Georgia-Pacific Corporation

Sixty Years of Growth

1986 Annual Report

1986 Sources of Cash

1986 Uses of Cash

Contents

SGP 0030599

Highlights

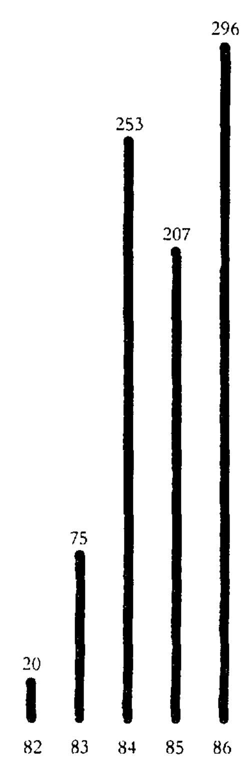
Georgia-Pacific Corporation and Subsidiaries

(Dollar amounts, except per share, and shares are in millions)	*1986*	*1985*	*Percent Change*
Net sales	$7,223	$6,716	8
Income from continuing operations before extraordinary item	296	207	43
Net income	296	187	58
Per common share — fully diluted			
Income from continuing operations before extraordinary item	2.64	1.80	47
Net income	2.64	1.61	64
Depreciation and depletion	339	310	9
Cash provided by continuing operations	575	771	(25)
Cash dividends paid	97	94	3
Total assets at year end	5,114	4,866	5
Return on capital employed[1]	10.4%	8.7%	
Return on common equity[1]	13.8%	10.2%	
Total debt-to-capital[1]	26.3%	32.0%	
Cash dividends declared per share of common stock	$ .85	$ .80	6
Shares of common stock outstanding at year end	107	103	4
Number of common shareholders of record	66,000	74,000	(11)
Number of employees	39,000	39,000	—

[1] *The method of calculating these amounts is described in the Financial Glossary presented on page 20.*

Net Sales
(Billions of dollars)

Income from Continuing Operations Before Extraordinary Item
(Millions of dollars)



SGP 0030600

Nineteen eighty-six was a year of solid performance for Georgia-Pacific. We invested to improve productivity and upgrade our product mix, to add value and reduce costs. We have improved profitability, and our financial position is strong.

Most important, the wealth of our shareholders increased. Your shares appreciated, and your Board of Directors increased the quarterly dividend to 25 cents per share in the fourth quarter.

Our net income rose to $296 million in 1986, 58 percent higher than in 1985. Sales reached $7.2 billion, compared with $6.7 billion in 1985. We capitalized on available resources, and improved profitability in an economic environment of low inflation and moderate growth. We also added value to our products and improved manufacturing efficiencies with investments in existing plants and mills. We think these investments will have higher rates of return than would investments in large acquisitions or in building new facilities.

We see ample opportunities ahead for growth in building products sales and profits. We expect single-family residential construction and the remodeling, repair and additions market to remain strong in 1987, but anticipate some decline in multi-family starts, partly because of tax reform.

Weak pricing likely will continue to challenge the building products industry during 1987 because of overcapacity in lumber and plywood production. The 15 percent tax on Canadian softwood lumber exported to the United States will give Canadian producers a new cost base that will be helpful to U.S. producers.

We will continue to achieve growth in our building products sector through internal investments and acquisitions that represent good production and marketing fits for Georgia-Pacific. We will maintain our strategy of integrating backward from distribution, as we have in roofing and moulding products, for example.

Pricing improved for most of our pulp and paper products during 1986 as a result of decreased inventories worldwide and the lower-valued U.S. dollar. Demand is strong for commodities such as market pulp and linerboard, as well as for higher-margin printing and writing papers. In the tissue sector, demand has improved slightly, but markets remain highly competitive. We expect continued strength in our major markets in 1987, with additional price improvements for pulp, linerboard and other grades.

In pulp and paper we plan to concentrate on containerboard and packaging, printing and writing paper, and tissue—areas where we think we can be a major factor in the market. As we maintain our ability to meet the needs of our external pulp markets, we also plan to upgrade the value of our pulp by integrating forward into new paper capacity. We anticipate continued growth during 1987 through both internal investments and acquisitions.

Our capital investments in 1986 were $482 million. In 1987 we expect to invest approximately $600 million, excluding possible acquisitions. We expect that we will be able to fund this capital program and pay our dividends without increasing debt.

While there will be opportunities to expand our markets in the future, formidable challenges also will affect the way we do business.

Not only are we operating in highly competitive businesses, but the fiscal and economic environment in the U.S. and abroad also presents challenges.

In the past 10 years, there have been eight major tax code revisions and many other changes in law and regulation. American business needs a stable tax environment to plan for the kinds of investments our industry must make to be competitive in world markets. With enactment of the new tax law, American industry lost investment tax credits and accelerated depreciation rates, in exchange for the promise of lower taxes in the future. If this promise is not kept, the effect on business confidence and business investment will be dramatic and adverse.

These challenges, however, do not dampen our optimism about G-P's ability to compete effectively. Our return on equity has risen from 1 percent in 1982 to almost 14 percent in 1986, providing good momentum for continued improvement. Our management structure and profit improvement programs are focused on achieving continued growth in returns to our shareholders. We are optimistic about our prospects for achieving the goal of consistent and superior returns on our shareholders' equity.

Your Board recently announced the appointment of Ronald P. Hogan as executive vice president–operations. He has contributed substantially to the growth of our nationwide Distribution Division, and he will work directly with Robert A. Schumacher in managing Georgia-Pacific's operations.

We know you join us in thanking all Georgia-Pacific employees for their fine contributions to our improved performance in 1986.

Robert A. Schumacher
President and
Chief Operating Officer

T Marshall Hahn, Jr.

T. Marshall Hahn, Jr.
Chairman and
Chief Executive Officer

February 13, 1987

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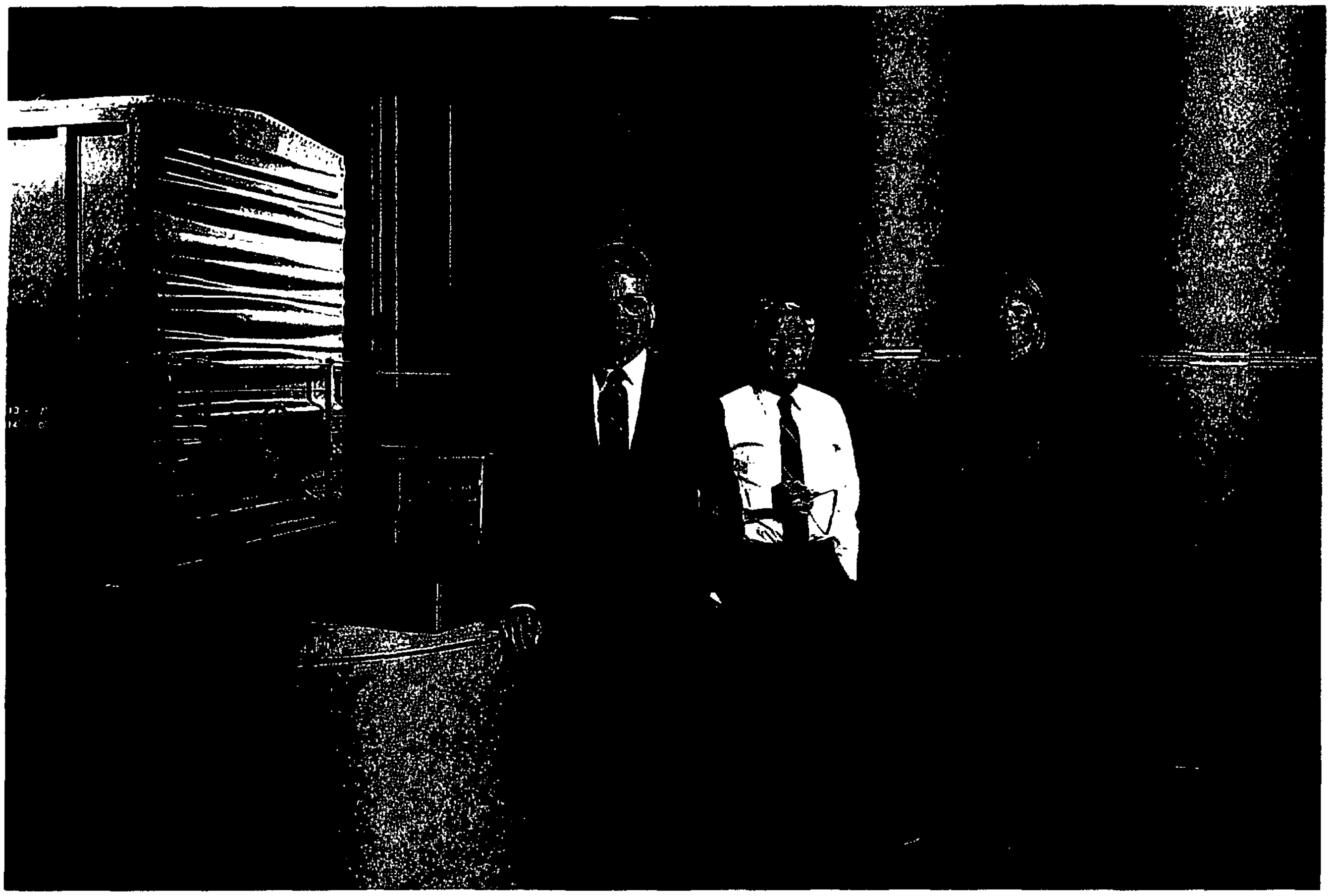


At Monticello, Mississippi, Georgia-Pacific recently rebuilt a linerboard machine, bringing production at the mill to 2,200 tons per day of strong, high-quality containerboard for the corrugated box industry. (Left to right) Danny Martinez, senior vice president–pulp and paper manufacturing; Ken Forehand, general manager and Karen Hanzlik, midwestern sales representative–containerboard, are three of the key employees making this mill one of the industry's finest.

1927 — *Georgia Hardwood Lumber Company, a wholesaler of lumber, is founded by Owen R. Cheatham in Augusta, Georgia.*

1928

1929 — *Because of low overhead and fixed expenses, Georgia Hardwood stays open during the depression, while banks and businesses fail by the thousands.*

1930

Pulp and Paper

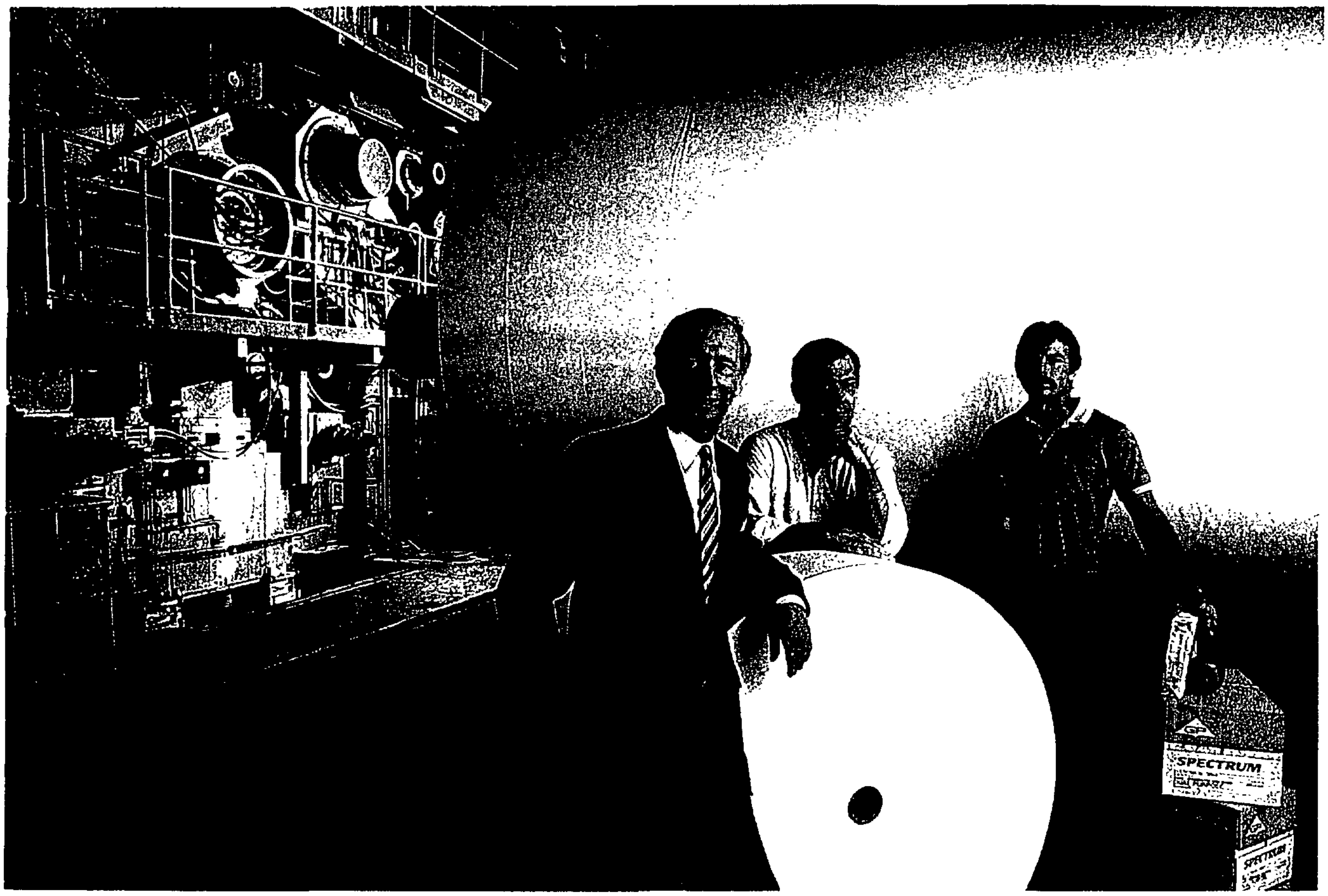
[illegible]

Lower exchange rates for the U.S. dollar were a major factor in improved market conditions, but we also [illegible]

[illegible]

[illegible]

[illegible]



At Port Hudson, Louisiana, one of the world's largest and fastest uncoated free-sheet paper machines started up in April 1986. Instrumental team members making this project a success are (left to right): Dave Dimling, vice president–printing paper division; Jerry Kincaid, production manager–fine paper and Ron Benge, crew leader.

1939

1940 — *Georgia Hardwood acquires several additional sawmills and concentration yards at Walterboro, Cleveland and Fairfax, South Carolina; Tabor City, North Carolina; Dumas, Arkansas; and Steelwood, Alabama.*

1941 — *The company organizes sales efforts in cypress, railroad materials, veneer and export departments.*

1942

Bellingham, Washington, is one of four Georgia-Pacific mills that will produce ANGEL SOFT®, the new premium bath tissue product that represents our commitment to softness and quality. Key Georgia-Pacific people in the ANGEL SOFT bath tissue introduction are (left to right): Leroy Carlson–warehouse lead; Howard McDowell, manager–paper operations and Mike Wilson, vice president–sales and marketing consumer and commercial paper products.

1943 — *The Georgia Distributing Yard (GDY) is formed to serve supply depots for the U.S. Army Corps of Engineers.*

1944

1945 — *Throughout the war years (1941-1945) Georgia Hardwood is the largest supplier of lumber to the U.S. Armed Forces and is awarded the Army-Navy "E" for its outstanding support of the war effort.*

1946

[illegible]

[illegible] the fall of 1987.

[illegible]

[illegible] dollar exchange rates [illegible] Georgia-Pacific exported approximately [illegible] Georgia-Pacific's largest [illegible] pulp production.

