

GEORGIA PACIFIC CORP
Form 10-Q
October 27, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 1, 2005

Commission File Number 1-3506

GEORGIA-PACIFIC CORPORATION

(Exact name of registrant as specified in its charter)

Georgia
(State or other jurisdiction of
incorporation or organization)

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

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133 Peachtree Street, N.E.,

Atlanta, Georgia 30303

(Address of Principal Executive Offices) (Zip Code)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

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

As of the close of business on October 24, 2005, Georgia-Pacific Corporation had 260,309,202 shares of Georgia-Pacific Common Stock outstanding.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

Georgia-Pacific Corporation and Subsidiaries

(In millions, except per share amounts)	Third Quarter		First Nine Months	
	2005	2004	2005	2004
Net sales	\$ 4,713	\$ 4,741	\$ 14,127	\$ 15,151
Costs and expenses:				
Cost of sales	3,587	3,516	10,654	11,386
Selling and distribution	269	252	806	902
Depreciation, amortization and accretion	233	231	699	711
General and administrative	198	212	566	656
Other losses (income), net	9	(8)	60	(9)
Operating profit	417	538	1,342	1,505
Interest, net	145	167	453	542
Income from continuing operations before income taxes	272	371	889	963
Provision for income taxes	129	132	347	352
Income from continuing operations	143	239	542	611
Income (loss) from discontinued operations, net of taxes	2	1	2	(4)
Net income	\$ 145	\$ 240	\$ 544	\$ 607
Basic per share:				
Income from continuing operations	\$ 0.55	\$ 0.93	\$ 2.10	\$ 2.40
Loss from discontinued operations, net of taxes	0.01	0.01	0.01	(0.02)
Net income	\$ 0.56	\$ 0.94	\$ 2.11	\$ 2.38
Diluted per share:				
Income from continuing operations	\$ 0.54	\$ 0.91	\$ 2.05	\$ 2.33
Loss from discontinued operations, net of taxes	0.01		0.01	(0.02)
Net income	\$ 0.55	\$ 0.91	\$ 2.06	\$ 2.31
Shares (denominator):				
Weighted average shares outstanding	258.9	256.0	258.3	254.9
Dilutive securities:				

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Options and other equity securities	5.6	7.2	6.0	7.5
Total assuming conversion	264.5	263.2	264.3	262.4

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

Georgia-Pacific Corporation and Subsidiaries

(In millions)	First Nine Months	
	2005	2004
Cash flows from operating activities		
Net income	\$ 544	\$ 607
Adjustments to reconcile net income to cash provided by operations (excluding the effect of dispositions):		
Depreciation	670	696
Amortization of intangible assets, deferred charges and accretion	45	59
Stock compensation expense	20	85
Deferred income taxes	(35)	79
Other losses (income), net	60	(14)
Increase in receivables	(107)	(481)
Increase in inventories	(89)	(60)
(Decrease) increase in accounts payable	(26)	208
Change in other working capital	(11)	40
Change in taxes payable/receivable	244	(38)
Change in other assets and other long-term liabilities	(99)	(263)
Other, net	1	39
Cash provided by operations	1,217	957
Cash flows from investing activities		
Property, plant and equipment investments	(506)	(448)
Acquisitions		(23)
Net proceeds from sales of assets	74	1,416
Other	(4)	(14)
Cash (used for) provided by investing activities	(436)	931
Cash flows from financing activities		
Repayments of long-term debt	(3,263)	(5,264)
Additions to long-term debt	2,808	3,901
Fees paid to issue debt	(1)	(14)
Fees paid to retire debt	(14)	(35)
Net change in bank overdrafts	10	(15)
Net decrease in accounts receivable secured borrowings and short-term notes	(280)	(303)
Proceeds from option plan exercises	15	53
Cash dividends paid (\$0.525 per share and \$0.375 per share, respectively)	(137)	(97)
Other, net		(2)
Cash used for financing activities	(862)	(1,776)
Effect of exchange rate changes on cash and equivalents	(30)	(4)
(Decrease) increase in cash and equivalents	(111)	108
Balance at beginning of period	225	51
Balance at end of period	\$ 114	159

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Supplemental disclosures of cash flow information:		
Total interest cost, net continuing operations	\$ 458	\$ 552
Interest capitalized	(5)	(10)
Interest expense, net continuing operations	453	542
Interest expense, net discontinued operations		5
Total interest expense, net	\$ 453	\$ 547
Interest paid	\$ 497	\$ 582
Income tax paid, net	\$ 127	\$ 308
Debt assumed by buyer	\$	\$ 73

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

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CONSOLIDATED BALANCE SHEETS (Unaudited)

Georgia-Pacific Corporation and Subsidiaries

(In millions, except shares and per share amounts)	October 1, 2005	January 1, 2005
ASSETS		
Current assets		
Cash and equivalents	\$ 114	\$ 225
Receivables, less allowances of \$28 and \$26, respectively	1,803	1,766
Inventories	1,600	1,548
Deferred income tax assets	28	28
Taxes receivable		56
Other current assets	294	324
Total current assets	3,839	3,947
Property, plant and equipment		
Land, buildings, machinery and equipment, at cost	18,168	17,934
Accumulated depreciation	(10,153)	(9,529)
Property, plant and equipment, net	8,015	8,405
Goodwill, net	7,414	7,551
Intangible assets, net	646	701
Other assets	2,414	2,468
Total assets	\$ 22,328	\$ 23,072
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Secured borrowings and other short-term notes	\$ 288	\$ 568
Current portion of long-term debt	653	57
Accounts payable	1,583	1,668
Accrued compensation	259	323
Taxes payable	187	
Other current liabilities	1,022	1,000
Total current liabilities	3,992	3,616
Long-term debt, excluding current portion	6,999	8,064
Other long-term liabilities	3,535	3,698
Deferred income tax liabilities	1,391	1,469
Total liabilities	15,917	16,847
Commitments and contingencies (Note 11)		
Shareholders' equity		
Preferred stock, no par value; 10,000,000 shares authorized; no shares issued or outstanding		
Junior preferred stock, no par value; 25,000,000 shares authorized; no shares issued or outstanding		
Common stock, par value \$0.80; 400,000,000 shares authorized; 259,115,000 and 256,992,000 shares issued and outstanding	207	205
Additional paid-in capital	3,667	3,610
Retained earnings	2,497	2,090

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Accumulated other comprehensive income	40	320
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Total shareholders' equity	6,411	6,225
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Total liabilities and shareholders' equity	\$ 22,328	\$ 23,072
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The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

Georgia-Pacific Corporation and Subsidiaries

(In millions)	Third Quarter		First Nine Months	
	2005	2004	2005	2004
Net income	\$ 145	\$ 240	\$ 544	\$ 607
Other comprehensive income (loss), net of tax:				
Derivative instruments:				
Fair market value adjustments on derivatives	4	2	9	2
Reclassification adjustments for gains included in net income	(7)		(9)	
Foreign currency translation adjustments	1	54	(284)	(11)
Unrealized loss on securities			(2)	
Minimum pension liability adjustment	1		6	26
Comprehensive income	\$ 144	\$ 296	\$ 264	\$ 624

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

GEORGIA-PACIFIC CORPORATION AND SUBSIDIARIES

October 1, 2005

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

Management is responsible for the unaudited financial statements included in this document. The financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of our financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in our audited financial statements for the fiscal year ended January 1, 2005 in our [Form 10-K](#) filed with the SEC on March 1, 2005.

Certain 2004 amounts have been reclassified to conform to the 2005 presentation.

In March 2005, we corrected our accounting for an insurance policy with a three-year term expiring in June of 2005. From 2002 through 2004, we had recorded all payments made under the policy as prepaid insurance, which was amortized into expense. However, a portion of these payments was refundable based upon actual loss experience and, therefore, should have been recorded as a deposit rather than as an insurance expense. Losses covered by the deposit were to be expensed as incurred. We concluded that the resulting overstatement of insurance expense during 2002 through 2004 was not material, either individually or in the aggregate, to our results of operations, to trends for those periods affected, or to a fair presentation of our financial statements. Accordingly, results for the prior periods have not been restated. Instead, we reduced our insurance expense (cost of sales) and increased other current assets by \$24 million to correct this error in the first quarter of 2005 and \$1 million in the third quarter of 2005. We received a total cash refund of \$31 million related to the refund of the deposit in the third quarter of 2005.

We recorded net losses related to our equity method investments of \$2 million and \$1 million for the third quarters of 2005 and 2004, respectively, and \$5 million and \$7 million for the first nine months of 2005 and 2004, respectively. Minority interests in income of less than wholly-owned consolidated subsidiaries totaled \$4 million and \$16 million for the third quarter and the first nine months of 2005, respectively, and \$3 million and \$13 million for the third quarter and first nine months of 2004, respectively. These amounts are included in cost of sales on our consolidated statements of operations.

We classify certain shipping and handling costs as selling and distribution expenses. Shipping and handling costs included in selling and distribution expenses were \$62 million and \$185 million for the third quarter and first nine months of 2005, respectively and \$63 million and \$233 million for the third quarter and first nine months of 2004, respectively.

Interest, net is interest expense of \$538 million and \$625 million, net of interest income of \$85 million and \$78 million, for the first nine months of 2005 and 2004, respectively. A majority of our interest income is associated with the notes received in connection with our sale of a 60% controlling interest in Unisource Worldwide, Inc. (Unisource) in 2002 and sales of various timberlands in prior years.

