

1998 **ANNUAL REPORT**

To Our Shareowners:

Nineteen ninety-eight marked the conclusion of International Paper's celebration of one hundred years of operation as a company. In January 1898, 17 pulp and paper mills united to form what has become the largest paper company in the world. It was, therefore, all the more appropriate that 1998 also marked the occasion of one more very significant event—the announcement of our merger with a world class company—Union Camp Corporation.

As we begin our second century, we are again adapting to a new and different future. A future that will see continued growth in the global demand for paper and other forest products. Growth that while strong in the United States, will, as their economies rebound, be even stronger in other parts of the world—Asia, Eastern Europe and South America.

It is a future where our customers are driven not only by price but by how well we can help them solve problems and in turn be more successful. It will be a future where many of those same customers, as their activities become more global, will demand global service. It is a belief that consolidation will continue and, as a result, our industry will be stronger. And finally, it is a view that as a consequence of step changes in how we operate—taking more costs out and putting more value in—we will see a major improvement in earnings.

Merger with Union Camp Corporation

Last year, our most important decision by far was to merge with Union Camp Corporation. A paper and forest products company with world class operations and a low cost structure, Union Camp is a perfect match for International Paper, particularly with its strengths in uncoated paper and in containerboard. Clearly this will help us with our customers through far greater flexibility in servicing their needs. Our distribution operation, **xpedx**, will be strengthened as a result of the addition of Union Camp's Alling and Cory distribution business. There is an attractive chemicals business that provides good balance with International Paper's Arizona Chemical. This merger also adds 1.6 million acres of timberlands, most of which are adjacent to the lands of International Paper, bringing the U.S. total to 7.5 million acres. It is our belief that extensive economies of scale will significantly enhance International Paper's earnings going forward.

Cost reductions and operations improvements from the merger alone should amount to at least \$300 million by the end of the year 2000.

Consolidation

We also view the merger with Union Camp Corporation as a major development in the consolidation of our industry. And because of the value that is created, we will actively look to make more such moves in the future, if we believe these actions will enhance our company's profitability and ultimately benefit our shareowners. Growth is important to us, but it is only a means to an end. That end is better service for our customers and increased return for our shareowners. We have made the determination not to build new domestic capacity and we expect that our growth will continue to come through very

targeted acquisitions, expansion in growing markets overseas and an aggressive customer-driven way of doing business.

As evidence of our commitment to our paper, packaging and natural resources businesses, we made acquisitions last year to strengthen our operations and enhance our prospects for greater returns. The most significant of these included the Zellerbach distribution business, the Weston Paper industrial packaging business and OAO Svetogorsk, a Russian pulp and paper manufacturer. Also, Carter Holt Harvey, the largest forest products company in New Zealand and a company in which we own a majority stake, expanded its folding carton and cup operations into Australia, the latter jointly with our U.S. foodservice business.

Reduction of Assets and Capacity

Our actions in the past three years have also pruned businesses that had no fit in our future. The Imaging Products Division and Veratec, our nonwovens business, have been sold. We've also sold non-strategic timberlands on the West Coast and in New York and Pennsylvania. These non-core assets represented nearly 10% of our asset base. And even in our principal businesses, we've closed down significant assets—1.3% of U.S. industry linerboard capacity was closed, and 3% of U.S. industry uncoated papers was closed or reallocated to other product lines.

Financial Performance

In 1998, International Paper's net sales totaled \$19.5 billion, down 3% from year-earlier levels. For 1998, net earnings of \$236 million, or \$.77 per share, included special items that reduced our earnings by \$72 million, or \$.23 per share. Full-year earnings before special items were \$308 million, or \$1.00 per share.

While we made progress in improving our return on investment (ROI) last year, our returns are far from satisfactory. We use ROI as the key measurement of financial performance because it focuses attention on the efficient use of capital as well as on earnings. Management incentive compensation is tied to measurable ROI objectives, the most prominent of which is doing better against competition.

Our actions during 1998, and continuing in 1999, are centered on improving our profitability. Many new initiatives have been put in place, and many of the existing ones reinvigorated. Our company accomplished a great deal, although industry conditions severely pressured prices and volumes and offset many of the positive actions we were able to put in place.

Success Drivers

Internally, we are employing three key drivers to raise International Paper's level of profitability. The first is focusing on customers in all that we do, driven by a dedication to providing solutions to our customers and ensuring our products and services help them

to become more profitable. The second is operational excellence, continuing to do everything we do—from making paper, to supporting our customers, to how we pay our bills—but doing it even better. Through cost reduction and improved capital efficiency, we reduced our costs by over \$300 million in 1998 and expect to do even better in 1999. We are very excited about the realignment of our facilities with specific product segments and customers. We are already starting to see significant benefits in terms of costs and customer responsiveness. For the second consecutive year, we brought capital spending in 1998 below depreciation and amortization levels. The third key driver is the engagement of our employees in the entire process. The people of International Paper are our most valuable resource. They're the ones that originate the most effective ideas for improving productivity, make our facilities safer, preserve the environment and build strong relationships with customers. We are currently implementing a company-wide program designed to build on our "people assets."

Outlook

Things continue to look good in the United States and are starting to look better in many other parts of the world. We are seeing recovery in the Asian markets that will have a positive effect not only in the United States but also on Carter Holt Harvey. There are very low rates of new capacity anticipated in the United States and European markets. There, the supply/demand relationship seems to have begun to equalize. We do, however, anticipate a significant increase in the Asian output of uncoated printing papers, and some of this is likely to be exported to the United States and Europe. But, generally, for most of our other major paper and packaging product lines, the capacity outlook is as favorable as it has been in a generation. We are beginning to see improving market conditions and expect this trend to gain strength as we look to the remainder of 1999, and into the year 2000 and beyond.

In addition to the Union Camp merger, International Paper has a number of substantial internal initiatives under way that will result in a major improvement in our performance.

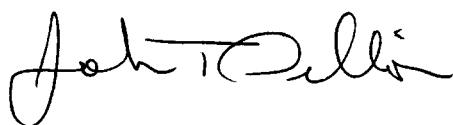
- We are building on our success with coordinated selling to customers, previously served by separate International Paper units.
- We are developing a broad array of new and improved products to meet the technologically advanced equipment and printing processes of the 21st century.
- We expect that the well-known HammerMill® brand name will be positioned in the expanding retail market in entirely new ways that will benefit that growing consumer base.
- We will keep our capital spending below depreciation and amortization levels and expect it to be under \$1 billion this year. Our projects are centered on cost savings, productivity and product quality efforts as well as on meeting our environmental standards.
- We will continue to manage our capacity so as to keep our production in balance with our customers' requirements. Using more precise unit cost and revenue data, we have learned how to reduce production without adversely impacting our cost structure.

- In 1999, we fully expect to surpass our 1998 cost reductions and are aggressively looking to take an additional \$400 million out of our system in costs this year, over and above the savings to be realized from the merger with Union Camp Corporation.

Commitment

If you were to ask me, “What are we all about at International Paper?”, the answer would be an absolute commitment to improving the profitability of this company—we are going to do whatever it takes to improve the return to our shareowners. We will do this by becoming a premier company in each of our core businesses. We will do this by working even more closely with our customers, helping them to be more successful. We will do this by growing our presence around the world. And we will do this by actively engaging our employees.

Simply put, we intend to be the very best company in the global paper and forest products industry—measured against any standard and against any competitor. I am convinced that in so doing, International Paper will produce a very strong return for our shareowners.

A handwritten signature in black ink, appearing to read "John T. Dillon". The signature is fluid and cursive, with a large initial "J" and a distinct "D".

John T. Dillon
Chairman and Chief Executive Officer
April 15, 1999

International Paper would like to acknowledge the many contributions made by its three retiring directors: Williard (Bill) C. Butcher, former Chairman and CEO of the Chase Manhattan Bank; Thomas (Tom) C. Graham, former Chairman of the Board of AK Steel Corporation; and Edmund (Ed) T. Pratt, Jr., retired Chairman and CEO of Pfizer Inc. We very much appreciate their guidance and encouragement over both the good and the difficult times for our industry.