Georgia-Pacific [illegible] exchange rates, the outlook for pulp and paper exports is positive.

[illegible]

[illegible]

[illegible]

[illegible]

We are encouraged by the positive direction of our company in 1986, and expect these positive trends to continue throughout 1987.

[illegible]

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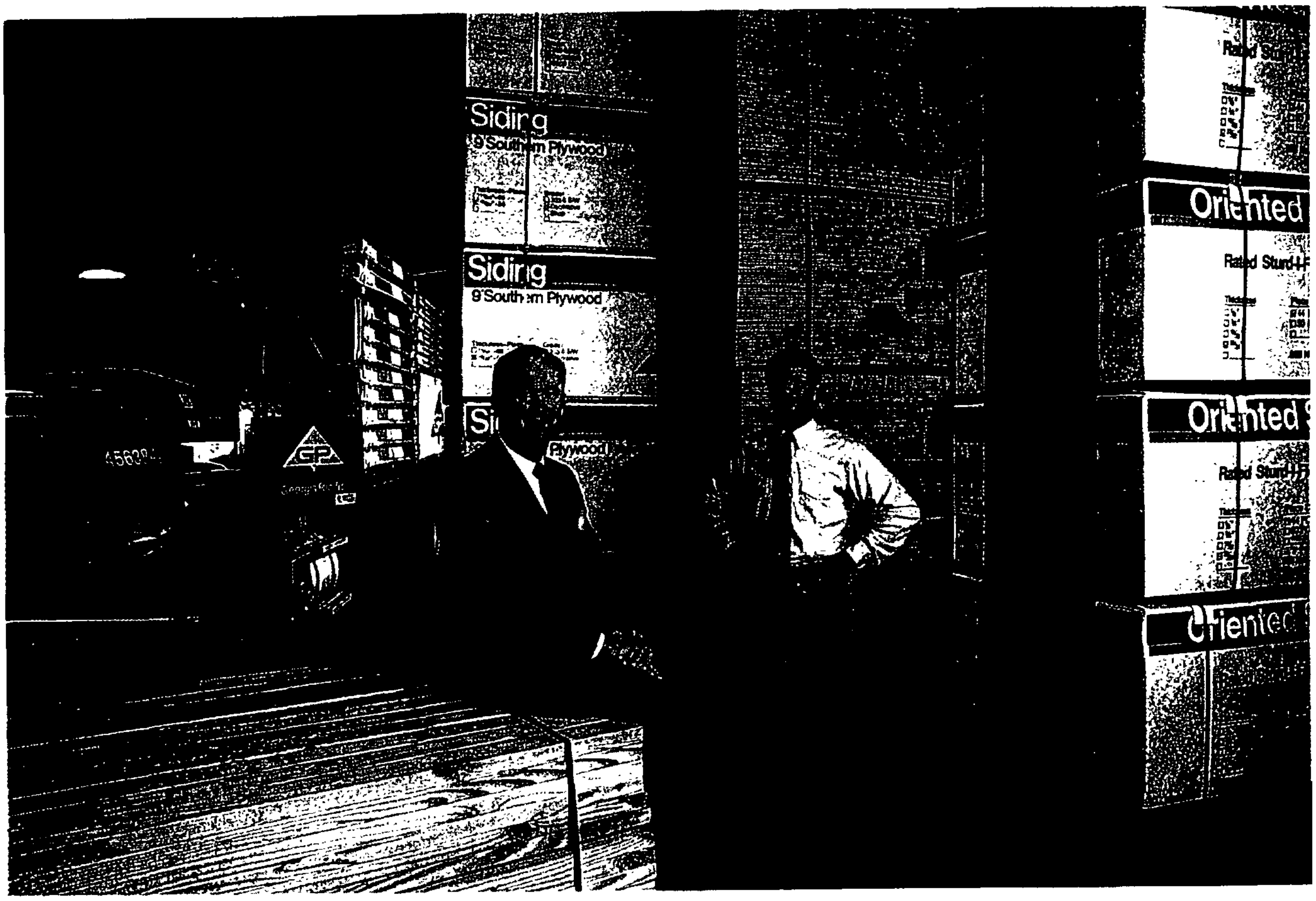


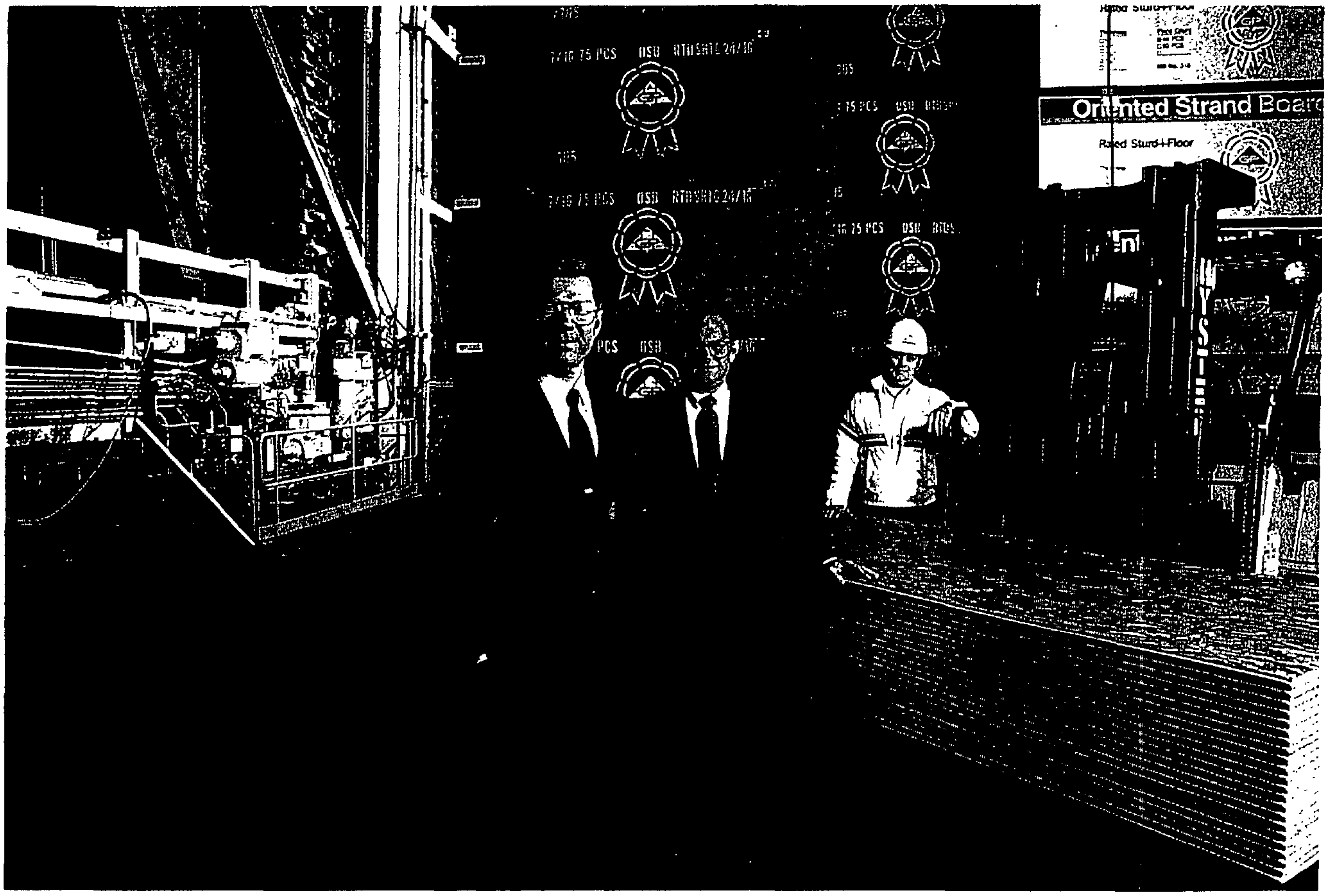
The Distribution Center at Atlanta, Georgia, is one of 141 centers, which have enabled Georgia-Pacific to establish a strong position in remodeling/repair markets—including the rapidly growing do-it-yourself (DIY) segment. (Left to right) Ron Hogan, executive vice president–operations (formerly senior vice president–distribution), and Mike Parramore, branch manager, help make the Distribution Division a unique asset in Georgia-Pacific's building products group.

1955

1956 *The company's name changes to Georgia-Pacific Corporation. G-P acquires the Coos Bay Lumber Company, Coos Bay, Oregon, and the Hammond Lumber Company in Northern California. Ten new distribution centers bring the total to 40. Company sales reach $121 million.*

1957 *G-P enters the pulp and paper business at Toledo, Oregon, with construction of a kraft pulp and paper mill*

1958



Georgia-Pacific further strengthened its position in the structural panel industry with an oriented strand board plant at Grenada, Mississippi. The facility uses the industry's latest technology, and has a capacity of 250 million square feet annually. Part of the Georgia-Pacific team that makes it go are (left to right): Dave Mortensen, senior vice president–wood products manufacturing; Steve Jackson, vice president–distribution division marketing and advertising and Jim Vanderhoof, plant manager.

1959 • *G-P adds 15 distribution centers for a total of 60, and acquires Booth-Kelly Lumber Company, Springfield, Oregon, including approximately 150,000 acres of timberlands.*

1960 • *G-P acquires the W.M. Ritter Lumber Company of Roanoke, Virginia, including sawmills and timberlands with reserves of natural gas and coal. Timber ownership totals one million acres. G-P sales exceed $200 million.*

1961 • *The company adds paper converting facilities in Washington, California, Iowa, Illinois and Arkansas. Employees total 11,000.*

1962 • *G-P acquires the Crossett Company, Crossett, Arkansas, including 565,000 acres of timberlands, and adds a corrugated container plant at Modesto, California, and a grocery bag and sack plant at Toledo, Oregon. Sales now total $325 million.*

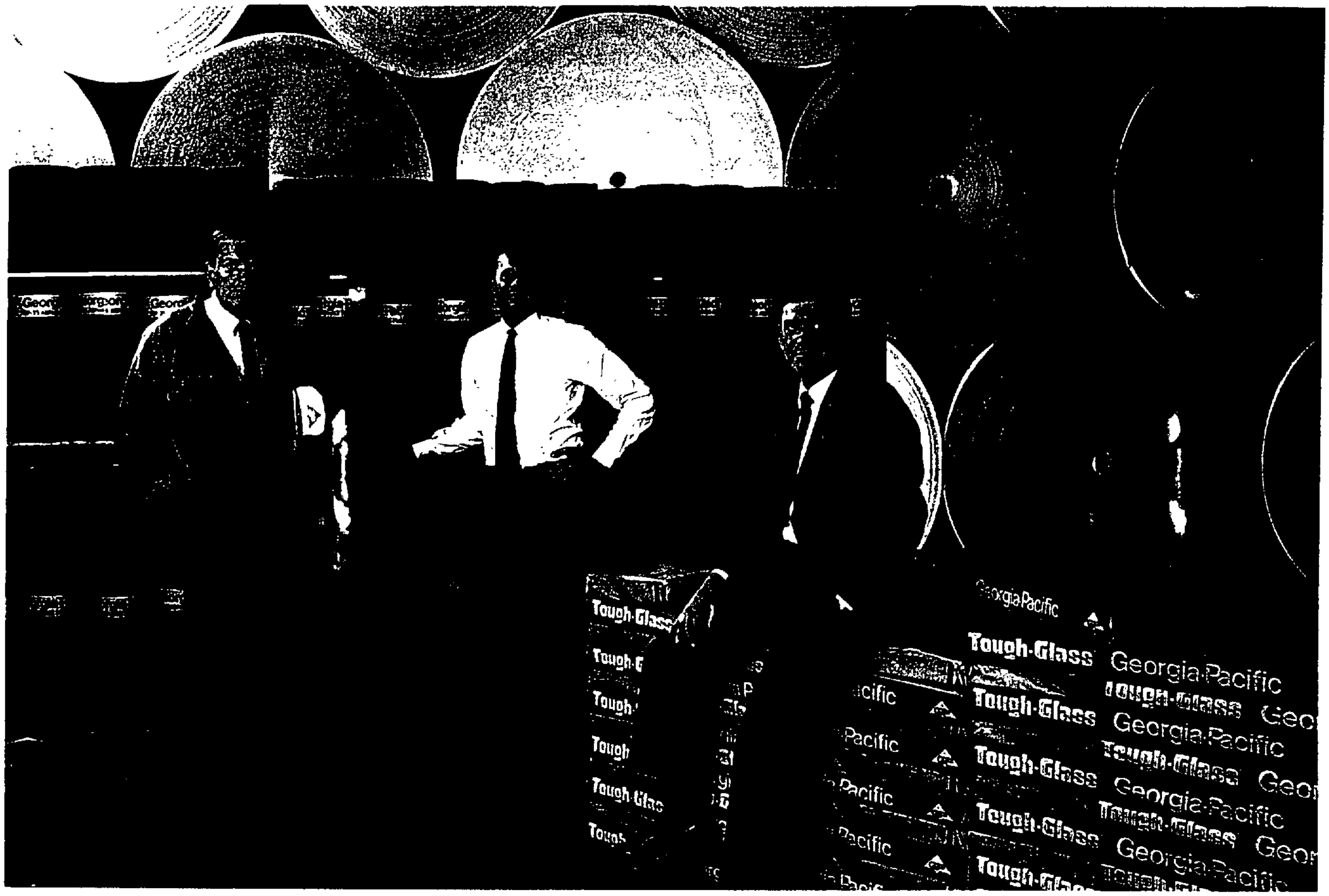
Georgia-Pacific's gypsum plant at Brunswick, Georgia, produces wallboard and joint compound along with our highly successful new product, DENS-GLASS™ gypsum board. Part of the Georgia-Pacific gypsum team effort are (left to right): Horace Batts–warehouse diagrammer; Oscar Covington, plant manager and Glenn Wilson, senior vice president—gypsum and roofing division.

1971 — *G-P announces capacity expansion at Port Hudson. Sales reach $1.4 billion.*

1972 — *Louisiana-Pacific Corporation is created in a spin-off of plant and timber assets primarily in the Far West and mid-South.*

1973 — *G-P acquires redwood timberlands and sawmills at Fort Bragg, California, and announces a $1 billion, five-year capital investment program. Sales reach $2.2 billion.*

1974



Georgia-Pacific's roofing plant at Hampton, Georgia, near Atlanta, manufactures shingles and rolled roofing for the rapidly growing Southeast. Georgia-Pacific added roofing production af·r establishing these products in its distı 'ıution system. (Left to right) John Klikus, plant manager; Ric Durand, general sales manager and Don Glass, vice president–roofing division, are some of the key people making this marketing-to-manufacturing transition a success.

1975 G-P acquires Exchange Oil & Gas Corporation, New Orleans, Louisiana, and starts up three plywood plants in Alabama, Georgia and South Carolina. Distribution centers now exceed 140, and the company now operates more than 200 plants and mills with 33,500 employees.

1976 G-P announces entry into roofing manufacturing with the acquisition of a plant at Franklin, Ohio, and adds a new box plant at Plano, Texas. Company sales reach $3 billion.

1977

1978 Two more Southern pine plywood plants at Logansport, Louisiana, and Peterman, Alabama, are completed, and the Franklin, Ohio, roofing plant is expanded. G-P exceeds $4 billion in sales

[illegible]

We [illegible] to [illegible] our fiberglass [illegible] roofing, which now represents about [illegible] percent of Georgia-Pacific's roofing [illegible]. Recently we introduced [illegible] and [illegible] [illegible] shingles [illegible] wood shingles.