Other Losses (Income), net

The following amounts are included in Other losses (income), net

(In millions)	Third Quarter		First Nine Months	
	2005	2004	2005	2004
Asset impairments	\$ 14	\$	\$ 19	\$ 13
Early extinguishment of debt			17	53
Estimated loss on warehouse sublease	1		12	
Gain on sale of assets	(19)	(10)	(16)	(75)
Settlement of asbestos insurance receivable	(4)		(1)	
Tax-exempt bond liability reserve (Note 11)			11	
Unisource sales tax audit charge	7		7	
Change in environmental liabilities, net of insurance receivables	8		8	
Other	2	2	3	
Other losses (income), net	\$ 9	\$ (8)	\$ 60	\$ (9)

Stock-Based Compensation

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

(In millions, except per share amounts)	Third Quarter		First Nine Months	
	2005	2004	2005	2004
Net income as reported	\$ 145	\$ 240	\$ 544	\$ 607
APB No. 25 stock-based employee compensation expense for 2002 awards		4		17
Less stock-based employee compensation expense determined under the fair value based method, net of taxes		(1)		(4)
Pro forma net income	\$ 145	\$ 243	\$ 544	\$ 620
Stock based employee compensation cost, net of taxes, included in the determination of net income as reported	\$ 16	\$ 15	\$ 16	\$ 61

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Basic net income per share:				
As reported	\$ 0.56	\$ 0.94	\$ 2.11	\$ 2.38
Pro forma	0.56	0.95	2.11	2.43
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Diluted net income per share:				
As reported	\$ 0.55	\$ 0.91	\$ 2.06	\$ 2.31
Pro forma	0.55	0.92	2.06	2.36
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Accounting Changes

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154, *Accounting Changes and Error Corrections a replacement of APB No. 20 and FASB Statement No. 3* (SFAS No. 154). SFAS No. 154 changes the requirements of accounting for and reporting a change in accounting principle and applies to all voluntary changes in accounting principle and changes required by an accounting pronouncement, in the event that the accounting pronouncement does not include specific transition provisions. SFAS No. 154 requires retrospective application of changes in accounting principle to prior periods financial statements unless it is impracticable. SFAS No. 154 also requires that a change in the method of depreciation, amortization or depletion of long-lived, nonfinancial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. The guidance contained in APB Opinion No. 20, *Accounting Changes* for reporting the correction of an error was carried forward in SFAS No. 154 without change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

In April 2005, the SEC adopted a new rule that changes the adoption dates of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R), which is a revision of SFAS No. 123. The SEC s new rule allows companies to implement SFAS No. 123R at the beginning of their next fiscal year, instead of the next reporting period that begins after June 15, 2005. The rule does not change the accounting required by Statement No. 123R; it only changes the dates for compliance with the standard. We plan to adopt SFAS No. 123R using the modified prospective method at the beginning of our 2006 fiscal year and do not believe that the adoption will have a material impact on our results of operations or financial position.

In March 2005, the FASB issued FASB Interpretation (FIN) No. 47, *Accounting for Conditional Asset Retirement Obligations An Interpretation of FASB Statement No. 143* (FIN 47). FIN 47 clarifies that the term conditional asset retirement obligation, as used in SFAS No.143, *Accounting for Asset Retirement Obligations* (SFAS No. 143), refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. We plan to adopt FIN 47 at the end of our 2005 fiscal year and do not believe that the adoption will have a material impact on our results of operations or financial position.

In December 2004, the FASB issued FASB Staff Position 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004* (FSP 109-1). The American Jobs Creation Act (AJCA), introduced a special tax deduction related to qualified production activities. This deduction is equal to 3% of qualified income for years 2005 and 2006, then is scheduled to increase to a 6% deduction for years 2007 through 2009, and finally, will increase to a 9% deduction beginning in year 2010. FSP 109-1 clarifies that this tax deduction should be accounted for as a special tax deduction in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS No. 109). Effective in the first quarter of fiscal 2005, we qualified for this special tax deduction and considered it in determining our income tax provision. This tax deduction resulted in an approximate 1% reduction in the federal statutory income tax rate applicable to both the third quarter and the first nine months of 2005.

Also in December 2004, the FASB issued Staff Position No. 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* (FSP 109-2). The AJCA provides for a special one-time tax deduction, or dividend received deduction (DRD), of 85% of certain foreign earnings that are repatriated to the United States and reinvested in qualified investments in the United States. Such qualified investments include: compensation and benefits for employees, hiring and training, capital and infrastructure investments, research and development, and advertising and marketing expenditures.

During the third quarter of 2005, we completed our evaluation of whether to repatriate unremitted earnings of certain of our non-U.S. subsidiaries under the provisions of the AJCA and determined to repatriate approximately \$709 million of such earnings, of which approximately \$673 million qualifies for the special one-time deduction. On September 28, 2005, we repatriated \$200 million and anticipate completing the remaining repatriation by the end of 2005. We recorded income tax expense, net of current year generated tax credits, and a related income tax liability of approximately \$36 million in the third quarter of 2005 based on total earnings to be repatriated of \$709 million.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29* (SFAS No. 153). SFAS No. 153 eliminates the exception to fair value for exchanges of similar productive assets and replaces it with a general exception for exchange transactions that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to

change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005 and is to be applied prospectively. The adoption of SFAS No. 153 is not expected to have a material impact on our consolidated financial statements.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs - an Amendment of ARB No. 43, Chapter 4* (SFAS No. 151), which is the result of the FASB's efforts to converge U.S. accounting standards for inventory with International Accounting Standards. SFAS No. 151 requires abnormal amounts of idle facility expense, freight, handling costs, and wasted material to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We plan to adopt SFAS No. 151 at the beginning of our 2006 fiscal year and do not expect the adoption to have a material impact on our results of operations or financial position.

2. **EARNINGS PER SHARE.** Basic earnings per share is computed based on net income and the weighted average number of common shares outstanding. Diluted earnings per share reflects the assumed issuance of common shares under long-term incentive stock option plans. The decrease in dilutive securities during 2005 was due primarily to a decrease in the number of shares potentially issuable under our plans. The computation of diluted earnings per share does not assume conversion or exercise of securities that would have an antidilutive effect on earnings per share.

3. **DIVESTITURES.**

In August 2005, we completed the sale of our majority ownership in G-P Flakeboard, Inc., our Canadian medium-density fiberboard operations, to the minority interest owner, and the sale of our Richwood, WV, hardwood lumber mill. Total proceeds received were \$69 million and we recorded a \$20 million gain related to these sales.

Bellingham Tissue Operation

In January 2005, we completed the sale of our Bellingham, Washington, facility to the Bellingham Port Authority (the Port). We received no proceeds from the sale, but the Port assumed substantially all of our environmental liabilities associated with the facility. In addition, we have an agreement with the Port to lease back the land associated with this facility.

Building Products Distribution

On May 7, 2004, we completed the sale of our building products distribution segment. This business did not qualify for discontinued operations reporting and is included in continuing operations in our 2004 results of operations through the date of the sale.

Discontinued Operations

On May 7, 2004, we sold our stand-alone market pulp mills at Brunswick, Georgia, and New Augusta, Mississippi, and a short-line railroad. The results of operations associated with these businesses have been reported as discontinued operations in the accompanying consolidated statements of operations. During the third quarter of 2005, we recorded a \$2 million credit for income tax true-ups related to the sale. Operating results of these discontinued operations are:

DISCONTINUED OPERATIONS

CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

(In millions)	Third Quarter	First Nine Months
2004		
Net sales	\$	\$ 220
Costs and expenses:		
Cost of sales	1	179
Selling and distribution		6
Depreciation, amortization and accretion		13
General and administrative		4
Interest, net		5
Other income, net	(3)	(5)
Total costs and expenses	(2)	202
Income from discontinued operations before income taxes	2	18
Provision for income taxes	1	22
Income (loss) from discontinued operations, net of taxes	\$ 1	\$ (4)

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

During the third quarter and first nine months of 2004, we sold non-strategic assets and included the related gains and losses in Other losses (income), net on the consolidated statements of operations. These sales are detailed in the following table:

(In millions)	Pre-tax Gain	
	Included in	
	Other Losses (Income), Net	
	Third Quarter	First Nine Months
2004:		
Brazilian pulp business	\$ (2)	\$ 24
Packaging assets		23
Other	5	7

4. ASSET IMPAIRMENTS AND RESTRUCTURING.

2005:

On September 29, 2005, we approved a restructuring program within our North America Consumer Products segment, primarily in our commercial tissue operations. As part of this program, along with planned restructuring activities in our International Consumer Products segment, we plan to:

Reduce structural costs in our commercial tissue operations by optimizing the inherent low cost papermaking at our mills in Savannah, Georgia, and Muskogee, Oklahoma, and right-sizing the Green Bay, Wisconsin mills;

Relocate various other tissue operations within the U.S. to more cost-efficient locations; and

Reduce costs in our International Consumer Products segment through the implementation of restructuring in Kunheim, France, and further investments and rationalization to improve operating efficiencies in the United Kingdom and the Nordic region.

We estimate that during the course of the entire two-year program, the workforce within our North America and International Consumer Products segments will be reduced by approximately 1,100 positions. As a result of the restructuring, we expect to incur a total of approximately \$106 million in restructuring charge. Of the \$106 million, \$87 million is related to our North America Consumer products segment and \$19 million is related to our International Consumer products segment. During the third quarter of 2005, \$41 million of the estimated \$106 million was expensed in the following categories:

(In millions)

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Cost of sales	\$ 24
Selling and distribution	
Depreciation, amortization and accretion	2
General and administrative	
Other losses (income), net	15

Income (loss) before income taxes	\$ (41)
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Of the \$106 million, we expect to incur approximately \$21 million in employee-related costs, including severance and other termination benefits; approximately \$53 million in net asset impairment charges, accelerated depreciation, and

storeroom writeoffs; and approximately \$32 million in other facility-related exit costs. We expect to incur net cash expenditures of approximately \$49 million in connection with these charges.

