2005	4.1	2.4	–	12.1	18.6
	2004	1.0	8.1	–	3.7	12.8
Interest expense[7]	2006	70.5	17.3	–	(0.1)	87.7
	2005	60.6	17.4	–	0.2	78.2
	2004	55.7	18.3	–	–	74.0
Depreciation, depletion and amortization	2006	18.5	13.4	1.5	0.2	33.6
	2005	19.9	14.2	1.6	0.2	35.9
	2004	20.6	14.0	1.7	0.8	37.1
Income (loss) before income taxes	2006	(78.0) [8]	25.2	(4.4)	428.1 [9]	370.9
	2005	(69.9)	74.0	(4.1)	(4.1)	(4.1)
	2004	(49.3)	19.5	(3.1)	(14.0)	(46.9)
Capital expenditures	2006	13.3	1.7	0.6	–	15.6
	2005	14.7	1.2	3.4	0.4	19.7
	2004	29.8	2.4	0.2	0.3	32.7
Total assets	2006	441.9	299.5	36.4	232.1	1,009.9
	2005	421.4	345.3	36.4	245.2	1,048.3

(1) Includes severance costs of $1.5 million related to a reduction in workforce.

(2) Includes stock-based compensation expense of $(2.0) million in 2006, $3.7 million in 2005 and $6.1 million in 2004. Also includes a $1.9 million charge in 2005 and 2004 in connection with an environmental matter associated with a former subsidiary of the Company. See Note 11 for further information.

(3) Includes severance costs of $0.7 million related to the closure of Palco's Fortuna mill and a $4.6 million asset impairment charges (see Note 5).

(4) Includes $1.4 million charge for employee severance and benefit costs related to the closure of Palco's Carlotta mill.

(5) Includes $3.1 million for settlement of a lawsuit filed by Palco against several insurance companies seeking reimbursement of settlement payments and defense costs related to a legal matter which was settled in 2002.

(6) Includes a $4.3 million benefit to correct the cumulative effect of an overstatement of intercompany interest from 1995 to 2000 and income from investments in limited partnerships of $7.3 million. See Note 4.

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

(8) Includes a $11.6 million gain from the sale of certain properties as part of the Scopac Land Sale Program.

(9) 2006 includes a $430.9 million reversal of net investment in Kaiser (see Notes 1 and 10).

Product Sales

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

	Years Ended December 31,		
	2006	2005	2004
Forest products:			
Lumber, net of discount	$ 121.6	$ 155.9	$ 179.2
Logs	3.5	8.2	6.1
Wood chips	2.7	3.5	3.1
Cogeneration power	8.5	10.9	10.8
Other	3.7	3.3	2.9
Total forest products sales	$ 140.0	$ 181.8	$ 202.1
Real estate:			
Real estate and development	$ 69.8	$ 142.2	$ 59.7
Resort, commercial and other operations	16.7	17.8	17.9
Commercial lease properties	18.4	18.3	17.2
Total real estate sales	$ 104.9	$ 178.3	$ 94.8
Racing:			
Gross pari-mutuel commissions	$ 37.1	$ 36.5	$ 39.5
Other	9.5	9.8	11.1
Total racing sales	$ 46.6	$ 46.3	$ 50.6

Geographical Information

The Company's forest products and racing operations are located in the United States. The Company's real estate operations are located in the United States and Puerto Rico. For the year ended December 31, 2006, $0.7 million of net sales attributable to the Company's forest products segment were made to foreign customers.

Major Customers and Export Sales

For the years ended December 31, 2006, 2005 and 2004, sales to any one customer did not exceed 10% of consolidated revenues. Export sales were less than 1% of total revenues in 2006, 2005 and 2004. Approximately 40% of the real estate segment's 2005 revenue was attributable to five transactions.

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

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

	December 31,	
	2006	2005
Cash and cash equivalents	$ 44.0	$ 84.4
Marketable securities	141.4	128.9
Investments in limited partnerships	26.9	31.2
	212.3	244.5
Less: restricted cash and marketable securities	(51.3)	(37.0)
Unrestricted cash and marketable securities	$ 161.0	$ 207.5

Cash Equivalents

Cash equivalents consist of highly liquid money market instruments with maturities of three months or less. As of December 31, 2006 and 2005, the carrying amounts of the Company's cash equivalents approximated fair value.

Marketable Securities

Marketable securities generally consist of U.S. corporate debt securities, U.S. treasury obligations, and other debt securities with contractual maturities ranging from one year to five years and are classified as available-for-sale securities. The fair value of substantially all marketable securities is determined by quoted market prices. As of December 31, 2006 and 2005, the carrying amounts of the Company's marketable securities approximated fair value. Investment, interest and other income (expense), net, includes gross realized gains (losses) on sales of available-for-sale securities as follows (in millions):

	Years Ended December 31,		
	2006	2005	2004
Gross realized gains	$ –	$ –	$ 0.6
Gross realized losses	(0.1)	(0.4)	(0.4)

The net adjustment to unrealized holding gains (losses) on available-for-sale securities included as a separate component of shareholders' deficit totaled $1.3 million, $(0.1) million, and $(1.7) million in 2006, 2005, and 2004, respectively.

As of December 31, 2006, there were no occurrences where the fair value of investment securities were in a continuous unrealized loss position for less than twelve months and for twelve months or more. Gross unrealized losses on investment securities at December 31, 2006, were not material.

Investments in Limited Partnerships

The Company has an equity interest in several limited partnerships which invest in diversified portfolios of common stocks and equity securities, in addition to exchange-traded options, futures, forward foreign currency contracts, and other arbitrage opportunities. The Company's ownership percentages in these partnerships are not significant. Investment, interest and other income (expense), net, includes income from the Company's investment in these partnerships for the years ended December 31, 2006, 2005, and 2004 was $(0.6) million, $7.3 million and $1.8 million, respectively.

Restricted Cash, Cash Equivalents, Marketable Securities and Other Investments

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

	December 31,	
	2006	2005
Current:		
Restricted cash and cash equivalents	$ 3.6	$ 6.1
Restricted marketable securities, held in SAR Account	39.5	23.0
	43.1	29.1
Non Current:		
Restricted Scopac Timber Notes and other amounts held in SAR Account	2.8	52.9
Other amounts restricted under the Scopac Indenture	2.5	2.5
Other long-term restricted amounts	5.7	5.4
Less: Amounts attributable to Scopac Timber Notes held in SAR Account	(2.8)	(52.9)
	8.2	7.9
Total restricted cash and cash equivalents and marketable securities	$ 51.3	$ 37.0

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

5. Property, Plant and Equipment

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

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

	Estimated Useful Lives	December 31, 2006	December 31, 2005
Land and improvements	5 – 30 years	$ 145.3	$ 140.6
Buildings	5 – 40 years	267.6	269.8
Machinery and equipment	3 – 15 years	157.6	144.8
Construction in progress		1.0	7.7
		571.5	562.9
Less: accumulated depreciation		(234.5)	(207.9)
		$ 337.0	$ 355.0

Capital expenditures for property, plant and equipment were $13.7 million, $17.3 million and $29.7 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 was $28.7 million, $28.8 million, and $27.9 million, respectively.

In 2005, as part of Palco's on-going evaluation of its sawmill activities, Palco's long-lived assets were subject to impairment reviews due to changes in their expected use and revised estimates of undiscounted cash flows. As a result, impairment charges of $4.6 million were recognized in 2005 primarily related to two sites, the Carlotta mill site and Palco's remanufacturing facility in Scotia. There was an additional impairment change of $0.7 million recognized in 2006 resulting from Palco's regular evaluation of its sawmill activities.

6. Investments in Unconsolidated Affiliates

RMCAL Development LP (Mirada Villas)

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

FireRock, LLC

A subsidiary of the Company continues to hold a 50% interest in a joint venture named FireRock, LLC, which was formed to develop an 808-acre area in Fountain Hills called FireRock. The Company is accounting for the joint venture under the equity method. The development is a residential, golf-oriented, upscale master-planned community. Lot sales concluded in 2004, but the venture continues to own and operate the country club located in the development.

7. Debt

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

	December 31, 2006	December 31, 2005
Prior Palco-Britt Facilities	$ –	$ 58.7
Palco Revolving Credit Facility due July 18, 2011	24.1	–
Palco Term Loan due July 18, 2011	84.3	–
Scopac Line of Credit, due July 2006	36.2	31.3
6.55% Scopac Class A-1 Scopac Timber Notes due July 20, 2028	7.3	36.6
7.11% Scopac Class A-2 Scopac Timber Notes due July 20, 2028	243.2	243.2
7.71% Scopac Class A-3 Scopac Timber Notes due July 20, 2028	463.3	463.3
7.56% Lakepointe Notes due June 8, 2021	113.5	114.8
7.03% Motel Notes due May 1, 2018	44.7	46.1
6.08% Beltway Notes due November 9, 2024	28.6	29.2
7.12% Palmas Notes due December 20, 2030	28.7	29.2
Other notes and contracts, primarily secured by receivables, buildings, real estate and equipment	5.3	5.1
Total Principal Outstanding	1,079.2	1,057.5
Less: short term borrowings and current maturities	(180.7)	(112.5)
Class A-1 Scopac Timber Notes held in the SAR Account, at par value(1)	(2.8)	(13.9)
Class A-2 Scopac Timber Notes held in the SAR Account, at par value(1) (2)	–	(41.5)
Discount on sale of Class A-2 Scopac Timber Notes held in SAR Account	(10.3)	–
	$ 885.4	$ 889.6

(1) The Scopac Indenture provides that a Scopac Timber Note does not cease to be outstanding because Scopac holds the instrument. Consequently, Scopac is required to pay and has paid interest and principal on the Scopac Timber Notes repurchased and held in the SAR Account.

(2) The Class A-2 Scopac Timber Notes held in the SAR Account were sold in October 2006.

On January 18, 2007, the Debtors (Palco and its five wholly owned subsidiaries, including Scopac), filed for protection under Chapter 11 of the Bankruptcy Code. As a result of the commencement of the Bankruptcy Cases, the operative documents provide that the outstanding principal of, and accrued interest on, all obligation debts of the Debtors became immediately due and payable. However, claims for principal and accrued interest on the Debtors' indebtedness are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession. The automatic stay provisions of Chapter 11 of the Bankruptcy Code make it unnecessary to reclassify prepetition long-term liabilities as of the Filing Date even though prepetition creditors might demand payment or there is a violation of a covenant in the debt agreement. Accordingly, the Debtors' long-term debt obligations, except for the Palco Term Loan, where the Borrowers did not meet the required minimum EBITDA maintenance covenant for the three months ended December 31, 2006, have been classified in accordance with their contractual terms in the accompanying consolidated financial statements.

Short Borrowings and Current Maturities

Short term borrowings and current maturities include the Palco Revolving Credit Facility and the Scopac Line of Credit, as well as the current maturities of long-term indebtedness.

Also included in short-term borrowings and current maturities at December 31, 2006, is the Palco Term Loan resulting from the Borrowers not meeting the required minimum EBITDA maintenance covenant for the three months ended December 31, 2006.

Palco Credit Agreements

At December 31, 2005, and June 30, 2006, Palco and Britt were in default under the Prior Palco-Britt Facilities due to financial covenant breaches. The existence of the defaults required Palco to pay interest on amounts borrowed under the Prior Palco-Britt Facilities at a per annum rate 2% higher than the rate at which interest would have been owed had no default existed.

On July 18, 2006, Palco and Britt, as Borrowers, closed on the Palco Term Loan, a five-year $85.0 million secured term loan, and the Palco Revolving Credit Facility, a five-year $60.0 million secured asset-based revolving credit facility, and terminated the Prior Palco-Britt Facilities. The Palco Term Loan was fully funded at closing. The Palco Term Loan and the Palco Revolving Credit Facility required MGI to provide a $10.0 million subordinated loan to the Borrowers, which was also funded at closing. The Borrowers used approximately (i) $56.5 million of the Palco Term Loan to pay off the Prior Palco-Britt Facilities and cash collateralize previously-existing letters of credit; and $6.0 million to pay transaction costs. The remaining $32.5 million of loan proceeds were used for general corporate purposes. As of December 31, 2006, $84.3 million was outstanding under the Palco Term Loan and $24.1 million of borrowings were outstanding and $13.7 million of letters of credit were issued under the Palco Revolving Credit Facility.