[illegible]

G-P's [illegible] building products [illegible] continues to be supported by its nationwide Distribution Division, with [illegible] centers throughout the United States. This division [illegible] for our manufacturing [illegible] capacity. This [illegible] for [illegible] growth potential.

One of the [illegible] remodeling/ [illegible] (DIY) segment [illegible] 1986 [illegible] 1987.

In the second quarter of 1987 we will begin a pilot program in [illegible] California [illegible] specialty products, such as [illegible] moulding and millwork, [illegible] doors and garage doors. [illegible] special handling.

We are further [illegible] the position of our Distribution Division [illegible] source of building products by installing a [illegible] computer network. The program is expected to be completed in the 1987 third quarter, and will [illegible] order processing and excellent customer service. This [illegible] improved credit and inventory control as well as [illegible] analysis.

SGP 0030616

[illegible]

[illegible] a leading supplier of resins, adhesives and chemicals to the building products and pulp and paper industries. The division supplies products and technical services to many large users of industrial resins and major pulp and paper manufacturers, in addition to meeting G-P's internal requirements.

Last year Georgia-Pacific's [illegible] introduced a revolutionary powdered adhesive, for which a patent is pending. The new [illegible] plywood, [illegible] improving productivity and also resulting in a more stable panel.

Production began at the company's [illegible] facility at [illegible], Michigan, at the end of 1986. The new facility [illegible] incorporating the most [illegible] technology available [illegible]

The paper chemicals business brought several new products to the market during 1986. [illegible]

[illegible] Georgia, which is undergoing a major expansion during 1987. [illegible]

[illegible]

We are [illegible] about the performance of the [illegible] during 1986 [illegible] confident that our progress will continue in 1987.

[illegible]

[illegible]

SGP 0030617

Georgia-Pacific's new Beaver Creek resin plant near Grayling, Michigan, began operation at the end of 1986. The plant will manufacture adhesive and wet strength resins, strengthening the Chemical Division's position as a leading supplier to the building products and paper industries in the Midwest. Three key Chemical Division employees involved with this plant are (left to right): Joe Newman, plant manager; Steve Setera, sales manager–Great Lakes Region and Jim Taylor, vice president–chemical division.

Financial Contents

Georgia-Pacific Corporation and Subsidiaries

Financial Glossary

Book value per common share — common shareholders' equity minus the unamortized discount on redeemable preferred stock, divided by the number of common shares outstanding (as of the end of the year).

Current ratio — total current assets divided by total current liabilities (as of the end of the year).

Effective income tax rate — provision for income taxes divided by income from continuing operations before income taxes.

Return on capital employed — income from continuing operations plus interest expense (net of taxes) and deferred income tax expense, divided by capital employed as of the beginning of the year. Capital employed is calculated as total assets, excluding net assets of discontinued operations, minus noninterest-bearing current liabilities.

Return on common equity — income from continuing operations divided by common shareholders' equity as of the beginning of the year.

Return on sales (industry segments) — segment operating profits divided by sales to unaffiliated customers.

Total debt-to-capital — total debt divided by the sum of total debt, deferred income taxes, other long-term liabilities, redeemable preferred stock and common shareholders' equity (as of the end of the year).

Georgia-Pacific recognizes as its primary economic responsibility the need to improve the return to its shareholders. Our framework for establishing financial goals, measuring operating performance, making investment decisions and compensating management has been designed to make us more efficient at allocating and managing capital. Shareholder value is enhanced only when the return generated on the capital we employ is greater than our cost of capital. While this principle represents our primary financial goal, we remain more concerned about long-term performance than performance in any single year.

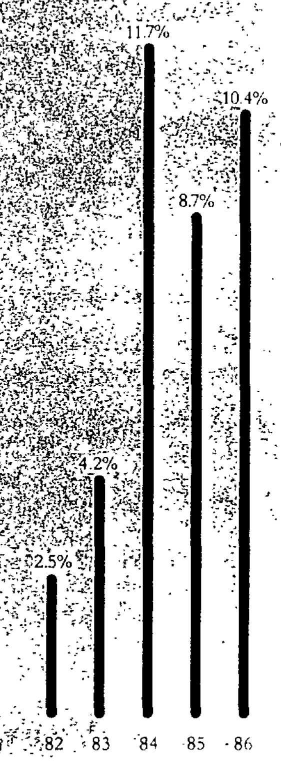
Environment
Operating results improved in 1986 for Georgia-Pacific and many other forest products companies. Pulp and paper markets improved from their depressed levels of 1985 as the U.S. dollar lowered in value relative to foreign currencies and worldwide inventories declined. Lower interest rates resulted in increased housing construction and strong demand for most building materials, although prices remained low due to competitive industry conditions. Further improvements are expected in 1987.

Georgia-Pacific's common stock price increased to $37.00 per share at the end of 1986 from $26.50 at the previous year end. Many forest products companies experienced similar stock gains during 1986, which could discourage near-term acquisition activity. We expect, however, that restructuring will continue in the industry and that there will be opportunities to acquire attractive properties. For Georgia-Pacific, the question will continue to be whether or not the properties can be acquired at attractive prices. The multiples currently being paid for properties require that the purchaser add considerable value if returns commensurate with risks are to be earned for the shareholder.

Return on Capital Employed
Return on capital employed is our most important measure of performance. *Return* as used here means profits after actual taxes paid but before financing charges. It is calculated by adjusting income from continuing operations to exclude interest expense (net of taxes) and deferred income tax expense. Total capital employed, measured as of the beginning of the year, is defined as total assets, excluding net assets of discontinued operations, minus noninterest-bearing current liabilities.

Our long-term objective in focusing on this ratio is to generate returns in excess of our cost of capital and thereby add to the wealth of our shareholders. Georgia-Pacific's incentive compensation program bases awards on return on capital employed, which acts to align our managers' economic interests with those of our shareholders.

Return on Capital Employed



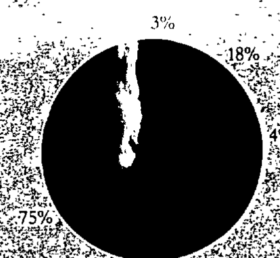
During the last five years we have gained on this long-term objective. Georgia-Pacific's return on capital employed was 10.4 percent in 1986, still below our cost of capital but significantly improved from 1982 when our return on capital employed was only 2.5 percent. Over this period of time, we completed a major program of divesting underperforming assets as well as assets unrelated to core forest products businesses. The cash generated from these divestitures enabled us to reduce debt as well as make substantial capital investments to reduce manufacturing costs and upgrade product mix. Georgia-Pacific's improved returns are also attributable to external factors which have strengthened building products and pulp and paper markets.

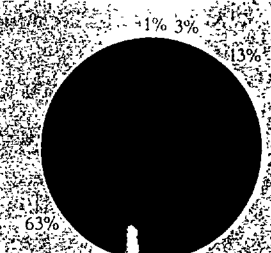
Cash Flow

Performance objectives for operating managers include incentives to reduce costs and manage working capital more efficiently. These incentives reward improvements in cash flow from operations, enabling us to make needed capital investments, reduce debt and pay increased dividends.

Georgia-Pacific's continuing operations generated almost $2.7 billion of cash over the past five years, more than three times the cumulative reported earnings of $851 million during that period.

This cash-generating capacity was used to finance a substantial portion of Georgia-Pacific's growth. From 1982 through 1986, cash provided by operations accounted for 79.1 percent of Georgia-Pacific's total cash sources. During that same period, operating cash flows were supplemented with $643 million of cash proceeds from asset sales and liquidation of investments, including the divestitures of the company's Chemical Packaging Division in 1986, its oil and gas subsidiary in 1985 and its commodity chemicals subsidiary in 1984.

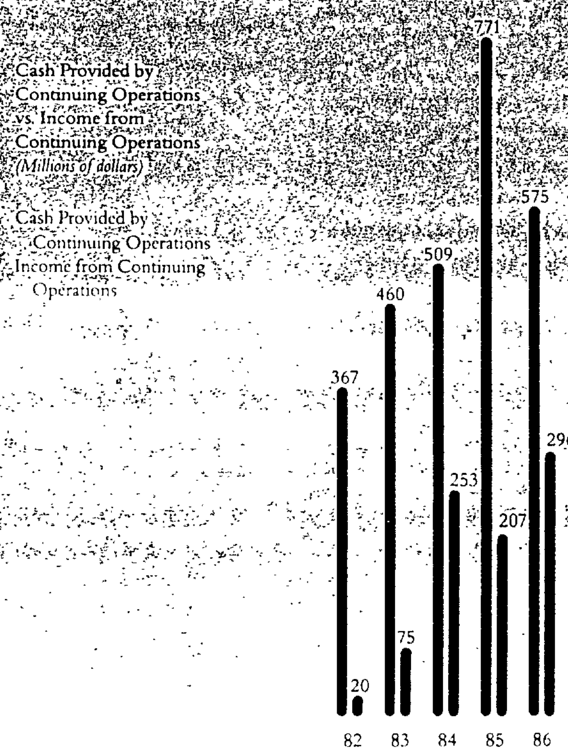




Five-year Sources and Uses of Cash / 1982–86
(Millions)

Sources of Cash	
Continuing Operations	$2,682
Discontinued Operations Prior to Sale	139
Total from Operations	2,821
Asset Sales and Liquidation of Investments	643
Other	100
	$3,564
Uses of Cash	
Capital Expenditures	$2,229
Net Repayments of Debt and Preferred Stock	702
Dividend Payments	472
Litigation Settlement and Other	111
Cash on Hand	50
	$3,564

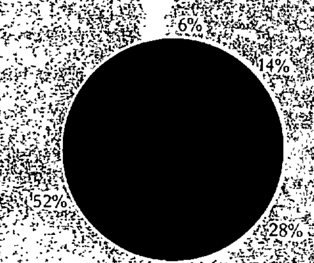
Cash Provided by Continuing Operations vs. Income from Continuing Operations
(Millions of dollars)



Capital Investments

From 1982 through 1986, Georgia-Pacific spent more than $2.2 billion on capital projects, including more than $1.9 billion for property, plant and equipment and $319 million for timber and timberlands. Recent investments in property, plant and equipment have been concentrated in upgrading and modernizing our pulp and paper segment.

Capital expenditures are categorized as defensive, those Georgia-Pacific must make to stay in business, and as high return, those that are justified on the basis of their return. Although some defensive expenditures have positive returns, they are not undertaken primarily for that reason. Our ability to make high return investments will determine to a great extent Georgia-Pacific's ability to improve return on capital employed over the long term.



Five-year Capital Expenditures by Industry Segment/1982–86
(Millions)

Property, Plant & Equipment	
Building Products	$ 618
Pulp & Paper	1,165
Corporate & Other	127
	1,910
Timber and Timberlands	319
	$2,229

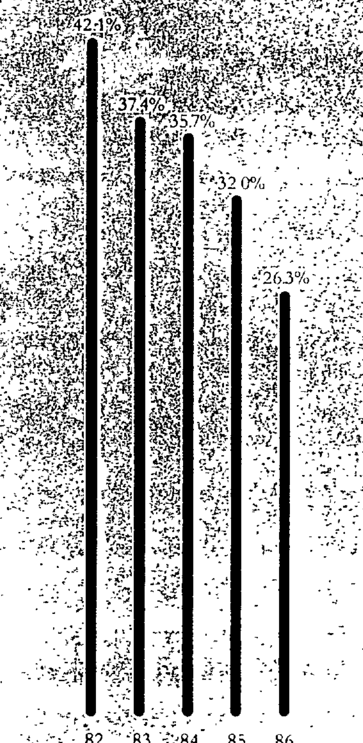
Because of its central importance to our performance, we try to be rigorous in the discipline of capital budgeting. Each major proposed capital project is evaluated by the amount of free cash flow generated over the life of the investment. We define free cash flow as operating profits after taxes paid, plus noncash charges such as depreciation, minus any new investment required. Our definition of new investment includes working capital requirements as well as capital expenditures. The process is designed to ensure that projects presented as defensive are necessary and that internal discounted cash flow returns reflect reasonable expectations. Post-completion audits are performed on all major high return projects, both internal projects and acquisitions, to substantiate the achievement of targeted rates of return.

Capital expenditures of approximately $600 million are projected for 1987, absent any major acquisitions. We expect to finance this program with internally-generated funds. Consistent with the pattern of recent years, the majority of that amount is expected to be invested in pulp and paper.

Capital Structure

We believe that managing Georgia-Pacific's capital structure within a 30 to 35 percent range of total debt-to-capital will keep the company's cost of capital competitive while ensuring access to most major capital markets. This access will provide the needed flexibility to take advantage of internal and external investment opportunities as they arise. We calculate total debt-to-capital by dividing total debt into the sum of total debt, deferred income taxes, other long-term liabilities, redeemable preferred stock and common shareholders' equity (as of the end of the year).

Total Debt-to-Capital

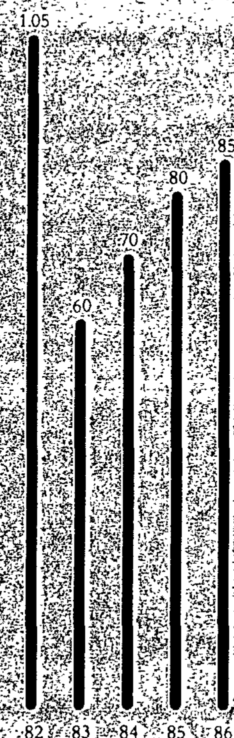


Total debt-to-capital has been reduced to 26.3 percent from 42.1 percent since the end of 1982. During that time, total debt has been reduced to $1.2 billion from $1.9 billion.

Dividends

We recognize the importance of dividends in addition to stock performance as part of the total return to Georgia-Pacific's shareholders. As reflected in the chart, quarterly dividends were reduced to 15 cents per share late in 1982 in response to depressed earnings levels over several years. Consistent with our guideline of paying approximately one-third of sustainable earnings, the quarterly dividend rate was increased to 20 cents per share in mid-1984 and again to 25 cents per share in late 1986 as Georgia-Pacific's profitability improved.

Dividends Declared
per Common Share
(Amounts in dollars)



The amount of future dividends will be determined by capital needs and other cash requirements and by the prospective returns on incremental capital retained in the business. Our objective is to maximize total returns to shareholders over the long term.

Liquidity and Capital Resources

Cash provided by continuing operations amounted to $575 million in 1986 and $771 million in 1985. The 1985 amount includes $150 million of cash generated through successful efforts in reducing inventories and receivables in response to depressed business conditions. A normal build-up of inventories and receivables occurred as conditions improved in 1986, requiring the use of $121 million of cash. Cash flow from continuing operations, supplemented with $92 million proceeds from liquidation of investments and $79 million proceeds from sales of assets, was sufficient to fund $482 million of capital expenditures, reduce outstanding debt and preferred stock by a net $160 million and pay $97 million in dividends. Effective in the 1986 fourth quarter, the Board of Directors voted to increase the quarterly dividend on common stock to 25 cents (from 20 cents) per share.

Considerable progress was made in reducing and restructuring outstanding debt and preferred stock during 1986:

—$150 million of 9¼% sinking fund debentures due March 15, 2016 were issued at par,

—$24 million of 12% notes due at various dates beginning in 2006 were retired,

—$50 million of redeemable preferred stock was purchased,

—$65 million of 14⅝% notes due April 15, 1987 were retired,

—$100 million of 12¼% sinking fund debentures due March 1, 2013 were called for redemption or purchased in open market transactions,

—$150 million of 10.10% notes due June 15, 1990 were redeemed,

—$14 million of zero coupon debentures due June 15, 1986 were retired, and

—$87 million of 5¼% convertible subordinated debentures due April 1, 1996 were called for redemption. By the redemption date, 2,790,000 shares of common stock had been issued upon conversion of $86 million of debentures at $30.87 per share, and $1 million cash had been paid for debentures that were redeemed.