Activities related to restructuring for the third quarter of 2005 were as follows:

(In millions)	Work Force Reductions	Facility Exit Costs	Asset Impairments	Other	Total
Beginning reserve balance	\$	\$	\$	\$	\$
Additions	16	1	24		41
Costs charged against reserve		(1)			(1)
Reclassifications of reserve to other balance sheet accounts:					
Inventories			(8)		(8)
Property plant & equipment			(16)		(16)
Other assets					
Ending reserve balance	\$ 16	\$	\$	\$	\$ 16

During the first six months of 2005, we had asset impairment charges of approximately \$5 million primarily related to the closure of our Caledonia gypsum mine and asset impairments at our Green Bay Broadway facility.

2004:

In June 2004, we signed a letter of intent with the Bellingham Port Authority to sell our Bellingham, Washington facility. In connection with this agreement, we determined that the value of the related assets was impaired. Accordingly, in the second quarter of 2004, we recorded pre-tax charges to earnings of \$11 million for asset impairments related to this facility. The sale to the Port was completed in January 2005.

2001:

In connection with the acquisition of Fort James Corporation (Fort James), in 2001 we recorded liabilities of \$35 million, primarily for lease and contract termination costs at administrative facilities that were closed in California, Connecticut, Illinois, Virginia, Wisconsin and Europe. These leases and contracts expire through 2012. The current remaining balance of the reserve for the lease agreements is approximately \$10 million.

5. **INVENTORY VALUATION.** Inventories are valued at the lower of cost or market and include the costs of materials, labor and manufacturing overhead. The last-in, first-out (LIFO) method was used to determine the cost of approximately 68% and 60% of inventories at October 1, 2005 and January 1, 2005, respectively. The cost of other inventories, primarily inventories of foreign subsidiaries and supplies, generally is determined using the first-in, first-out method or weighted-average cost. The value of inventories as presented in our consolidated balance sheets, before reduction for the LIFO reserve, approximates replacement cost at the respective dates. The major components of inventories were as follows:

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(In millions)	October 1, 2005	January 1, 2005
Raw materials	\$ 724	\$ 685
Finished goods	761	743
Supplies	281	278
LIFO reserve	(166)	(158)
Total inventories	\$ 1,600	\$ 1,548

6. **GOODWILL AND INTANGIBLE ASSETS.** We are required to assess the fair value of the net assets underlying all acquisition-related goodwill on a reporting unit basis. When the fair value is less than the related carrying value, entities are required to reduce the amount of goodwill. Our reporting units with goodwill are: North America tissue, towel and napkin; Dixie; international consumer products; packaging; lumber; gypsum and chemical.

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The changes in the carrying amount of goodwill for the first nine months of 2005 and 2004 by reportable segment were:

(In millions)	North America Consumer Products	International Consumer Products	Packaging	Building Products	Consolidated
Balance as of January 3, 2004	\$ 5,831	\$ 987	\$ 630	\$ 36	\$ 7,484
Goodwill acquired during the year			1		1
Reclassifications	2				2
Foreign currency translation		(9)			(9)
Balance as of October 2, 2004	\$ 5,833	\$ 978	\$ 631	\$ 36	\$ 7,478
Balance as of January 1, 2005	\$ 5,816	\$ 1,067	\$ 631	\$ 37	\$ 7,551
Tax related adjustments	(12)	(5)			(17)
Foreign currency translation		(121)		1	(120)
Balance as of October 1, 2005	\$ 5,804	\$ 941	\$ 631	\$ 38	\$ 7,414

Intangible Assets

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

(In millions)	As of October 1, 2005		As of January 1, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Trademarks	\$ 670	\$ 73	\$ 702	\$ 64
Patents and other	136	87	139	76
Total	\$ 806	\$ 160	\$ 841	\$ 140

The aggregate amortization expense for the first nine months of 2005 and 2004 was \$26 million and \$24 million, respectively.

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

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

(In millions)	First Nine Months	
	2005	2004
Asset retirement obligation at the beginning of the year	\$ 50	\$ 49
Accretion expense	4	3
Revisions in estimated cash flow		(1)
Payments	(1)	(1)
Write-offs	(1)	(1)
Asset retirement obligation at the end of the third quarter	\$ 52	\$ 49

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8. **DEBT.** Our debt decreased by \$749 million to \$7,940 million at October 1, 2005 from \$8,689 million at January 1, 2005. This decrease includes the effect of changes in foreign currency exchange rates and the fair market value of hedged instruments of \$7 million and \$10 million, respectively, during this time period. For the first nine months of 2005, the weighted average interest rate on our total debt, including outstanding interest rate exchange agreements, was 7.3%.

As of October 1, 2005, we had \$288 million outstanding under our \$800 million accounts receivable secured borrowing program through G-P Receivables, Inc., our wholly-owned subsidiary. The total costs of the program for the first nine months of 2005 and 2004 were \$18 million and \$11 million, respectively.

During the second quarter of 2005, the Internal Revenue Service (IRS) determined that two issues of tax-exempt bonds totaling \$61 million issued in 1995 to finance a portion of solid waste disposal facilities at our Toledo, Oregon mill in the mid-to-late 1990s did not qualify for tax-exempt status. However, each of these issues was retired (one in 1996 and the other in 1998) with the proceeds of tax-exempt refunding bonds. One of these refunding issues is currently under IRS examination along with 11 other issues of tax-exempt bonds that financed solid waste disposal facilities at various mills. If any of these issues were to be declared taxable by the IRS, we would be required under the bond indentures to redeem such bonds. Depending on the ultimate outcome of these examinations, it is possible that we will redeem bonds with an aggregate principal balance of up to \$293 million with approximately \$7 million of unamortized debt discount and issuance costs at October 1, 2005. We expect any payments required to redeem these bonds would be funded through our senior credit facility. For further information regarding these bonds, see Note 11.

During the second quarter of 2005, we called \$250 million of our 8.625% debentures due April 30, 2025. In conjunction with this transaction, we recorded a pretax charge of \$13 million for call premiums and to write off deferred debt issuance costs during the second quarter of 2005. This charge for the early extinguishment of debt was included in Other losses (income), net in the accompanying consolidated statements of operations.

During the first quarter of 2005, we repurchased and retired \$25 million of our 9.375% senior notes due February 1, 2013. In conjunction with this transaction, we recorded a pretax charge of \$4 million for premiums and to write off deferred debt issuance costs. This charge for the early extinguishment of debt was included in Other losses (income), net on the accompanying consolidated statements of operations.

During the first quarter of 2005, we gave notice of our intent to exercise an early buyout option on capital leases with associated borrowings of \$42 million due through February 15, 2010 and February 15, 2012. The payment for the early buyout will be made on or about February 15, 2006. Accordingly, we have reclassified the related borrowings as Current portion of long-term debt on the accompanying consolidated balance sheets as of October 1, 2005.

Our \$2.5 billion, five-year, unsecured senior credit facility, which includes a \$500 million non-amortizing term loan, matures July 2, 2009. Amounts committed and outstanding under this facility include the following:

(In millions)	October 1, 2005
Commitments:	
Revolving loans	\$ 2,000
Term loans	500
Credit facilities available	2,500

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Amounts Committed and Outstanding:	
Letters of credit agreements ⁽¹⁾	(483)
Revolving loans due July 2009, average rate of 5.0%	(48)
Term loans due July 2009, average rate of 5.3%	(500)
<hr/>	
Total committed and outstanding	(1,031)
<hr/>	
Total credit available	\$ 1,469
<hr/>	

⁽¹⁾ Includes only standby letters of credit supported by our senior credit facility.

As of October 1, 2005, we had an additional \$24 million in letters of credit outstanding from various financial institutions.

Approximately \$109 million of our industrial revenue bonds are supported by letters of credit that expire within one year. We have the ability and intent to refinance these revenue bonds on a long-term basis. Therefore, maturities of these obligations are reflected in accordance with their stated terms.

We have interest rate exchange agreements that effectively convert \$500 million of fixed-rate obligations to floating-rate obligations. For the nine months ended October 1, 2005, these agreements decreased interest expense by \$2 million. The agreements had a weighted-average maturity of approximately four years at October 1, 2005. The estimated fair value of these agreements at October 1, 2005 was a \$16 million liability which is included in Other long-term liabilities in the consolidated balance sheets. Additionally, our debt balance has been reduced by the corresponding amount.

At October 1, 2005, we had an interest rate exchange agreement (a collar) that effectively capped a \$47 million floating rate obligation to a maximum interest rate of 7.5% and established a minimum interest rate on this obligation of 5.5%. Our interest expense is unaffected by this agreement when the market interest rate falls within this range. For the first nine months ended October 1, 2005, this agreement reduced interest expense by approximately \$1 million. This interest rate exchange agreement matured October 25, 2005.

The estimated fair value of our interest rate exchange collar at October 1, 2005 was an asset of less than \$1 million, which represents the estimated amount we would have received if this agreement were terminated on October 1, 2005. The fair value at October 1, 2005 was estimated by calculating the present value of anticipated cash flows. The discount rate used was an estimated borrowing rate for similar debt instruments with like maturities.

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

9. **DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES.** During the first quarter of 2005, we entered into commodity swap agreements under our company-wide natural gas hedging program to reduce the risk inherent in fluctuating natural gas prices. These swap agreements are considered cash flow hedges of our natural gas purchases and differences paid and received under the swap agreements are recognized as adjustments to gas costs. These hedges are considered to be highly effective in offsetting the cash flows of our natural gas costs and, therefore, the changes in fair value are recorded in accumulated other comprehensive income. With each type of cash flow hedge, the settlement of the forecasted transaction will result in the reclassification into earnings of gains and losses that are reported in accumulated other comprehensive income.