The amount available for borrowings under the Palco Revolving Credit Facility was normally the sum of 85% of the Borrowers' eligible accounts receivable plus the lesser of (i) 80% of the book value of Borrowers' eligible inventory or (ii) 85% of the net orderly liquidation value of such inventory. However, during each period from October 15 through January 15, the amount available for borrowing under the Palco Revolving Credit Facility was the sum of 95% of Borrowers' eligible accounts receivable plus the lesser of (i) 90% of the book value of Borrowers' eligible inventory or (ii) 95% of the net orderly liquidation value of such inventory. The amount available under the Palco Revolving Credit Facility could not exceed $60.0 million.

The Palco Term Loan bore interest at the rate of LIBOR plus 8.75%. Loans under the Palco Revolving Credit Facility bore interest at the rate of LIBOR plus 2.75% or prime plus 0.75%, at the Borrowers' option; however, incremental borrowings made during the period from October 15 through January 15 bore interest at the rate of LIBOR plus 4.50% or prime plus 2.50%, as applicable.

Both the Palco Term Loan and the Palco Revolving Credit Facility contained substantially identical restrictive covenants that limited the Borrowers' ability to incur debt, grant liens, make investments, pay dividends, make capital expenditures or merge or consolidate, and required the Borrowers to maintain specified minimum levels of EBITDA throughout the life of the facilities and specified minimum fixed charge coverage ratios and maximum leverage ratios commencing December 31, 2007. The Palco Term Loan also required the Borrowers to repay a substantial portion of the outstanding principal of the Palco Term Loan with the net proceeds from various required asset sales, including the real property associated with Palco's former Fortuna and Carlotta sawmills, and Palco-owned homes in Scotia, California to be sold after certain milestones had been met. Any remaining principal balance of the Palco Term Loan was due on the maturity date. The Palco Term Loan and the Palco Revolving Credit Facility contained customary events of default and customary remedies with respect to the occurrence of an event of default and each was secured by a security interest in the stock of Palco held by MGI, and substantially all of the assets of the Borrowers (other than Palco's equity interest in Scopac).

The Borrowers did not meet the required minimum EBITDA maintenance covenant for the three-month period ended September 30, 2006, due to an unplanned severance charge and a legal settlement. On November 20, 2006, MGI made a loan to Palco, enabling the Borrowers to exercise their cure right under the two debt facilities. The Borrowers also notified the lenders that changing market conditions and other factors would likely adversely affect the Borrowers' ability to comply with the financial covenants at December 31, 2006 and in future periods.

The Borrowers did not meet the required minimum EBITDA maintenance covenant for the three-month period ended December 31, 2006. Accordingly, the Palco Term Loan has been reclassified as a current liability in the Company's consolidated balance sheet.

In January 2007, Palco did not have sufficient liquidity to pay all of the interest due on the Palco Term Loan. Based upon a review of its alternatives under the circumstance, and consultation with its legal advisors, on January 18, 2007, Palco elected to file for voluntary protection under Chapter 11 of the Bankruptcy Code. As a result of the commencement of the Bankruptcy Cases, lender claims are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession.

The Palco Term Loan and Palco Revolving Credit Facility each included prepayment premiums of 3%, 2% and 1% that would have been payable in connection with any prepayment of the Palco Term Loan or reduction or termination of the Palco Revolving Credit Facility during the first, second and third years, respectively.

Scopac Credit Agreements

Scopac's indebtedness consists of the Scopac Timber Notes ($713.8 million principal outstanding as of December 31, 2006) and the Scopac Line of Credit ($36.2 million principal outstanding as of December 31, 2006), each being secured by (i) Scopac's timberlands and timber rights, (ii) certain contract rights and other assets, (iii) the proceeds of the foregoing, and (iv) the funds held by the Trustee in various accounts related to the Scopac Timber Notes.

Scopac Line of Credit

The Scopac Line of Credit allowed Scopac to borrow up to one year's interest on the aggregate outstanding principal balance of the Scopac Timber Notes. On May 18, 2006, the Scopac Line of Credit was extended to July 6, 2007.

Borrowings under the Scopac Line of Credit generally bore interest at the Base Rate (as defined in the agreement) plus 0.25% or at LIBOR plus 1.0% (at any time that borrowings have not been continually outstanding for more than six months).

Scopac Timber Notes

General

In July 1998, Scopac issued $867.2 million aggregate principal amount of Scopac Timber Notes, which are due July 20, 2028. The Scopac Timber Notes are senior secured obligations of Scopac and do not constitute obligations of, and are not guaranteed by, Palco or any other person. The Scopac Timber Notes were issued in three classes: Class A-1 Scopac Timber Notes aggregating $160.7 million, Class A-2 Scopac Timber Notes aggregating $243.2 million, and Class A-3 Scopac Timber Notes aggregating $463.3 million.

The Scopac Timber Notes were structured to link, to the extent of cash available, the deemed depletion of Scopac Timber (through the harvest and sale of logs) to the required amortization of the Scopac Timber Notes. The required amount of amortization on any Scopac Timber Notes payment date was determined by various mathematical formulas set forth in the Scopac Indenture. The amount of principal Scopac was required to pay (on a cumulative basis and subject to available cash) through any Scopac Timber Notes payment date is referred to as **"Minimum Principal Amortization."** If the Scopac Timber Notes were amortized in accordance with Minimum Principal Amortization, the final installment of principal would have been paid on January 20, 2010, July 20, 2017 and July 20, 2028 for the Class A-1, Class A-2 and Class A-3 Scopac Timber Notes, respectively. Scheduled Amortization is the amount of principal which Scopac was required to pay (on a cumulative basis) through any Scopac Timber Notes payment date in order to avoid prepayment or deficiency premiums. If all payments of principal were made in accordance with Scheduled Amortization, Scopac would have paid the final installment of principal on January 20, 2014. Such final installment would have included a single "bullet" principal payment of $463.3 million related to the Class A-3 Scopac Timber Notes.

Scopac Timber Note Payment Dates

Amounts payable on the Scopac Timber Notes were due semi-annually, generally on January 20 and July 20 of each year).

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

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

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

On the note payment date in July 2006, Scopac used its existing cash resources, all of the remaining funds available under the Scopac Line of Credit, $10.2 million of funds from the Scopac Land Sale Program, a $3.7 million timber/log purchase by MGI, and a $2.1 million early log payment by Palco to pay all of the $27.1 million of interest due ($25.4 million net of interest due in respect of Scopac Timber Notes held in the SAR Account). Using funds held in the SAR Account, Scopac also repaid $10.0 million of principal on the Scopac Timber Notes ($6.2 million net of principal in respect of Scopac Timber Notes held in the SAR Account).

As the January 2007 Scopac Timber Notes payment date approached, it became apparent that Scopac would not have sufficient liquidity to make the interest payment. The failure of Scopac to pay all of the interest on the Scopac Timber Notes when due constitutes an event of default under the Scopac Indenture. In the event of a failure to pay interest on the Scopac Timber Notes in full when due, the Trustee under the Scopac Indenture or the holders of at least 25% of the aggregate outstanding principal amount of the Scopac Timber Notes were entitled to cause all principal, interest and other amounts related to the Scopac Timber Notes to become immediately due and payable. In the event of any such acceleration, the Agent under the Scopac Line of Credit was also entitled to accelerate the advances then outstanding thereunder. If such accelerations of Scopac Timber Notes and/or advances under the Scopac Line of Credit were to occur, the Trustee was entitled to exercise all rights under the Scopac Indenture and related security documents, including applying funds to pay accelerated amounts, and selling the Scopac Timberlands, the Scopac Timber Rights and Scopac's other assets and using the proceeds thereof to pay accelerated amounts. Based upon a review of its alternatives under the circumstance and consultation with its legal advisors, on January 18, 2007, Scopac elected to file for voluntary protection under Chapter 11 of the Bankruptcy Code. As a result of the commencement of the Bankruptcy Cases, lender claims are stayed (deferred) while the Debtors continue to operate the businesses as debtors-in-possession.

Trustee

U.S. Bank, the Trustee under the Scopac Indenture, resigned effective May 1, 2006. Scopac appointed Deutsche Bank National Trust Company as successor Trustee, which appointment became effective May 1, 2006. Deutsche Bank National Trust Company resigned effective August 25, 2006 and Scopac appointed Bank of New York as successor Trustee, which appointment became effective August 25, 2006.

SAR Account

In November 1999, $169.0 million of funds from the sale of 5,600 acres of timberlands owned principally by Salmon Creek and Palco were contributed to Scopac and set aside in the SAR Account (Scheduled Amortization Reserve Account). Amounts in the SAR Account are part of the collateral securing the Scopac Timber Notes and were used to make principal payments to the extent that cash flows from operations are insufficient to pay Scheduled Amortization on the Scopac Timber Notes. In addition, on or after January 20, 2014, any amounts then remaining in the SAR Account were to be used to amortize the Class A-3 Scopac Timber Notes. Funds could be released to Scopac from the SAR Account if the amount in the account at that time exceeded the Required Scheduled Amortization Reserve Balance (as defined and set forth in the Scopac Indenture). If the balance in the SAR Account fell below the Required Scheduled Amortization Reserve Balance, up to 50% of any Remaining Funds (funds that could otherwise be released to Scopac free of the lien securing the Scopac Timber Notes) were required to be used on each monthly deposit date to replenish the SAR Account. As of December 31, 2006, the amount held in the SAR Account was $79.5 million below the Required Scheduled Amortization Reserve Balance.

If the amount on deposit in the SAR Account on a Scopac Timber Notes payment date was less than what was needed to reduce outstanding principal in accordance with Scheduled Amortization, only the amount on deposit in the SAR Account was required to be paid as a principal payment on the Scopac Timber Notes. At December 31, 2006, the SAR Account balance was $42.3 million (consisting of $2.8 million of Class A-1 Scopac Timber Notes held in the SAR Account and $39.5 million in marketable securities). On October 11, 2006, Scopac completed a private placement of the $41.5 million par value of repurchased Class A-2 Scopac Timber Notes held in the SAR Account at a sales price of $750 per $1,000 principal amount, plus accrued interest from July 20, 2006. The net proceeds of approximately $30.2 million were deposited into the SAR Account. The difference between the net proceeds and the par value of the Scopac Timber Notes that were sold is recorded as a contra-debt account and will be amortized to principal over the remaining contractual term of the notes.

Letters of Credit

At December 31, 2006, Palco had $13.7 million of letters of credit issued in the aggregate, principally a $9.9 million letter of credit with the State of California to secure its workers compensation liabilities and a $3.5 million letter of credit to satisfy certain liability insurance obligations.

At December 31, 2006, the Company's real estate segment had letters of credit outstanding in the amount of $3.5 million to satisfy certain liability insurance policy requirements.

Lakepointe Notes

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

Beltway Notes

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

Motel Notes

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

Palmas Country Club, Inc. Notes

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

Contractual Maturities

Contractual maturities of outstanding indebtedness at December 31, 2006, are as follows (in millions):

	Years Ending December 31,					
	2007	2008	2009	2010	2011	Thereafter
Palco Term Loan	$ 84.3	$ –	$ –	$ –	$ –	$ –
Palco Revolving Credit Facility	24.1	–	–	–	–	–
Scopac Line of Credit	36.2	–	–	–	–	–
Scopac Timber Notes[(1)]	33.8	30.2	23.7	27.5	31.7	566.9
Lakepointe Notes	1.7	1.8	2.0	2.1	2.5	103.4
Motel Notes	1.4	1.8	2.2	2.3	2.5	34.5
Beltway Notes	0.7	0.7	0.8	0.8	0.8	24.8
Palmas Notes	0.5	0.5	0.6	0.6	0.6	25.9
Other	0.8	0.6	0.2	0.3	0.3	3.1
	$ 183.5	$ 35.6	$ 29.5	$ 33.6	$ 38.4	$ 758.6

(1) The Scopac Indenture provides that a Scopac Timber Note does not cease to be outstanding because Scopac holds the instrument. Accordingly, the amounts shown in the table above reflect total amounts outstanding, including amounts related to Scopac Timber Notes held in the SAR Account.

Capitalized Interest

There was no interest capitalized during 2006. Interest capitalized during the years ended December 31,2005 and 2004 was $0.4 million and $0.8 million, respectively. Interest capitalized related to Palco's new sawmill amounted to $0.4 million for the year ended December 31, 2005.

Loan Covenants

In addition to the previously discussed Palco Term Loan and Palco Revolving Credit Facility, certain other debt instruments restrict the ability of the Company's subsidiaries to transfer assets, make loans and advances or pay dividends to the Company, and require certain subsidiaries to maintain a minimum net worth.