At the end of 1986, Georgia-Pacific's total debt-to-capital had been reduced to 26.3 percent from its 1985 year-end level of 32.0 percent. The Corporation has been authorized by its Board of Directors to purchase common stock in the open market or in privately negotiated transactions in order to maintain total debt-to-capital within a target range, currently 30 to 35 percent. This target range should provide flexibility for both internal and external investment opportunities as they arise.

At December 31, 1986, the Corporation had $250 million of debt securities registered for sale with the Securities and Exchange Commission under a shelf registration statement. This financing source will enable the Corporation to react quickly to acquisition opportunities and to favorable market conditions for restructuring existing debt.

The Corporation's existing bank lines of credit totaled $700 million at December 31, 1986, of which approximately $275 million was being used to support commercial paper borrowings and other short-term instruments. These agreements establish unsecured lines of credit of $385 million until May 1, 1989 and $315 million until May 1, 1988. These committed lines of credit, together with other available financing sources and Georgia-Pacific's capacity to generate funds from operations, are adequate to finance growth and to meet operating and liquidity needs for the foreseeable future.

Working capital amounted to $583 million and $660 million, respectively, at December 31, 1986 and December 31, 1985. The current ratio, defined as total current assets divided by total current liabilities, was 1.7 to 1 at December 31, 1986 and 2.0 to 1 at December 31, 1985.

Georgia-Pacific's capital expenditures totaled $482 million in 1986 and $642 million in 1985. The 1986 figure includes investments in property, plant and equipment of $426 million ($390 million at existing facilities plus $36 million of acquisitions) and $56 million of timber and timberlands acquisitions. Capital expenditures of approximately $600 million are projected for 1987.

Approximately 44 percent of total capital expenditures in 1986 were in the pulp and paper segment. A major project to upgrade production from market pulp to white paper at our Port Hudson, Louisiana facility was completed in April. Major projects are now underway to rebuild a tissue machine at our Palatka, Florida facility and to expand and modernize four disposable diaper facilities acquired in 1985. Both projects should be completed in late 1987.

The building products segment accounted for approximately 40 percent of total capital expenditures in 1986. This includes the acquisition of a hardboard manufacturing company with five operating facilities located in Minnesota, Wisconsin and Arkansas, and the acquisitions of three moulding manufacturing plants located in California. In June, a major expansion was completed at our Crossett, Arkansas plywood facility. Construction of a new thermosetting resins plant in Beaver Creek, Michigan was completed in December. Construction of a new gypsum wallboard plant near Las Vegas, Nevada is expected to be completed in late 1987.

In the 1986 fourth quarter, the Corporation received cash proceeds of $92 million from liquidation of portions of its investment in Georgia Gulf Corporation, purchaser of the Corporation's commodity chemicals subsidiary in 1984. A $33 million pre-tax gain was recorded from this liquidation, including $17 million from the sale of approximately 969,000 warrants. The Corporation retained a $16 million investment in preferred stock and warrants exercisable for approximately 1,831,000 shares of common stock.

In July 1986, the Corporation completed the sales of its Chemical Packaging Division assets to two unrelated parties in separate transactions. These sales generated cash proceeds of approximately $43 million.

In November 1986, pursuant to the settlement of a condemnation proceeding with the Federal government, the Corporation received approximately $14 million in cash. A $10 million extraordinary gain, net of related income taxes of $4 million, had been recorded upon entry of the judgment in 1985.

In February 1986, the Corporation sold its Georgia-Pacific Plastics, Inc. subsidiary, whose principal asset was an expandable polystyrene plant located in Painesville, Ohio. This completed our program to divest certain lines of business, including commodity chemicals and oil and gas, which were discontinued in 1984.

Under the Tax Reform Act of 1986 (the Act), the Federal tax rate on ordinary income will decline from 46 percent in 1986 to 40 percent in 1987 and 34 percent in 1988. The rate at which capital gains are taxed, however, will increase from 28 percent in 1986 to 34 percent in 1987. Certain other provisions of the Act repealed the investment tax credit (generally for property placed in service after December 31, 1985) and, after December 31, 1986, will modify inventory capitalization rules, lengthen depreciable lives and establish a new alternative minimum tax which will limit the benefits of tax preference items.

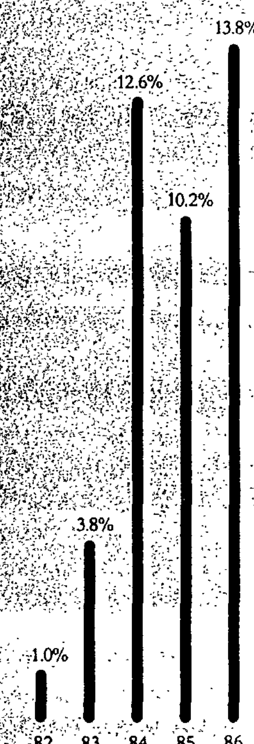
The higher tax rates for capital gains and other rule changes are expected to more than offset benefits the Corporation would have otherwise realized from lower tax rates on ordinary income. In the future, we anticipate higher effective income tax rates, particularly in 1987 as the new tax rates are phased in. Although the initial cost of future capital investments will increase without the investment tax credit, lower ordinary tax rates on income generated by these capital projects should offset some of this increase. Consequently, we do not foresee a significant impact on future capital investments.

1986 Compared with 1985

Georgia-Pacific's consolidated net sales of $7.2 billion in 1986 were 7.5 percent higher than the 1985 level of $6.7 billion. Income from continuing operations increased 43.0 percent to $296 million in 1986 ($2.69 per share on a primary basis) from $207 million ($1.83 per share) in 1985. A $30 million loss from discontinued operations, which was partially offset by a $10 million extraordinary gain from settlement of a condemnation suit, lowered 1985 net income to $187 million ($1.64 per share).

Return on common equity, calculated as income from continuing operations divided by common shareholders' equity as of the beginning of the year, improved to 13.8 percent in 1986 from 10.2 percent in 1985.

Return on Common Equity



Effective January 1, 1986, the Corporation adopted Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions". This change in accounting principle increased income from continuing operations approximately $11 million in 1986. Also effective January 1, 1986, a new timber capitalization policy was adopted and applied retroactively, which had the cumulative effect of increasing 1986 income from continuing operations approximately $8 million.

Income from continuing operations also includes a $33 million pre-tax gain from liquidation of investments in 1986 and a $19 million pre-tax gain on the sale of certain Oregon timberlands in 1985. These gains are classified as "Unusual items" in the accompanying financial statements and excluded from segment operating re ults.

The impact of the new tax law reduced 1986 income from continuing operations approximately $17 million through repealing the investment tax credit, although some credits were allowed in 1986 under transition rules. These lost investment tax credits were recorded in the 1986 fourth quarter and were the primary reason for a 39.0 percent effective income tax rate for the year, compared to 33.0 percent in 1985.

Future provisions for taxes currently payable are expected to increase under the new tax law, particularly in 1987 as the higher capital gains tax rate and the full impact of lost investment tax credits are realized. Timing differences arising in future years will result in lower provisions for deferred taxes because of lower statutory tax rates on ordinary income. Under existing generally accepted accounting principles, deferred taxes provided prior to 1987 will not be adjusted for the new lower tax rates until the related income or expense item enters into taxable income. Given the present accounting rules and our expectation of continued investment in capital assets, it is unlikely that the effect of lower tax rates on existing deferred tax balances will significantly affect future operating results. However, if the liability method of accounting for income taxes were to be adopted, as is currently proposed by the Financial Accounting Standards Board, existing deferred tax balances would be reduced.

The remaining discussion refers to the "Selected Industry Segment Data" table.

The building products segment reported sales of $4.9 billion in 1986, up 8.6 percent from $4.5 billion in 1985. Operating profits of $500 million in 1986 included an $11 million pre-tax reduction of expense due to the adoption of a new timber capitalization policy. Excluding this adjustment, operating profits increased to $489 million in 1986 from $391 million in 1985, as the return on sales improved to 10.1 percent from 8.7 percent. Increased volume and reduced manufacturing costs were the major reasons for this segment's improved results. Average prices for plywood and lumber in 1986 were comparable to 1985 levels, while gypsum, roofing and thermosetting resins prices were lower on average in 1986 than in 1985. For 1987, we anticipate little change in our building products markets, with continued highly competitive prices for lumber and structural panels.

Selected Industry Segment Data

	Year ended December 31		
	1986	*1985*	*1984*
Trade sales			
Building products	$4,853	$4,470	$4,452
Pulp and paper	2,281	2,134	2,111
Other operations	89	112	119
	$7,223	$6,716	$6,682
Operating profits			
Building products	$ 500	$ 391	$ 379
Pulp and paper	146	29	202
Other operations	35	35	20
	681	455	601
General corporate	(91)	(33)	(68)
Interest expense	(138)	(132)	(156)
Unusual items	33	19	19
Income taxes	(189)	(102)	(143)
Income from continuing operations	$ 296	$ 207	$ 253

Sales in the pulp and paper segment reached $2.3 billion in 1986, 6.9 percent higher than the 1985 level of $2.1 billion. Operating profits rose to $146 million in 1986 from the 1985 level of $29 million, as the return on sales improved to 6.4 percent from 1.4 percent. The improved results in 1986 are due primarily to decreased inventories worldwide and the lower valued U.S. dollar, as well as timely upgrading and modernization of mills and equipment.

Results in the prior year were hampered by lost production time due to labor problems and several major equipment conversion projects. Average prices for pulp, linerboard, kraft paper and commercial tissue were higher in 1986 than in 1985. Prices for printing papers, corrugated boxes and multiwall packaging also strengthened during 1986, particularly late in the year, although average prices for the year were lower than in 1985. We expect continued improvement in most of our pulp and paper markets in 1987, especially commodity grades such as pulp, linerboard and uncoated freesheet paper.

General corporate charges increased to $91 million in 1986 from $33 million in 1985. This increase relates primarily to higher compensation expense for stock options due to stock price increases as well as losses from early retirements of high interest rate debt in 1986.

Total interest costs decreased to $147 million in 1986 from $162 million in 1985 as a result of reduced debt levels and lower interest rates. Interest expense of $138 million in 1986 was higher than the 1985 level of $132 million, due to less interest being capitalized on construction projects in 1986.

1985 Compared with 1984

Georgia-Pacific's consolidated net sales were $6.7 billion for both 1985 and 1984. Income from continuing operations decreased to $207 million ($1.83 per share on a primary basis) in 1985 from $253 million ($2.28 per share) in 1984. A $30 million loss from discontinued operations, which was partially offset by a $10 million extraordinary gain from settlement of a condemnation suit, lowered 1985 net income to $187 million ($1.64 per share). A $134 million loss from discontinued operations in 1984 lowered net income in that year to $119 million (97 cents per share).

The results of continuing operations include a $19 million pre-tax gain on the sale of certain Oregon timberlands in 1985 and a $19 million pre-tax gain on the sale of the Corporation's former headquarters building in Portland, Oregon in 1984. These gains are classified as "Unusual items" in the accompanying financial statements and excluded from segment operating results.

The remaining discussion refers to the "Selected Industry Segment Data" table.

Sales in the building products segment were $4.5 billion for both 1985 and 1984. Operating profits increased to $391 million in 1985 from $379 million in 1984, as the return on sales improved to 8.7 percent from 8.5 percent. The improved results were achieved despite lower average prices for lumber and plywood sheathing in 1985. Competition from low-cost Canadian lumber imports and excess industry capacity in plywood sheathing markets held prices below levels historically experienced with similar levels of demand. Reductions in Georgia-Pacific's fiber and conversion costs and strong gypsum markets helped offset the effects of these pricing conditions. Gypsum operations were this segment's most profitable in 1985, although average prices for the year were slightly lower than in 1984.

The pulp and paper segment reported a 1.1 percent sales increase to $2.1 billion in 1985, reflecting a full-year contribution from the linerboard, kraft paper and corrugated container operations obtained through an acquisition in mid-1984. Operating profits declined sharply in 1985 to $29 million from $202 million in 1984, as the return on sales fell to 1.4 percent from 9.6 percent. A strong U.S. dollar and excess worldwide pulp capacity made U.S. products less competitive overseas and caused an accumulation of domestic inventories, resulting in lower prices for a number of this segment's major products. Average prices for pulp, linerboard, kraft paper and printing papers were all below 1984 average price levels. Tissue was the only major product for which average prices improved in 1985 as compared to 1984. The 1985 pulp and paper results were also affected by lost production time caused by a strike at our Crossett, Arkansas pulp and paper mill during most of the third quarter and by major equipment conversion projects at several mills, particularly in the fourth quarter. A $12 million operating loss was reported in the 1985 fourth quarter on sales which were 23 percent below the fourth quarter of 1984.

General corporate charges decreased to $33 million from $68 million in 1984. Much of this reduction is attributable to interest and dividend income on the debentures and preferred stock obtained from the sale of a commodity chemicals subsidiary in December 1984.

Interest expense declined to $132 million in 1985 from $156 million in 1984. This reduction is primarily attributable to increased capitalization of interest as a result of the large capital expenditures program in 1985. Total interest costs of $162 million in 1985 were slightly lower than the 1984 level of $167 million.

For a discussion of "Income Taxes", see Note 11.

Responsibility for Financial Statements

Georgia-Pacific Corporation and Subsidiaries

The financial statements on the following pages, which consolidate the accounts of Georgia-Pacific Corporation and its subsidiaries, have been prepared in conformity with generally accepted accounting principles.

Management of Georgia-Pacific Corporation is responsible for the accurate and objective preparation of the consolidated financial statements. Accordingly, the Corporation maintains a system of policies, procedures and controls which is designed to provide reasonable assurance that assets are safeguarded and that accounting records are reliable. Management believes that the proper internal controls are in place and that the system is adequate and effective in safeguarding assets and providing reliable accounting records.

An independent evaluation of the system is performed by the Corporation's qualified internal audit staff in order to confirm that the system is adequate and operating effectively. As indicated in the Independent Auditors' Report, Arthur Andersen & Co. performs a separate independent examination of the Corporation's consolidated financial statements for the purpose of determining that the statements are presented fairly in accordance with generally accepted accounting principles applied on a consistent basis. Arthur Andersen & Co. is appointed by the Board of Directors and meets regularly with the Audit Committee of the Board.

The Audit Committee consists of three outside directors who review the work of the Corporation's internal auditors and independent public accountants and approve fees paid for audit and non-audit services.

The independent public accountants and internal audit staff have full and free access to the Audit Committee.

James C. Van Meter

James C. Van Meter
Executive Vice President and
Chief Financial Officer

T. Marshall Hahn, Jr.

T. Marshall Hahn, Jr.
Chairman and
Chief Executive Officer

February 13, 1987

Independent Auditors' Report

To the Shareholders and Board of Directors of Georgia-Pacific Corporation:

We have examined the balance sheets of Georgia-Pacific Corporation (a Georgia corporation) and subsidiaries as of December 31, 1986 and 1985 and the related statements of income, common shareholders' equity and changes in financial position for each of the three years in the period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Georgia-Pacific Corporation and subsidiaries as of December 31, 1986 and 1985 and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1986, in conformity with generally accepted accounting principles which, except for the changes (with which we concur) in the method of accounting for pensions described in Note 5 and the method of accounting for reforestation costs described in Note 1, were applied on a consistent basis.

Arthur Andersen & Co.