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

FOR FISCAL YEAR ENDED DECEMBER 31, 1998

COMMISSION FILE NO. 1-3157

INTERNATIONAL PAPER COMPANY

(Exact name of Company as specified in its charter)

NEW YORK

(State or other jurisdiction of
incorporation or organization)

13-0872805

(I.R.S. Employee Identification No.)

TWO MANHATTANVILLE ROAD, PURCHASE, N.Y. 10577

(Address of principal executive offices) (Zip Code)

COMPANY'S TELEPHONE NUMBER, INCLUDING AREA CODE: 914-397-1500

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$1 per share par value	New York Stock Exchange
7 ⁷ / ₈ % Debentures due 2038	New York Stock Exchange

Indicate by check mark whether the Company (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 Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

The Aggregate market value of the common stock of the Company outstanding as of March 18, 1999, held by non-affiliates of the Company was \$13,899,334,203, calculated on the basis of the closing price on the Composite Tape on March 18, 1999. For this computation, the Company has excluded the market value of all common stock beneficially owned by all executive officers and directors of the Company and their associates as a group and treasury stock. Such exclusion is not to signify in any way that members of this group are "affiliates" of the Company.

The number of shares outstanding of the Company's common stock, as of March 18, 1999:

Outstanding	In Treasury
306,851,559	867,331

The following documents are incorporated by reference into the parts of this report indicated below:

Proxy Statement dated April 27, 1999 (to be filed on or about April 27, 1999)

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PART I

ITEM 1. BUSINESS

GENERAL

International Paper Company, (referred to subsequently as the “Company” or “International Paper”) a New York corporation incorporated in 1941 as the successor to the New York corporation of the same name organized in 1898, is a global paper and forest products company that produces printing and writing papers, pulp, tissue, paperboard and packaging and wood products. It also manufactures specialty chemicals and specialty panels and laminated products. The Company’s primary markets and manufacturing and distribution operations are in the United States, Europe and the Pacific Rim.

In the United States at December 31, 1998, the Company operated 26 pulp, paper and packaging mills, 58 converting and packaging plants, 31 wood products facilities, 9 specialty panels and laminated products plants and 6 specialty chemicals plants. Production facilities at December 31, 1998 in Europe, Asia, Latin America and Canada included 14 pulp, paper and packaging mills, 35 converting and packaging plants, 4 wood products facilities, 3 specialty panels and laminated products plants and 5 specialty chemicals plants. The Company distributes printing, packaging, graphic arts and industrial supply products, primarily manufactured by other companies, through over 250 distribution branches located primarily in the United States, and also engages in oil and gas and real estate activities in the United States. At December 31, 1998, the Company controlled approximately 5.9 million acres of forestlands in the United States.

Through Carter Holt Harvey, the Company, primarily in New Zealand and Australia, operates 6 mills producing pulp, paper, packaging and tissue products, 27 converting and packaging plants and 52 wood products manufacturing and distribution facilities. Carter Holt Harvey distributes paper and packaging products through 19 distribution branches located in New Zealand and Australia. In New Zealand, Carter Holt Harvey controls approximately 820,000 acres of forestlands.

From 1991 through 1998, International Paper’s capital expenditures approximated \$9.7 billion, excluding mergers and acquisitions. These expenditures reflect the continuing efforts to improve product quality and environmental performance, lower costs, expand production capacity, and acquire and improve forestlands. Capital spending in 1998 was approximately \$1.0 billion and is budgeted to be just under \$1.0 billion in 1999. A further discussion of capital expenditures can be found on page 23 of Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Discussions of mergers and acquisitions can be found on pages 14 and 23 of Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations and on pages 55 and 56 of Item 8. Financial Statements and Supplementary Data, Note 5. Mergers and Acquisitions.

Discussions of restructuring charges and other special items can be found on pages 25 through 33 of Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations and on pages 56 through 64 of Item 8. Financial Statements and Supplementary Data, Note 6. Restructuring and Other Charges.

FINANCIAL INFORMATION CONCERNING INDUSTRY SEGMENTS

The financial information concerning segments is set forth on pages 42 through 44 of Item 8. Financial Statements and Supplementary Data.

FINANCIAL INFORMATION ABOUT INTERNATIONAL AND DOMESTIC OPERATIONS

The financial information concerning international and domestic operations and export sales is set forth on page 45 of Item 8. Financial Statements and Supplementary Data.

COMPETITION AND COSTS

Despite the size of the Company's manufacturing capacities for paper, paperboard, packaging and pulp products, the markets in all of the cited product lines are large and highly fragmented. The markets for wood and specialty products are similarly large and fragmented. There are numerous competitors, and the major markets, both domestic and international, in which the Company sells its principal products are very competitive. These products are in competition with similar products produced by others, and in some instances, with products produced by other industries from other materials.

Many factors influence the Company's competitive position, including prices, costs, product quality and services. Information on the impact of prices and costs on operating profits is contained on pages 14 through 22 of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

MARKETING AND DISTRIBUTION

Paper and packaging products are sold through the Company's own sales organization directly to users or converters for manufacture. Sales offices are located throughout the United States as well as internationally. Significant volumes of products are also sold through paper merchants and distributors, including facilities in the Company's distribution network.

The Company's U.S. production of lumber and plywood is marketed through independent and Company-owned distribution centers. Specialty products are marketed through various channels of distribution.

DESCRIPTION OF PRINCIPAL PRODUCTS

The Company's principal products are described on pages 15 through 17 of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Production of major products for 1998, 1997 and 1996 was as follows:

**PRODUCTION BY PRODUCT
(UNAUDITED)**

	<u>1998</u>	<u>1997</u>	<u>1996(D,E)</u>
Printing Papers (In thousands of tons)			
White Papers and Bristols	3,742	3,986	3,875
Coated Papers	1,241	1,304	1,089
Market Pulp (A)	1,907	2,148	2,007
Newsprint	95	86	94
Packaging (In thousands of tons)			
Containerboard	2,887	2,945	2,702
Bleached Packaging Board	2,148	2,191	1,885
Industrial Papers	614	691	667
Industrial and Consumer Packaging (B)	3,503	3,379	3,313
Specialty Products (In thousands of tons)			
Tissue	148	147	126
Forest Products (In millions)			
Panels (sq. ft. $\frac{3}{8}$ "-basis) (C)	1,588	1,445	1,242
Lumber (board feet)	2,200	2,153	1,815
MDF (sq. ft. $\frac{3}{4}$ "-basis)	174	204	285
Particleboard (sq. ft. $\frac{3}{4}$ "-basis)	195	188	192

(A) This excludes market pulp purchases.

(B) A significant portion of this tonnage was fabricated from paperboard and paper produced at the Company's own mills and included in the containerboard, bleached packaging board and industrial papers amounts in this table.

(C) Panels include plywood and oriented strand board.

(D) Includes Federal Paper Board from March 12, 1996.

(E) Certain reclassifications and adjustments have been made to prior-year amounts.

RESEARCH AND DEVELOPMENT

The Company operates research and development centers at Sterling Forest, New York; Cincinnati, Ohio; Panama City, Florida; Erie, Pennsylvania; Kaukauna, Wisconsin; West Chicago, Illinois; Odenton, Maryland; Saint-Priest, France; Annecy, France; a regional center for applied forest research in Bainbridge, Georgia; a forest biotechnology center in Rotorua, New Zealand; and several product laboratories. Research and development activities are directed to short-term, long-term and technical assistance needs of customers and operating divisions; process, equipment and product innovations; and improvement of profits through tree generation and propagation research. Activities include studies on improved forest species and management; innovation and improvement of pulping, bleaching, chemical recovery, papermaking and coating processes; packaging design and materials development; innovation and improvement of printing plates, pressroom/plate chemistries and plate processors; reduction of environmental discharges; re-use of raw materials in manufacturing processes; recycling of consumer and packaging paper products; energy conservation; applications of computer controls to manufacturing operations; innovations and improvement of products; and development of various new products. Product development efforts specifically address product safety as well as the minimization of solid waste. The cost to the Company of its research and development operations was \$89.5 million in 1998, \$99.9 million in 1997 and \$112.5 million in 1996.