Estimated Fair Value

The Company's publicly traded debt instruments (the Scopac Timber Notes) are thinly traded financial instruments; accordingly, their market prices at any balance sheet date may not be representative of the prices that would be derived from a more active market. The fair value of publicly traded debt is determined based on quoted market prices. The fair value of debt which is not publicly traded is estimated using cash flows discounted at current borrowing rates. At December 31, 2006, the estimated fair value of current and long-term debt was $791.6 million. At December 31, 2005, the estimated fair value of the Company's current and long-term debt was $864.5 million.

Weighted Average Interest on Short-Term Borrowings

During 2006 and 2005, the Company had average short-term borrowings outstanding of $114.9 million and $67.2 million, respectively, under the credit facilities described above. The weighted average interest rate for these facilities during 2006 and 2005 was 10.0% and 7.6%, respectively.

8. Income Taxes

The Company files a consolidated federal income tax return together with its domestic subsidiaries.

Income (loss) before income taxes, minority interests, discontinued operations and cumulative effect of accounting change by geographic area is as follows (in millions):

	Years Ended December 31,		
	2006	2005	2004
Domestic	$ 365.8	$ (23.9)	$ (58.6)
Foreign	5.1	19.8	11.7
	$ 370.9	$ (4.1)	$ (46.9)

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

The benefit for income taxes on loss before income taxes and cumulative effect of an accounting change consists of the following (in millions):

	Years Ended December 31,		
	2006	2005	2004
Current:			
Federal	$ –	$ –	$ –
State and local	–	1.1	(1.3)
Foreign	(1.8)	(0.6)	(0.2)
	(1.8)	0.5	(1.5)
Deferred:			
Federal	–	–	–
State and local	4.2	(1.1)	1.8
Foreign	1.8	0.7	–
	6.0	(0.4)	1.8
	$ 4.2	$ 0.1	$ 0.3

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

	Years Ended December 31,		
	2006	2005	2004
Income (loss) before income taxes and cumulative effect of accounting change	$ 370.9	$ (4.1)	$ (46.9)
Amount of federal income tax benefit based upon the statutory rate	$ (129.8)	$ 1.4	$ 16.4
Gain on reversal of net investment in Kaiser	150.8	–	–
Changes in valuation allowances and revision of prior years' tax estimates	(20.9)	(1.3)	(16.0)
Foreign taxes, net of federal tax benefit	–	0.1	(0.2)
State and local taxes, net of federal tax effect	–	–	0.4
Effect of change in state tax code	4.2	–	–
Other	(0.1)	(0.1)	(0.3)
	$ 4.2	$ 0.1	$ 0.3

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

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

	December 31, 2006	December 31, 2005
Deferred income tax assets:		
Postretirement benefits other than pensions	$ 4.8	$ 5.3
Loss and credit carryforwards	181.0	146.5
Other liabilities	20.1	24.4
Real estate	9.3	11.1
Timber and timberlands	25.9	22.0
Other	15.6	28.0
Valuation allowances	(125.1)	(102.7)
Total deferred income tax assets, net	131.6	134.6
Deferred income tax liabilities:		
Property, plant and equipment	(33.3)	(41.4)
Other	(8.4)	(9.3)
Total deferred income tax liabilities	(41.7)	(50.7)
Net deferred income tax assets	$ 89.9	$ 83.9

The Company evaluated all appropriate factors in determining the realizability of the $181.0 million in deferred tax assets attributable to loss and credit carryforwards. These factors included any limitations on the use of loss and credit carryforwards, results of operations for 2006 and prior years, the reversal of deferred gains, other temporary differences, the year the carryforwards expire, and the levels of taxable income necessary for utilization. The Company also considered the potential recognition of the deferred gains on sales of timber and timberlands. Based on this evaluation, the Company provided valuation allowances of $26.4 million and $13.4 million related to loss and credit carryforwards in 2006 and 2005, respectively. With respect to the $64.4 million of deferred tax assets attributable to loss and credit carryforwards for which a valuation allowance has not been provided, the Company believes that it is more likely than not that it will realize the benefit for these carryforwards.

The net deferred income tax assets in the above table do not include any potential tax benefit attributable to the Company's investment in its 50,000,000 Kaiser Shares. For federal tax purposes, the Company's basis is estimated to be $388.0 million, which results in a federal tax benefit at current federal statutory income tax rates of approximately $135.8 million. As a result of the cancellation of the Company's Kaiser Shares in 2006, the Company expects it will take a worthless stock deduction on its 2006 consolidated federal income tax return. However, it is uncertain whether the deduction meets certain criteria required for asset recognition purposes. Accordingly, the Company has not recorded the resulting tax asset of approximately $135.8 million in its consolidated balance sheet as of December 31, 2006.

		Expiring
Regular tax attribute carryforwards:		
Net operating loss carryforwards	$ 444.8	2007-2026
Alternative minimum tax credits	4.4	Indefinite
General business tax credits	1.6	2025
Alternative minimum tax attribute carryforwards:		
Net operating losses	466.6	2007-2026

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

As discussed in Note 1, the Bankruptcy Cases could result in claims against and could have adverse impacts on MAXXAM Parent and its affiliates, including MGHI and/or MGI. For example, it is possible that certain transactions could be completed in connection with a potential restructuring or reorganization of the Debtors, such as a sale of all or a portion of the equity ownership in the Debtors, a sale of a substantial portion of the Debtors' assets and/or a cancellation of some or all of the Debtors' indebtedness, which could require the utilization of all or a substantial portion of, or the loss of a significant portion of, the Company's net operating losses or other tax attributes for federal and state income tax purposes and could require tax payments. In addition, the Company may be required to establish certain deferred tax liabilities as a result of loss of control of the Debtors effective as of the Filing Date.

9. Employee Benefit and Incentive Plans

Pension and Other Postretirement Benefit Plans

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

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

The funded status of the MAXXAM Pension Plan and the Palco Retirement Plan and other postretirement benefit plans and the accrued benefit liability included in other long-term liabilities as of December 31, 2006 and 2005, respectively, were as follows (in millions):

	Pension Benefits		Medical/Life Benefits	
	Years Ended December 31,			
	2006	2005	2006	2005
Change in projected benefit obligation:				
Projected benefit obligation at beginning of year	$ 98.2	$ 101.3	$ 10.3	$ 12.6
Service cost	–	2.8	0.3	0.4
Interest cost	5.4	5.6	0.5	0.5
Actuarial (gain) loss	(6.2)	0.4	(0.8)	(1.9)
Curtailments, settlements and amendments	–	(8.1)	–	(1.0)
Benefits paid	(3.3)	(3.8)	(0.7)	(0.3)
Projected benefit obligation at end of year	$ 94.1	$ 98.2	$ 9.6	$ 10.3
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 63.4	$ 60.3	$ –	$ –
Actual return on assets	8.1	4.6	–	–
Employer contributions	11.0	2.3	0.7	0.3
Plan participants' contributions	–	–	0.3	1.7
Benefits paid	(3.3)	(3.8)	(1.0)	(2.0)
Fair value of plan assets at end of year	$ 79.2	$ 63.4	$ –	$ –
Funded status:				
Projected benefit obligation in excess of plan assets	$ (15.0)	$ (34.8)	$ (9.6)	$ (10.3)
Unrecognized actuarial loss		13.2		–
Unrecognized prior service costs		–		(1.4)
Net amount recognized		$ (21.6)		$ (11.7)
Amounts recognized in the Consolidated Balance Sheet:				
Accrued benefit liability	$ (15.0)	$ (34.8)	$ (9.6)	$ (11.7)
Accumulated other comprehensive income	4.2	13.2	(2.1)	–
Net amount recognized	$ (10.8)	$ (21.6)	$ (11.7)	$ (11.7)

The MAXXAM Pension Plan and the Palco Retirement Plan each had accumulated benefit obligations in excess of its plan assets as of December 31, 2006 and 2005.

The components of pension and other postretirement medical benefits expense for the three years ended December 31, 2006, were as follows (in millions):

	Pension Benefits			Medical/Life Benefits		
	Years Ended December 31,					
	2006	2005	2004	2006	2005	2004
Components of net periodic benefit costs:						
Service cost	$ –	$ 2.8	$ 3.1	$ 0.3	$ 0.4	$ 0.5
Interest cost	5.4	5.6	5.6	0.5	0.5	0.7
Expected return on assets	(5.7)	(5.3)	(5.1)	–	–	–
Recognized net actuarial loss	0.3	0.7	–	–	–	–
Amortization of prior service costs	–	–	–	(0.2)	(0.2)	(0.2)
Net periodic benefit costs	0.0	3.8	3.6	0.6	0.7	1.0
Curtailments, settlements and other	–	(0.2)	–	–	(0.1)	(0.1)
Adjusted net periodic benefit costs	$ 0.0	$ 3.6	$ 3.6	$ 0.6	$ 0.6	$ 0.9

Amounts recognized in the consolidated statements of financial position consist of:

	Pension Benefits		Medical/Life Benefits	
	Years Ended December 31,			
	2006	2005	2006	2005
Current liabilities	$ 0.3	$ –	$ 0.4	$ –
Noncurrent liabilities	14.7	–	9.1	–
	$ 15.0	$ –	$ 9.5	$ –

Amounts recognized in consolidated accumulated other comprehensive income consist of:

	Pension Benefits		Medical/Life Benefits	
	Years Ended December 31,			
	2006	2005	2006	2005
Net actuarial (gain) loss	$ 4.2 [1]	$ –	$ (0.9) [1]	$ –
Prior service cost	–	–	(1.2) [2]	–
	$ 4.2	$ –	$ (2.1)	$ –

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[1] It is expected that none of this amount will be amortized into income in 2007.
[2] It is expected that $0.2 million will be amortized into income in 2007.

The incremental effect of applying SFAS No. 158 on individual line items on the consolidated balance sheet, were as follows (in millions):

	Before Application of SFAS No. 158	Adjustment	After Application of SFAS No. 158
Liability for pension and postretirement medical	$ 26.6	$ (2.1)	$ 24.5
Accumulated other comprehensive income	(4.2)	2.1	(2.1)
Total stockholders' equity	(211.8)	–	(211.8)

The measurement date used for the MAXXAM Pension Plan and the Palco Retirement Plan and the Company's postretirement benefit plans was December 31, 2006. The underlying assumptions of these plans for the three years ended December 31, 2006, were as follows (in millions):

	Pension Benefits			Medical/Life Benefits		
	Years Ended December 31,					
	2006	2005	2004	2006	2005	2004
Weighted-average assumptions:						
Discount rate used to determine benefit obligation	6.0%	5.625%	5.875%	6.0%	5.625%	5.875%
Discount rate used to determine net periodic benefit cost	5.625%	5.875%	6.25%	5.625%	5.875%	6.25%
Expected return on plan assets	8.75% (1)	8.75% (1)	8.50%	–	–	–
Rate of compensation increase	–	–	4.11%	–	–	–

(1) Not applicable as the Plans were frozen effective December 31, 2005

The average annual assumed rate of increase in the per capita cost of covered benefits under the Company's postretirement medical plans (i.e., health care cost trend rate) for 2007 is 9.0% for all participants. The rate of increase is assumed to decline gradually to 5.0% in 2011 for all participants and remain at that level thereafter. Assumed health care cost trend rates have a significant effect on the amounts reported. A one-percentage-point change in assumed health care cost trend rates as of December 31, 2006 would have the following effects (in millions):

	1-Percentage-Point Increase	1-Percentage-Point Decrease
Effect on total of service and interest cost components	$ 0.1	$ (0.1)
Effect on the postretirement benefit obligations	1.1	(1.0)

The MAXXAM Pension Plan's and the Palco Retirement Plan's investments are held under separate trust agreements with an independent trustee. The MAXXAM Pension Plan's and the Palco Retirement Plan's separate Investment Committees establish the investment policies for the plans' assets and have selected certain investment funds maintained by the trustee (or its affiliates and third parties) for investment of plan assets. The Investment Committees also determine the portion of plan assets to be invested in such funds. The trustee's affiliates or third parties select the investment managers for these funds and the portion of each fund to be managed by the respective investment managers. The investment managers in turn determine in which equity, debt and/or other securities the assets under their direction will be invested. Actual investment results achieved by the investment funds are reviewed by the Investment Committees on a regular basis. As of December 31, 2006, the Investment Committees' target asset allocations were 70% for equity securities and 30% for fixed income securities for the MAXXAM Pension Plan and the Palco Retirement Plan.

The weighted-average asset allocations for each of the pension plans at December 31, 2006 and 2005, by asset category are as follows:

	Years Ended December 31,	
	2006	2005
Asset Category:		
Equity securities	70%	70%
Debt securities	30	30
Total	100%	100%

The expected rate of return on plan assets assumption, used in the determination of net periodic pension cost, will be 8.75% for 2007. The Company's rate of return assumption is based on historical returns on plan assets and the expected long-term returns for the asset allocation targets in place at December 31, 2006.