Atlanta, Georgia
February 13, 1987

SGP 0030628

Statements of Income

Georgia-Pacific Corporation and Subsidiaries

(Millions, except per share amounts)	*Year ended December 31* 1986	1985	1984
Net sales	$7,223	$6,716	$6,682
Costs and expenses			
Cost of sales	5,783	5,553	5,441
Selling, general and administrative	511	431	426
Depreciation and depletion	339	310	282
Interest	138	132	156
	6,771	6,426	6,305
Income from continuing operations before unusual items, income taxes and extraordinary item	452	290	377
Unusual items	33	19	19
Income from continuing operations before income taxes and extraordinary item	485	309	396
Provision for income taxes	189	102	143
Income from continuing operations before extraordinary item	296	207	253
Discontinued operations:			
Operating income, net of taxes	—	—	26
(Loss) on disposal, net of taxes	—	(30)	(160)
(Loss) from discontinued operations	—	(30)	(134)
Income before extraordinary item	296	177	119
Settlement of condemnation suit, net of taxes	—	10	—
Net income	$ 296	$ 187	$ 119
Per common share—primary			
Income from continuing operations before extraordinary item	$ 2.69	$ 1.83	$ 2.28
(Loss) from discontinued operations	—	(.29)	(1.31)
Income before extraordinary item	2.69	1.54	.97
Settlement of condemnation suit	—	.10	—
Net income	$ 2.69	$ 1.64	$ .97
Per common share—fully diluted			
Income from continuing operations before extraordinary item	$ 2.64	$ 1.80	$ 2.24
(Loss) from discontinued operations	—	(.28)	(1.27)
Income before extraordinary item	2.64	1.52	.97
Settlement of condemnation suit	—	.09	—
Net income	$ 2.64	$ 1.61	$ .97

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

Statements of Changes in Financial Position

Georgia-Pacific Corporation and Subsidiaries

31

(Millions)	Year ended December 31 1986	1985	1984
Cash provided by (used for) continuing operations			
Income from continuing operations before extraordinary item	$296	$207	$253
Items in income not affecting cash			
Depreciation	316	270	247
Depletion	23	40	35
Deferred income taxes	87	84	90
Gain on sales of assets	(30)	–	–
Gain on liquidation of investments	(33)	–	–
Other	7	35	8
	666	636	633
Cash provided by (used for) working capital			
Receivables	(61)	86	(86)
Inventories	(60)	64	(61)
Prepaid expenses	(15)	(9)	2
Accounts payable and accrued liabilities	45	(6)	21
	(91)	135	(124)
Cash provided by continuing operations	575	771	509
Cash provided by discontinued operations	11	117	291
Cash provided by (used for) extraordinary item			
Settlement of condemnation suit, net of taxes	–	10	–
Items in condemnation settlement not affecting cash	–	(10)	–
Cash received from condemnation settlement	14	–	–
Cash provided by extraordinary item	14	–	–
Cash provided by (used for) financing activities			
Repayments of long-term debt	(661)	(481)	(375)
Additions to long-term debt	476	358	312
Net increase in bank overdrafts	79	–	–
Net (decrease) in commercial paper and other short-term notes	(4)	(6)	–
Preferred stock purchase offer	(50)	(40)	(32)
Common stock issued from conversion of debentures	86	–	–
Debentures converted into common stock	(86)	–	–
Cash (used for) financing activities	(160)	(169)	(95)
Cash provided by (used for) investment activities			
Capital expenditures			
Property, plant and equipment	(426)	(619)	(575)
Timber and timberlands	(56)	(23)	(135)
	(482)	(642)	(710)
Proceeds from sales of assets	79	32	62
Proceeds from liquidation of investments	92	–	–
Other	(14)	11	22
Cash (used for) investment activities	(325)	(599)	(626)
Cash dividends paid	(97)	(94)	(86)
Increase (decrease) in cash	18	26	(7)
Balance at beginning of year	62	36	43
Balance at end of year	$ 80	$ 62	$ 36

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

SGP 0030630

Balance Sheets

Georgia-Pacific Corporation and Subsidiaries

(Millions, except shares and per share amounts)	*December 31* *1986*	*1985*
Assets		
Current assets		
Cash	$ 80	$ 62
Receivables, less allowances of $21 and $19	618	569
Inventories	681	634
Prepaid expenses	41	26
	1,420	1,291
Timber and timberlands, net	844	804
Property, plant and equipment		
Land and improvements, buildings, machinery and equipment, at cost	5,052	4,741
Accumulated depreciation	(2,361)	(2,135)
	2,691	2,606
Net assets of discontinued operations	—	11
Other assets	159	154
	$5,114	$4,866
Liabilities and Shareholders' Equity		
Current liabilities		
Bank overdrafts, net	$ 79	$ —
Commercial paper and other short-term notes	100	104
Current portion of long-term debt	134	41
Accounts payable	295	276
Accrued compensation	87	73
Accrued interest	23	38
Other current liabilities	119	99
	837	631
Long-term debt, excluding current portion	893	1,257
Deferred income taxes	695	606
Other long-term liabilities	124	69
Commitments and contingencies		
Redeemable preferred stock		
Adjustable rate convertible preferred stock, without par value; authorized 10,000,000 shares (involuntary liquidating value $39.00 per share)	113	156
Common shareholders' equity		
Common stock, par value $.80; authorized 150,000,000 shares; 107,987,000 and 104,368,000 shares issued	86	83
Additional paid-in capital	1,101	1,004
Retained earnings	1,304	1,114
Less—Common stock held in treasury, at cost; 639,000 and 1,143,000 shares	(19)	(35)
Accumulated translation adjustments	(20)	(19)
	2,452	2,147
	$5,114	$4,866

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

Statements of Common Shareholders' Equity

Georgia-Pacific Corporation and Subsidiaries

33

(Millions, except shares) Common Stock Shares, Issued	Common Stock Shares, Treasury		Total	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Translation Adjustments
103,344,000	1,829,000	**Balance at December 31, 1983**	$2,013	$83	$ 989	$1,001	$(57)	$ (3)
		Net income	119	—	—	119	—	—
		Cash dividends declared						
		Common stock	(72)	—	—	(72)	—	—
		Preferred stock	(13)	—	—	(13)	—	—
		Common stock issued						
	(240,000)	Stock option plans	6	—	(2)	—	8	—
771,000		Employee stock purchase plan	12	—	12	—	—	—
		Translation adjustments	(24)	—	—	—	—	(24)
		Other	(6)	—	—	(6)	—	—
104,115,000	1,589,000	**Balance at December 31, 1984**	2,035	83	999	1,029	(49)	(27)
		Net income	187	—	—	187	—	—
		Cash dividends declared						
		Common stock	(82)	—	—	(82)	—	—
		Preferred stock	(11)	—	—	(11)	—	—
		Common stock issued						
	(446,000)	Stock option plans	11	—	—	(3)	14	—
253,000		Employee stock purchase plan	5	—	5	—	—	—
		Translation adjustments	8	—	—	—	—	8
		Other	(6)	—	—	(6)	—	—
104,368,000	1,143,000	**Balance at December 31, 1985**	2,147	83	1,004	1,114	(35)	(19)
		Net income	296	—	—	296	—	—
		Cash dividends declared						
		Common stock	(89)	—	—	(89)	—	—
		Preferred stock	(8)	—	—	(8)	—	—
		Common stock issued						
	(504,000)	Stock option plans	14	—	—	(2)	16	—
829,000		Employee stock purchase plan	14	1	13	—	—	—
2,790,000		Conversion of debentures	86	2	84	—	—	—
		Other	(8)	—	—	(7)	—	(1)
107,987,000	639,000	**Balance at December 31, 1986**	$2,452	$86	$1,101	$1,304	$(19)	$(20)

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

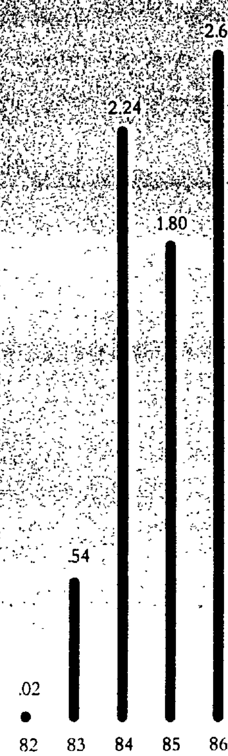
Note 1. Summary of Significant Accounting Policies

Principles of Consolidation.
The consolidated financial statements include the accounts of Georgia-Pacific Corporation and subsidiaries (Corporation). All significant inter-company balances and transactions are eliminated in consolidation.

Income Per Common Share.
Income per common share is computed based on income applicable to common stock (after preferred stock dividends and discount accretion) and the weighted average number of common shares outstanding. The computation of primary income per common share assumes: (1) conversion of the redeemable preferred stock into common shares, when the effect is dilutive; and (2) issuance of common shares under dilutive stock option and stock purchase plans, net of an assumed buyback of treasury shares at the average market price. In addition, the computation of fully diluted income per common share assumes: (1) treasury buyback for dilutive stock option and stock purchase plans at the year end market price, if higher than the average market price; and (2) conversion of the 5¼% convertible subordinated debentures into common shares, when the effect is dilutive.

Fully Diluted Income per Common Share
(Amounts in dollars)

Income from continuing operations before extraordinary items and accounting change



The average number of shares used in the income per common share computations for 1986, 1985 and 1984, respectively, were 104,782,000; 103,432,000 and 102,293,000 for primary and 107,504,000; 106,550,000 and 105,336,000 for fully diluted.

Inventory Valuation.
Inventories are valued at the lower of average cost or market. Inventory costs include costs of materials, labor and plant overhead. The major classes of inventories were as follows:

(Millions)	December 31 *1986*	*1985*
Inventories at lower of average cost or market		
Raw materials	$186	$189
Finished goods	517	477
Supplies	77	73
	780	739
LIFO reserve	(99)	(105)
	$681	**$634**

The last-in, first-out (LIFO) dollar value pool method of inventory valuation is utilized for the majority of inventories at manufacturing facilities and the Corporation's manufactured inventories located at its building products distribution centers. The average cost method is used for all other inventories. Inventories valued using the LIFO method represented approximately 55% and 52%, respectively, of consolidated inventories at December 31, 1986 and 1985.

Effective January 1, 1985, the Corporation realigned its LIFO inventory pools to correspond to natural business units rather than divisional product groups. Management believes this pooling change minimizes the impact of price level changes on inventory valuations, thereby achieving a better matching of costs and revenues. The effect of this change on the accompanying financial statements was not material.

Property, Plant and Equipment.

Property, plant and equipment are recorded at cost. Lease obligations for which the Corporation assumes substantially all the property rights and risks of ownership are capitalized. Replacements of major units of property are capitalized and the replaced properties retired. Maintenance, repairs and replacements of minor units of property are charged to expense as incurred.

The major classes of property, plant and equipment were as follows:

(Millions)	December 31 1986	1985
Land and improvements	$ 123	$ 120
Buildings	549	511
Machinery and equipment	4,318	3,955
Construction in progress	62	155
	$5,052	$4,741

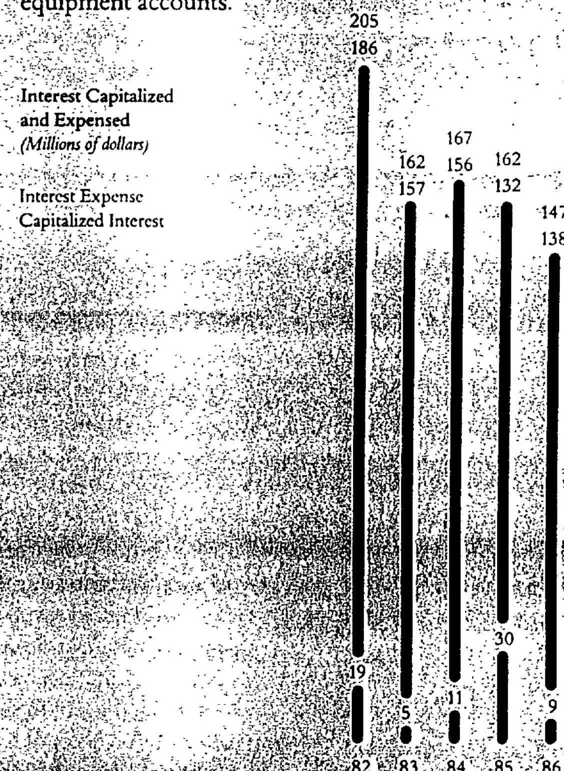
Provisions for depreciation are computed using composite rates based upon estimated service lives. The ranges of composite rates for the principal classes are: land improvements—5% to 7%; buildings—3% to 5%; and machinery and equipment—5% to 20%. Effective January 1, 1985, certain manufacturing facilities which previously used the units-of-production method of depreciation were retroactively converted to the straight-line method to conform with the Corporation's other operations. The effect of this change on the accompanying financial statements was not material.

No gain or loss is recognized on normal property dispositions; property cost is credited to the property accounts and charged to the accumulated depreciation accounts and any proceeds are credited to the accumulated depreciation accounts. When there are abnormal dispositions of property, the cost and related depreciation amounts are removed from the accounts and any gain or loss is reflected in income.

The Corporation capitalizes interest on projects where construction takes considerable time and entails major expenditures. Such interest is charged to the property, plant and equipment accounts and amortized over the approximate life of the related assets in order to properly match expenses with revenues resulting from the facilities. Interest capitalized and expensed was as follows:

(Millions)	Year ended December 31 1986	1985	1984
Total interest costs	$147	$162	$167
Interest costs capitalized	(9)	(30)	(11)
Interest expense	$138	$132	$156

The Corporation defers net operating costs on new construction projects during the start-up phase and amortizes the deferral over five years. The amounts deferred, which were not material in 1986, 1985 and 1984, are included in the property, plant and equipment accounts.



Timber and Timberlands.

The Corporation depletes its investment in timber over the total fiber that will be available during the estimated growth cycle. Timber carrying costs are expensed as incurred. Effective January 1, 1986, the Corporation changed its accounting for timber costs to capitalize certain reforestation costs previously expensed in order to achieve a better matching of these costs with the revenues realized from the eventual harvesting of the timber. This capitalization policy was applied retroactively and had the cumulative effect of increasing 1986 net income approximately $8 million. The new capitalization policy is not expected to materially affect depletion expense in future periods.

Reclassifications.

Certain amounts have been reclassified in 1985 and 1984 to conform with the 1986 presentation.

SGP 0030634

Note 2. Unusual Items

The Corporation realized certain gains during the last three years which are considered to be unusual items:

	Year ended December 31		
(Millions)	1986	1985	1984
Liquidation of investments	$33	$ —	$ —
Sale of timberlands	—	19	—
Sale of Portland office building	—	—	19
	$33	$19	$19

In the 1986 fourth quarter, the Corporation received cash proceeds of $92 million from liquidation of portions of its investment in Georgia Gulf Corporation, purchaser of the Corporation's commodity chemicals subsidiary in 1984 (Note 3). A $33 million pre-tax gain was recorded from this liquidation, including $17 million from the sale of approximately 969,000 warrants. The Corporation retained a $16 million investment in preferred stock and warrants exercisable for approximately 1,831,000 shares of common stock. Neither the preferred stock, the remaining warrants, nor the underlying common stock are registered securities, and therefore may not currently be offered for sale to the public.

The Corporation has an agreement with an unrelated third party to sell or exchange approximately 134,000 acres of Oregon timberlands from time to time over a three-year period ending April 1, 1988. A pre-tax gain of $19 million was recorded in 1985 from the sale of a portion of the timberlands under this agreement.

The Corporation's former headquarters building in Portland, Oregon, owned by GA-MET, a joint venture in which the Corporation has a 50% ownership interest, was sold in 1984. The Corporation recorded a pre-tax gain of $19 million from this transaction.