ENVIRONMENTAL PROTECTION

Controlling pollutants discharged into the air, water and groundwater to avoid adverse impacts on the environment, making continual improvements in environmental performance and achieving 100% compliance with applicable laws and regulations are continuing objectives of the Company. The Company has invested substantial funds to modify facilities to assure compliance, and plans to make substantial capital expenditures for this purpose in the future.

A total of \$100 million was spent in 1998 to control environmental releases into the air and water and to assure environmentally sound management and disposal of solid and hazardous waste. The Company expects to spend approximately \$80 million in 1999 for similar capital programs. Amounts to be spent for environmental control projects in future years will depend on new laws and regulations, changes in legal requirements and changes in environmental concerns. Taking these uncertainties into account, the Company's preliminary estimate for additional environmental appropriations during the period 2000 through 2001 is approximately \$230 million.

On April 15, 1998, the United States Environmental Protection Agency (EPA) promulgated new pulp and paper mill standards for air emissions and water discharges from bleached kraft mills to be met three to eight years after final promulgation (the "Cluster Regulations"). The estimated spending for 1999 through 2001 includes the cost of these regulations as well as other environmental projects. The Company has spent \$206 million over the last five years to convert 15 of its U.S. and European bleached mills to Elemental Chlorine Free (ECF) pulping, one of the requirements of the Cluster Regulations, and for certain other environmental projects related to the Cluster Regulations. The additional cost related to the Cluster Regulations for the three years 1999 to 2001 is estimated to be \$194 million. Projected Cluster costs for the following five years are in the range of \$120 to \$180 million. The final cost depends on the outcome of Cluster water regulations for pulp and paper subcategories other than bleached papergrade kraft. Regulations for these subcategories are not likely to become final until late 2000 or 2001.

The Company now estimates that annual operating costs, excluding depreciation, will increase approximately \$20 million when these regulations are fully implemented.

The Company expects the significant effort it has made in the analysis of environmental issues and the development of environmental control technology to enable it to keep costs for compliance with environmental regulations, at, or below, industry averages.

A further discussion of environmental issues can be found on pages 34 and 35 of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Additional information is available in the Company's annual environmental report published in September of 1998.

EMPLOYEES

As of December 31, 1998, the Company had approximately 80,000 employees, of whom 54,000 were located in the United States and the remainder overseas. Of the domestic employees, approximately 35,500 were hourly employees, approximately 15,000 of whom were represented by the Paper, Allied-Industrial, Chemical and Energy International Union.

During 1998, new labor agreements were reached at the Louisiana and Moss Point mills. Pine Bluff mill negotiations were still in progress at year end. During 1999, a labor agreement at the Erie mill is scheduled to be negotiated. During 2000, labor agreements are scheduled to be negotiated at the Camden, Natchez, Reigelwood and Hamilton mills.

During 1998, labor agreements expired at four packaging, three building materials, two chemical and two distribution locations. New labor agreements were negotiated at each location. An initial contract at one distribution location was still in progress at year end; one additional packaging location has a contract open from a previous year; two additional packaging locations settled contracts which expired in a previous year.

RAW MATERIALS

For information as to the sources and availability of raw materials essential to the Company's business, see Item 2. *PROPERTIES*.

ITEM 2. PROPERTIES

FORESTLANDS

The principal raw material used by International Paper is wood in various forms. At December 31, 1998, the Company controlled approximately 5.9 million acres of forestlands in the United States. An additional 820,000 acres of forestlands in New Zealand were held through Carter Holt Harvey, a consolidated subsidiary of International Paper.

During 1998, the U.S. forestlands supplied 3.2 million cords of roundwood to the Company's U.S. facilities. This amounted to the following percentages of the roundwood requirements of its U.S. mills and forest products facilities: 12% in its Northern mills and 29% in its Southern mills. The balance was acquired from other private industrial and nonindustrial forestland owners, with only an insignificant amount coming from public lands of the United States government. In addition, 3.0 million cords of wood were sold to other users in 1998. In November 1994, the Company adopted the Sustainable Forestry Principles developed by the American Forest and Paper Association in August 1994.

MILLS AND PLANTS

A listing of the Company's production facilities can be found in Appendix I hereto, which information is incorporated herein by reference.

The Company's facilities are in good operating condition and are suited for the purposes for which they are presently being used. The Company continues to study the economics of modernizing or adopting other alternatives for higher cost facilities. Further discussions of new mill and plant projects can be found on page 23 of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

CAPITAL INVESTMENTS AND DISPOSITIONS

Given the size, scope and complexity of its business interests, International Paper continuously examines and evaluates a wide variety of business opportunities and planning alternatives, including possible acquisitions and sales or other dispositions of properties. Planned capital investments for 1999 are set forth on pages 14 and 23 of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 3. LEGAL PROCEEDINGS

MASONITE LITIGATION

A lawsuit which was certified as a nationwide class action and was filed against the Company and Masonite Corporation, a wholly owned subsidiary of the Company (Masonite), on December 27, 1994, in Mobile County Circuit Court, Mobile, Alabama has been settled. This lawsuit alleged that hardboard siding, which is used as exterior cladding for residential dwellings and is manufactured by Masonite, fails prematurely, allowing moisture intrusion. It alleged further that the presence of moisture in turn causes the failure of the structure underneath the siding. The class consists of all owners of homes in the United States having Masonite hardboard siding incorporated into buildings between 1980 and January 15, 1998. It is impossible to know how many homes have this siding, but it is estimated that there are between three and four million. As previously reported, a Phase I trial was conducted in August and September of 1996 to determine the sole issue of inherent product defect. The jury, in attempting to apply the various laws of all the states on a nationwide basis, returned a mixed decision that found in favor of the Company and Masonite in some jurisdictions and in favor of the plaintiffs in other jurisdictions. As also previously reported, a Phase II trial was set for July 14, 1997, on the remaining issues in the case. The Phase II trial was not conducted owing to the settlement.

Final approval of the settlement was granted by the Mobile County Circuit Court on January 15, 1998. The settlement provides for monetary compensation to class members meeting the requirements of the settlement agreement on a claims-made basis for a period of seven years for those having Masonite hardboard siding manufactured between 1980 and 1989 and for a period of ten years for those having Masonite hardboard siding manufactured between 1990 and January 15, 1998, with certain specified deductions based on years of use. The settlement also provides for the payment of attorneys' fees equaling 15% of settlement amounts paid to class members, with a non-refundable advance of \$47.5 million plus \$2.5 million in costs, both of which have been paid. Through December 31, 1998, approximately \$7.6 million has been paid to class members pursuant to the settlement, and additionally an approximate \$2.5 million has been paid in administrative costs, including costs to administer the compensation program and to provide notice to class members of the settlement. While the amounts that will be paid in the future to class members and to pay for administrative costs are not presently known with certainty, it is believed that this settlement will not have a material adverse effect on the Company's consolidated financial position or results of operations. The Company and Masonite have the right, in their sole discretion, to terminate this settlement after seven years from the date of final approval.

A more detailed discussion of the Masonite litigation can be found on pages 34 through 36 of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and pages 67 and 68 of Item 8. Financial Statements and Supplementary Data, Note 11. Commitments and Contingent Liabilities.