Each company's funding policy is to make annual contributions to its respective plan which equal or exceed the minimum funding requirements of ERISA. The Company is in compliance with this policy. An assumed long-term rate of return on plan assets of 8.75% was used in the determination of the ERISA minimum funding requirements for the plan years ended December 31, 2006 and 2005. Expected funding requirements for the MAXXAM Pension Plan for 2007 is approximately $0.9 million and expected funding requirements for the Palco Retirement Plan for 2007 is approximately $3.6 million.. As discussed in Note 1, Palco may not be successful in obtaining additional liquidity sufficient to fund its operating cash needs for 2007. The failure of Palco to meet its minimum pension funding requirements could result in a termination of the Palco Retirement Plan. See Note 1 for further information. Expected funding requirements for postretirement medical benefits for 2007 are approximately $0.4 million.

The Company also has an unfunded Supplemental Executive Retirement Plan that provides certain key employees defined pension benefits that supplement those provided by the MAXXAM Pension Plan and Palco Retirement Plan. The Company had $3.5 million and $3.4 million accrued as projected benefit obligations in the Consolidated Balance Sheet for such plan at December 31, 2006 and 2005, respectively. This plan was frozen effective December 31, 2005.

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

Years Ended December 31,	Pension Benefits	Medical/ Life Benefits
2007	$ 3.8	$ 0.4
2008	3.9	0.5
2009	4.2	0.5
2010	4.5	0.6
2011	4.7	0.7
Years 2012-2016	27.5	4.2

Savings and Incentive Plans

The Company has two defined contribution savings plan designed to enhance the existing retirement programs of participating employees. Effective January 1, 2006, new company–paid benefits were added to the defined contribution savings plans. The new company paid benefits, when combined with the participating employer matching contribution, provided up to 17% of participants, eligible compensation in the form of additional employer contributions. Effective January 1, 2006, the Company established a Supplemental Savings Plan (**"SSP"**) in order to provide certain participants in the MAXXAM Savings Plan with certain retirement benefits they would have received under the MAXXAM Savings Plan were it not for the limits on benefits imposed by section 415(c) and section 401(a)(17) of the Internal Revenue Code. Employer contributions for all of these plans were $3.0 million, $0.8 million and $0.7 million for the years ended December 31, 2006, 2005 and 2004, respectively.

10. Investment in Kaiser

Under generally accepted accounting principles for entities consolidated through voting interests, consolidation is generally required for investments of more than 50% of the outstanding voting stock of an investee, except when control is not held by the majority owner. Under these rules, legal reorganization or bankruptcy represent conditions which can preclude consolidation in instances where control rests with the bankruptcy court, rather than the majority owner. On February 12, 2002, Kaiser and certain of its subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. As a result, the Company discontinued consolidating Kaiser's financial results beginning February 12, 2002, and began reporting its investment in Kaiser using the cost method.

In February 2002, Kaiser and certain of its subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. Kaiser's plan of reorganization provided for the cancellation of Kaiser's equity, including the Company's Kaiser Shares, without consideration or obligation. Kaiser's plan of reorganization became effective on July 6, 2006, and Kaiser emerged from bankruptcy. As a result, the Company no longer has any ownership interest in or affiliation with Kaiser. Since the Company's Kaiser Shares were cancelled without obligation, the Company reversed the $516.2 million of losses in excess of its investment in Kaiser along with the accumulated other comprehensive losses of $85.3 million related to Kaiser, resulting in a net gain of $430.9 million, recognized in the third quarter of 2006. As a result of the cancellation of the Company's Kaiser Shares in 2006, the Company expects it will take a worthless stock deduction on its 2006 consolidated federal income tax return. However, it is uncertain whether the deduction meets certain criteria required for asset recognition purposes. Accordingly, the Company has not recorded the resulting tax asset of approximately $135.8 million in its consolidated balance sheet as of December 31, 2006.

Also see "Deconsolidation of Kaiser" in Note 1.

11. Commitments, Regulatory and Environmental Factors and Contingencies

Commitments

The Company leases certain facilities and equipment under operating leases. Minimum rental commitments under operating leases at December 31, 2006, are as follows:

Years Ended December 31,	(In millions)
2007	$ 3.1
2008	2.7
2009	1.9
2010	0.8
2011	0.7
Thereafter	1.4
Total minimum lease payments	$ 10.6

Rental expense for operating leases was $3.8 million, $4.2 million and $4.7 million for the years ended December 31, 2006, 2005 and 2004, respectively.

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

Years Ended December 31,	(In millions)
2007	$ 17.5
2008	17.8
2009	18.0
2010	18.0
2011	18.3
Thereafter	171.8
Total minimum rentals	$ 261.4

Regulatory and Environmental Factors

Forest Products Operations

Regulatory and environmental matters and litigation have had a significant adverse effect on the Company's forest products business, which is subject to a variety of California and federal laws and regulations, as well as the HCP, dealing with timber harvesting practices, threatened and endangered species and habitat for such species, air and water quality and other matters. Compliance with such laws and regulations also plays a significant role in the Company's Forest Products business.

Environmental Plans

In March 1999, Palco, Scopac and Salmon Creek (the **"Palco Companies"**) consummated their 1996 Headwaters Agreement (the **"Headwaters Agreement"**) with the United States and California. Pursuant to the Headwaters Agreement, approximately 5,600 acres of timberlands owned by the Palco Companies were transferred to the United States government in exchange for $300.0 million, approximately 7,700 acres of timberlands, and approval by the federal and state governments of the Environmental Plans. In connection with approval of the Environmental Plans, California incidental take permits (the **"California Permits"**) and federal incidental take permits (the **"Federal Permits,"** and together with the California Permits, the **"Permits"**), were issued with respect to certain threatened, endangered and other species found on the timberlands covered by the Environmental Plans.

From March 1999 until October 2002, Scopac prepared THPs in accordance with the SYP. The SYP was intended to comply with regulations of the California Department of Forestry and Fire Protection (**"CDF"**) requiring timber companies to demonstrate sustained yield, i.e., that their projected average annual harvest for any decade within a 100-year planning period will not exceed the average annual growth level at the end of the 100-year planning period. The forest practice rules allow companies which do not have a sustained yield plan to follow alternative procedures to document compliance with the sustained yield requirements. As discussed below (see "–Contingencies–Timber Harvest Litigation"), in October 2003, the Court hearing the *EPIC-SYP/Permits lawsuit* entered a judgment invalidating the SYP and the California Permits, although that decision was reversed in December 2005. As a result of an earlier stay order issued in this case and the trial court's judgment, Scopac from October 2002 until March 2005 obtained review and approval of its THPs under an alternative procedure in the California forest practice rules known as "Option C." Option C is available to landowners who have submitted an "Option A" plan to the CDF for review (as was done by Palco). An approved Option A plan is an alternative to obtaining approval of a sustained yield plan. Palco's Option A plan (**"Option A Plan"**) was approved by the CDF in March 2005. The Palco Companies are currently relying upon its Option A Plan to obtain THP approvals.

The HCP and Federal Permits allow incidental "take" of certain federally listed species located on the Palco Timberlands so long as there is no "jeopardy" to the continued existence of such species. The HCP identifies the measures to be instituted in order to minimize and mitigate the anticipated level of take to the greatest extent practicable. The HCP and Federal Permits have terms of 50 years. Since the consummation of the Headwaters Agreement in March 1999, there has been a significant amount of work and additional costs required in connection with the implementation of the Environmental Plans, and this work and the additional costs are expected to continue for the foreseeable future.

Water Quality

Laws and regulations dealing with water quality are impacting or have the potential to impact the Palco Companies primarily in three areas: efforts by the federal Environmental Protection Agency (the **"EPA"**) and the North Coast Regional Water Quality Control Board (**"North Coast Water Board"**) to establish total maximum daily load limits (**"TMDLs"**) in watercourses that have been declared to be water quality impaired; actions by the North Coast Water Board imposing waste discharge reporting requirements, and various mitigation, erosion control and clean-up measures; and the development by the North Coast Water Board and its staff of special permitting requirements for the Freshwater and Elk River watersheds known as watershed-wide waste discharge requirements (**"WWDRs"**).

Under the CWA, the EPA is required to establish TMDLs in watercourses that have been declared to be "water quality impaired." The EPA and the North Coast Water Board are in the process of establishing TMDLs for many northern California rivers and certain of their tributaries, including nine watercourses that flow within the Palco Timberlands. The relevant contaminant on the Palco Timberlands, is simple sediment – dust, dirt and gravel – that is abundant in watercourses largely as a function of the area's normally heavy rainfall and soil that erodes easily. The Company expects the process of establishing TMDLs to continue into 2010. The EPA has issued a report dealing with TMDLs on three of the nine watercourses. The agency indicated that the requirements under the HCP would significantly address the sediment issues that resulted in TMDL requirements for these watercourses. Presently, the North Coast Water Board is in the process of establishing the TMDL requirements applicable to two other watercourses on the Palco Timberlands, Freshwater and Elk River, with a targeted completion of 2008 for these two watercourses. Scopac's scientists are actively working with North Coast Water Board staff to ensure that these TMDLs recognize and incorporate the environmental protection measures of the HCP. The final TMDL requirements applicable to the Palco Timberlands may require aquatic protection measures that are different from or in addition to those in the HCP or that result from the prescriptions to be developed pursuant to the watershed analysis process provided for in the HCP. These requirements could further restrict harvesting on the Palco Timberlands.

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

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

On May 8, 2006, the North Coast Water Board adopted WWDRs for the Freshwater and Elk River. The decision allows harvesting in these two watersheds, up to approximately 50% of the applicable annual harvest limit established by the CDF for each watershed (**"CDF Harvest Limit"**), once the staff of the North Coast Water Board reviews and enrolls THPs submitted by Scopac. The North Coast Water Board's decision also allowed the enrollment of additional THPs, bringing the total to approximately 75% of the CDF Harvest Limit for these two watersheds, upon approval of a monitoring and reporting program by the Executive Officer of the North Coast Water Board staff. The monitoring and reporting program was approved on September 29, 2006, allowing enrollment by the staff of the North Coast Water Board of the additional THPs for these two watersheds planned for harvest in 2006. This monitoring and reporting program will also govern future THPs in these two watersheds. However, there can be no assurance that additional THPs in these two watersheds will ultimately be enrolled or harvested as planned in 2006 or future years. The North Coast Water Board's adoption of these WWDRs has been appealed to the State Water Board, but the appeals are being held in abeyance pending implementation of the WWDRs. As harvesting activities on the Palco Timberlands cannot readily be moved between watersheds due to, among other things, historic harvest patterns, adjacency restrictions, and the age classes of trees, development of WWDRs and the various other matters described herein are expected to result in reduced harvest levels in 2006 and beyond.

Effective January 1, 2004, California Senate Bill 810 provides regional water quality control boards with additional authority related to the approval of THPs on land within impaired watersheds. The Company is uncertain of the operational and financial effects which will ultimately result from Senate Bill 810; however, because substantially all rivers and waterbodies on the Palco Timberlands are classified as sediment-impaired, implementation of this law could result in additional delays in obtaining approvals of THPs, lower harvest levels and increased costs and additional protection measures beyond those contained in the HCP.

Contingencies

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

Forest Products Reorganization Proceedings

On January 18, 2007, Palco and its five wholly owned subsidiaries, including Scopac, filed separate voluntary petitions for reorganization under Chapter 11 of the Bankruptcy Code. See Note 1, "–Reorganization Proceedings of Palco and its Subsidiaries" for further information regarding the bankruptcy proceedings of Palco and its subsidiaries, including potential adverse impacts on MAXXAM Parent and its affiliates. Also see Item 1A. "Risk Factors–Risks Related to the Bankruptcy Cases" and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations–Financial Condition and Investing and Financing Activities–Forest Products Operations."

Timber Harvest Litigation

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

In March 1999, an action entitled *Environmental Protection Information Association, Sierra Club v. California Department of Forestry and Fire Protection, California Department of Fish and Game, The Pacific Lumber Company, Scotia Pacific Company LLC, Salmon Creek Corporation, et al.* (***"EPIC-SYP/Permits lawsuit"***) was filed in Superior Court in Humboldt County, California (No. CV-990445). This action alleged, among other things, various violations of the California Endangered Species Act and the California Environmental Quality Act, and challenged, among other things, the validity and legality of the SYP and the California Permits and sought, among other things, to prevent implementation of THPs approved in reliance upon these documents. In March 1999, a similar action, entitled *United Steelworkers of America, AFL-CIO, CLC, and Donald Kegley v. California Department of Forestry and Fire Protection, The Pacific Lumber Company, Scotia Pacific Company LLC and Salmon Creek Corporation* (***"USWA lawsuit"***), was filed in Humboldt County Superior Court (No. CV-990452) challenging the validity and legality of the SYP. The *EPIC-SYP/Permits* and *USWA lawsuits* were consolidated for trial.