Note 3. Discontinued Operations

The Corporation has disposed of certain lines of business, including all of its commodity chemicals and oil and gas operations. These dispositions were completed in the first quarter of 1986 with the sale of its Georgia-Pacific Plastics, Inc. subsidiary, whose principal asset was an expandable polystyrene plant in Painesville, Ohio, for $13 million in cash.

In September 1985, the Corporation sold its Exchange Oil & Gas Corporation subsidiary (Exchange). After adjusting for cash received from Exchange prior to the sale, net cash proceeds were approximately $136 million at closing. Also during 1985, the Corporation sold its Polymer, Inc. subsidiary, whose principal asset was a color concentrate plant in Farmingdale, New York, for $8 million in cash.

In December 1984, the Corporation sold its commodity chemicals subsidiary, Georgia-Pacific Chemicals, Inc., to the executive group managing that business. Under the terms of the agreement, the Corporation received $192 million in cash plus debt, preferred stock and warrants which had an estimated value of $70 million.

The Corporation initially estimated a $160 million loss on disposal of discontinued operations, net of related income tax benefits of $137 million, which was recorded in the fourth quarter of 1984. This estimate was revised in the 1985 third quarter, at which time an additional $30 million loss, net of related income tax benefits of $14 million, was recorded. Prior to the decision to dispose of these operations, operating income of $26 million, net of income taxes of $14 million, had been recorded in 1984 on net sales of $446 million.

Cash provided by discontinued operations consisted of the following:

	Year ended December 31		
(Millions)	1986	1985	1984
Cash provided by (used for):			
Operating income (loss), net of taxes, noncash items and changes in working capital	$ (2)	$ (13)	$130
Capital expenditures prior to sale	—	(14)	(31)
Proceeds from sale of assets	13	144	192
	$11	$117	$291

Note 4. Extraordinary Item

In November 1986, pursuant to a court-approved settlement of a condemnation proceeding filed in 1975 against the Federal government, the Corporation received approximately $14 million in cash. A $10 million extraordinary gain, net of related income taxes of $4 million, had been recorded in 1985 upon entry of the judgment.

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Note 5. Retirement Plans

Defined Benefit Pension Plans.

Most of the Corporation's employees participate in noncontributory defined benefit pension plans. These include plans which are administered solely by the Corporation, plans which are administered jointly by the Corporation and other employers or labor unions, and union-administered multiemployer plans. The Corporation's funding policy for solely administered plans is consistent with the applicable requirements of Federal law. Contributions to jointly administered and multiemployer plans are generally based on fixed hourly rates as set forth in negotiated labor contracts.

Benefits under the majority of plans for hourly employees (including multiemployer plans) are primarily related to years of service. The Corporation has separate plans for salaried employees and officers under which benefits are primarily related to earnings and years of service. The officers' plan is not funded since it is nonqualified for Federal income tax purposes.

Effective January 1, 1986, the Corporation adopted Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" (SFAS 87). This change in accounting principle reduced pension expense by approximately $22 million before income taxes in 1986, principally due to amortization of the initial excess of plan assets over the projected benefit obligation over estimated remaining service periods ranging from 10 to 17 years. Net income increased approximately $11 million as a result of this change.

The table below sets forth the funded status of the solely and jointly administered plans and the amounts recognized in the accompanying Balance Sheets. The weighted average discount rates and rates of increase in future compensation levels used in determining the projected benefit obligation were 8.0% and 6.0% at November 30, 1986 and 9.0% and 6.0% at November 30, 1985. The expected long-term rate of return on plan assets used in determining net periodic pension cost in 1986 was 7.5%.

Plan assets consist principally of common stock, bonds, mortgage securities, guaranteed investment contracts, cash equivalents and real estate. At December 31, 1986, $9 million of current prepaid pension cost was included in prepaid expenses, with the remaining $13 million of noncurrent prepaid pension cost included in other assets. The unfunded accrued pension costs of $11 million and $10 million, respectively, at December 31, 1986 and 1985, were included in other long-term liabilities.

	Year ended December 31, 1986		*Year ended December 31, 1985*	
(Millions)	*Plans Having Assets in Excess of Accumulated Benefits*	*Plan Having Accumulated Benefits in Excess of Assets*	*Plans Having Assets in Excess of Accumulated Benefits*	*Plans Having Accumulated Benefits in Excess of Assets*
Accumulated benefit obligation at November 30				
Vested portion	$303	$ 13	$225	$ 11
Nonvested portion	29	2	20	1
	332	15	245	12
Effect of projected future compensation levels	40	3	29	2
Projected benefit obligation at November 30	372	18	274	14
Plan assets at fair value at November 30	497	4	402	3
Plan assets in excess of (less than) projected benefit obligation	125	(14)	128	(11)
Contributions made in December	5	—	2	—
Unrecognized net loss	10	2	—	—
Unrecognized prior service cost	2	—	—	—
Unrecognized net (asset) obligation from initial application of SFAS 87	(120)	1	(130)	1
Prepaid (accrued) pension cost at December 31	$ 22	$(11)	$ —	$(10)

Pension expense included the following components in 1986:

(Millions)	
Net periodic pension cost for solely and jointly administered pension plans	
Service cost of benefits earned	$22
Interest cost on projected benefit obligation	26
Actual return on plan assets	(79)
Net amortization and deferral	38
	7
Contributions to multiemployer pension plans	4
	$11

The Corporation contributed $29 million to solely and jointly administered pension plans in 1986.

Prior to adopting SFAS 87, the Corporation's policy was to expense its annual pension contributions. The total expense recognized for defined benefit pension plans was $35 million in 1985 and $26 million in 1984.

Defined Contribution Plan.
The Corporation also sponsors a Savings and Capital Growth Plan (Savings Plan) to provide eligible salaried employees with additional income upon retirement. The Corporation makes annual contributions to the Savings Plan equal to 3% of the first $100,000 of each participant's annual compensation, as defined. The Corporation also matches 50% of voluntary before-tax contributions up to a maximum matching contribution of 3% of a participant's compensation. At November 30, 1986, approximately 11,000 employees were eligible to participate in the Savings Plan, which had net assets of approximately $260 million.

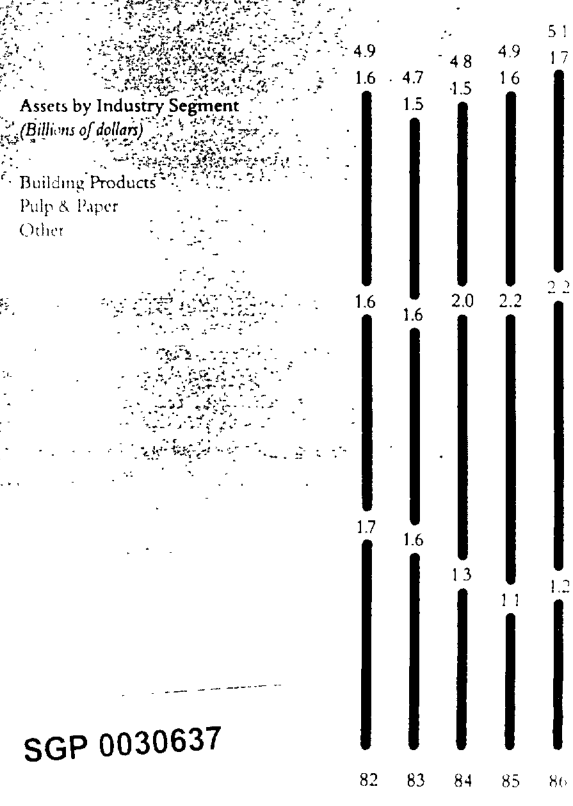
The cost of the Savings Plan was $15 million in 1986 and $13 million in 1985. In 1984, the Corporation contributed $5 million to its former Stock Bonus Plan, which was amended and restated as the Savings Plan effective January 1, 1985. Annual contributions to the former Stock Bonus Plan were limited based on the availability of the Corporation's profits.

Retiree Health Care and Life Insurance Benefits.
The Corporation also provides certain health care and life insurance benefits to eligible retired employees. Effective January 1, 1985, the Corporation changed its method of accounting for these benefits to accrue the full actuarially determined cost for currently retired employees and to amortize the actuarially determined cost of active employees' retirement benefits over their estimated remaining service period. The Corporation previously expensed these benefits as paid. Management believes this change results in a better matching of the costs of retiree benefits with the periods benefited from employee service. The effect of the change on the accompanying financial statements was not material.

Note 6. Industry Segment Information

The Corporation's primary operations are reported in two industry segments: (1) Building products, which includes the manufacture and distribution of structural panels (plywood, particleboard, oriented strand board, waferboard, etc.), lumber, gypsum, roofing, formaldehyde and thermosetting resins; and, (2) Pulp and paper, which includes the manufacture and distribution of containers and packaging (linerboard, kraft paper, corrugated boxes, etc.), printing and fine papers, tissue, market pulp and pulp mill by-product chemicals.

Certain industry segment information for the years 1984 through 1986 is presented on the following page. The Corporation's sales to foreign markets represented less than 10% of total sales to unaffiliated customers in each of those years. No single customer accounted for more than 10% of total sales to unaffiliated customers in any year during that period.



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(Millions)	Sales to Unaffiliated Customers	Intersegment Sales	Total Revenues	Operating Profits (Losses)	Depreciation and Depletion	Capital Expenditures	Assets
Year ended December 31, 1986							
Building products	$4,853	$235	$5,088	$500	$153	$192	$1,694
Pulp and paper	2,281	77	2,358	146	176	213	2,253
Other operations	89	29	118	35	5	6	60
	7,223	341	7,564	681	334	411	4,007
Eliminations and adjustments							
Intersegment sales	–	(341)	(341)	–	–	–	–
Timber and timberlands	–	–	–	–	–	56	844
Unusual items (Note 2)	–	–	–	33	–	–	–
General corporate	–	–	–	(91)	5	15	263
Interest expense	–	–	–	(138)	–	–	–
Income taxes	–	–	–	(189)	–	–	–
Total	$7,223	$ –	$7,223	$296	$339	$482	$5,114
Year ended December 31, 1985							
Building products	$4,470	$188	$4,658	$391	$145	$164	$1,623
Pulp and paper	2,134	76	2,210	29	149	435	2,175
Other operations	112	28	140	35	7	7	71
	6,716	292	7,008	455	301	606	3,869
Eliminations and adjustments							
Intersegment sales	–	(292)	(292)	–	–	–	–
Timber and timberlands	–	–	–	–	–	23	803
Unusual items (Note 2)	–	–	–	19	–	–	–
General corporate	–	–	–	(33)	9	13	183
Interest expense	–	–	–	(132)	–	–	–
Income taxes	–	–	–	(102)	–	–	–
Continuing operations	6,716	–	6,716	207	310	642	4,855
Discontinued operations, net	–	–	–	(30)	–	–	11
Settlement of condemnation suit, net	–	–	–	10	–	–	–
Total	$6,716	$ –	$6,716	$187	$310	$642	$4,866
Year ended December 31, 1984							
Building products	$4,452	$189	$4,641	$379	$144	$137	$1,535
Pulp and paper	2,111	66	2,177	202	123	402	1,982
Other operations	119	27	146	20	6	7	80
	6,682	282	6,964	601	273	546	3,597
Eliminations and adjustments							
Intersegment sales	–	(420)	(420)	–	–	–	–
Timber and timberlands	–	–	–	–	–	135	840
Unusual items (Note 2)	–	–	–	19	–	–	–
General corporate	–	–	–	(68)	9	29	190
Interest expense	–	–	–	(156)	–	–	–
Income taxes	–	–	–	(143)	–	–	–
Continuing operations	6,682	(138)	6,544	253	282	710	4,627
Discontinued operations, net	446	138	584	(134)	79	33	158
Total	$7,128	$ –	$7,128	$119	$361	$743	$4,785

Intersegment sales are recorded at estimated fair market values and income on such sales is included in operating profits (losses).

Timber and timberlands have not been allocated to industry segments because they are managed jointly to supply raw materials to both the building products and pulp and paper segments.

Logs and residual fiber are included at cost in the operating profits of the various manufacturing facilities.

Note 7. Indebtedness

Long-term debt consisted of the following:

(Millions)	Year ended December 31 1986	1985
Commercial paper and other short-term notes	$ 175	$ 153
Notes		
10.10%	—	150
Floating rate, currently 6.00% due 1987	32	32
13½% due 1994, redeemable after 1991	100	100
14⅝%	—	65
[illegible]% due 1990, redeemable after 1987	53	53
37% due 1988	76	76
Insurance companies		
6⅞% term loan, payable in annual installments through 1989	3	4
9⅜% term loan, payable in annual installments through 1997	7	7
10½% term loan, payable in semi-annual installments through 1996	4	4
10⅔% term loans, payable in semi-annual installments through 1996	32	35
13.60% senior notes due 1987	50	50
Revenue bonds, average interest rate 6.13% with varying annual payments to 2014	153	166
Purchase contracts and other, average interest rate 3.68% with varying payments to 2000	65	96
Debentures		
5¼% convertible subordinated debentures	—	87
9¼% sinking fund debentures due 2016	150	—
12¼% sinking fund debentures	—	100
Zero coupon debentures, effective interest rates of 9.30% to 10.30%, maturing annually 1987 through 1990	56	70
Discount term debentures, effective interest rate 11.30% due 2015	125	125
	1,081	1,373
Less: Current portion	134	41
Unamortized discount	54	75
	$ 893	$1,257

The scheduled maturities of long-term debt are $134 million in 1987, $102 million in 1988, $23 million in 1989, $77 million in 1990 and $28 million in 1991.

As of December 31, 1986, the Corporation had three bank revolving credit agreements providing for aggregate lines of credit of $700 million.

One of these agreements is with nine domestic money center banks and establishes a $385 million unsecured revolving line of credit until May 1, 1989, at which time the outstanding balance may be converted to a term loan repayable in eight equal semiannual installments beginning on June 30, 1989. Commitment fees during the revolving loan period are ¼ of 1 percent of the daily average unused available credit. The interest rates associated with this agreement are based on either the prime rate, certificate of deposit rate or the offshore rate.

A second agreement is with ten banks and establishes an unsecured revolving line of credit totaling $215 million until May 1, 1988. Commitment fees during the revolving loan period are ¼ of 1 percent of the daily average unused available credit. The interest rates associated with this agreement are based on either the prime rate, Federal funds rate or Eurodollar interbank offered rate.

A third agreement is with four banks and establishes a $100 million unsecured revolving line of credit until May 1, 1988. Commitment fees during the loan period are ¼ of 1 percent of the daily average unused available credit. The interest rates associated with this agreement are based on either the prime rate or certificate of deposit rate.

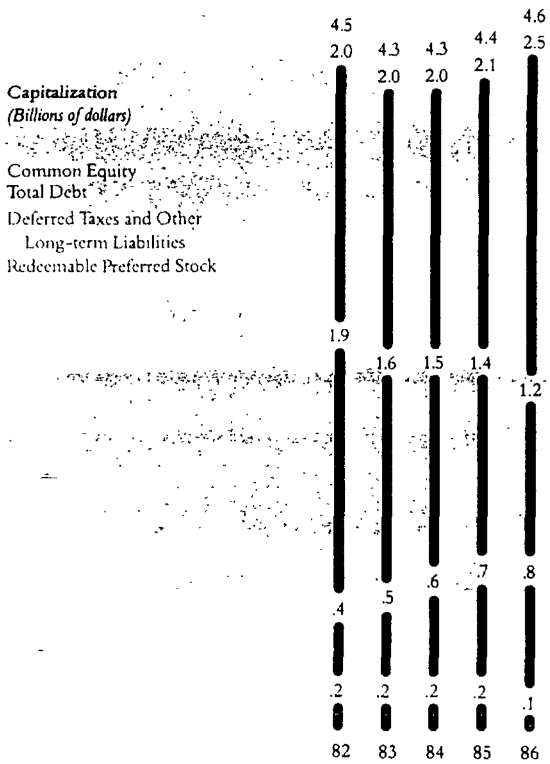
The Corporation uses these three agreements to support commercial paper and other short-term borrowings. At December 31, 1986, $175 million of commercial paper and other short-term borrowings with an average interest rate of 7.11% were classified as long-term debt. Management intends to refinance these borrowings on a long-term basis by either replacing them with long-term obligations or with equity securities or by renewing, extending or replacing them with short-term obligations.