OTHER LITIGATION

As of March 30, 1999, there were no other pending judicial proceedings, brought by governmental authorities against the Company, for alleged violations of applicable environmental laws or regulations. The Company is engaged in various administrative proceedings that arise under applicable environmental and safety laws or regulations, including approximately 71 active proceedings under the Comprehensive

Environmental Response, Compensation and Liability Act (“CERCLA”) and comparable state laws. Most of these proceedings involve the cleanup of hazardous substances at large commercial landfills that received waste from many different sources. While joint and several liability is authorized under the CERCLA, as a practical matter, liability for CERCLA cleanups is allocated among the many potential responsible parties. Based upon previous experience with respect to the cleanup of hazardous substances and upon presently available information, the Company believes that it has no or *de minimis* liability with respect to 12 of these sites; that liability is not likely to be significant at 44 sites; and that estimates of liability at 15 of these sites is likely to be significant but not material to the Company’s consolidated financial position or results of operations.

The Company’s majority-owned subsidiary, Carter Holt Harvey, has an indirect shareholding of 30.05% in Chile’s largest industrial company, COPEC. This shareholding is held through Carter Holt Harvey’s 50% interest in Inversiones y Desarrollo Los Andes S.A. (“Los Andes”), which holds 60.1% of the shares of COPEC. The other 50% of Los Andes is owned by Inversiones Socoroma S.A. (“Socoroma”), a Chilean investment company. In late 1993, Carter Holt Harvey commenced several actions in Chilean courts challenging certain corporate governance documents of Los Andes, as well as agreements between Carter Holt Harvey’s subsidiary and Socoroma. All of those actions have now been terminated. In December 1994, Socoroma commenced an arbitration action seeking to expel Carter Holt Harvey from Los Andes at a price which is less than the carrying value. In April 1998, the arbitrator dismissed Socoroma’s request, but granted it the right to claim monetary damages for Carter Holt Harvey’s breach of certain of its obligations as a participant in the Los Andes joint venture.

While any proceeding or litigation has an element of uncertainty, the Company believes that the resolution of this issue will not have a material adverse effect on its consolidated financial position or results of operations.

The Company is also involved in other contractual disputes, administrative and legal proceedings and investigations of various types. While any litigation, proceeding or investigation has an element of uncertainty, the Company believes that the outcome of any proceeding, lawsuit or claim that is pending or threatened, or all of them combined, will not have a material adverse effect on its consolidated financial position or results of operations.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 1998.

SPECIAL ITEM. EXECUTIVE OFFICERS OF THE COMPANY

**INTERNATIONAL PAPER COMPANY
EXECUTIVE OFFICERS
AS OF MARCH 30, 1999
INCLUDING NAME, AGE, OFFICES AND POSITIONS HELD ⁽¹⁾ AND
BUSINESS EXPERIENCE DURING THE PAST FIVE YEARS**

John T. Dillon, 60, chairman and chief executive officer since 1996. Prior to that he was executive vice president-packaging from 1987 to 1995 when he assumed the position of president and chief operating officer.

C. Wesley Smith, 59, executive vice president-operations group since 1998. Prior thereto he was executive vice president-printing papers from 1992 and president-International Paper Europe from 1989.

James P. Melican, Jr., 58, executive vice president-legal and external affairs. He assumed his current position in 1991.

David W. Oskin, 56, executive vice president-consumer packaging since 1995, and was CEO and managing director of Carter Holt Harvey Limited of New Zealand from 1992 to 1995.

Milan J. Turk², 60, executive vice president-specialty businesses since 1996. Prior thereto he was senior vice president-specialty products from 1993.

Marianne M. Parrs, 55, executive vice president-administration and chief financial officer since March 9, 1999. She was senior vice president-administration and chief financial officer since 1998, and prior thereto was senior vice president and chief financial officer from 1995. She was staff vice president-tax from 1993-1995, and controller-printing papers from 1985 to 1993.

Andrew R. Lessin, 56, vice president and controller since 1995. Prior thereto he was the controller from 1990.

William B. Lytton, 50, senior vice president and general counsel since January 1999. Prior thereto he was vice president and general counsel since 1996. He was vice president and associate general counsel for Martin Marietta from 1993 to 1995, and vice president and general counsel for Lockheed Martin Electronics from 1995 to 1996.

(1) Executive officers of International Paper are elected to hold office until the next annual meeting of the board of directors following the annual meeting of shareholders and until election of successors, subject to removal by the board.

(2) Mr. Turk will retire on December 31, 1999.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Dividend per share data on the Company's common stock and the high and low sale prices for the Company's common stock for each of the four quarters in 1998 and 1997 are set forth on page 81 of Item 8. Financial Statements and Supplementary Data.

As of March 18, 1999, there were 30,570 holders of record of the Company's common stock.

ITEM 6. SELECTED FINANCIAL DATA

ELEVEN-YEAR FINANCIAL SUMMARY

Dollar amounts in millions, except per share amounts and stock prices

	<u>1998</u>	<u>1997</u>	<u>1996</u>	<u>1995</u>
Results of Operations				
Net sales	\$19,541	\$20,096	\$20,143	\$19,797
Costs and expenses, excluding interest	18,756	19,760	19,403	17,276
Earnings before income taxes, minority interest, extraordinary item and cumulative effect of accounting changes	392⁽¹⁾	16 ⁽²⁾	802 ⁽³⁾	2,028
Minority interest expense, net of taxes	76⁽¹⁾	129 ⁽²⁾	169 ⁽³⁾	156
Extraordinary item				
Cumulative effect of accounting changes				
Net earnings (loss)	236⁽¹⁾	(151) ⁽²⁾	303 ⁽³⁾	1,153
Earnings (loss) applicable to common shares	236⁽¹⁾	(151) ⁽²⁾	303 ⁽³⁾	1,153
Financial Position				
Working capital	\$ 2,374	\$ 1,065	\$ 104	\$ 1,010
Plants, properties and equipment, net	12,079	12,369	13,217	10,997
Forestlands	2,795	2,969	3,342	2,803
Total assets	26,356	26,754	28,252	23,977
Long-term debt	6,407	7,154	6,691	5,946
Common shareholders' equity	8,902	8,710	9,344	7,797
Per Share of Common Stock—Assuming No Dilution⁽⁹⁾				
Earnings (loss) before extraordinary item and cumulative effect of accounting changes	\$.77	\$ (.50)	\$ 1.04	\$ 4.50
Extraordinary item				
Cumulative effect of accounting changes				
Earnings (loss)	.77	(.50)	1.04	4.50
Cash dividends	1.00	1.00	1.00	.92
Common shareholders' equity	28.99	28.82	31.13	29.87
Common Stock Prices⁽⁹⁾				
High	55¹/₄	61	44 ⁵ / ₈	45 ³ / ₄
Low	35¹/₂	38 ⁵ / ₈	35 ⁵ / ₈	34 ¹ / ₈
Year-end	44¹³/₁₆	43 ¹ / ₈	40 ¹ / ₂	37 ⁷ / ₈
Financial Ratios				
Current ratio	1.7	1.2	1.0	1.2
Total debt to capital ratio	31.4	38.9	38.9	38.5
Return on equity	2.7^(1,10)	(1.7) ^(2,10)	3.4 ^(3,10)	16.1
Return on investment	2.8^(1,10)	1.2 ^(2,10)	3.3 ^(3,10)	8.4
Capital Expenditures	\$ 1,049	\$ 1,111	\$ 1,394	\$ 1,518
Number of Employees	80,000	82,000	87,000	81,500

ELEVEN-YEAR FINANCIAL SUMMARY (Continued)