During the nine months ended October 1, 2005, the settlement of these transactions decreased gas costs by \$12 million, with an additional \$19 million to be reclassified to earnings for our October 2005 gas costs. There were no such contracts outstanding at October 1, 2005.

We use interest rate exchange agreements to manage our interest rate risk. These interest rate exchange agreements are considered hedges of specific borrowings and differences paid and received under the swap arrangements are recognized as adjustments to interest expense. Such contracts had a total notional amount of \$500 million at October 1, 2005. These hedges are considered to be highly effective and no ineffectiveness was recorded during the first nine months of 2005. Changes in the fair value of these swaps and that of the related debt, the net of which is zero, are recorded in Interest, net on the accompanying consolidated statements of operations. At October 1, 2005, the fair market value of such contracts was a liability of \$16 million and was recorded in Other long-term liabilities on the accompanying consolidated balance sheets. Additionally, our debt balance has been reduced by the corresponding amount.

10. RETIREMENT PLANS.

Defined Benefit Pension Plans

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

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

Net periodic pension cost during the third quarters and first nine months of 2005 and 2004 included the following components:

(In millions)	Third Quarter		First Nine Months	
	2005	2004	2005	2004
Service cost of benefits earned	\$ 37	\$ 34	\$ 110	\$ 108
Interest cost on projected benefit obligation	62	62	188	188
Expected return on plan assets	(76)	(70)	(226)	(214)
Amortization of losses	10	9	30	26
Amortization of prior service cost	4	3	12	11
Settlement and curtailment losses				13
Contributions to multiemployer pension plans	3	2	7	7
Net periodic pension cost	\$ 40	\$ 40	\$ 121	\$ 139

The net periodic pension cost above includes approximately \$1 million for the first nine months of 2004 reported as discontinued operations.

During the first nine months of 2005, we recognized \$121 million of pension expense. We anticipate recording an additional \$41 million of pension expense during the remainder of 2005 for a total of \$162 million.

During the first nine months of 2005, we made pension contributions of \$103 million. We presently anticipate contributing an additional \$125 million to fund our pension plans during the remainder of 2005 for a total of \$228 million.

Health Care and Life Insurance Benefits

Net periodic postretirement benefit cost during the third quarters and first nine months of 2005 and 2004 included the following components:

(In millions)	Third Quarter		First Nine Months	
	2005	2004	2005	2004
Service cost of benefits earned	\$ 1	\$ 1	\$ 2	\$ 3
Interest cost on accumulated postretirement benefit obligation	8	9	27	28
Amortization of prior service credit	(6)	(4)	(14)	(13)
Amortization of unrecognized loss	2		6	1

Net periodic postretirement benefit cost	\$ 5	\$ 6	\$ 21	\$ 19
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During the first nine months of 2005, we recognized \$21 million of postretirement benefit expense. We anticipate recording an additional \$6 million in postretirement benefit cost during the remainder of 2005 for a total of \$27 million.

During the first nine months of 2005, we made contributions of \$50 million for the payment of benefits. We presently anticipate contributing an additional \$19 million for the payment of benefits from our retiree medical plans during the remainder of 2005 for a total of \$69 million.

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

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

ENVIRONMENTAL MATTERS

We are involved in environmental remediation activities at approximately 162 sites, both owned by us and owned by others, where we have been notified that we are or may be a potentially responsible party (PRP) under the United States Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) or similar state superfund laws. Of the known sites in which we are involved, we estimate that approximately 43% are being investigated, approximately 18% are being remediated and approximately 39% are being monitored (an activity that occurs after either site investigation or remediation has been completed). The ultimate costs to us for the investigation, remediation and monitoring of many of these sites cannot be predicted with certainty, due to the often unknown nature and magnitude of the pollution or the necessary cleanup, the varying costs of alternative cleanup methods, the amount of time necessary to accomplish the cleanups, the evolving nature of cleanup technologies and governmental regulations, and the inability to determine our share of multiparty cleanups or the extent to which contribution will be available from other parties, all of which factors are taken into account to the extent possible in estimating our liabilities. We have established reserves for environmental remediation costs for these sites that we believe are probable and reasonably able to be estimated. To the extent that we are aware of unasserted claims, consider them probable, and can estimate their potential costs, we have included appropriate amounts in the reserves.

Based on analyses of currently available information and previous experience with respect to the cleanup of hazardous substances, we believe it is reasonably possible that costs associated with these sites may exceed current reserves by amounts that may prove insignificant or that could range, in the aggregate, up to approximately \$128 million. This estimate of the range of reasonably possible additional costs is less certain than the estimates upon which reserves are based, and in order to establish the upper limit of this range, assumptions least favorable to us among the range of reasonably possible outcomes were used. In estimating both our current reserve for environmental remediation and the possible range of additional costs, we have not assumed we will bear the entire cost of remediation of every site to the exclusion of other known PRPs who may be jointly and severally liable. The ability of other PRPs to participate has been taken into account, based generally on their financial condition and probable contribution on a per-site basis.

The following table presents the activity in our environmental liability account for the third quarters and first nine months of 2005 and 2004:

(In millions)	Third Quarter		First Nine Months	
	2005	2004	2005	2004
Beginning balance	\$ 220	\$ 239	\$ 237	\$ 230
Expense included in earnings:				
Related to previously existing matters	11		17	2
Related to new matters		1		6
Amounts related to divestiture:				
Bellingham divestiture			(14)	
Reclassification of reserves				7
Payments	(4)	(3)	(13)	(8)
Ending balance	\$ 227	\$ 237	\$ 227	\$ 237

KALAMAZOO RIVER SUPERFUND SITE

We are currently implementing an Administrative Order by Consent (AOC) entered into with the Michigan Department of Natural Resources and the United States Environmental Protection Agency (EPA) regarding an investigation of the Kalamazoo River Superfund Site.

A draft Remedial Investigation/Feasibility Study (RI/FS) for the Kalamazoo River was submitted to the State of Michigan on October 30, 2000 by us and other PRPs. The draft RI/FS evaluated five remedial options ranging from no

action to total dredging of the river and off-site disposal of the dredged materials. In February 2001, the PRPs, at the request of the State of Michigan, also evaluated 9 additional potential remedies. The cost for these remedial options ranges from \$0 to \$2.5 billion. The draft RI/FS recommends a remedy involving stabilization of over twenty miles of riverbank and long-term monitoring of the riverbed. The total cost for this remedy is approximately \$73 million. It is unknown over what timeframe these costs will be paid out. The United States EPA has taken over management of the RI/FS and is evaluating the proposed remedy. We cannot predict what impact or change will result from the United States EPA's assuming management of the site.

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

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

It is anticipated that the cost for closure of the second disposal area, the Willow Boulevard/A Site landfill, will be approximately \$12 million. The State of Michigan prepared and United States EPA has accepted a new RI/FS for this landfill. The new RI/FS evaluates the same remedies proposed by the PRPs. The decision as to the actual remedy will be made by the United States EPA which decision is expected later this year. We believe the United States EPA will require a remedy for this landfill similar to the King Highway landfill closure. It is anticipated these costs will be paid out over the next five years, and costs for post-closure care for 30 years following certification of the closure. We are solely responsible for closure and post-closure care of the Willow Boulevard portion of the landfill, and are sharing costs for the A Site portion of the landfill with Millennium Holdings on an equal basis. A final determination as to how closure and post-closure costs for the A Site will be allocated between us and Millennium Holdings has not been made; however, our share should not exceed 50%.

We have spent approximately \$36 million on the Kalamazoo River Superfund Site through October 1, 2005, broken down as follows: (in millions)

Site	Expenditures to Date
River	\$ 21
King Highway	10
A Site	2
Willow Boulevard	3
	\$ 36

All of these amounts were charged to earnings.

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

FOX RIVER SITE

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

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

The ROD calls for the removal by dredging of all sediments in OUs 3 and 4 containing PCBs above one part per million. The amount of sediment estimated to contain PCBs above one part per million is 586,800 cubic yards in OU 3 and 5,880,000 cubic yards in OU 4. The ROD also calls for monitored natural recovery for OU 5. The ROD estimates the dredging remedy for OUs 3 and 4 and the monitored natural recovery for OU 5 will cost \$324 million. However, the ROD does allow for capping as an alternative remedy to dredging in certain areas of OUs 3 and 4 if capping would be less costly than dredging and provide the same level of protection as dredging. The WDNR estimated that approximately 40% of the total volume of contaminated sediments in OUs 3 and 4 would be eligible for capping based upon the capping criteria defined in the ROD. The allowance for capping in the ROD represents a major change from the proposed remedial action plan issued by WDNR in 2001, which did not provide or allow for capping in any areas of OUs 3 and 4.

Six other companies have been identified by the governments as PRPs. Under an interim allocation agreement, we were paying 30% of costs incurred by the PRPs in analyzing and responding to all of the governmental documents which preceded the issuance of the ROD. With the issuance of the ROD, we do not anticipate that the PRPs will be engaged in any further formal remedial investigation work as a group. We believe that all of the PRPs are liable for some portion of the costs of remediating OUs 4 and 5, and that our ultimate liability will be less than 30% of the total estimated cost of remediating the Fox River site.

Following issuance of the ROD we analyzed its remedial provisions as well as the relevant facts impacting our potential liability. We concluded that we will be able to utilize the capping remedy to the extent permitted by the ROD. We also concluded that there are geographic limitations on our potential liability, and that we can limit our responsibility for the removal and capping of PCBs to the part of OU 4 immediately adjacent to and downstream from the Fort James facility in Green Bay, Wisconsin. We share liability for any appropriate monitoring in OU 5 with all of the PRPs.

We have spent approximately \$41million from 1995 to October 1, 2005 on the Fox River site, some of which was spent by Fort James prior to its acquisition by us.