Following the trial, the Court in October 2003 entered a judgment invalidating the SYP and the California Permits and in September 2004 granted the plaintiffs' request for reimbursement of an aggregate of $5.8 million in attorneys' fees and other expenses. The Palco Companies and the State of California appealed both decisions. In December 2005, the appellate court reversed the trial court's decision invalidating the SYP and the California Permits. The plaintiffs have appealed the appellate court's decision to the California Supreme Court, which has accepted the appeal for review. The defendants' appeal of the trial court's award of attorneys fees and expenses is still pending at the appellate court. Due to the Bankruptcy Cases, both the California Supreme Court and the appellate court have entered orders staying the proceedings pending before each court.

In July 2001, an action entitled *Environmental Protection Information Association v. Pacific Lumber, Scotia Pacific Company LLC* (No. C01-2821) (***"Bear Creek lawsuit"***) was filed in the U.S. District Court for the Northern District of California, and later amended to add the EPA as a defendant. The lawsuit alleges that harvesting and other forestry activities under certain of Scopac's approved THPs will result in discharges of pollutants in violation of the CWA. The plaintiff asserts that the CWA requires the defendants to obtain a permit from the North Coast Water Board before beginning timber harvesting and road construction activities and is seeking to enjoin these activities until such permit has been obtained. The plaintiff also seeks civil penalties of up to $27,500 per day for the alleged continued violation of the CWA. In October 2003, the Court upheld the validity of an EPA regulation that exempts harvesting and other forestry activities from certain discharge requirements. Both state and federal agencies, along with Palco and other timber companies, have relied upon this regulation for more than 25 years. However, the Court interpreted the regulation in such a way as to narrow the forestry operations that are exempted, thereby limiting the regulation's applicability and subjecting culverts and ditches to permit requirements. This ruling has widespread implications for the timber industry in the United States. The case is not yet final as the trial has not yet been held, and there are many unresolved issues involving interpretation of the Court's decision and its application to actual operations. On June 30, 2006, the plaintiff filed a motion for partial summary judgment seeking to establish the Palco Companies' liability and the Palco Companies filed a motion for summary judgment asserting that the plaintiff lacks standing to maintain the lawsuit. A hearing on these motions was held on October 3, 2006, and the Court took the matter under submission. Due to the Bankruptcy Cases, the Court has entered an order staying this matter.

Should the Court's October 2003 decision ultimately become final and be held to apply to all of the timber operations of Palco and Scopac, it may have some or all of the following effects: imposing additional permitting requirements, delaying approvals of THPs, increasing harvesting costs, and adding water protection measures beyond those contained in the HCP. The Company believes that civil penalties should not be awarded for operations that occurred prior to the Court's decision due to the historical reliance by timber companies on the regulation and Palco's belief that the requirements under the HCP are adequate to ensure that sediment and pollutants from harvesting activities on the Palco Timberlands will not reach levels harmful to the environment. While the impact of a conclusion to this case that upholds the October 2003 ruling may be adverse, the Company does not believe that such an outcome should have a material adverse impact on the Company's consolidated financial condition, results of operations or liquidity. Nevertheless, due to the numerous ways in which the Court's interpretation of the regulation could be applied to actual operations, there can be no assurance that this will be the case.

On November 20, 2002, two similar actions entitled *Alan Cook, et al. v. Gary Clark, et al.* (***"Cook action"***) and *Steve Cave, et al. v. Gary Clark, et al.* (***"Cave action"***) were filed in Humboldt County Superior Court (No.'s DR020718 and DR020719, respectively), which also name Palco and certain affiliates as defendants. The *Cook action* alleges, among other things, that defendants' logging practices have contributed to an increase in flooding along Freshwater Creek (which runs through the Palco Timberlands), resulting in personal injury and damage to the plaintiffs' properties. Plaintiffs further allege that in order to have THPs approved in the affected areas, the defendants engaged in certain unfair business practices. The plaintiffs seek, among other things, compensatory and exemplary damages, injunctive relief, and appointment of a receiver to ensure that the watershed is restored. The *Cave action* contains similar allegations and requests similar relief with respect to the Elk River watershed (a portion of which is contained on the Palco Timberlands). On October 13, 2005, an action entitled *Edyth Johnson, et al. v. Charles E. Hurwitz, an individual; MAXXAM Inc., et al.* (No. DR040720) was filed in Humboldt County Superior Court (***"Johnson action"***) and contains allegations similar to the *Cave* and *Cook* actions. The Company does not believe the resolution of these actions should result in a material adverse effect on its consolidated financial condition, results of operations or liquidity. Notices have been filed with the Court to stay these matters due to the Bankruptcy Cases.

On February 25, 2003, the District Attorney of Humboldt County filed a civil suit entitled *The People of the State of California v. The Pacific Lumber Company, Scotia Pacific Holding Company and Salmon Creek Corporation* in the Humboldt County Superior Court (No. DR030070) (***"Humboldt DA action"***). The suit was filed under California's unfair competition law and alleges that the Palco Companies used certain unfair business practices in connection with completion of the Headwaters Agreement, and that this resulted in the harvest of significantly more trees than would have otherwise been the case. The suit sought a variety of remedies including a civil penalty of $2,500 for each additional tree that has been or will be harvested due to this alleged increase in harvest, as well as restitution and an injunction in respect of the additional timber harvesting allegedly being conducted. On June 14, 2005, the Court dismissed this matter in its entirety. On September 19, 2005, the District Attorney appealed this decision, however, the Company believes that the dismissal ruling has substantially diminished the exposure of the Palco Companies with respect to this matter. Due to the Bankruptcy Cases, the Court has entered an order staying this matter.

In December 2005, Palco and Scopac filed a claim (**"Claim"**) with the California Victim Compensation and Government Claims Board (**"Claims Board"**) against the North Coast Water Board, the State Water Board and the State of California (Claim No. G558159). The Claim alleges that the defendants have substantially impaired the contractual and legal rights of Palco and Scopac under the Headwaters Agreement and the related permits, authorizations and approvals. The Claim also alleges that the actions of the defendants have caused the companies substantial damages, but does not specify an amount. While the Claims Board has indicated that it is investigating the matter, it failed to approve or deny the claim by the statutory deadline. As a result, the Claim is by operation of law treated as having been denied, and Palco may now file a claim for damages in California state court. This suit was filed by Palco and Scopac on December 20, 2006 in Superior Court in Fresno, California (No. CECG 0422).

While the above-described legal proceedings are, in general, stayed as against the Debtors while the companies are in bankruptcy, such proceedings could be dismissed as against the Debtors as the stay is modified by the Bankruptcy Court, if the Bankruptcy Cases are dismissed, or in certain circumstances, upon the emergence of the companies from bankruptcy. Also see Item 1A. "Risk Factors–Risk Factors Related to Forest Products Regulatory Matters."

OTS Contingency and Related Matters

On December 26, 1995, the United States Department of Treasury's Office of Thrift Supervision (**"OTS"**) initiated a formal administrative proceeding (***"OTS action"***) against the Company and others alleging, among other things, misconduct by the Company and certain of its affiliated persons (**"Respondents"**) and others with respect to the failure of United Savings Association of Texas (the **"USAT"**). The OTS sought damages ranging from $326.6 million to $821.3 million under various theories. Following 110 days of proceedings before an administrative law judge during 1997-1999, and over two years of post-trial briefing, on September 12, 2001, the administrative law judge issued a recommended decision in favor of the Respondents on each claim made by the OTS. On October 17, 2002, the *OTS action* was settled for $0.2 million with no admission of wrongdoing on the part of the Respondents.

As a result of the dismissal of the *OTS action*, a related civil action, alleging damages in excess of $250 million, was subsequently dismissed. This action, entitled *Federal Deposit Insurance Corporation, as manager of the FSLIC Resolution Fund v. Charles E. Hurwitz* (***"FDIC action"***), was originally filed by the Federal Deposit Insurance Corporation (the **"FDIC"**) in August 1995 against Mr. Charles E. Hurwitz (Chairman and Chief Executive Officer of the Company).

In May 2000, the Respondents filed a counterclaim to the *FDIC action* in the U.S. District Court in Houston, Texas (No. H95-3956). In November 2002, the Respondents filed an amended counterclaim and an amended motion for sanctions (collectively, the **"Sanctions Motion"**). The Sanctions Motion states that the FDIC illegally paid the OTS to bring the *OTS action* against the Respondents and that the FDIC illegally sued for an improper purpose (i.e., in order to acquire timberlands held by a subsidiary of the Company). The Respondents are seeking as a sanction to be made whole for the attorneys' fees they have paid (plus interest) in connection with the *OTS* and *FDIC actions*. As of December 31, 2006, such fees were in excess of $40.9 million. On August 23, 2005, a U.S. District Court ruled on the Sanctions Motion, ordering the FDIC to pay the Respondents $72.3 million. The FDIC has appealed the District Court decision to the U.S. Fifth Circuit Court of Appeals. The U.S. District Court award has not been accrued as of December 31, 2006 and December 31, 2005. There can be no assurance that the Company will ultimately collect this award.

Other Matters

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

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

12. Stockholders' Deficit

Preferred Stock

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

Stock Option Plans

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

In 2002, the Company adopted the MAXXAM 2002 Omnibus Employee Incentive Plan (**"2002 Omnibus Plan"**). 700,000 shares of Common Stock and 70,000 shares of Class A Preferred Stock are reserved for awards pursuant to the 2002 Omnibus Plan, of which 148,687 and 70,000 shares, respectively, were available to be awarded at December 31, 2006. The 2002 Omnibus Plan replaced the MAXXAM 1994 Omnibus Plan (**"1994 Omnibus Plan"**). Any shares which were not then already the subject of grants under the 1994 Omnibus Plan are no longer available to be awarded.

Concurrent with the adoption of the 1994 Omnibus Plan, the Company adopted the MAXXAM 1994 Non-Employee Director Plan (**"1994 Director Plan"**). 35,000 shares of Common Stock are reserved for awards under the 1994 Director Plan, of which 12,900 were available to be awarded at December 31, 2006.

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

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

	Years Ended December 31,		
	2006	**2005**	**2004**
Expected volatility	33%	38%	41%
Expected dividends	–	–	–
Expected term (in years)	6.20	6.44	6.63
Risk-free rate	4.70%	4.35%	3.63%

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

A summary of activity under the Company's stock option plans during 2006 is presented below:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Balance at January 1, 2006	1,114,306	$ 25.06		
Granted	94,300	27.93		
Exercised	(42,744)	16.76		
Forfeited or expired	(84,009)	26.65		
Balance at December 31, 2006	1,081,853	$ 25.52	5.50	$ 8.5
Exercisable at December 31, 2006	796,261	$ 25.38	4.52	$ 7.1

Total compensation cost for share-based payment arrangements for the year ended December 31, 2006, was a benefit of $2.0 million due primarily to a reduction in the per share market price of the Company's Common Stock. As of December 31, 2006, total estimated compensation related to non-vested grants not yet recognized is $3.5 million and the weighted average period over which it is expected to be recognized is 2.0 years, although the Company may ultimately not have to pay all of such amount. During the year ended December 31, 2006, there were $0.5 million in options exercised and $1.3 million, based on the weighted average fair value, in options were vested.

The following table summarizes information about stock options outstanding as of December 31, 2006:

Range of Exercise Prices	Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
$ 9.40 - $15.88	283,230	5.14	$12.09	248,970	$ 12.46
$16.38 - $19.72	333,608	5.77	18.64	277,496	18.42
$26.50 - $45.50	367,415	6.56	34.82	172,195	39.64
$50.50 - $62.00	97,600	1.62	52.95	97,600	52.95
	1,081,853	5.50	25.52	796,261	25.38

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

Rights

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

Under certain circumstances, including if any person becomes an Acquiring Person other than through certain offers for all outstanding shares of stock of the Company, or if an Acquiring Person engages in certain "self-dealing" transactions, each Series A Right would enable its holder to buy Class A Preferred Stock (or, under certain circumstances, preferred stock of an acquiring company) having a value equal to two times the exercise price of the Series A Right, and each Series B Right would enable its holder to buy Common Stock of the Company (or, under certain circumstances, common stock of an acquiring company) having a value equal to two times the exercise price of the Series

B Right. Under certain circumstances, Rights held by an Acquiring Person will be null and void. In addition, under certain circumstances, the Board is authorized to exchange all outstanding and exercisable Rights for stock, in the ratio of one share of Class A Preferred Stock per Series A Right and one share of Common Stock per Series B Right. The Rights, which do not have voting privileges, expire on December 11, 2009, but may be redeemed by action of the Board prior to that time for $0.01 per right, subject to certain restrictions.