Dollar amounts in millions, except per share amounts and stock prices

	<u>1994</u>	<u>1993</u>	<u>1992</u>	<u>1991</u>
Results of Operations				
Net sales	\$14,966	\$13,685	\$13,598	\$12,703
Costs and expenses, excluding interest	13,902	12,837	13,125 ⁽⁶⁾	11,695 ⁽⁷⁾
Earnings before income taxes, minority interest, extraordinary item and cumulative effect of accounting changes	715 ⁽⁴⁾	538	226 ⁽⁶⁾	693 ⁽⁷⁾
Minority interest expense, net of taxes	47	36	15	42
Extraordinary item			(6)	
Cumulative effect of accounting changes	(75)		(50)	(215)
Net earnings (loss)	357 ⁽⁴⁾	289 ⁽⁵⁾	86 ⁽⁶⁾	184 ⁽⁷⁾
Earnings (loss) applicable to common shares	<u>357⁽⁴⁾</u>	<u>289⁽⁵⁾</u>	<u>86⁽⁶⁾</u>	<u>184⁽⁷⁾</u>
Financial Position				
Working capital	\$ 796	\$ 472	\$ (165)	\$ 404
Plants, properties and equipment, net	9,139	8,872	8,884	7,848
Forestlands	802	786	759	743
Total assets	17,836	16,631	16,516	14,941
Long-term debt	4,464	3,601	3,096	3,351
Common shareholders' equity	<u>6,514</u>	<u>6,225</u>	<u>6,189</u>	<u>5,739</u>
Per Share of Common Stock—Assuming No Dilution⁽⁹⁾				
Earnings (loss) before extraordinary item and cumulative effect of accounting changes	\$ 1.73	\$ 1.17	\$.58	\$ 1.80
Extraordinary item			(.02)	
Cumulative effect of accounting changes	(.30)		(.21)	(.97)
Earnings (loss)	1.43	1.17	.35	.83
Cash dividends	.84	.84	.84	.84
Common shareholders' equity	<u>25.87</u>	<u>25.12</u>	<u>25.23</u>	<u>25.52</u>
Common Stock Prices⁽⁹⁾				
High	40¼	35	39¼	39½
Low	30¾	28¾	29¼	25¼
Year-end	<u>37¾</u>	<u>33¾</u>	<u>33¾</u>	<u>35¾</u>
Financial Ratios				
Current ratio	1.2	1.1	.96	1.1
Total debt to capital ratio	41.2	38.5	38.0	39.1
Return on equity	5.6 ⁽⁴⁾	4.7 ⁽⁵⁾	1.4 ⁽⁶⁾	3.2 ⁽⁷⁾
Return on investment	<u>4.2⁽⁴⁾</u>	<u>3.6⁽⁵⁾</u>	<u>2.0⁽⁶⁾</u>	<u>3.5⁽⁷⁾</u>
Capital Expenditures	<u>\$ 1,114</u>	<u>\$ 954</u>	<u>\$ 1,368</u>	<u>\$ 1,197</u>
Number of Employees	<u>70,000</u>	<u>72,500</u>	<u>73,000</u>	<u>70,500</u>

ELEVEN-YEAR FINANCIAL SUMMARY (Continued)

Dollar amounts in millions, except per share amounts and stock prices

	<u>1990</u>	<u>1989</u>	<u>1988</u>
Results of Operations			
Net sales	\$12,960	\$11,378	\$ 9,587
Costs and expenses, excluding interest	11,695 ⁽⁸⁾	9,739	8,199
Earnings before income taxes, minority interest, extraordinary item and cumulative effect of accounting changes	988 ⁽⁸⁾	1,434	1,223
Minority interest expense, net of taxes	33	26	22
Extraordinary item			
Cumulative effect of accounting changes			
Net earnings (loss)	569 ⁽⁸⁾	864	754
Earnings (loss) applicable to common shares	<u>569⁽⁸⁾</u>	<u>845</u>	<u>733</u>
Financial Position			
Working capital	\$ 784	\$ 366	\$ 781
Plants, properties and equipment, net	7,287	6,238	5,456
Forestlands	751	764	772
Total assets	13,669	11,582	9,462
Long-term debt	3,096	2,324	1,853
Common shareholders' equity	<u>5,632</u>	<u>5,147</u>	<u>4,557</u>
Per Share of Common Stock—Assuming No Dilution ⁽⁹⁾			
Earnings (loss) before extraordinary item and cumulative effect of accounting changes	\$ 2.61	\$ 3.86	\$ 3.28
Extraordinary item			
Cumulative effect of accounting changes			
Earnings (loss)	2.61	3.86	3.28
Cash dividends	.84	.77	.64
Common shareholders' equity	<u>25.67</u>	<u>23.67</u>	<u>20.57</u>
Common Stock Prices ⁽⁹⁾			
High	29 ⁷ / ₈	29 ³ / ₈	24 ³ / ₄
Low	21 ³ / ₈	22 ⁵ / ₈	18 ¹ / ₄
Year-end	<u>26³/₄</u>	<u>28¹/₄</u>	<u>23¹/₄</u>
Financial Ratios			
Current ratio	1.2	1.1	1.5
Total debt to capital ratio	36.1	33.9	25.8
Return on equity	10.5 ⁽⁸⁾	17.8	17.0
Return on investment	<u>7.2⁽⁸⁾</u>	<u>11.3</u>	<u>11.0</u>
Capital Expenditures			
	<u>\$ 1,267</u>	<u>\$ 887</u>	<u>\$ 645</u>
Number of Employees			
	<u>69,000</u>	<u>63,500</u>	<u>55,500</u>

ELEVEN-YEAR FINANCIAL SUMMARY (Continued)

Financial Glossary

Current ratio—
current assets divided by current liabilities

Total debt to capital ratio—
long-term debt plus notes payable and current maturities of long-term debt divided by long-term debt, notes payable and current maturities of long-term debt, deferred income taxes, minority interest, other liabilities, preferred securities and total common shareholders' equity.

Return on equity—
net earnings divided by average common shareholders' equity (computed monthly).

Return on investment—
net earnings plus after-tax interest expense and minority interest expense divided by an average of total assets minus accounts payable and accrued liabilities.

Footnotes to Eleven-Year Financial Summary

- (1) Includes a \$20 million pre-tax gain (\$12 million after taxes) on the sale of the Company's Veratec nonwovens business, an \$83 million pre-tax gain (\$50 million after taxes) from the reversal of previously established reserves that are no longer required, a \$111 million pre-tax charge (\$68 million after taxes) for the impairment of oil and gas reserves due to low prices, a \$105 million pre-tax restructuring and asset impairment charge (\$56 million after taxes and minority interest) and \$16 million of pre-tax charges (\$10 million after taxes) related to our share of charges taken by Scitex, a 13% investee company, for the write-off of in-process research and development related to an acquisition and costs to exit the digital video business.
- (2) Includes a pre-tax business improvement charge of \$535 million (\$385 million after taxes), a \$150 million pre-tax provision for legal reserve (\$93 million after taxes), a pre-tax charge of \$125 million (\$80 million after taxes) for anticipated losses associated with the sale of the imaging businesses, and a pre-tax gain of \$170 million (\$97 million after taxes and minority interest expense) from the redemption of certain retained west coast partnership interests and the release of a related debt guaranty.
- (3) Includes a pre-tax restructuring and asset impairment charge of \$515 million (\$362 million after taxes), a \$592 million pre-tax gain on the sale of a west coast partnership interest (\$336 million after taxes and minority interest), a \$155 million pre-tax charge (\$99 million after taxes) for the write-down of the investment in Scitex and a \$10 million pre-tax charge (\$6 million after taxes) for our share of a restructuring charge announced by Scitex in November 1996.
- (4) Includes \$17 million (\$10 million after taxes) of additional earnings related to the change in accounting for start-up costs.
- (5) Includes \$25 million of additional income tax expense to revalue deferred tax balances to reflect the increase in the U.S. statutory federal income tax rate.
- (6) Includes restructuring and other charges totaling \$398 million (\$263 million after taxes).
- (7) Includes a \$60 million pre-tax restructuring charge (\$37 million after taxes) and additional expenses related to the adoption of SFAS No. 106 of \$25 million (\$16 million after taxes).
- (8) Includes a \$212 million pre-tax restructuring charge (\$137 million after taxes).
- (9) Per share data and common stock prices have been adjusted to reflect a two-for-one stock split in September 1995. All per share amounts are computed before the effects of dilutive securities.
- (10) Return on equity was 3.5% and return on investment was 3.2% in 1998 before special items. Return on equity was 3.3% and return on investment was 3.0% in 1997 before special items. Return on equity was 4.8% and return on investment was 3.6% in 1996 before special items.