Along with another PRP, we have entered into an Administrative Order by Consent (AOC) to prepare the remedial design for OUs 3, 4 and 5. We submitted a Basis of Design Report for the WDNR and United States EPA in August of this year.

In 2002, we entered into an agreement with the WDNR and the United States Fish and Wildlife Service to settle claims for natural resource damages under CERCLA, the Federal Water Pollution Control Act, and state law for approximately \$12 million, and to date have paid approximately \$10 million of this amount. The agreement was entered by the Federal District Court in Wisconsin on March 19, 2004 and is now effective. The \$12 million to be paid under this agreement is separate and apart from any costs related to remediation of the Fox River site.

In 1999 we and Chesapeake Corporation formed a joint venture to which a Chesapeake subsidiary, Wisconsin Tissue Mills, Inc., contributed tissue mills and other assets located along the Fox River. Wisconsin Tissue is one of the PRPs for the Fox River site. Chesapeake and Wisconsin Tissue specifically retained all liabilities arising from Wisconsin Tissue's status as a PRP, and indemnified the joint venture and us against these liabilities. In 2001, we (having acquired all of Chesapeake's interest) sold this joint venture to Svenska Cellulosa Aktiebolaget (publ) (SCA) and indemnified SCA and the joint venture against all environmental liabilities (including all liabilities arising from the Fox River site for which Wisconsin Tissue is ultimately responsible) arising prior to the closing of the SCA sale. As part of the agreement pursuant to which we acquired Chesapeake's interest in the joint venture, Chesapeake specifically agreed that we would retain Chesapeake's prior indemnification for these liabilities.

OTHER

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

ASBESTOS LITIGATION

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

The following table presents information about the approximate number of our asbestos claims during the first nine months of each of 2005 and 2004:

	First Nine Months	
	2005	2004
Claims Filed ¹	8,000	22,800
Claims Resolved ²	10,300	27,300
Claims Unresolved at End of Period	57,400	59,800

¹ Claims Filed includes all asbestos claims for which service has been received and/or a file has been opened by us and each such claim represents a plaintiff who is pursuing an asbestos claim against us.

² Claims Resolved include asbestos claims which have been settled or dismissed or which are in the process of being settled or dismissed based upon agreements or understandings in place with counsel for the claimants.

In addition, Fort James Corporation, one of our wholly-owned subsidiaries, currently is defending approximately 790 asbestos premises liability claims.

From the commencement of this litigation through October 1, 2005, we either had settled, had dismissed or were in the process of settling a total of approximately 354,600 asbestos claims. For this same period our asbestos payments, for liability, defense and administration, before insurance recoveries and tax benefits, totaled approximately \$945 million. We generally settle asbestos claims for amounts we consider reasonable given the facts and circumstances of each claim.

At the end of 2004, National Economic Research Associates (NERA), nationally recognized consultants in projecting asbestos liabilities, reviewed our asbestos indemnity payments and claims activity in 2004 and compared them to the forecast it prepared in 2002 of our total asbestos liabilities for 2003 through 2012 and subsequently extended in 2003 through 2013. Based on this review, NERA determined that our indemnity payments in 2004 were in line with the 2002 forecast. NERA concluded, as it did at the end of 2003, that the assumptions used in its 2002 forecast to estimate our future asbestos indemnity payments remained valid, and that no changes to the underlying forecast were necessary with respect to that portion of our total liability, other than extending it through 2014. NERA advised that there was a reasonable basis for estimating that \$48 million should be added to our reserves to cover estimated indemnity payments in 2014 so that our total reserves cover the next ten years. We also worked with NERA to develop a revised projection of defense costs based on our historical defense spending. At the end of 2004, we added, with NERA 's concurrence, \$109 million to our overall asbestos reserve for defense costs through 2014.

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In 2004, as in prior years, and with advice from legal counsel and Navigant Consulting, nationally recognized consultants in insurance, we reviewed our existing insurance policies, analyzed publicly available information bearing on the creditworthiness of our various insurers, and employed insurance allocation methodologies which we and our advisors considered appropriate to ascertain the amount of probable insurance recoveries from our insurers for our present and future asbestos liabilities. Assumptions were made about self-insurance reserves, policy exclusions, liability caps and gaps in our coverage, the resolution of allocation issues among various layers of insurers, as well as insolvencies of certain of our insurance carriers and the continued solvency of our other insurers. Based on this analysis, Navigant Consulting projected our expected insurance recoveries for asbestos liabilities and costs over the period through 2014. In the fourth quarter of 2004, we reduced our insurance receivable by \$2 million to reflect the insolvencies of two small insurers, largely offset by a settlement with another insurer that was more favorable than expected. In the third quarter of 2005, we recorded a credit of \$4 million as a result of a settlement agreement we reached with an insurer during the quarter. In the second quarter of 2005, we recorded a charge of \$3 million as a result of a settlement agreement we reached with an insurer during the quarter.

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

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

Generally, NERA's projections assume:

That the number of new claims to be filed against us each year through 2014 will decline at a fairly constant rate each year;

That the percentage of claims settled by us will be about three-quarters of the total number of claims resolved (whether by settlement or dismissal) each year through 2014;

That the average estimated per case settlement costs are anticipated to decrease slightly each year over the period through 2014; and

That the total amount paid by us in settlements and for defense costs will decline at varying rates over the period through 2014.

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

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

We currently maintain a reserve to cover the probable and reasonably estimable asbestos liabilities and defense costs we believe we will pay through 2014, net of expected insurance recoveries during this same period. The following table summarizes accruals to, and payments from, our reserve for our total asbestos personal injury liabilities, receipts from our insurance carriers and other changes to our expected insurance receivables for the first nine months of each of 2005 and 2004:

(In millions)	First Nine Months	
	2005	2004
Asbestos Liabilities		
Beginning balance	\$ 984	\$ 1,027
Accruals		
Payments	(113)	(145)

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Ending balance	\$ 871	\$ 882
Insurance Receivable		
Beginning balance	\$ 525	\$ 576
Recoveries/writeoffs	1	
Receipts	(26)	(26)
Ending balance	\$ 500	\$ 550

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

During the first nine months of 2005, the number of new asbestos claims filed against us declined sharply from the same period in 2004, due in part to the effect of tort reform legislation enacted in Mississippi and Texas and recent decisions of the Mississippi Supreme Court relating to venue and jurisdiction. Our indemnity payments to settle pending asbestos cases were below our projections for the first nine months of 2005 and down from the same period of 2004. Our defense costs during the first nine months of 2005 were approximately equal to our projections for the period and to the same period of 2004. Due to the timing of certain payments that we expected to pay in the third quarter but did not, we expect our indemnity payments and defense costs for the fourth quarter to be higher than those in prior quarters this year, but at present we expect indemnity payments and defense costs for all of 2005 to be below comparable levels during 2004.

There can be no assurance that our currently accrued asbestos liabilities will be sufficient to cover our payments for such liabilities and related defense costs, or that our accrued insurance recoveries will be realized, through 2014. We believe that it is reasonably possible that we will incur additional charges for our asbestos liabilities and defense costs in the future which could exceed our existing reserves, but cannot estimate such excess amount at this time. We also believe that it is reasonably possible that such excess liabilities could be material to our operating results in any given quarter or year but, based on the information available to us at present, do not believe that it is reasonably possible that such excess liabilities would have a material adverse effect on our long-term results of operations, liquidity or consolidated financial position.

OTHER LITIGATION

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

In March 2000, CP and CV filed for bankruptcy. Various creditors have alleged that the borrowings made by CP and CV, and the payments to Fort James for the assets transferred to CV and CP, caused those companies to become insolvent, and that the transfer of these assets therefore was a fraudulent conveyance. In September 2001, CV filed suit in Federal District Court in San Francisco against Fort James asserting, among other claims, that the transactions described above constituted fraudulent conveyances and seeking unspecified damages. Early in July 2004, that court dismissed a number of these claims but continued proceedings with respect to two remaining fraudulent conveyance claims. The court had earlier lifted an injunction imposed by the Federal Bankruptcy Court in Oakland, which prevented us from proceeding with an action we filed in Delaware that asserts that, in a 1998 agreement, CV and CP released all claims against Fort James. CV and CP appealed these rulings, and in August 2005, the United States Court of Appeals for the Ninth Circuit ruled that we should be precluded from proceeding with the Delaware action. Those claims will be litigated in the Federal District Court in San Francisco along with the remaining fraudulent conveyance claims. A trial date has been set for February 2007.

Fort James does not believe that any of its actions in establishing CV or CP involved a fraudulent conveyance or caused the bankruptcy of those companies, and it intends to defend itself vigorously. Accordingly, no amounts have been accrued for a liability in this matter.

TAX-EXEMPT BOND MATTERS

During the second quarter of 2005, the Internal Revenue Service (IRS) determined that two issues of tax-exempt bonds totaling \$61 million issued in 1995 to finance a portion of solid waste disposal facilities at our Toledo, Oregon mill in the mid-to-late 1990s did not qualify for tax-exempt status. However, each of these issues was retired (one in 1996 and the other in 1998) with the proceeds of tax-exempt refunding bonds. One of these refunding issues is currently under IRS examination. We have publicly stated that we will take steps to ensure that the holders of these series of bonds, to the extent they ultimately pay any federal taxes on such interest, will be made whole with respect to any such payments.

In addition, the IRS has been examining whether four series of bonds issued by agencies of the State of Virginia, the proceeds of which were used to construct a portion of solid waste disposal facilities at our Big Island, Virginia mill, were properly issued as tax-exempt bonds. The IRS has issued Preliminary Adverse Determinations that interest paid on these four bond issues was taxable. These determinations are not a final determination of the taxability of such bonds, and we intend to pursue further discussions with the IRS on this issue.