On March 4, 1986, the Corporation issued $150 million of 9¼% sinking fund debentures due March 15, 2016. The debentures require the Corporation to make sinking fund payments commencing in 1997 and are redeemable (subject to certain restrictions) at any time at the Corporation's option.

In March 1986, $24 million of 12% notes classified as "purchase contracts and other" in the accompanying table were retired. The Corporation also retired $65 million of 14⅝% notes in April 1986 and redeemed $150 million of 10.10% notes in June 1986. The Corporation purchased $26 million of its outstanding 12¼% sinking fund debentures in June and redeemed the remaining $74 million in December 1986.

On June 15, 1986, $14 million of zero coupon debentures were retired as scheduled. The remaining zero coupon debentures may not be redeemed prior to maturity. The discount term debentures do not bear interest prior to June 15, 1990 but bear interest thereafter at 11.30%, require the Corporation to make sinking fund payments commencing in 1996 and are redeemable (subject to certain restrictions) at any time on or after June 15, 1990 at the Corporation's option.

In the fourth quarter of 1986, the Corporation called for redemption its outstanding 5¼% convertible subordinated debentures. By the redemption date, 2,790,000 shares of common stock had been issued upon conversion of $86 million of debentures at $30.87 per share, and $1 million cash had been paid for debentures that were redeemed.



In December 1986, the Corporation terminated two interest rate exchange agreements which were being used as hedges against anticipated future rollovers of $102 million of commercial paper borrowings. The Corporation paid $25 million in termination fees which are being amortized to interest expense over the periods from termination until the original 1991 maturity dates of the terminated agreements.

At December 31, 1986, the Corporation had registered for sale up to $250 million of debt securities under a shelf registration statement with the Securities and Exchange Commission.

The floating rate notes are convertible by the holder, prior to April 1, 1987, into 8½% debentures due 2009, and are redeemable in whole or in part at the Corporation's option. Prior to April 1, 1987, the Corporation may also convert the notes into fixed rate debentures due 2009 at a defined premium over the yield on 30-year Treasury securities, but not less than 8½%. The conversion by the Corporation is subject to the election by the holder to have the notes mature on the specified conversion date. The interest rate on the notes is adjustable semiannually to a rate based upon the six-month Treasury bill rate plus a specified premium.

At December 31, 1986, $63 million of long-term debt was secured by property and timber with a net book value of $136 million, including $83 million net book value (original cost $198 million) relating to certain manufacturing and pollution control facilities which were financed with the proceeds from revenue bonds issued by governmental units and guaranteed by the Corporation. The Corporation leases such facilities from the governmental units and pays all costs incidental to ownership of the properties.

Certain insurance company loan agreements place limitations on cash dividends that can be paid. The amount of retained earnings available for cash dividends under the most restrictive covenants of these agreements is approximately $872 million. In addition, the agreements require the Corporation to maintain a minimum of $250 million of consolidated working capital and impose certain limitations on additional borrowings.

Note 8. Redeemable Preferred Stock

(Millions)	Adjustable Rate Convertible Preferred Stock Series A	Series B	Series C	Total
Balance at December 31, 1983	$148	$33	$34	$215
Shares repurchased	(32)	–	–	(32)
Amortization of the excess of involuntary liquidating value over fair value at issue date	3	1	3	7
Balance at December 31, 1984	119	34	37	190
Shares repurchased	(32)	(8)	–	(40)
Amortization of the excess of involuntary liquidating value over fair value at issue date	3	–	3	6
Balance at December 31, 1985	90	26	40	156
Shares repurchased	(32)	(7)	(11)	(50)
Amortization of the excess of involuntary liquidating value over fair value at issue date	3	1	3	7
Balance at December 31, 1986	**$ 61**	**$20**	**$32**	**$113**

The number of shares of adjustable rate convertible preferred stock (preferred stock) issued and outstanding were as follows:

	December 31 1986	1985
Series A	1,656,000	2,484,000
Series B	573,000	765,000
Series C	1,049,000	1,318,000
Total	3,278,000	4,567,000

The preferred stock was recorded at fair market value on the date of issue. The excess of involuntary liquidating value over such fair market value is being amortized over a ten-year period by a charge to retained earnings and a corresponding credit to preferred stock.

Subject to adjustment for common stock dividends and splits, each share of the preferred stock has a conversion price of $39.00 and an involuntary liquidating value of $39.00, and is convertible into one share of common stock and entitled to one vote. In addition, whenever six quarterly dividends on Series A preferred stock are unpaid, the holders of such Series A stock are entitled to elect two directors of the Corporation until all past dividends have been paid.

Each share of preferred stock is entitled to receive cumulative quarterly cash dividends at the annual rate of $2.24. Such dividend rate is subject to increase up to a maximum of $4.00 per share should the Corporation fail to make the scheduled purchase offers, as described in the following paragraphs, unless the average of the last reported sales prices for the Corporation's common stock during a prescribed period of time is at least 108% of the conversion price of the preferred stock during such period.

Subject to the price of the Corporation's common stock and the appropriate action by the Board of Directors, the Corporation has the option to make offers to purchase, at a price of $39.00 per share plus accumulated dividends, a specified number of shares annually. In 1986, the Corporation accepted tenders for the purchase of approximately 828,000 shares of Series A, 192,000 shares of Series B and 269,000 shares of Series C preferred stock at $39.00 per share. Based on the price of its common stock, the Corporation has elected not to make a purchase offer in 1987. The optional preferred stock purchase offers for the years subsequent to 1987 would be for approximately 1,289,000 shares in 1988, 458,000 shares in 1989 and 242,000 shares in 1990.

The preferred stock will be subject to optional redemption (Series A—1987 through 1988, Series B—1987 through 1989 and Series C—1987 through 1990) at $39.00 per share plus accumulated dividends provided that the average of the last reported sales prices for the Corporation's common stock for a prescribed period of time is at least 125% of the then conversion price of the preferred stock. When these conditional redemption periods expire, the preferred stock may be redeemed, without limitation, at $39.00 per share plus accumulated dividends.

Subject to certain limitations, the Corporation is required to redeem on an annual basis, as a sinking fund, approximately 414,000 shares of Series A beginning in 1988, 96,000 shares of Series B beginning in 1989 and 134,000 shares of Series C beginning in 1991, at $39.00 per share plus accumulated dividends.

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Note 9. Common Stock

At December 31, 1986, the following authorized shares of the Corporation's common stock were reserved for issue:

1987 Employee Stock Purchase Plan	2,000,000
1984 Employee Stock Option Plan	4,103,000
Conversion of redeemable preferred stock	3,278,000
	9,381,000

The Corporation called its 5¼% convertible subordinated debentures during 1986, which resulted in the issuance of 2,790,000 common shares to holders who elected to convert their debentures into common stock at a conversion price of $30.87 per share (Note 7).

During 1986, the Corporation adopted, subject to shareholder approval, the 1987 Employee Stock Purchase Plan (Purchase Plan). In connection with the Purchase Plan, 2,000,000 shares of common stock were reserved for issue at a subscription price of $39.53 per share. The subscription period began January 30, 1987 and ends on March 13, 1987. Subscribers have the option to receive their payments plus interest at the rate of 7% per annum in lieu of stock. The Purchase Plan expires on March 31, 1989.

The Corporation issued 829,000 shares during 1986 under the 1984 Employee Stock Purchase Plan, which expired on October 31, 1986.

In connection with the 1984 Employee Stock Option Plan (Option Plan), 4,103,000 shares of common stock were reserved for issue. The Option Plan provides for the granting of stock options to certain officers and employees. Holders of stock options may be granted cash awards, payable upon exercise of an option, of an amount not to exceed 100% of the amount by which the market value of the common stock, as defined, exceeds the option price. In addition, holders may be granted rights to surrender all or part of the related stock option in exchange for common stock with a fair market value equal to the amount by which the market value of the common stock, as defined, exceeds the option price.

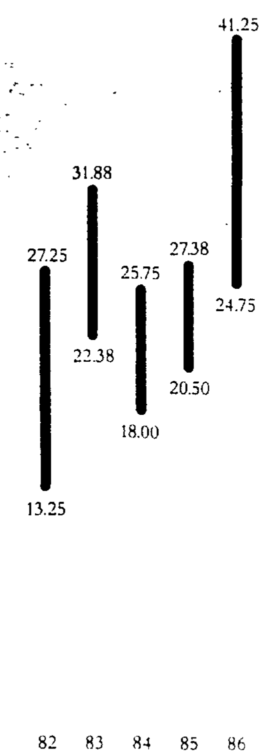
Compensation resulting from stock options and cash awards is initially measured at the grant date based on the market value of the common stock, with adjustments made in subsequent periods for market price fluctuations. The Corporation recognized stock options compensation expense of $33 million in 1986, $6 million in 1985 and $4 million in 1984.

Additional information relating to options is as follows:

	Year ended December 31	
	1986	*1985*
Options outstanding		
at January 1	1,226,000	1,710,000
Granted	1,408,000	–
Exercised/Surrendered	(1,107,000)	(453,000)
Cancelled	(36,000)	(31,000)
Options outstanding at December 31	1,491,000	1,226,000
Options available for grant at December 31	2,612,000	3,986,000
Total reserved shares	4,103,000	5,212,000
Options exercisable at December 31	115,000	1,226,000
Option prices per share		
Granted	$26	–
Exercised/Surrendered	$21–$25	$21–$25
Cancelled	$21–$26	$21–$22

The shares and prices relating to the Purchase Plan, the Option Plan and the redeemable preferred stock are subject to adjustment for certain changes in the capital structure, including common stock splits and stock dividends.

Common Stock Price Range
(Amounts in dollars)



Note 10. Commitments and Contingencies

The Corporation is a 50% partner in a joint venture (GA-MET) with Metropolitan Life Insurance Company (Metropolitan). GA-MET owns and operates the Corporation's office headquarters complex in Atlanta, Georgia. The Corporation accounts for its investment in GA-MET under the equity method.

During 1986, GA-MET borrowed $170 million from Metropolitan for the primary purpose of retiring debt incurred from the acquisition and construction of the Atlanta headquarters complex. The note bears interest at 9½% and requires monthly payments of principal and interest with a final installment due in 2011. The note is secured by the land and building of the Atlanta headquarters complex. In the event of foreclosure, each partner has severally guaranteed payment of one-half of any shortfall of collateral value to the outstanding secured indebtedness. Based on present market conditions and building occupancy, the likelihood of any obligation to the Corporation with respect to this guarantee is considered remote.

During 1986, the Corporation adopted a program to self-insure for general liability claims up to $25 million in amount. These risks were previously insured with a nominal deductible amount.

Note 11. Income Taxes

The provision for income taxes is based on pretax financial accounting income which differs from taxable income. Differences generally arise because certain items, such as depreciation and capitalized interest, are reflected in different time periods for financial accounting and tax purposes.

The Corporation uses the flow-through method of accounting for investment tax credits. Under the flow-through method, investment tax credits are recognized as a reduction of income tax expense in the year the qualified investment is made.

The provision for income taxes for continuing operations consisted of the following:

	Year ended December 31		
(Millions)	*1986*	*1985*	*1984*
Federal income taxes, net of investment tax credit			
Current	$ 79	$ 13	$ 40
Deferred	87	84	90
State income taxes	23	5	13
	$189	$102	$143

The difference between the ordinary Federal income tax rate and the Corporation's effective income tax rate for continuing operations is summarized as follows:

	Year ended December 31		
	1986	*1985*	*1984*
Federal income tax rate	46%	46%	46%
Increase (decrease) as a result of			
Value of timber appreciation taxed at capital gains rate	(8)	(10)	(6)
Investment tax credit	(3)	(10)	(4)
State income taxes, net of Federal benefit	3	3	3
Other	1	4	(3)
	39%	33%	36%

The Tax Reform Act of 1986 increased the effective income tax rate by 4% in 1986 due to the repeal of the investment tax credit, although some credits were allowed under the transition rules. The following is a summary of the components of the deferred tax provision for continuing operations:

	Year ended December 31		
(Millions)	*1986*	*1985*	*1984*
Excess of tax depreciation over financial depreciation	$87	$97	$83
Write-down of certain assets	(15)	(6)	10
Sale of tax benefits	(12)	(13)	(13)
Fees paid to terminate interest rate exchange agreements	12	–	–
Prepayment of pension expense	11	–	–
Deferred start-up costs, net	7	4	(6)
Capitalized interest, net	(4)	6	(6)
Reinstatement from recognition of investment tax credits in 1982	–	–	22
Other	1	(4)	–
	$87	$84	$90

Note 12. Acquisition

In July 1984, the Corporation acquired certain assets from St. Regis Corporation for approximately $360 million in a transaction accounted for as a purchase. The purchased assets included a linerboard and kraft paper mill, related timberlands and cutting contracts in Mississippi, 16 corrugated container plants, and certain current assets related to those operations. The results of these operations have been included in the accompanying Statements of Income from the date of acquisition. Had the operations been acquired as of the beginning of 1984, the Corporation's operating results for that year would not have been materially affected.

Note 13. Litigation

The Corporation is a party to various legal proceedings generally incidental to its business. Although the ultimate disposition of these proceedings is not presently determinable, management does not believe that adverse determinations in any or all of such proceedings will have a material adverse effect upon the financial condition of the Corporation.

Note 14. Unaudited Selected Quarterly Financial Data

	1st Quarter		*2nd Quarter*		*3rd Quarter*		*4th Quarter*	
(Millions, except per share amounts)	*1986*	*1985*	*1986*	*1985*	*1986*	*1985*	*1986*	*1985*
Net sales	$1,604	$1,580	$1,929	$1,794	$1,909	$1,752	$1,781	$1,590
Gross profit	287	269	374	323	411	302	368	269
Income from continuing operations before extraordinary item	30	49	86	67	97	58	83	33
Income before extraordinary item	30	49	86	67	97	28	83	33
Net income	30	49	86	67	97	28	83	43
Per common share income from continuing operations before extraordinary item								
Primary	.25	.43	.79	.61	.90	.52	.75	.27
Fully diluted	.25	.42	.77	.60	.88	.51	.74	.27
Per common share income before extraordinary item								
Primary	.25	.43	.79	.61	.90	.23	.75	.27
Fully diluted	.25	.42	.77	.60	.88	.23	.74	.27
Per common share net income								
Primary	.25	.43	.79	.61	.90	.23	.75	.37
Fully diluted	.25	.42	.77	.60	.88	.23	.74	.36
Dividends declared per common share	.20	.20	.20	.20	.20	.20	.25	.20
Price range of common stock								
High	33.50	27.38	34.25	25.13	37.38	25.63	41.25	26.88
Low	24.75	21.00	28.00	20.50	29.00	21.13	35.63	20.63

Income from continuing operations before extraordinary item includes:

– a $12 million pre-tax increase in the 1986 first quarter from adoption of a new timber capitalization policy (Note 1);

– a $33 million pre-tax gain from liquidation of investments in the 1986 fourth quarter (Note 2);

– a $17 million increase in income tax expense in the 1986 fourth quarter due to the repeal of the investment tax credit under the Tax Reform Act of 1986 (Note 11); and

– a $19 million pre-tax gain from the sale of timberlands in the first quarter of 1985 (Note 2).