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

CORPORATE OVERVIEW

Results of Operations

International Paper's 1998 net sales totaled \$19.5 billion, declining 3% from \$20.1 billion in 1997 and 1996. In 1998, the impact of acquisitions and sales of businesses largely offset each other. The decline in sales resulted from lower sales volumes and prices and the weakening New Zealand dollar. Sales outside the United States declined to \$4.7 billion in 1998, or 24% of consolidated net sales, from \$5.7 billion, or 28% of consolidated net sales in 1997. Export sales from the U.S. were at a disadvantage because of the strong U.S. dollar and declined to \$1.2 billion from \$1.4 billion in 1997 and 1996. Total 1998 international sales of \$5.9 billion compared with \$7.1 billion in 1997 and \$7.3 billion in 1996.

Full-year 1998 net earnings of \$236 million or \$.77 per share included special items that reduced net earnings by \$72 million or \$.23 per share. This compared with a 1997 net loss of \$151 million or \$.50 per share and 1996 net earnings of \$303 million or \$1.04 per share. Special items totaling a net loss of \$461 million or \$1.53 per share and \$131 million or \$.45 per share were recorded in 1997 and 1996, respectively. Earnings before special items were \$308 million or \$1.00 per share in 1998 compared with earnings before special items of \$310 million or \$1.03 per share in 1997 and \$434 million or \$1.49 per share in 1996.

Operating profit totaled \$1.1 billion in both 1998 and 1997, down from \$1.4 billion in 1996. Lower sales volumes and prices for many of our products reduced 1998 operating profit by about \$400 million as compared with 1997. However, this decline was offset by \$300 million of manufacturing and other cost reductions and lower material costs as well as higher profits from forestland sales. In 1998, we curtailed production by 1 million tons at our U.S. pulp and paper mills, more than 60% of which was market-related. In 1997, lower prices cost our U.S. businesses over \$500 million in earnings compared with 1996, more than negating the impact of profit improvement programs that added over \$300 million to 1997 earnings.

Excluding special items, return on investment was 3.2% in 1998 compared with 3.0% in 1997 and 3.6% in 1996. Despite progress, management recognizes that current financial returns are not satisfactory and continues to focus on company-wide business improvement initiatives. These are described more fully in the section titled "Special Items Including Restructuring and Business Improvement Actions" and in the discussion and analysis of each business segment.

Despite the negative effect that unsettled global economic conditions had on the paper and forest products industry, we accomplished a great deal in 1998. We have significantly reduced costs, improved our performance with customers, learned how to more efficiently manage capacity in weak markets, sharpened our focus on winning businesses, and completed the sale of about \$1 billion of nonstrategic assets. Focusing on improvement in our core businesses, we completed several acquisitions during the year to improve our competitive position and to better serve our customers. Significant among these acquisitions were the Zellerbach distribution business, the Weston Paper industrial packaging business, and OAO Svetogorsk, a Russian pulp and paper manufacturer. Carter Holt Harvey also expanded its folding carton and cup operations into Australia, the latter jointly with our U.S. foodservice business.

Our most significant move in 1998 was the negotiation of a merger with Union Camp Corporation, a leading U.S. manufacturer of paper, packaging, chemicals and wood products and a significant forestland owner. The merger, valued at approximately \$6.6 billion including the assumption of debt, is subject to approval by International Paper and Union Camp shareholders. Under the terms of the merger agreement, Union Camp shareholders will receive International Paper common shares worth \$71 for each Union Camp share. The merger, which will be accounted for as a pooling of interests, should be completed early

in the second quarter of 1999. Cost savings from combining the two companies are expected to be about \$300 million annually.

We expect that there will be significant one-time costs in 1999 associated with the Union Camp merger. These include the direct expenses of the merger, which we estimate to be about \$40 million, and those charges associated with actions to be taken to achieve the \$300 million of annual cost savings.

In 1999, we anticipate that global economic conditions and excess worldwide capacity will continue to present sizable challenges for our industry. Both the U.S. and Europe should grow more slowly than in 1998. We expect recovery in Asian markets, although it is likely to be slow. Nevertheless, we are seeing signs of improvement in supply and demand relationships and are more optimistic about the latter part of 1999 and beyond. Reflecting this, we announced price increases for linerboard, uncoated papers and pulp in the 1999 first quarter.

DESCRIPTION OF INDUSTRY SEGMENTS

U.S. and European Papers

Uncoated Papers: International Paper is one of the largest U.S. producers of uncoated papers, with production of nearly 2 million tons annually. Products include reprographics paper, offset printing papers, and converting grades for tablets and envelopes. Market franchises include the *Hammermill* and *Springhill* brands. We also make uncoated bristols for file folders, tags, tickets and index cards.

Coated Papers: We supply over 1.3 million tons of coated papers and bristols from 6 U.S. mills for book and magazine publishing, catalogs, and direct-mail and other print advertising. The Company ranks fourth among U.S. coated groundwood producers and manufactured about 525,000 tons in 1998. We also produce coated freesheet, such as *Accolade*, for upscale catalogs and magazines and we make coated bristols used for book covers and commercial printing applications.

Pulp: We produced about 1.4 million tons of market pulp in the U.S. in 1998. Grades range from pulp used to make paper, to fluff pulp for hygiene products, to specialty pulps used in items such as cigarette filters and fabrics. Approximately 22% of our production is specialty pulps, which exhibit more price stability than paper pulps.

European Papers: We are a leading supplier of office, coated and specialty papers in European markets supplying over 2 million tons annually from 12 mills in France, Germany, Poland, the United Kingdom and Russia. International Paper S.A. is Europe's second largest producer of reprographics paper. Zanders produces premium coated papers such as *Ikono*, used in high-end marketing brochures and annual reports. Kwidzyn produces office papers, pulp, coated board and newsprint in Poland. Klucze is a leading supplier of brand facial tissue in Poland. Our December 1998 acquisition of a low-cost pulp and paper mill in Svetogorsk, Russia, complements our existing operations in Europe producing liquid packaging board, office papers and market pulp.

Industrial and Consumer Packaging

Industrial Packaging: International Paper is the third largest manufacturer of containerboard in the U.S. and is capable of producing 3 million tons annually from 6 mills. Nearly one third is specialty grades such as *PineLiner*, *ColorBrite* and *BriteTop*. About 60% of our production is converted into corrugated boxes and other packaging by our 32 U.S. container plants. These include 11 plants acquired through our merger with Weston Paper in April 1998. In Europe, we have 1 recycled mill in France and 17 container plants in the United Kingdom, Italy, Spain and France that produce 850,000 tons annually. Our plants in Southern Europe are the leading providers of corrugated packaging for agricultural products. In March 1998, we added 3 corrugated container plants and a recycled containerboard mill to our global reach by partnering

with a producer of industrial packaging in Turkey. We also produce 300,000 tons of kraft paper each year that is used in multiwall and retail bags.

Consumer Packaging: As the world's largest producer of bleached board, we supply 2 million tons annually from 6 U.S. mills. Our *Everest* and *Starcote* brands are used globally for folding cartons for food, cosmetics, pharmaceuticals, computer software and tobacco, and in beverage packaging for juice and milk. Over one third of our bleached board is made into packaging and other products in our own plants. Our 21 beverage packaging plants throughout the world offer complete systems, from cartons to filling machines, for both fresh and aseptic packaging. In the U.S., 13 plants provide folding cartons for retail use and disposable packaging to the foodservice industry. We also have joint ventures with Carter Holt Harvey in Australia and Chile.