Shares Reserved for Issuance

At December 31, 2006, the Company had 2,740,707 shares of Common Stock and 808,119 shares of Class A Preferred Stock reserved for future issuances in connection with various options, convertible securities and other rights, as described above.

Voting Control

As of December 31, 2006, Mr. Charles E. Hurwitz beneficially owned (exclusive of securities acquirable upon exercise of stock options but inclusive of securities as to which Mr. Hurwitz disclaims beneficial ownership) directly and through various entities (principally Gilda Investments, LLC, a wholly owned subsidiary of Giddeon Holdings, Inc.) an aggregate of 99.2% of the Company's Class A Preferred Stock and 54.4% of the Company's Common Stock (resulting in combined voting control of approximately 79.5% of the Company). Mr. Hurwitz is the Chairman of the Board and Chief Executive Officer of the Company and President and Director of Giddeon Holdings, Inc. Giddeon Holdings, Inc. is wholly owned by Mr. Hurwitz, members of his immediate family and trusts for the benefit thereof.

13. Significant Acquisitions and Dispositions

Real Estate Transactions

During 2005, the Company realized substantial revenues from sales of properties at its Mirada development. Sales at Mirada were $26.9 million in 2006 as compared to $57.0 million in 2005.

Additionally, the Company during 2006 sold 12 lots at its Fountain Hills development. Sales at Fountain Hills were $19.3 million in 2006 as compared to $48.3 million in 2005.

At the Company's Palmas development, there were two sales in 2006 that generated revenues aggregating $16.0 million. Sales at Palmas were $40.1 million in 2006, as compared to $54.4 million in 2005.

14. Supplemental Cash Flow and Other Information

	Years Ended December 31,		
	2006	2005	2004
		(In millions)	
Supplemental information on non-cash investing and financing activities:			
Repurchases of debt using restricted cash and marketable securities	$ –	$ –	$ 10.9
Supplemental disclosure of cash flow information:			
Interest paid, net of capitalized interest	$ 81.1	$ 73.5	$ 72.7
Income taxes paid, net	1.5	0.3	0.4

15. Quarterly Financial Information (Unaudited)

Summary quarterly financial information for the years ended December 31, 2006 and 2005 is as follows (in millions, except share information):

	Three Months Ended			
	March 31	June 30	September 30	December 31
2006:				
Net sales	$ 80.2	$ 63.5	$ 77.8 [1]	$ 70.0
Operating income (loss)	6.3	2.0	443.5 [1]	(2.8)
Income (loss) before income taxes	(9.5)	(15.4)	418.7 [1]	(22.9)
Net income (loss)	(10.2)	(11.2)	418.7 [1]	(22.9)
Basic earnings (loss), after cumulative effect of accounting change, per common and common stock equivalent share[2]	$ (1.59)	$ (1.97)	$ 79.61	$ (4.36)
Diluted earnings (loss), after cumulative effect of accounting change, per common and common stock equivalent share[2]	$ (1.59)	$ (1.97)	$ 69.32	$ (4.36)
2005:				
Net sales	$ 83.0	$ 87.2	$ 105.8	$ 130.4
Operating income	2.8	6.5	19.7	26.5
Income (loss) before income taxes	(14.2)	(9.6)	4.3	15.4
Net income (loss)	(14.2)	(9.6)	4.3	15.5
Basic earnings (loss) per common and common equivalent share[2]	$ (2.38)	$ (1.60)	$ 0.72	$ 2.60
Diluted earnings (loss) per common and common stock equivalent share[2]	$ (2.38)	$ (1.60)	$ 0.62	$ 2.22

[1] Includes gain of $430.9 million related to reversal of net investment in Kaiser.
[2] The sum of the quarterly income per share amounts may not equal the annual amount reported, as per share amounts are computed independently for each quarter and for the full year based on the respective weighted average common shares outstanding.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company’s reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, the Company has investments in certain unconsolidated entities. As the Company does not control or manage these entities, its disclosure controls and procedures with respect to such entities are necessarily substantially more limited than those it maintains with respect to its consolidated subsidiaries.

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

Changes in Internal Control over Financial Reporting

Since September 30, 2006, there have been no changes in the Company's internal controls over financial reporting that materially affected or are reasonably likely to materially affect the internal controls over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

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

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

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

As of the end of the period covered by this report, our management carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. This evaluation was based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that the Company's internal control over financial reporting was effective as of December 31, 2006.

Dated: March 30, 2007

Attestation Report of the Registered Public Accounting Firm

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

We have audited management's assessment, included in the accompanying Annual Report on Internal Controls over Financial Reporting, that MAXXAM Inc. and subsidiaries ("Company") maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2006 and 2005, and the related consolidated statements of operations, cash flows, and stockholders' deficit for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedules listed in the Index at Item 15(a)(2). Our report dated March 30, 2007 expressed an unqualified opinion on those financial statements and financial statement schedules based on our audit and the report of other auditors and included an explanatory paragraph regarding the ability of MAXXAM Inc. and subsidiaries to realize their timber-related assets and discharge their timber related liabilities in the normal course of business and to continue as a going concern.

DELOITTE & TOUCHE LLP

Houston, Texas
March 30, 2007

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

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

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Index to Financial Statements

1. Financial Statements (included under Item 8):

2. Financial Statement Schedules:

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

(b) Exhibits

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

SCHEDULE I – CONDENSED FINANCIAL INFORMATION OF REGISTRANT

MAXXAM INC.

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

	December 31, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 12.0	$ 46.1
Marketable securities and other investments	124.7	104.8
Other current assets	5.8	6.1
Total current assets	142.5	157.0
Deferred income taxes	60.4	57.9
Other assets	1.0	1.1
	$ 203.9	$ 216.0
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable and other accrued liabilities	$ 5.0	$ 8.7
Total current liabilities	5.0	8.7
Intercompany loans	177.6	209.3
Losses recognized in excess of investment in Kaiser	–	516.2
Losses recognized in excess of investments in subsidiaries	205.9	108.5
Other noncurrent liabilities	27.2	34.6
Total liabilities	415.7	877.3
Stockholders' deficit:		
Preferred stock, $0.50 par value; $0.75 liquidation preference; 2,500,000 shares authorized; Class A $0.05 Non-Cumulative Participating Convertible Preferred Stock; 668,964 shares issued, respectively; 668,119 shares outstanding, respectively	0.3	0.3
Common stock, $0.50 par value; 13,000,000 shares authorized; 10,063,359 shares issued; 5,257,657 and 5,967,942 shares outstanding, respectively	5.0	5.0
Additional capital	225.3	225.3
Accumulated deficit	(296.0)	(670.4)
Accumulated other comprehensive loss	1.0	(96.6)
Treasury stock, at cost (shares held: preferred – 845; common – 4,805,702 and 4,095,417, respectively)	(147.4)	(124.9)
Total stockholders' deficit	(211.8)	(661.3)
	$ 203.9	$ 216.0

See notes to consolidated financial statements and accompanying notes.

SCHEDULE I – CONDENSED FINANCIAL INFORMATION OF REGISTRANT (Continued)

MAXXAM INC.

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

	Years Ended December 31,		
	2006	2005	2004
Investment, interest and other income, net	$ 2.6	$ 7.8	$ 3.7
Intercompany interest expense, net	(16.7)	(13.8)	(9.9)
Interest expense	0.1	(0.2)	(0.1)
General and administrative expenses	(5.4)	(15.0)	(16.0)
Equity in losses of subsidiaries	(45.1)	2.7	(28.9)
Reversal of net investment in Kaiser	430.9	–	–
Income (loss) before benefit in lieu of income taxes and cumulative effect of accounting change	366.4	(18.5)	(51.2)
Benefit in lieu of income taxes	8.7	14.5	4.6
Cumulative effect of accounting change	(0.7)	–	–
Net income (loss)	$ 374.4	$ (4.0)	$ (46.6)

See notes to consolidated financial statements and accompanying notes.

SCHEDULE I – CONDENSED FINANCIAL INFORMATION OF REGISTRANT (Continued)

MAXXAM INC.

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

	Years Ended December 31,		
	2006	2005	2004
Cash flows from operating activities:			
Net loss income (loss)	$ 374.4	$ (4.0)	$ (46.6)
Adjustments to reconcile net loss to net cash used for operating activities:			
Reversal of net investment in Kaiser	(430.9)	–	–
Equity in losses of subsidiaries	45.1	(2.7)	28.9
Non-cash stock-based compensation expense	(2.0)	3.7	6.1
Net (gains) losses on marketable securities and other investments	(2.2)	(6.6)	2.2
Decrease in receivables, prepaids and other assets	0.4	0.8	0.7
Decrease (increase) in deferred income tax assets	(2.5)	0.8	3.2
(Increase) decrease in accounts payable and other liabilities	(4.4)	(0.5)	1.0
Net cash used for operating activities	(22.1)	(8.5)	(4.5)
Cash flows from investing activities:			
Net sales (purchases) of marketable securities and other investments	9.4	2.5	(17.5)
Dividends received from subsidiaries	15.2	26.2	5.9
Investments in and net advances from subsidiaries	(13.1)	35.1	23.0
Loans to subsidiaries	(1.0)	(17.3)	–
Capital expenditures	–	(0.4)	(0.3)
Net cash provided by investing activities	10.5	46.1	11.1
Cash flows from financing activities:			
Treasury stock repurchases	(22.5)	(0.2)	–
Net cash used for financing activities	(22.5)	(0.2)	–
Net increase(decrease) in cash and cash equivalents	(34.1)	37.4	6.6
Cash and cash equivalents at beginning of year	46.1	8.7	2.1
Cash and cash equivalents at end of year	$ 12.0	$ 46.1	$ 8.7
Supplementary schedule of non-cash investing and financing activities:			
Deferral of interest payment on intercompany note payable	$ 4.8	$ 5.2	$ 11.3
Non-cash dividends received from subsidiaries	44.8	–	21.6
Supplemental disclosure of cash flow information:			
Interest paid	$ 16.1	$ 6.1	$ 0.5

See notes to consolidated financial statements and accompanying notes.

MAXXAM INC.

NOTES TO FINANCIAL STATEMENTS

1. Investment in Kaiser

Kaiser's plan of reorganization provided for the cancellation of Kaiser's equity, including the Company's Kaiser Shares, without consideration or obligation. Kaiser's plan of reorganization became effective on July 6, 2006, and Kaiser emerged from bankruptcy. Since the Company's Kaiser Shares were cancelled without obligation, the Company reversed the $516.2 million of losses in excess of its investment in Kaiser along with the accumulated other comprehensive losses of $85.3 million related to Kaiser, resulting in a net gain of $430.9 million, recognized in the third quarter of 2006. As a result of the cancellation of the Company's Kaiser Shares in 2006, the Company expects it will take a worthless stock deduction on its 2006 consolidated federal income tax return. However, it is uncertain whether the deduction meets certain criteria required for asset recognition purposes. Accordingly, the Company has not recorded the resulting tax asset of approximately $135.8 million in its consolidated balance sheet as of December 31, 2006.

2. Deferred Income Taxes

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

3. Intercompany Loans

Intercompany loans, which include accrued interest, consists of the following (in millions):

	December 31, 2006	December 31, 2005
Note payable to MAXXAM Group Holdings Inc.	$ 153.3	$ 183.8
Net advances	24.3	25.5
	$ 177.6	$ 209.3

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MAXXAM INC.