Finally, during 2005, the IRS notified state government bodies that issued other series of bonds, the proceeds of which were used to construct portions of solid waste recycling and disposal facilities at several of our other mills, that it intends to examine whether such bonds were properly issued as tax-exempt bonds. These series of bonds selected by the IRS for examination are: (i) \$11,600,000 County Commission of Fayette County, West Virginia, Solid Waste Disposal Facility Revenue Bonds (Georgia-Pacific Corporation Project), Series 1995; (ii) \$19,500,000 Industrial Development Authority of the County of Campbell, Virginia, Solid Waste Disposal Facility Revenue Bonds (Georgia Pacific Corporation Project), Series 1994; (iii) \$80,890,000 Development Authority of Effingham County, Georgia, Solid Waste Disposal Revenue Bonds (Fort James Project), Series 1998; (iv) \$25,000,000 Liberty County, Florida Industrial Development Revenue Bonds (Georgia-Pacific Corporation Project), Series 2004; (v) \$24,875,000 Industrial Development Board of the City of Butler 5.75% Solid Waste Disposal Revenue Refunding Bonds (Georgia-Pacific Corporation Project), Series 2004; (vi) \$14,200,000 Industrial Development Board of the Parish of East Baton Rouge, Louisiana, Inc. Solid Waste Disposal Revenue Bonds (Georgia-Pacific Corporation Project), Series 2004; and (vii) \$10,000,000 County of Jasper, Indiana 5 5/8% Economic Development Revenue Bonds (Georgia-Pacific Corporation Project), Series 1997.

We have had meetings with officials of the IRS to discuss the two series of Oregon bonds, and a settlement of the tax-exempt status of all the other bond issues which the IRS is reviewing or intends to examine, including the Virginia bonds discussed above. We strongly disagree with the IRS's view that any of such bonds, including the Oregon and Virginia bonds, were not properly issued as tax-exempt bonds, and are preparing to litigate this issue if necessary. Discussions with the IRS have continued throughout the third quarter. However, we have yet to reach a settlement. Based on all the information available to us, we established an overall reserve of \$11 million in the second quarter, representing our estimate of our costs to resolve these matters. Based on the current facts and circumstances, we believe that this reserve continues to represent our best estimate of our potential liability. We will continue to evaluate our exposure and we will adjust the reserve as circumstances warrant.

In July 2005, the Philadelphia office of the Securities and Exchange Commission advised us that it had commenced an informal, non-public inquiry into whether any federal securities laws violations had occurred in connection with the IRS review of the tax-exempt status of the Oregon bonds described above. The SEC has informed us that the informal inquiry is not an indication that any violations of law have occurred, and we intend to cooperate with and assist the SEC in its informal inquiry.

GUARANTEES AND INDEMNIFICATIONS

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

payments under these indemnities until events arise that would trigger a liability under the indemnities.

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

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

We do not believe that any amounts that we may be required to pay under the indemnities set forth in the agreements relating to recent divestitures will be material to our results of operations, financial position, or liquidity. In the case of each divestiture, we believe that there is a remote likelihood that we will be required to pay any material amounts under any of the indemnity provisions. As a result, we have estimated that the fair value of these indemnities at the date of the closing of the related transaction is minimal and, accordingly, no amounts have been recorded. Should circumstances change, increasing the likelihood of payments related to a specific indemnity, we will accrue a liability when future payment is probable and the amount is reasonably estimable.

There have been no material changes to our indemnifications during the third quarter of 2005. A complete discussion of our indemnifications is detailed in Note 17 of the Notes to Consolidated Financial Statements included in our Annual Report on [Form 10-K](#) filed with the SEC for the fiscal year ended January 1, 2005.

12. **CONDENSED CONSOLIDATING INFORMATION.** Fort James is an issuer of certain securities registered under the Securities Act of 1933, thus subjecting it to reporting requirements under Section 15(d) of the Securities Exchange Act of 1934. Fort James guarantees our \$500 million and \$1.475 billion senior notes outstanding as of October 1, 2005, which were issued on September 30, 2003 and August 29, 2003, respectively. Fort James Operating Company, a subsidiary of Fort James, also guarantees these senior notes and certain other securities issued by Fort James. Both Fort James and the Fort James Operating Company guarantee our senior credit facility. Each subsidiary issuer or subsidiary guarantor is 100% owned by us and all guarantees are full and unconditional.

During the second quarter of 2005, we completed a reorganization of Fort James subsidiaries resulting in increases in other assets and intercompany notes receivable in the consolidating balance sheets of our guarantor and non-guarantor subsidiaries as a result of the transfer of intercompany notes receivable between our guarantor and non-guarantor subsidiaries.

Included in other non-guarantor subsidiaries is our wholly-owned subsidiary, G-P Receivables Inc. (G-P Receivables), which is a special purpose entity into which some of our receivables and the receivables of participating domestic subsidiaries are sold, as more fully described in [Note 8](#). G-P Receivables bought these receivables at a significant discount during the first three months of 2004 resulting in G-P Receivables recognizing a credit to general and administrative expense of \$286 million, and Georgia-Pacific Corporation, Fort James Operating Company, and other non-guarantor subsidiaries recognizing a corresponding charge to general and administrative expense of \$256 million, \$4 million and \$26 million, respectively. At the end of the second quarter of 2004, the transfer agreement between G-P Receivables and our participating domestic subsidiaries was amended whereby the discount factor was substantially reduced for all future purchases. As a result, the credit to general and administrative expenses recognized by G-P Receivables was significantly less subsequent to that time.

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

CONSOLIDATING STATEMENTS OF INCOME

THIRD QUARTER 2005

In millions	Georgia-Pacific Corp.	Fort James Corp.	Fort James Operating Company	Fort James	Other	Consolidating Adjustments	Consolidated Amounts
				Non-Guarantor Subsidiaries	Non-Guarantor Subsidiaries		
Net sales	\$ 2,201	\$	\$ 1,234	\$ 527	\$ 1,220	\$ (469)	\$ 4,713
Costs and expenses:							
Cost of sales	1,777		864	404	1,011	(469)	3,587
Selling and distribution	77		116	48	28		269
Depreciation, amortization and accretion	68		93	33	39		233
General and administrative	135		40	25	(2)		198
Other (income) losses, including equity income in affiliates	(119)	(46)	12	(1)	(18)	181	9
Operating profit (loss)	263	46	109	18	162	(181)	417
Interest expense (income), net	111	28	88	(94)	12		145
Income (loss) from continuing operations before income taxes	152	18	21	112	150	(181)	272
Provision (benefit) for income taxes	9	(10)	9	78	43		129
Income (loss) from continuing operations	143	28	12	34	107	(181)	143
Income (loss) from discontinued operations, net of taxes	2						2
Net income (loss)	\$ 145	\$ 28	\$ 12	\$ 34	\$ 107	\$ (181)	\$ 145

CONSOLIDATING STATEMENTS OF INCOME

THIRD QUARTER 2004

In millions	Georgia-Pacific	Fort James	Fort James	Fort James	Other	Consolidating	Consolidated
	Corp.	Corp.	Operating Company	Non-Guarantor Subsidiaries	Non-Guarantor Subsidiaries		
Net sales	\$ 2,396	\$	\$ 1,206	\$ 537	\$ 1,183	\$ (581)	\$ 4,741
Costs and expenses:							
Cost of sales	1,883		838	399	977	(581)	3,516
Selling and distribution	79		103	47	23		252
Depreciation, amortization and accretion	67		89	33	42		231
General and administrative	141		41	26	4		212
Other (income) losses, including equity income in affiliates	(174)	(88)	5	1	3	245	(8)
Operating profit (loss)	400	88	130	31	134	(245)	538
Interest expense, net	111	4	91	(61)	22		167
Income (loss) from continuing operations before income taxes	289	84	39	92	112	(245)	371
Provision (benefit) for income taxes	50	(2)	15	28	41		132
Income (loss) from continuing operations	239	86	24	64	71	(245)	239
Income from discontinued operations, net of taxes	1						1
Net income (loss)	\$ 240	\$ 86	\$ 24	\$ 64	\$ 71	\$ (245)	\$ 240

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CONSOLIDATING STATEMENTS OF INCOME

FIRST NINE MONTHS 2005

In millions	Georgia-Pacific	Fort	Fort James	Fort James	Other	Consolidating	Consolidated
	Corp.	James	Operating	Non-Guarantor	Non-Guarantor		
	Corp.	Corp.	Company	Subsidiaries	Subsidiaries	Adjustments	Amounts
Net sales	\$ 6,658	\$	\$ 3,721	\$ 1,638	\$ 3,651	\$ (1,541)	\$ 14,127
Costs and expenses:							
Cost of sales	5,368		2,595	1,224	3,008	(1,541)	10,654
Selling and distribution	226		343	145	92		806
Depreciation, amortization and accretion	202		280	99	118		699
General and administrative	363		121	82			566
Other (income) losses, including equity income in affiliates	(395)	(228)	16	(1)	(14)	682	60
Operating profit (loss)	894	228	366	89	447	(682)	1,342
Interest expense (income), net	311	33	266	(224)	67		453
Income (loss) from continuing operations before income taxes	583	195	100	313	380	(682)	889
Provision (benefit) for income taxes	41	(12)	44	141	133		347
Income (loss) from continuing operations	542	207	56	172	247	(682)	542
Income (loss) from discontinued operations, net of taxes	2						2
Net income (loss)	\$ 544	\$ 207	\$ 56	\$ 172	\$ 247	\$ (682)	\$ 544

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CONSOLIDATING STATEMENTS OF INCOME