Distribution

Through **xpedx**, our North American merchant distribution business, we supply industry, wholesalers and end users with a vast array of printing, packaging, graphic arts, maintenance and industrial products. **xpedx** operates over 90 warehouses, 130 sales offices and 180 retail stores in the U.S. and Mexico. The segment also includes the operations of Zellerbach acquired in August and integrated with **xpedx** during 1998. Overseas, Papeteries de France, Scaldia in the Netherlands and Impap in Poland serve European markets. About 20% of distribution sales are products produced by International Paper's own facilities.

Specialty Products

Industrial Papers: We produce 370,000 tons of specialty industrial papers used in applications such as pressure-sensitive labels, food and industrial packaging, industrial sealant and tapes, and consumer hygiene products.

Chemicals: Arizona Chemical is a leading processor of crude tall oil and crude sulfate turpentine, natural by-products of the papermaking process. Products also include specialty resins used in adhesives and inks, made at 11 plants in the U.S. and Europe.

Fine Papers: We produce and market over 130,000 tons annually of premium quality text, cover, coated and business papers under the brand names *Beckett*, *Strathmore*, *Hammermill Premium* and *Zanders Design*.

Petroleum: This business manages mineral rights on Company-owned and leased land, and explores for and develops oil and gas reserves. These assets contribute to our results and serve as a partial hedge against fluctuating energy prices.

Forest Products

Forest Resources: International Paper owns or manages about 5.9 million acres of forestlands in the U.S., mostly in the South. In 1998, these forestlands supplied over 20% of the Company's wood requirements.

Wood Products: Our 21 U.S. plants produce southern pine lumber, plywood and oriented strand board (OSB). These plants are located in the southern U.S. near our forestlands. We produce approximately 1.8 billion board feet of lumber, over 650 million square feet of plywood and 925 million square feet of OSB.

Masonite: From 8 locations in North America and Europe, Masonite manufactures and markets *CraftMaster* door facings and other molded products for residential and commercial construction, as well as a broad line of hardboard exterior siding, industrial hardboard and a wide range of softboard products for the home and office. Our worldwide capacity for door facings is approximately 1.2 billion square feet.

Decorative Products: We produce high- and low-pressure laminates, particleboard and graphic arts products. Markets served include residential and commercial construction, furniture, store fixtures, graphic arts and specialty niche markets.

Carter Holt Harvey

Carter Holt Harvey is 50.3% owned by International Paper. It is one of the largest forest products companies in the Southern Hemisphere, with operations in New Zealand, Australia and Chile. The Australasian market accounts for 85% of its sales. Asia, particularly Korea and Japan, is an important market for its logs. Carter Holt Harvey's forest operations own 820,000 acres of sustainable radiata pine plantations in New Zealand currently yielding 5 million cubic meters of logs annually. This yield is expected to increase to 7 million cubic meters by 2005. About 75% of the harvest is processed through Carter Holt Harvey's wood products and pulp and paper businesses. Their access to one of the largest low-cost softwood fiber bases in the Southern Hemisphere is a key strength.

Carter Holt Harvey is the largest Trans-Tasman company producing lumber, plywood and engineered wood products. It has 600 million board feet of lumber capacity. Carter Holt Harvey is New Zealand's largest manufacturer and marketer of pulp and paper products, with overall annual capacity of 850,000 tons at 4 mills. Its major products are linerboard and pulp. Carter Holt Harvey produces 150,000 tons of tissue products from 2 mills and 7 converting facilities and is the market leader and largest manufacturer in Australia. *Sorbent* is the most recognized local tissue brand in this market. Carter Holt Harvey produces corrugated boxes and plastic packaging with a focus on the horticulture, primary produce and foodservice markets in New Zealand and Australia. It also has a significant share of the Australian cup market through its Continental Cup joint venture with International Paper. The distribution business comprises the Carters building supplies chain in New Zealand and paper merchants B. J. Ball in New Zealand and Raleigh Paper in Australia.

Carter Holt Harvey owns a 50% stake in a joint venture that holds 60% of Compania de Petroleos de Chile (COPEC), Chile's largest industrial conglomerate, which is listed on the Santiago, Chile, Stock Exchange. COPEC owns and manages the largest forest reserves in Chile, comprising 1.2 million acres of mainly radiata pine; has annual pulp capacity of over 1.3 million tons; and is a major producer of sawtimber.

INDUSTRY SEGMENT RESULTS

U.S. and European Papers

U.S. and European Papers posted sales of \$4.9 billion compared with \$5.2 billion in 1997 and 1996. Economic turmoil in Asia significantly affected the worldwide supply/demand balance during 1998, causing weak markets and prices for the Company's pulp and paper products. Despite the success of management actions to reduce costs, operating profit fell to \$135 million in 1998 from \$170 million in 1997 and \$180 million in 1996.

U.S. Papers sales were \$2.7 billion, down from \$2.9 billion in 1997 and \$2.8 billion in 1996. The decline between 1998 and 1997 reflects weaker sales volumes for uncoated papers and bristols, offset to some extent by higher prices for coated papers. Demand in the U.S. began to weaken in the second quarter of 1998 and continued to wane throughout the year. The U.S. net trade balance suffered considerably—soft export markets, a strong U.S. dollar and rising imports all playing a part. In view of these weak markets, we curtailed production at our U.S. mills to avoid building inventories. U.S. Papers operating profit in 1998 improved considerably from 1997 levels but was below 1996.

Uncoated papers sales were \$1.6 billion in 1998, a decline of 10% from 1997 and 15% from 1996. Prices fell steadily during 1998 and, on average, were flat with 1997. Shipments were down by 10% from 1997. Following profitable results in 1997 and 1996, a loss was reported in 1998.

U.S. Coated Papers sales of \$1.1 billion increased 4% over 1997 and 20% over 1996. Operating profit improved considerably in 1998 after declining 30% in 1997, primarily as the result of start-up costs associated with production of *Accolade*, our new lightweight coated free sheet product. On average, prices increased nearly \$40 per ton, about 4% over 1997. The first half of 1998 was characterized by strong demand for both coated groundwood and our premium coated paper product, *Accolade*. However, demand weakened significantly by mid-year as customers liquidated inventories. The market was adversely impacted by imports as well, and prices fell steadily as the year progressed.

Pulp sales from our U.S. facilities were \$590 million in 1998 and declined 17% from 1997. The business reported a loss in 1998 compared with profits in 1997 and 1996. Average paper pulp prices were 8% below 1997. Volume was lower as well, owing to weak export markets and generally soft paper demand. Sales for specialty pulp were also lower, due to weakness in Asia for cigarette filter tow and declining demand for rayon.

European Papers sales were \$1.6 billion, about 5% lower than in 1997 and 1996. European demand for paper grew modestly in 1998, but markets were weak especially in the second half of 1998. Market-related downtime was taken in uncoated and coated papers in the second half of the year. European Paper's 1998 shipments of uncoated and coated papers were off 2% to 3%. Prices were lower than in 1997 across all product lines, considerably so for coated papers and pulp, and a strong U.S. dollar reduced the value of our sales even further. Despite lower sales, operating profit for our European operations improved more than 30% from 1997 as productivity and cost-reduction efforts more than offset lower sales. Zanders reported an operating profit for the second consecutive year. Kwidzyn's performance was particularly strong, as the mill achieved record newsprint and boxboard production.

Our U.S. and European Papers businesses completed a number of actions that will help improve future profits. We completed a restructuring program that reduced our U.S. Papers capacity by 400,000 tons. We undertook a major new program to improve the cost position of our U.S. mills. The first phase is the reduction of 750 jobs at 3 mills. A recent upgrade at our Natchez, Miss., mill should boost specialty pulp sales in 1999. And we plan to aggressively market our *Hammermill* brand and expect its increased sales will enrich our sales mix. In December 1998, we purchased a paper mill in Svetogorsk, Russia, near Finland, that houses one of Europe's widest uncoated papers machines, capable of producing 250,000 tons annually.