SGP 0030644

Five-year Selected Financial Data

Georgia-Pacific Corporation and Subsidiaries

(Millions, except per share amounts)	*Year ended December 31* 1986	1985	1984	1983	1982
Operations					
Net sales	$7,223	$6,716	$6,682	$6,040	$5,003
Costs and expenses					
Cost of sales	5,783	5,553	5,441	4,978	4,206
Selling, general and administrative	511	431	426	374	359
Depreciation and depletion	339	310	282	289	275
Interest	138	132	156	157	186
Provision for restructuring operations[1]	—	—	—	135	30
	6,771	6,426	6,305	5,933	5,056
Income (loss) from continuing operations before unusual items, income taxes and extraordinary items[2]	452	290	377	107	(53)
Unusual items	33	19	19	—	79
Provision for income taxes	189	102	143	32	6
Income from continuing operations before extraordinary items[2]	$ 296	$ 207	$ 253	$ 75	$ 20
Financial position, end of year					
Current assets	$1,420	$1,291	$1,406	$1,268	$1,176
Timber and timberlands, net	844	804	840	753	748
Property, plant and equipment, net	2,691	2,606	2,270	1,989	2,214
Net assets of discontinued operations	—	11	158	653	651
Other assets	159	154	111	69	130
Total assets	5,114	4,866	4,785	4,732	4,919
Current liabilities	837	631	640	612	716
Long-term debt	893	1,257	1,383	1,453	1,618
Deferred income taxes	695	606	503	413	365
Other long-term liabilities	124	69	34	26	22
Redeemable preferred stock	113	156	190	215	209
Total net assets	$2,452	$2,147	$2,035	$2,013	$1,989
Working capital	$ 583	$ 660	$ 766	$ 656	$ 460
Other statistical data					
Capital expenditures	$ 482	$ 642	$ 710	$ 188	$ 207
Per common share					
Income (loss) from continuing operations before extraordinary items—primary[2]	2.69	1.83	2.28	.53	(.01)
Income from continuing operations before extraordinary items—fully diluted[2]	2.64	1.80	2.24	.54	.02
Dividends declared	.85	.80	.70	.60	1.05
Market price: High	41.25	27.38	25.75	31.88	27.25
Low	24.75	20.50	18.00	22.38	13.25
Year end	37.00	26.50	25.00	24.75	26.25
Book value[3]	22.70	20.59	19.58	19.48	19.22
Shares of common stock outstanding at year end	107	103	103	102	101
Number of common shareholders of record (thousands)	66	74	79	80	88
Number of employees (thousands)	39	39	40	39	44
Effective income tax rate[3]	39.0%	33.0%	36.1%	29.9%	23.1%
Return on capital employed[3]	10.4%	8.7%	11.7%	4.2%	2.5%
Return on common equity[3]	13.8%	10.2%	12.6%	3.8%	1.0%
Total debt-to-capital[3]	26.3%	32.0%	35.7%	37.4%	42.1%
Current ratio[3]	1.7	2.0	2.2	2.1	1.6

[1] *Previously classified as unusual items.*
[2] *Before cumulative effect of accounting change in 1982.*
[3] *The method of calculating these amounts is described in the Financial Glossary presented on page 20.*

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Sales and Operating Profits by Industry Segment

Georgia-Pacific Corporation and Subsidiaries

(Millions)	*Year ended December 31* 1986		1985		1984		1983		1982	
Trade sales										
Building products										
Structural panels	$1,864	26%	$1,666	25%	$1,637	25%	$1,560	26%	$1,217	24%
Lumber	1,676	23	1,434	21	1,461	22	1,424	24	1,003	20
Gypsum	375	5	377	6	360	5	269	4	183	4
Roofing	230	3	260	4	268	4	222	4	197	4
Thermosetting resins	155	2	173	3	186	3	162	3	136	3
Other	553	8	560	8	540	8	506	8	450	9
	4,853	67	4,470	67	4,452	67	4,143	69	3,186	64
Pulp and paper										
Containers and packaging	1,029	14	1,037	15	909	13	647	11	605	12
Tissue	502	7	514	8	507	8	449	7	429	8
Printing and ne papers	461	7	356	5	445	7	450	7	437	9
Market pulp	221	3	157	2	225	3	191	3	187	4
Other	68	1	70	1	25	—	31	1	29	1
	2,281	32	2,134	31	2,111	31	1,768	29	1,687	34
Other operations	89	1	112	2	119	2	129	2	130	2
Continuing operations	$7,223	100%	$6,716	100%	$6,682	100%	$6,040	100%	$5,003	100%
Operating profits										
Building products	$ 500	73%	$ 391	86%	$ 379	63%	$ 277	92%	$ 128	66%
Pulp and paper	146	22	29	6	202	34	13	4	41	21
Other operations	35	5	35	8	20	3	13	4	25	13
Continuing operations	$ 681	100%	$ 455	100%	$ 601	100%	$ 303	100%	$ 194	100%

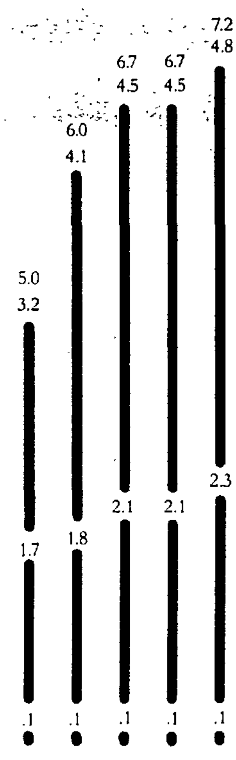
Sales figures exclude intercompany sales, but income on such sales is included in operating profits.

Operating profits are before income taxes, interest and general corporate expenses, unusual items, extraordinary items and cumulative effect of accounting change in 1982. Operating profits in 1983 and 1982 have been restated to include restructuring charges which were previously classified as unusual items. The restatement reduced 1983 operating profits by $77 million in building products and $58 million in pulp and paper, and reduced 1982 operating profits by $8 million in building products, $3 million in pulp and paper, $7 million in other operations and $12 million in general corporate charges.

Additional information regarding industry segments is presented in Note 6 of the Notes to Financial Statements.

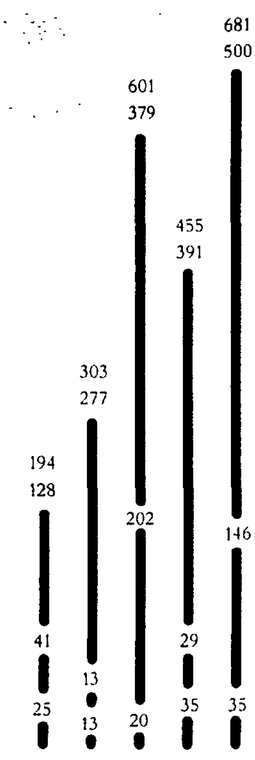
Sales by Industry Segme t
(Billions of dollars)

Building Products
Pulp & Paper
Other Operations



Operating Profits by Industry Segment
(Millions of dollars)

Building Products
Pulp & Paper
Other Operations



SGP 0030646

Operating Statistics

Georgia-Pacific Corporation and Subsidiaries

	As of December 31, 1986		Production				
	No. of Facilities	Rated Annual Capacity	1986	1985	1984	1983	1982
Building Products							
Structural panels							
Softwood plywood (3/8") (m.sq.ft.)	18	4,760	4,706	4,414	4,443	4,430	3,831
Hardwood plywood (sm) (m.sq.ft.)	2	373	335	311	343	442	444
Particleboard (3/4") (m.sq.ft.)	4	460	425	410	381	400	303
Softboard (1/2") (m.sq.ft.)	1	250	241	239	243	241	226
Hardboard (1/8") (m.sq.ft.)	7	1,183	349	368	361	346	220
Fiberboard (3/4") (m.sq.ft.)	1	75	75	76	69	77	63
Panelboard (1/8") (m.sq.ft.)	1	300	248	290	311	299	301
Waferboard (3/8") (m.sq.ft.)	1	155	139	128	112	64	22
Oriented strand board (3/8") (m.sq.ft.)	3	690	525	173	96	51	—
Lumber (m.bd.ft)	37	1,854	1,784	1,684	1,650	1,603	1,406
Moulding (m.bd.ft.)	3	39	8	—	—	—	—
Gypsum board (m.sq.ft.)	9	2,739	2,473	2,495	2,412	2,242	1,681
Roofing—shingles and rolls (t.squares)	5	8,096	7,361	7,789	7,539	5,973	5,363
Formaldehyde (m.lbs.)	10	1,195	1,233	1,188	1,169	1,081	966
Thermosetting resins (m.lbs.)	16	2,063	1,805	1,650	1,527	1,451	1,146
Distribution centers	141						
Pulp and Paper							
Pulp (t.tons)	27[1]	3,955	3,699	3,292	3,332	2,976	2,648
Paper (t.tons)		3,290	2,999	2,824	2,703	2,375	2,162
Corrugated packaging (m.sq.ft.)	30	18,224	14,572	13,703	11,880	8,427	7,680
Tissue products (t.tons)	4	471	437	432	422	422	393
Miscellaneous Facilities							
Building products	16						
Pulp and paper	20						
Other manufacturing operations	3						
Resources (as of December 31)							
North American timberlands (t.acres)							
Owned in fee			4,700	4,760	4,920	4,630	4,630
Controlled			530	480	480	530	510

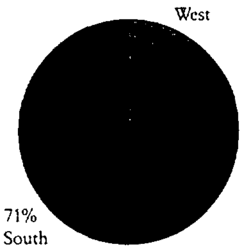
[1] *Total for pulp/paper*

sm = surface measure basis
t = thousands
m = millions

13% West

16% East

71% South



Timber Resource Base

North America (acres)	
Owned in Fee	4,700,000
Controlled	530,000
	5,230,000

T. Marshall Hahn, Jr.[1]
Chairman and Chief Executive Officer; Atlanta, Georgia

Willard S. Boothby, Jr.[1,3]
Managing Director, Paine Webber Incorporated; Investment Bankers; New York, New York

Robert L. Clare, Jr.[3,5]
Partner, Shearman & Sterling; Attorneys; New York, New York

Robert B. Claytor[1,3,4]
Chairman and Chief Executive Officer, Norfolk Southern Corporation; Norfolk, Virginia

Harvey C. Fruehauf, Jr.[1,4]
President, HCF Enterprises, Inc.; Private Investment Company; St. Clair Shores, Michigan

Richard V. Giordano[3,4]
Chairman and Chief Executive Officer, The BOC Group; London, England

Francis Jungers[1,2]
Private Business Consultant; Sunriver, Oregon

F. James McDonald[3,5]
President and Chief Operating Officer, General Motors Corporation; Detroit, Michigan

Robert E. McNair[2,5]
Partner, McNair Law Firm, P.A.; Columbia, South Carolina

Chauncey J. Medberry[2,4]
Chairman of the Board (retired), Bank of America N.T. & S.A. and Bankamerica Corporation; Los Angeles, California

Robert A. Schumacher
President and Chief Operating Officer; Darien, Connecticut

[1] *Executive Committee*
[2] *Audit Committee*
[3] *Stock Option Plan and Management Compensation Committee*
[4] *Finance Committee*
[5] *Nominating Committee*

We are saddened to report that Harold E. Sand, a member of the Board of Directors and a retired executive officer for Georgia-Pacific, died December 11, 1986, at the age of 69.

Mr. Sand joined Georgia-Pacific in 1956 when the company acquired Charles E. Sand Plywood Co., where he was president. The great success and strength of Georgia-Pacific's building products Distribution Division attest to the foresight and wisdom that characterized his leadership.

He was elected Executive Vice President–Building Products in 1970 and elected to the board in 1973. Mr. Sand retired from active management in 1982.

Officers

Georgia-Pacific Corporation and Subsidiaries

T. Marshall Hahn, Jr.
Chairman and Chief Executive Officer
Robert A. Schumacher
President and Chief Operating Officer
Harold L. Airington
Executive Vice President–Building Products
Ronald P. Hogan
Executive Vice President–Operations
Conrad Schweitzer
Executive Vice President–Pulp and Paper
James C. Van Meter
Executive Vice President and Chief Financial Officer
J. Kermit Birchfield, Jr.
Senior Vice President–Legal and Governmental Affairs
George A. MacConnell
Senior Vice President–Distribution Division
Daniel A. Martinez
Senior Vice President–Pulp and Paper Manufacturing
Davis K. Mortensen
Senior Vice President–Wood Products Manufacturing
Glenn E. Wilson
Senior Vice President–Gypsum and Roofing Division
Maurice W. Kring
Group Vice President–Tissue, Pulp and Paperboard
J. Wayne Amy
Vice President–Distribution Division, Southwest Region
Joseph J. Armetta
Vice President–Distribution Division, Midwest Region
David S. Dimling
Vice President–Printing Paper Division
Willie L. Duke
Vice President–Eastern Wood Products Manufacturing Division
Diane Durgin
Vice President–Law and Secretary
Donald L. Glass
Vice President–Roofing Division
Stephen K. Jackson
Vice President–Distribution Division Marketing and Advertising

Joseph H. Joiner
Vice President–Controller and Information Resources
John F. McGovern
Vice President–Finance
Dennis D. Melstrom
Vice President–Pulp and Paper Information Resources
Thomas F. Mitchell
Vice President–Government Affairs
Dewey L. Mobley
Vice President–Western Wood Products Manufacturing Division
Allan J. Nadeau
Vice President–Northern Pulp and Paper Division
Kelly E. Powell, Jr.
Vice President–Distribution Division, Western Region
John F. Rasor
Vice President–Mid-Continent Wood Products Manufacturing Division
David W. Reynolds
Vice President–Human Resources
Robert A. Starling
Vice President–Distribution Division, Southeast Region
Marion L. Talmadge
Vice President–Executive Affairs
James R. Taylor
Vice President–Chemical Division
Douglas A. Thom
Vice President–Packaging Division
Carroll T. Tolar
Vice President–Engineering
Michael A. Vidan
Vice President–Wood Products Sales Division
Michael B. Wilson
Vice President–Sales and Marketing Consumer and Commercial Paper Products
Wayne I. Tamblyn
Treasurer

Investor Information

[illegible]

Corporate Headquarters

Georgia-Pacific Center, 133 Peachtree Street, N.E., Atlanta, Georgia 30303

Stock Exchange and Symbols

Georgia-Pacific Corporation Common Stock (GP) and Preferred Stock (GPR A), (GPR B) and (GPR C) [illegible] New York Stock Exchange

Transfer Agent and Registrar

Bank of America NT & SA, Corporate Agency Service Center, P.O. Box 37002, San Francisco, California 94137

Shareholder Information

Registered G-P shareholders are eligible to participate in the G-P Dividend and Cash Investment Plan. [illegible] shareholder information [illegible] Corporate Secretary, Georgia-Pacific Corporation, P.O. Box 105605, Atlanta, Georgia [illegible] (404) 521-5210

Financial Information

A copy of the Georgia-Pacific 1986 Annual Report to the Securities and Exchange Commission on Form 10-K will be supplied without charge at any time after March 31, 1987. Annual Shareholder Updates are also available. Requests for financial information should be directed to: Cindy Connolly, Investor Relations, Georgia-Pacific Corporation, P.O. Box 105605, Atlanta, Georgia 30348 (404) 521-4721

An equal opportunity employer

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