Date: April 2, 2007 By: CHARLES E. HURWITZ
Charles E. Hurwitz
Chairman of the Board, Chief Executive Officer and President

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

Date: April 2, 2007 By: J. KENT FRIEDMAN
J. Kent Friedman
Vice Chairman of the Board and General Counsel

Date: April 2, 2007 By: ROBERT J. CRUIKSHANK
Robert J. Cruikshank
Director

Date: April 2, 2007 By: SHAWN M. HURWITZ
Shawn M. Hurwitz
Director

Date: April 2, 2007 By: EZRA G. LEVIN
Ezra G. Levin
Director

Date: April 2, 2007 By: STANLEY D. ROSENBERG
Stanley D. Rosenberg
Director

Date: April 2, 2007 By: MICHAEL J. ROSENTHAL
Michael J. Rosenthal
Director

Date: April 2, 2007 By: M. EMILY MADISON
M. Emily Madison
Vice President, Finance and
Interim Chief Financial Officer
(Principal Accounting Officer and
Interim Principal Financial Officer)

INDEX OF EXHIBITS

Exhibit Number	Description
3.1	Restated certificate of incorporation of the Company (conformed to include all amendments and certificates of designation thereto and incorporated herein by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004)
3.2	Certificate of Powers, Designations, Preferences and Relative, Participating, Optional and Other Rights of the Company's Class B Junior Participating Preferred Stock (incorporated herein by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)
3.3	Certificate of Designations of Class A $.05 Non-Cumulative Participating Convertible Preferred Stock of the Company (incorporated herein by reference to Exhibit 3.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 1999
3.4	Amended and Restated By-laws of the Company, dated March 30, 2000 (incorporated herein by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2000)
4.1	Rights Agreement, dated December 15, 1999, by and between the Company and American Stock Transfer & Trust Company (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on January 14, 2000
4.2	Scopac Indenture, dated July 20, 1998, between Scopac and State Street Bank and Trust Company (incorporated herein by reference to Exhibit 4.1 to the Company's Form 10-Q/A No. 1 filed with the SEC on September 15, 1998, and relating to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998; the **"Company June 1998 Form 10-Q"**)
4.3	First Supplemental Indenture, dated July 16, 1999, to the Scopac Indenture (incorporated herein by reference to Exhibit 4.1 to Scopac's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999; File No. 333-63825; the "Scopac June 1999 Form 10-Q")
4.4	Second Supplemental Indenture, dated November 18, 1999, to the Scopac Indenture (incorporated herein by reference to Exhibit 99.3 to Scopac's Report on Form 8-K filed on November 19, 1999; File No. 333-63825)
4.5	Deed of Trust, Security Agreement, Financing Statement, Fixture Filing and Assignment of Proceeds, dated July 20, 1998, relating to the Scopac Indenture (incorporated herein by reference to Exhibit 4.2 to the Company June 1998 Form 10-Q)
	Note: Pursuant to Regulation § 229.601, Item 601(b)(4)(iii) of Regulation S-K, upon request of the Securities and Exchange Commission, the Company hereby agrees to furnish a copy of any unfiled instrument which defines the rights of holders of long-term debt of the Company and its consolidated subsidiaries (and for any of its unconsolidated subsidiaries for which financial statements are required to be filed) wherein the total amount of securities authorized thereunder does not exceed 10 percent of the total consolidated assets of the Company
10.1	Credit Agreement (**"Scopac Credit Agreement"**), dated July 20, 1998, among Scopac, the financial institutions party thereto and Bank of America, N.A., as Agent (incorporated herein by reference to Exhibit 4.3 to the Company June 1998 Form 10-Q)
10.2	First Amendment, dated July 16, 1999, to the Scopac Credit Agreement (incorporated herein by reference to Exhibit 4.2 to the Scopac June 1999 Form 10-Q)
10.3	Second Amendment, dated June 15, 2001, to the Scopac Credit Agreement (incorporated herein by reference to Exhibit 4.1 to Scopac's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001; File No. 333-63825)
10.4	Third Amendment, dated June 30, 2003, to the Scopac Credit Agreement (incorporated herein by reference to Exhibit 4.1 to Scopac's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003; File No. 333-63825)
10.5	Fourth Amendment, dated May 18, 2006, to the Scopac Credit Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 10-K filed on May 23, 2006)

Exhibit Number	Description
10.6 to 10.11	[Reserved]
10.12	Revolving Credit Agreement, dated July 18, 2006, among Palco, Britt, the lenders from time to time party thereto and Marathon Structured Finance Fund L.P.(**“Marathon”**), as administrative agent (incorporated herein by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on July 21, 2006; the **“July 21, 2006 Form 8-K”**)
10.13	Term Loan Agreement, dated July 18, 2006, among Palco, Britt, the lenders from time to time party thereto and Marathon, as administrative agent (incorporated herein by reference to Exhibit 10.2 to the July 21, 2006 Form 8-K)
10.14	Guarantee and Collateral Agreement, dated July 18, 2006, executed by Palco, Britt, MGI, Salmon Creek and Scotia Inn in favor of Marathon, as administrative agent for the Revolving Credit Agreement (incorporated herein by reference to Exhibit 10.3 to the July 21, 2006 Form 8-K)
10.15	Guarantee and Collateral Agreement, dated July 18, 2006, executed by Palco, Britt, MGI, Salmon Creek and Scotia Inn in favor of Marathon, as administrative agent for the Term Loan Agreement (incorporated herein by reference to Exhibit 10.4 to the July 21, 2006 Form 8-K)
10.16	Deed of Trust, Security Agreement, Assignment of Rents And Leases And Fixture Filing, dated July 18, 2006, by and from Palco to Fidelity National Title Company, for the benefit of Marathon, as administrative agent for the Revolving Credit Agreement (incorporated herein by reference to Exhibit 10.5 to the July 21, 2006 Form 8-K)
10.17	Deed of Trust, Security Agreement, Assignment of Rents And Leases And Fixture Filing, dated July 18, 2006, by and from Palco to Fidelity National Title Company, for the benefit of Marathon, as administrative agent for the Term Loan Agreement (incorporated herein by reference to Exhibit 10.6 to the July 21, 2006 Form 8-K)
10.18	Omnibus Amendment to Revolving Credit Agreement and Guarantee and Collateral Agreement, dated October 12, 2006, among Palco, Britt, Marathon, LaSalle Business Credit, LLC and LaSalle Bank National Association (incorporated herein by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on October 17, 2006)
10.19	Stock Purchase Agreement, dated May 25, 2006, among the Company, Scion Qualified Value Fund and Scion Value Fund (incorporated herein by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on May 26, 2006)
10.20 to 10.22	[Reserved]
10.23	Revolving Credit Agreement (the **“Prior Palco Revolving Credit Agreement”**), dated April 19, 2005, among Palco, Britt, the lenders from time to time party thereto, and The CIT Group/Business Credit, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on April 25, 2005)
10.24	Term Loan Agreement (**“Prior Palco Term Loan Agreement”**), dated April 19, 2005, among Palco, Britt, the lenders from time to time party thereto and Credit Suisse First Boston (incorporated herein by reference to Exhibit 10.2 to the Company’s Current Report on Form 8-K filed on April 25, 2005)
10.25	Guarantee and Collateral Agreement, dated April 19, 2005, made by Palco, Britt, MGI, Salmon Creek and Scotia Inn Inc. in favor of The CIT Group/Business Credit, Inc. (incorporated herein by reference to Exhibit 10.3 to the Company’s Current Report on Form 8-K filed on April 27, 2005; the **“April 27, 2005 Form 8-K”**)
10.26	Guarantee and Collateral Agreement, dated April 19, 2005, made by Palco, Britt, MGI, Salmon Creek and Scotia Inn Inc. in favor of Credit Suisse First Boston (incorporated herein by reference to Exhibit 10.4 to the April 27, 2005 Form 8-K)

Exhibit Number	Description
10.27	Deed of Trust, Security Agreement, Assignment of Rents and Leases and Fixture Filing, dated April 19, 2005, by and from Palco to Fidelity National Title Company, for the benefit of The CIT Group/Business Credit, Inc., as administrative agent (incorporated herein by reference to Exhibit 10.5 to the April 27, 2005 Form 8-K)
10.28	Deed of Trust, Security Agreement, Assignment of Rents and Leases and Fixture Filing, dated April 19, 2005, by and from Palco to Fidelity National Title Company, for the benefit of Credit Suisse First Boston, as administrative agent (incorporated herein by reference to Exhibit 10.6 to the April 27, 2005 Form 8-K)
10.29	Omnibus Amendment, dated October 26, 2005, to the Prior Palco Revolving Credit Agreement and the Prior Palco Term Loan Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K of the Company filed on October 28, 2005)
10.30	Third Amendment, dated November 18, 2005, to the Prior Palco Revolving Credit Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 10-K filed on November 23, 2005)
10.31	Third Amendment, dated November 18, 2005, to the Prior Palco Term Loan Agreement (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on November 23, 2005)
10.32	Fourth Amendment, dated January 20, 2006, to the Prior Palco Revolving Credit Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 26, 2006)
10.33	Fourth Amendment, dated January 20, 2006, to the Prior Palco Term Loan Agreement (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on January 26, 2006)
10.34	Fifth Amendment, dated February 16, 2006, to the Prior Palco Revolving Credit Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 22, 2006)
10.35	Fifth Amendment, dated February 16, 2006, to the Prior Palco Term Loan Agreement (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on February 22, 2006)
10.36	Loan Agreement, dated June 28, 2001, between Lakepointe Assets LLC and Legg Mason Real Estate Services, Inc. (incorporated herein by reference to Exhibit 4.2 to MGHI's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001; File No. 333-18723; the **"MGHI June 2001 Form 10-Q"**)
10.36	Promissory Note, dated June 28, 2001, between Lakepointe Assets LLC and Legg Mason Real Estate Services, Inc. (incorporated herein by reference to Exhibit 4.3 to the MGHI June 2001 Form 10-Q)
10.37	Lease Agreement, dated June 28, 2001, between Lakepointe Assets LLC and Fluor Enterprises Inc. (incorporated herein by reference to Exhibit 10.1 to the MGHI June 2001 Form 10-Q)
10.38	Guarantee of Lease dated June 28, 2001, between Fluor Corporation and Lakepointe Assets LLC (incorporated herein by reference to Exhibit 10.2 to the MGHI June 2001 Form 10-Q)
10.39 to 10.40	[Reserved]
10.41	Tax Allocation Agreement (the **"MGHI Tax Allocation Agreement"**) , dated December 23, 1996, between the Company and MGHI (incorporated herein by reference to Exhibit 10.1 to MGHI's Registration Statement on Form S-4; Registration No. 333-18723)
10.42	Amendment of MGHI Tax Allocation Agreement, dated December 31, 2001 (incorporated herein by reference to Exhibit 10.2 to MGHI's Annual Report on Form 10-K for the year ended December 31, 2001; File No. 333-18723; the **"MGHI 2001 Form 10-K"**)
10.43	Tax Allocation Agreement (the **"MGI Tax Allocation Agreement"**), dated August 4, 1993, between the Company and MGI (incorporated herein by reference to Exhibit 10.6 to Amendment No. 2 to MGI's Registration Statement on Form S-2; Registration No. 33-56332)

Exhibit Number	Description
10.44	Amendment of MGI Tax Allocation Agreement, dated December 31, 2001, between the Company and MGI (incorporated herein by reference to Exhibit 10.4 to the MGHI 2001 Form 10-K)
10.45	Tax Allocation Agreement, dated May 21, 1988, among the Company, MGI, Palco and the corporations signatory thereto (incorporated herein by reference to Exhibit 10.8 to Palco's Annual Report on Form 10-K for the year ended December 31, 1988; File No. 1-9204)
10.46	Tax Allocation Agreement (the **"Palco Tax Allocation Agreement"**), dated March 23, 1993, among Palco, Scotia Pacific Holding Company, Salmon Creek Corporation and the Company (incorporated herein by reference to Exhibit 10.1 to Amendment No. 3 to the Registration Statement on Form S-1 of Scotia Pacific Holding Company; Registration No. 33-55538)
10.47	Amendment of Palco Tax Allocation Agreement, dated December 31, 2001 (incorporated herein by reference to Exhibit 10.7 to the MGHI 2001 Form 10-K)
10.48	Tax Allocation Agreement, dated February 9, 2004, among Britt, Palco, MGI and the Company (incorporated herein by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)
10.49 to 10.50	[Reserved]
10.51	New Master Purchase Agreement, dated July 20, 1998, between Scopac and Palco (incorporated herein by reference to Exhibit 10.1 to MGHI's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998; File No. 333-18723; the **"MGHI June 1998 Form 10-Q"**)
10.52	New Services Agreement, dated July 20, 1998, between Palco and Scopac (incorporated herein by reference to Exhibit 10.2 to the MGHI June 1998 Form 10-Q)
10.53	New Additional Services Agreement, dated July 20, 1998, between Scopac and Palco (incorporated herein by reference to Exhibit 10.3 to the MGHI June 1998 Form 10-Q)
10.54	New Reciprocal Rights Agreement, dated July 20, 1998, among Palco, Scopac and Salmon Creek (incorporated herein by reference to Exhibit 10.4 to the MGHI June 1998 Form 10-Q)
10.55	New Environmental Indemnification Agreement, dated July 20, 1998, between Palco and Scopac (incorporated herein by reference to Exhibit 10.5 to the MGHI June 1998 Form 10-Q)
10.56	Implementation Agreement with Regard to Habitat Conservation Plan for the Properties of Palco, Scopac and Salmon Creek, dated March 1, 1999, by and among the United States Fish and Wildlife Service, the National Marine Fisheries Service, The California Department of Fish and Game, the CDF, and the Palco Companies (incorporated herein by reference to Exhibit 99.3 to Scopac's Report on Form 8-K dated March 19, 1999; File No. 333-63825; the **"Scopac March 19, 1999 Form 8-K"**)
10.57	Agreement Relating to Enforcement of AB 1986, dated February 25, 1999, by and among the California Resources Agency, CDFG, CDF, the California Wildlife Conservation Board, Palco, Salmon Creek and Scopac (incorporated herein by reference to Exhibit 99.4 to the Scopac March 19, 1999 Form 8-K)
10.58	Habitat Conservation Plan, dated March 1, 1999, for the Properties of Palco, Scopac and Salmon Creek (incorporated herein by reference to Exhibit 99.5 to the Scopac March 19, 1999 Form 8-K)
10.59	Letter, dated February 25, 1999, from the CDF to Palco (incorporated herein by reference to Exhibit 99.8 to the Scopac March 19, 1999 Form 8-K)
10.60	Letter, dated March 1, 1999, from the CDF to Palco (incorporated herein by reference to Exhibit 99.9 to the Scopac March 19, 1999 Form 8-K)
10.61	Letter, dated March 1, 1999, from the U.S. Department of the Interior Fish and Wildlife Service and the U.S. Department of Commerce National Oceanic and Atmospheric Administration to Palco, Salmon Creek and Scopac (incorporated herein by reference to Exhibit 99.10 to the Scopac March 19, 1999 Form 8-K)
10.62	[Reserved]