FIRST NINE MONTHS 2004

In millions	Georgia-Pacific Corp.	Fort James Corp.	Fort James Operating Company	Fort James Non-Guarantor Subsidiaries	Other Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Amounts
Net sales	\$ 8,284	\$	\$ 3,556	\$ 1,667	\$ 3,412	\$ (1,768)	\$ 15,151
Costs and expenses:							
Cost of sales	6,553		2,553	1,198	2,850	(1,768)	11,386
Selling and distribution	345		331	144	82		902
Depreciation, amortization and accretion	212		271	100	128		711
General and administrative	932		125	83	(484)		656
Other (income) losses, including equity income in affiliates	(684)	(227)	7	(25)	6	914	(9)
Operating profit (loss)	926	227	269	167	830	(914)	1,505
Interest expense, net	354	21	283	(184)	68		542
Income (loss) from continuing operations before income taxes	572	206	(14)	351	762	(914)	963
(Benefit) provision for income taxes	(30)	(8)	(5)	115	280		352
Income (loss) from continuing operations	602	214	(9)	236	482	(914)	611
Income (loss) from discontinued operations, net of taxes	5				(9)		(4)
Net income (loss)	\$ 607	\$ 214	\$ (9)	\$ 236	\$ 473	\$ (914)	\$ 607

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CONSOLIDATING STATEMENTS OF CASH FLOWS

FIRST NINE MONTHS 2005

In millions	Georgia-Pacific Corp.	Fort James Corp.	Fort James Operating Company	Fort James Non-Guarantor Subsidiaries	Other Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Amounts
Cash provided by (used for) operating activities	\$ 1,009	\$ (251)	\$ 351	\$ 164	\$ (56)	\$	\$ 1,217
Cash flows from investing activities:							
Property, plant and equipment investments	(225)		(126)	(84)	(71)		(506)
Net proceeds (cost) from sales of assets	12				62		74
Other	(1)			(7)	4		(4)
Cash used for investing activities	(214)		(126)	(91)	(5)		(436)
Cash flows from financing activities:							
Net (decrease) increase in debt	(404)	3	(13)	(17)	(294)		(725)
Net change in intercompany payable/invested equity	(243)	248	(211)	(160)	366		
Fees paid to issue debt	(1)						(1)
Fees paid to retire debt	(14)						(14)
Proceeds from option plan exercises	15						15
Cash dividends paid	(137)						(137)
Cash (used for) provided by financing activities	(784)	251	(224)	(177)	72		(862)
Effect of exchange rate changes on cash and equivalents				(30)			(30)
Increase (decrease) in cash and equivalents	11		1	(134)	11		(111)
Balance at beginning of period	18			188	19		225
Balance at end of period	\$ 29	\$	\$ 1	\$ 54	\$ 30	\$	\$ 114

CONSOLIDATING STATEMENTS OF CASH FLOWS

FIRST NINE MONTHS 2004

In millions	Georgia-Pacific Corp.	Fort James Corp.	Fort James Operating Company	Fort James Non-Guarantor Subsidiaries	Other Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Amounts
Cash (used for) provided by operating activities	\$ (18)	\$ 26	\$ 320	\$ 367	\$ 262	\$	\$ 957
Cash flows from investing activities:							
Property, plant and equipment investments	(203)		(134)	(51)	(60)		(448)
Acquisitions	(20)		(3)				(23)
Net proceeds from sales of assets	1,046		3	71	296		1,416
Other	(4)	(13)	13	7	(17)		(14)
Cash provided by (used for) investing activities	819	(13)	(121)	27	219		931
Cash flows from financing activities:							
Net decrease in debt	(721)	(672)	(30)	(28)	(232)		(1,683)
Net change in intercompany payable/invested equity	10	659	(170)	(247)	(252)		
Fees paid to issue debt	(14)						(14)
Fees paid to retire debt	(35)						(35)
Proceeds from option plan exercises	53						53
Cash dividends paid	(97)						(97)
Cash (used for) provided by financing activities	(804)	(13)	(200)	(275)	(484)		(1,776)
Effect of exchange rate changes on cash and equivalents				(4)			(4)
(Decrease) increase in cash and equivalents	(3)		(1)	115	(3)		108
Balance at beginning of period	1		1	25	24		51
Balance at end of period	\$ (2)	\$	\$	\$ 140	\$ 21	\$	\$ 159

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CONSOLIDATING BALANCE SHEETS

AS OF OCTOBER 1, 2005

In millions	Other						Consolidating Adjustments	Consolidated Amounts
	Georgia-Pacific Corp.	Fort James Corp.	Fort James Operating Company	Fort James Non-Guarantor Subsidiaries	Non-Guarantor Subsidiaries			
ASSETS								
Current assets								
Cash and equivalents	\$ 29	\$	\$ 1	\$ 54	\$ 30	\$	\$	\$ 114
Receivables, less allowances	13			512	1,278			1,803
Inventories	537		549	264	250			1,600
Deferred income tax assets	58		(27)	2	(5)			28
Intercompany interest receivable	51	4		109	2	(166)		
Other current assets	148		25	63	74	(16)		294
Total current assets	836	4	548	1,004	1,629	(182)		3,839
Total property, plant and equipment, net	2,672		2,920	1,135	1,288			8,015
Goodwill, net	491		5,798	948	177			7,414
Intercompany note receivable	928	75		5,606	236	(6,845)		
Other assets	12,527	10,968	1,397	282	923	(23,037)		3,060
Total assets	\$ 17,454	\$ 11,047	\$ 10,663	\$ 8,975	\$ 4,253	\$ (30,064)		\$ 22,328
LIABILITIES AND SHAREHOLDERS' EQUITY								
Current liabilities								
Short-term debt	\$ 584	\$	\$ 55	\$ 10	\$ 292	\$	\$	\$ 941
Accounts payable	635		193	485	270			1,583
Intercompany interest payable	3	50	93	4	16	(166)		
Other current liabilities	1,025	6	185	126	141	(15)		1,468
Total current liabilities	2,247	56	526	625	719	(181)		3,992
Long-term debt, excluding current portion	6,264	419	165	50	101			6,999
Other long-term liabilities	2,097		527	131	840	(60)		3,535
Deferred income tax liabilities	(1)	(8)	782	177	441			1,391
Intercompany note payable	436	884	4,759	75	691	(6,845)		
Shareholders' /invested equity	6,411	9,696	3,904	7,917	1,461	(22,978)		6,411
Total liabilities and shareholders' equity	\$ 17,454	\$ 11,047	\$ 10,663	\$ 8,975	\$ 4,253	\$ (30,064)		\$ 22,328

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CONSOLIDATING BALANCE SHEETS

AS OF JANUARY 1, 2005

In millions	Georgia-Pacific Corp.	Fort James Corp.	Fort James Operating Company	Fort James		Consolidating Adjustments	Consolidated Amounts
				Non-Guarantor Subsidiaries	Other Non-Guarantor Subsidiaries		
ASSETS							
Current assets							
Cash and equivalents	\$ 18	\$	\$	\$ 188	\$ 19	\$	\$ 225
Receivables, less allowances	16			574	1,176		1,766
Inventories	489		515	298	246		1,548
Deferred income tax assets	58		(26)	1	(5)		28
Intercompany interest receivable	626	7		10	91	(734)	
Other current assets	238		17	53	83	(11)	380
Total current assets	1,445	7	506	1,124	1,610	(745)	3,947
Total property, plant and equipment, net	2,661		3,070	1,277	1,397		8,405
Goodwill, net	491		5,810	1,073	177		7,551
Intercompany note receivable	2,302	1,500		4,021	236	(8,059)	
Other assets	10,603	9,817	1,256	320	928	(19,755)	3,169
Total assets	\$ 17,502	\$ 11,324	\$ 10,642	\$ 7,815	\$ 4,348	\$ (28,559)	\$ 23,072
LIABILITIES AND SHAREHOLDERS' EQUITY							
Current liabilities							
Short-term debt	\$ 30	\$	\$ 15	\$ 12	\$ 568	\$	\$ 625
Accounts payable	616		206	555	291		1,668
Intercompany interest payable	91	279	8		355	(733)	
Other current liabilities	882	8	172	127	143	(9)	1,323
Total current liabilities	1,619	287	401	694	1,357	(742)	3,616
Long-term debt, excluding current portion							
	7,270	417	212	59	106		8,064
Other long-term liabilities	2,203	1	540	174	874	(94)	3,698
Deferred income tax liabilities	(51)	(8)	837	194	497		1,469
Intercompany note payable	236	887	4,758	83	2,095	(8,059)	
Shareholders' /invested equity	6,225	9,740	3,894	6,611	(581)	(19,664)	6,225
Total liabilities and shareholders' equity	\$ 17,502	\$ 11,324	\$ 10,642	\$ 7,815	\$ 4,348	\$ (28,559)	\$ 23,072

13. OPERATING SEGMENT INFORMATION. We have five reportable operating segments: North America consumer products, international consumer products, packaging, bleached pulp and paper, building products. In May 2004, we sold our building products distribution business. The following represents selected operating data for each reportable segment for the third quarters and first nine months of 2005 and 2004.