Exhibit Number	Description
	Executive Compensation Plans and Arrangements
10.63	MAXXAM 2002 Omnibus Employee Incentive Plan (incorporated hereby reference to Exhibit 99 to the Company's Schedule 14A dated April 30, 2002)
10.64*	Form of Stock Option Agreement under the MAXXAM 2002 Omnibus Employee Incentive Plan
10.65	MAXXAM 1994 Omnibus Employee Incentive Plan (incorporated herein by reference to Exhibit 99 to the Company's Schedule 14A dated April 29, 1994)
10.66	Form of Stock Option Agreement under the MAXXAM 1994 Omnibus Employee Incentive Plan (incorporated herein by reference to Exhibit 10.30 to the Company's Annual Report on Form 10-K for the year ended December 31, 1994)
10.67	MAXXAM Amended and Restated Non-Employee Director Stock Plan (incorporated herein by reference to Exhibit 99.1 to the Company's Schedule 14A dated April 20, 2004)
10.68*	Form of Stock Option Agreement under the Amended and Restated Non-Employee Director Plan
10.69	Form of deferred fee agreement for Company directors (incorporated herein by reference to Exhibit 10.26 to the Company's Annual Report on Form 10-K for the year ended December 31, 1996)
10.70	MAXXAM 1994 Executive Bonus Plan (Amended and Restated 2003) (incorporated herein by reference to Exhibit 99 to the Company's Schedule 14A dated April 5, 2004)
10.71*	MAXXAM Revised Capital Accumulation Plan of 1988 (As Amended and Restated December 2006)
10.72	MAXXAM Supplemental Executive Retirement Plan (incorporated herein by reference to Exhibit 10(ii) to MGI's Registration Statement on Form S-4 on Form S-2; Registration No. 33-42300)
10.73*	MAXXAM Supplemental Savings Plan, effective January 1, 2006
10.74	Form of Company deferred compensation agreement (incorporated herein by reference to Exhibit 10.35 to the Company's Annual Report on Form 10-K for the year ended December 31, 1995)
10.75 to 10.76	[Reserved]
10.77	Executive Employment Agreement, dated April 1, 2005, between the Company and M. Emily Madison (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 1, 2005.
10.78	Restricted Stock Agreement (the **"Restricted Stock Agreement"**), dated December 13, 1999, between the Company and Charles E. Hurwitz(incorporated herein by reference to Exhibit 10.53 to the Company's Annual Report on Form 10-K for the year ended December 31, 1999)
10.79	Amendment, dated December 16, 2003, to the Restricted Stock Agreement (incorporated herein by reference to Exhibit 10.35 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)
10.80	2006 Bonus Criteria for the MAXXAM Chief Executive Officer under the MAXXAM 1994 Executive Bonus Plan (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on April 4, 2006)
10.81	206 Bonus Criteria for the MAXXAM Vice Chairman and General Counsel under the MAXXAM 1994 Executive Bonus Plan (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on April 4, 2006)
*21.1	List of the Company's Subsidiaries
*23.1	Consent of Deloitte & Touche LLP
*31.1	Section 302 Certification of Chief Executive Officer
*31.2	Section 302 Certification of Chief Financial Officer
*32.1	Section 906 Certification of Chief Executive Officer

Exhibit Number	Description
*32.2	Section 906 Certification of Chief Financial Officer

* Included with this filing

Glossary of Defined Terms

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

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

1994 Omnibus Plan: The MAXXAM 1994 Omnibus Employee Incentive Plan

2002 Omnibus Plan: The MAXXAM 2002 Omnibus Employee Incentive Plan

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

AOCI: Accumulated other comprehensive income (loss)

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

APB Opinion No. 29: Accounting Principles Board Opinion 29, "Accounting for Nonmonetary Transactions"

Bankruptcy Cases: The Chapter 11 proceedings of the Debtors

Bankruptcy Code: The United States Bankruptcy Code

Bankruptcy Court: The United States Bankruptcy Court for the Southern District of Texas

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

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

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

Blackstone: The Blackstone Group, restructuring and financial advisors to Palco and Scopac

BOF: California Board of Forestry and Fire Protection

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

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

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

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

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

CDF: California Department of Forestry and Fire Protection

CDFG: California Department of Fish and Game

CDF Harvest Limit: Annual harvest limit established by the CDF

CEQA: California Environmental Quality Act

CESA: California Endangered Species Act

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

Claims Board: The California Victim Compensation and Government Claims Board

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

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

Company: MAXXAM Inc., including its subsidiaries

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

COSO: Committee of Sponsoring Organizations of the Treadway Commission

CWA: Federal Clean Water Act

Debtors: Palco, Scopac, Britt, SDLLC and Palco's other subsidiaries, all of which have filed for reorganization under the Bankruptcy Code

DIP financing: Debtor-in-possession financing

Director Plan: MAXXAM Non-Employee Director Stock Plan

EBITDA: As defined in Section 1.01 of the Palco Revolving Credit Facility and Palco Term Loan which, among other things, excludes the results of Scopac

Environmental Plans: The HCP and the SYP

EPA: Federal Environmental Protection Agency

EPIC-SYP/Permits lawsuit: An action entitled *Environmental Protection Information Association, Sierra Club v. California Department of Forestry and Fire Protection, California Department of Fish and Game, The Pacific Lumber Company, Scotia Pacific Company LLC, Salmon Creek Corporation, et al.* filed in the Superior Court of Humboldt County, California (No. CV990445)

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

ESA: The Federal Endangered Species Act

Exclusivity Period: 120 days following the date of filing of the Bankruptcy Cases, during which the Debtors generally have the exclusive right to propose plan(s) of reorganization under the Bankruptcy Court

Executive Plan: The Company's Executive Bonus Plan

FASB: Financial Accounting Standards Board

FDIC: Federal Deposit Insurance Corporation

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

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

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

Filing Date: January 18, 2007, the date the Debtors filed separate voluntary petitions with the Bankruptcy Court

FIN No. 48: FASB FIN No. 48, "Accounting for Uncertainty in Income Taxes, as Interpretation of FASB Statement 109"

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

Forest Practice Act: The California Forest Practice Act

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

GIS: Scopac's Geographical information system

GPS: Scopac's Global Positioning System

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

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

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

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

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

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

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

Kaiser Shares: 50,000,000 shares of the common stock of Kaiser owned by the Company and MGHI at the time of its cancellation in connection with Kaiser's Chapter 11 Bankruptcy

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

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

Laredo LLC: Laredo Race Park LLC, a wholly owned subsidiary of the Company

LIBOR: London Inter Bank Offering Rate

Marathon: Marathon Structured Finance Fund L.P., one of Palco's lenders

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

MAXXAM: MAXXAM Inc., including its subsidiaries

MAXXAM Parent: MAXXAM Inc., excluding its subsidiaries

MAXXAM Pension Plan: MAXXAM Parent's Pension Plan

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

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

Minimum Principal Amortization: The amount of principal Scopac was required to pay (on a cumulative basis and subject to available cash) through any Scopac Timber Notes payment date

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

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

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

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

NJDEP: New Jersey Department of Environmental Protection

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

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

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

Option C: An alternative procedure for timber owners to comply with California's sustained yield requirements

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

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

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

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

Palco Companies: Palco, Scopac and Salmon Creek, collectively

Palco Debtors: Palco, Britt, SDLLC, Salmon Creek and Scotia Inn

Palco Retirement Plan: Palco's pension plan

Palco Revolving Credit Facility: The five-year $60.0 million secured asset-based revolving credit facility evidenced by the Revolving Credit Agreement dated as of July 18, 2006, among Palco and Britt, as borrowers, and Marathon Structured Finance Fund L.P., as amended

Palco Term Loan: The five-year $85.0 million secured term loan evidenced by the Term Loan Agreement dated as of July 18, 2006, among Palco and Britt, as borrowers, and Marathon Structured Finance Fund L.P., as amended

Palco Timberlands: The Scopac Timber Property and the timberlands owned by Palco and Salmon Creek

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

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

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

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

Plans: The MAXXAM Pension Plan, the Palco Retirement Plan and the MAXXAM Supplemental Employee Retirement Plan

Prior Palco-Britt Facilities: The term loan and revolving credit facility prior to the Palco Term Loan and the Palco Revolving Credit Facility

PSLRA: Private Securities Litigation Reform Act of 1995

Racing Act: The Texas Racing Act and related regulations

Racing Commission: The Texas Racing Commission

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

Rights: The Series A and B Rights

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

S&P: Standard & Poor's Rating Service

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

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

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

SAR Account: Funds held in a reserve account titled the Scheduled Amortization Reserve Account and used to support principal payments on the Scopac Timber Notes

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

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

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

Scopac Indenture: The indenture governing the Scopac Timber Notes

Scopac Land Sale Program: Scopac's program pursuant to which it was seeking to sell certain timberland and various non-timberland properties, such as ranchlands and recreational areas

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

Scopac Timber: The timber in respect of the Scopac Timberlands and the Scopac Timber Rights

Scopac Timber Notes: Scopac's 6.55% Series B Class A-1 Timber Collateralized Notes, 7.11% Series B Class A-2 Timber Collateralized Notes and 7.71% Series B Class A-3 Timber Collateralized Notes due July 20, 2028

Scopac Timberlands: Approximately 200,000 acres of timberlands owed by Scopac

Scopac Timber Property: The timberlands in respect of the Scopac Timber

Scopac Timber Rights: Scopac's exclusive right to harvest on approximately 10,000 acres of timberlands owned by Palco and Salmon Creek

Scotia Inn Inc.: Scotia Inn, a wholly owned subsidiary of Palco

SDLLC: Scotia Development LLC, a wholly owned subsidiary of Palco as of the Filing Date

SEC: The Securities and Exchange Commission

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

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

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

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

SFAS: Statement of Financial Accounting Standards

SFAS No. 5: SFAS No. 5, "Accounting for Contingencies"

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

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

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

SFAS No. 154: SFAS No. 154, "Accounting Changes and Error Correction"

SFAS No. 157: SFAS No. 157, "Fair Value Measurements"

SFAS No. 158: SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans"

SFAS No. 159: SFAS No. 159, "The Fair Value of Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115"

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

State Water Board: California State Water Resources Control Board

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

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

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

TMDLs: Total maximum daily load limits

Trustee: The trustee under the Scopac Indenture

USAT: United Savings Association of Texas

USWA lawsuit: An action entitled *United Steelworkers of America, AFL-CIO, CLC, and Donald Kegley v. California Department of Forestry and Fire Protection, The Pacific Lumber Company, Scotia Pacific Company LLC and Salmon Creek Corporation* (No. CV990452) filed in the Superior Court of Humboldt County, California

Valco: Volta Aluminium Company Limited

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

Water Board Orders: Clean up and abatement orders issued by the North Coast Water Board for the Elk River watersheds

WWDRs: Watershed-wide discharge requirements

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