CONSOLIDATED SELECTED OPERATING SEGMENT DATA (Unaudited)

Georgia-Pacific Corporation and Subsidiaries

(Dollar amounts in millions)	Third Quarter 2005		Third Quarter 2004	
NET SALES TO UNAFFILIATED CUSTOMERS				
North America consumer products	\$ 1,501	32%	\$ 1,439	30%
International consumer products	479	10	498	11
Packaging	707	15	755	16
Bleached pulp and paper	392	8	419	9
Building products	1,632	35	1,628	34
Building products distribution				
Other	2		2	
Total net sales to unaffiliated customers	\$ 4,713	100%	\$ 4,741	100%
INTERSEGMENT SALES				
North America consumer products	\$		\$ (1)	
International consumer products				
Packaging	32		27	
Bleached pulp and paper	144		165	
Building products	188		180	
Building products distribution				
Other ¹	(364)		(371)	
Total intersegment sales	\$		\$	
TOTAL NET SALES				
North America consumer products	\$ 1,501	32%	\$ 1,438	30%
International consumer products	479	10	498	11
Packaging	739	16	782	16
Bleached pulp and paper	536	11	584	12
Building products	1,820	39	1,808	38
Building products distribution				
Other ¹	(362)	(8)	(369)	(7)
Total net sales	\$ 4,713	100%	\$ 4,741	100%
OPERATING PROFITS (LOSSES)				
North America consumer products	\$ 197	47%	\$ 206	38%
International consumer products	15	4	39	7
Packaging	45	11	100	19
Bleached pulp and paper ²	(5)	(1)	20	4
Building products	269	64	282	52
Building products distribution			13	3
Other ³	(104)	(25)	(122)	(23)

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Total operating profits	417	100%	538	100%
Interest expense	(145)		(167)	
Income from continuing operations before income taxes	272		371	
Provision for income taxes	(129)		(132)	
Income from continuing operations	143		239	
Income from discontinued operations, net of taxes	2		1	
Net income	\$ 145		\$ 240	

¹ Includes elimination of intersegment sales.

² Amounts in 2005 and 2004 include operating losses of \$6 and \$4 million, respectively, from our 38.85% minority interest in Unisource.

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

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CONSOLIDATED SELECTED OPERATING SEGMENT DATA (Unaudited)

Georgia-Pacific Corporation and Subsidiaries

(Dollar amounts in millions)	First Nine Months 2005		First Nine Months 2004	
NET SALES TO UNAFFILIATED CUSTOMERS				
North America consumer products	\$ 4,475	32%	\$ 4,207	28%
International consumer products	1,508	11	1,549	10
Packaging	2,173	15	2,119	14
Bleached pulp and paper	1,192	8	1,206	8
Building products	4,773	34	4,181	28
Building products distribution			1,883	12
Other	6		6	
Total net sales to unaffiliated customers	\$ 14,127	100%	\$ 15,151	100%
INTERSEGMENT SALES				
North America consumer products	\$ 1		\$	
International consumer products	1			
Packaging	93		79	
Bleached pulp and paper	443		461	
Building products	570		1,161	
Building products distribution			3	
Other ¹	(1,108)		(1,704)	
Total intersegment sales	\$		\$	
TOTAL NET SALES				
North America consumer products	\$ 4,476	32%	\$ 4,207	28%
International consumer products	1,509	11	1,549	10
Packaging	2,266	16	2,198	15
Bleached pulp and paper	1,635	11	1,667	11
Building products	5,343	38	5,342	35
Building products distribution			1,886	12
Other ¹	(1,102)	(8)	(1,698)	(11)
Total net sales	\$ 14,127	100%	\$ 15,151	100%
OPERATING PROFITS (LOSSES)				
North America consumer products	\$ 627	47%	\$ 476	32%
International consumer products	79	6	135	9
Packaging	188	14	227	15
Bleached pulp and paper ²	4		27	2
Building products	701	52	911	60
Building products distribution			111	7
Other ³	(257)	(19)	(382)	(25)
Total operating profits	1,342	100%	1,505	100%
Interest expense	(453)		(542)	
Income from continuing operations before income taxes	889		963	
Provision for income taxes	(347)		(352)	

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Income from continuing operations	542	611
Income (loss) from discontinued operations, net of taxes	2	(4)
<hr/>		
Net income	\$ 544	\$ 607
<hr/>		

¹ Includes elimination of intersegment sales.

² Amounts in 2005 and 2004 include operating losses of \$18 million and \$17 million, respectively, from our 38.85% minority interest in Unisource.

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

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

The following Management's Discussion and Analysis of Financial Condition and Results of Operations is designed to provide a narrative from the perspective of our management on our financial condition, results of operations, liquidity and certain other factors that may affect our future results. This discussion should be read in conjunction with the accompanying unaudited consolidated financial statements and notes to the consolidated financial statements, as well as our Annual Report on Form 10-K for the fiscal year ended January 1, 2005.

Company Overview

We are one of the world's leading manufacturers and marketers of tissue, packaging, paper, building products and related chemicals. We employ approximately 55,000 people at more than 300 locations in North and South America and Europe. Our operations break down into four principal businesses:

Consumer Products. Our consumer products business is the world's second largest manufacturer of retail and commercial tissue products. We rank first in North America and are a leading manufacturer in Europe. We also manufacture and market our Dixie® line of disposable tabletop products such as cups, plates, and cutlery for sale throughout North America;

Building Products. We are a leading producer of building products in the United States. We are the largest North American producer of structural panels, which includes plywood, oriented strand board and industrial panels. We are also a leading producer of pressure-treated lumber, gypsum products, chemicals and other products. Our portfolio consists of traditional and technologically advanced products, such as our leading moisture and mildew-resistant exterior gypsum sheathing, DensGlass Gold®, and our Plytanium® structural wood panels;

Packaging. We sell finished packaging products primarily to consumer product manufacturers in addition to being one of the largest suppliers of containerboard to independent converters in the United States. We believe our packaging business is built around some of the lowest-cost containerboard mills in the United States; and

Paper. Our office paper brands are sold through retailers throughout the United States. We are the largest supplier of office paper to the warehouse club and mass retailer channels, and the fifth-largest office paper producer in North America.

Our strategy is to improve our portfolio of businesses by investing in businesses that are high value-added and that position us closer to consumers. A key component of that strategy is improving our bath tissue, paper towel and napkin business, which we refer to as our tissue business. In our other paper and forest products businesses, we are focused on maximizing cash returns by differentiating our products, partnering with our large growing customers, and improving supply chain efficiencies.

A number of factors can affect our businesses, including the effectiveness of our operating initiatives, our relationship with several significant customers, changes in global and local business and economic conditions, inflationary cost pressures for raw materials and energy costs, our debt and liquidity and uncertainty about our asbestos liabilities. These and other risks are noted in the section entitled "Factors That May Affect Future Results" at the end of this discussion and analysis. For further information regarding our asbestos litigation, see Note 11 of the Notes to Consolidated Financial Statements, which information is incorporated herein by this reference.

OVERVIEW OF THIRD QUARTER 2005 RESULTS

Cash flow and liquidity continue to be strong.

Cash flow from operations for the third quarter of 2005 was \$609 million, up from \$449 million for the same period in 2004.

Debt was \$7,940 million at October 1, 2005.

Overall net sales were somewhat flat.

Building Products and North America Consumer Products sales were up in the quarter, compared to the third quarter of 2004. These increases were offset by lower sales in our Bleached Pulp and Paper, Packaging segments and International Consumer Products segments.

Average sales prices in our Packaging segment as well as structural panels were lower in the third quarter of 2005 compared to the same period in 2004, offset partially by increased gypsum prices.

Third Party Sales by Principal Business

Third Quarter

Operating profit and income from continuing operations for the third quarter of 2005 decreased from the same period in 2004.

Operating profit for the third quarter decreased 22% from \$538 million to \$417 million.

Income from continuing operations decreased 40% from \$239 million to \$143 million.

As a result of Hurricanes Katrina and Rita we have incurred charges and costs across our U.S. operations of approximately \$15 million related to lost inventory, repairs, equipment rental, lost revenue, product donations, additional freight and labor costs and other unreimbursed expenses. These costs were offset somewhat by increased pricing in our Building Products business during the quarter which is expected to remain strong in the fourth quarter. During the fourth quarter of 2005, we expect to incur additional charges and costs of approximately \$8 million to complete our recovery.

The hurricanes resulted in a significant spike in the already increasing cost of energy during September. Although we have seen some decline in energy prices from the September spike we do not expect that energy prices will return to pre-hurricane levels within the

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near future. Raw materials and energy inflation increased our operating costs approximately \$105 million and \$330 million during the third quarter and first nine months of 2005, respectively, compared to the same periods in 2004. Transportation costs for the third quarter and first nine months of 2005 were also higher, driven by higher fuel costs.

During the third quarter of 2005, we announced a restructuring program in our Consumer Products businesses. We estimate that during the course of the entire two-year program, the workforce within our North America and International Consumer Products segments will be reduced by approximately 1,100 positions. As a result of the restructuring, we expect to incur a total of approximately \$106 million in restructuring charges, \$41 million of which was expensed in the third quarter of 2005. Of the \$106 million, we expect to incur approximately \$21 million in employee-related costs, including severance and other termination benefits; approximately \$53 million in net asset impairment charges, accelerated depreciation, and storeroom writeoffs; and approximately \$32 million in other facility-related exit costs. We expect to incur net cash expenditures of approximately \$49 million in

connection with these charges. By the end of the two-year program, savings are expected to be approximately \$100 million annually. See Note 4 of the Notes to the Consolidated Financial Statements.

The third quarter 2005 results include \$20 million of gains on asset sales in our Building Products business.

During the third quarter of 2005, we recorded income tax expense, net of current year generated tax credits, and a related income tax liability of approximately \$36 million related to our decision to repatriate approximately \$709 million of unremitted earnings of certain of our non-U.S. subsidiaries under the AJCA.

The following chart shows the change in operating profit by segment.

Note: In May 2004, we sold our Building Products Distribution business.

RESULTS OF OPERATIONS AND RELATED INFORMATION

In this section, we discuss and analyze our net sales, operating profit and other information relevant to an understanding of our results of operations for the third quarter and first nine months of 2005. In this discussion and analysis, we compare our third quarter and first nine months of 2005 results with prior year results.

Analysis of Net Sales by Business Segment Third Quarter and Nine Months Ended October 1, 2005