As 1999 began, prices were lower than in 1998 for most products. Inventories of pulp are relatively low, customer inventories are at normal levels and we believe that prices have bottomed. However, we see only gradual price recovery this year. As a result, 1999 average prices are expected to be well below the 1998 average. The profit improvement programs now underway are expected to contribute \$200 million annually to pre-tax earnings of the U.S. and European Papers segment, which will partially offset the impact of lower prices.

Industrial and Consumer Packaging

Industrial and Consumer Packaging sales totaled \$4.6 billion in 1998, up from \$4.4 billion in 1997. 1998 operating profit increased to \$265 million from \$170 million in 1997. The improvement in both sales and earnings in 1998 was driven mainly by higher average prices for containerboard and corrugated boxes. Sales were \$4.3 billion in 1996 and operating profit was \$375 million.

Industrial Packaging revenues were \$2.3 billion in 1998, up from \$2.1 billion in 1997 and flat with 1996. After posting a loss in 1997, operating profit in 1998 was one half that of 1996. Following a period of strength in 1997, industrial packaging markets weakened during 1998. Excess capacity, rising imports and a collapse of export markets all played a role. Furthermore, U.S. industry box shipments grew only 1%, considerably less than in 1997. Over the course of the year, we curtailed our production by 400,000 tons to control our inventories. Although containerboard prices declined as 1998 progressed, on average they were 12% higher than in 1997.

During 1998, our Industrial Packaging businesses made progress on several fronts. In March, we entered into a joint venture with a manufacturer in Turkey, building our presence in Eastern Europe and Asia. Our merger with Weston, which owned a corrugated medium mill and 11 box plants, strengthened our capability in those U.S. markets where we did not previously have container plants. Also, it enabled us to increase the amount of company-produced containerboard used in our plants to 60%. Several manufacturing initiatives were accomplished in 1998 as well. We completed a capital project at our Mansfield, La., mill, which was successful in improving quality and production efficiency. We increased fiber yield and purchasing efficiency, reducing our per-ton costs by 3% to 4%. And we made organizational changes to foster better customer focus and sales mix.

We expect industrial packaging prices to recover in 1999 as downsizing by several North American producers should reduce U.S. industry capacity by 6%. We shut down our Gardiner, Ore., mill in late 1998 for an indefinite period of time due to the excess capacity in our Industrial Packaging business. Some price improvement was evident as 1999 began. Earnings improvement in 1999 will come from cost containment and marketing initiatives.

Consumer Packaging sales were \$2.3 billion, flat with 1997 and up from \$2.0 billion in 1996. Operating profit was essentially flat with 1997 and 12% below 1996. 1998 results continued to be hurt by the downturn in worldwide markets. Our shipments of bleached board were down nearly 4%, and those into export markets were off 10%. Weak international markets adversely affected both prices and sales mix in domestic markets as well. At year-end, prices for folding carton board were 6% lower than a year earlier.

Weak market conditions obscured the positive impact of a number of operating improvements in 1998. Our mills ran well, raw material and energy costs were down, and per-ton manufacturing costs were lower by 3%. We reorganized our operations to align more closely with customers and the markets they serve—beverage packaging, retail packaging and foodservice—thereby sharpening customer focus and our ability to offer total packaging solutions. We made two acquisitions with Carter Holt Harvey enabling us to jointly offer a full line of foodservice products in new markets: Continental Cup in Australia and the paper cup division of Marinetti S.A. in Chile.

As 1999 began, prices for consumer packaging products remained under pressure. While there are signs that conditions in Asia are stabilizing and the slump in export markets is easing, we do not expect significant price recovery this year. Therefore, earnings improvement will depend on internal initiatives.

Distribution

North American and European distribution sales totaled \$5.5 billion in 1998 compared with \$4.6 billion in 1997 and \$4.5 billion in 1996. Operating profit was \$80 million in 1998, declining from \$85 million in 1997 and \$100 million in 1996. Profit on sales declined from 1.9% in 1997 to 1.4% in 1998 due largely to lower margins.

xpedx, our North American distribution operation, posted sales of \$5.2 billion in 1998, up 22% from 1997 and 1996. The increase over 1997 was driven by unit sales growth of 5% and the acquisition of Zellerbach in August 1998. Excluding Zellerbach and Taussig Graphics Supply, acquired in late 1997, sales were \$4.5 billion in 1998. Despite sales growth, operating profit declined 10% mainly because of weaker margins. The margin decline was caused by lower sales prices and increasingly competitive markets for printing papers as both merchants and customers consolidate. Certain nonrecurring costs also reduced 1998 operating profit. These included marketing costs aimed at strengthening the **xpedx** brand name, as well as costs related to the Zellerbach integration. Operating profit in the second half of 1998 improved over the first half, reflecting better operating efficiencies and the impact of Zellerbach.

The successful integration of Zellerbach was largely completed in 1998. We combined the companies, retaining only those customers and markets that met our strategic and financial objectives. Of Zellerbach's 38 primary locations, 25 were merged with **xpedx** facilities in 1998, 2 were closed and 7 remain as stand-

alone operations in markets not previously served by **xpedx**. The last 4 were merged in early 1999. As of year-end 1998, we had surpassed our goal to eliminate 1,000 jobs. **xpedx** enters 1999 poised to better serve customers with a broader range of products and the best capabilities of both organizations. Furthermore, **xpedx** continued its ongoing program of consolidating warehousing operations into more efficient regional distribution centers.

xpedx plans to achieve higher sales and earnings in 1999, with the full-year impact of Zellerbach, further volume growth and ongoing profit-improvement initiatives. In 1999, the adoption of a sophisticated purchasing discipline will yield many advantages, among them lower working capital and better service capability.

Our European distribution operations—Papeteries de France, Scaldia in the Netherlands and Impap in Poland—posted sales of \$340 million, increasing 4% from 1997 and 1996. Operating profit was flat with 1997 and 1996.

Overall, we expect higher sales and earnings for the distribution businesses in 1999.

Specialty Products

Specialty Products sales in 1998 were \$1.3 billion compared with \$1.4 billion in 1997 and 1996. Sales were lower across this group of businesses, especially Chemicals and Petroleum. Results were affected by the downturn in the Asian markets and new competitive capacity. Earnings were \$125 million in 1998, declining from \$155 million last year and \$175 million in 1996. Restructuring and cost-reduction programs had a very positive impact, and the primary reasons for the decline in earnings were lower oil and gas and industrial paper prices.

Industrial Papers sales were \$540 million, down slightly from \$550 million in 1997 and 1996. Operating earnings in 1998 were down 35% versus 1997 and were one half that of 1996. U.S. demand for release-backing products grew only 3% in 1998, lower than in recent years. At the same time, new capacity entered the market with overseas demand weakening. Prices were down 3% to 5%. Plans are underway to take substantial costs out of this business.

Fine Papers sales in 1998 were \$295 million, 6% lower than 1997 and 10% below 1996. Despite lower sales, operating earnings increased slightly over both 1997 and 1996 due to restructuring actions taken over the past two years. We consolidated production on our most efficient machines, reduced fixed costs, and centralized our converting and finishing operations. There should be additional positive carryover effects of these actions in 1999.

Chemicals sales were \$410 million in 1998, down 10% from 1997 and 4% from 1996, while operating earnings improved 14% over 1997 and 43% over 1996. Sales volumes declined in 1998 due to competitive pricing and product substitution in both the U.S. and Europe. We reduced fixed costs by 15% and improved both product quality and the reliability of our operations. These actions more than offset the impact of lower sales. In 1999, we expect additional earnings improvement.

Petroleum posted 1998 sales of \$75 million compared with \$105 million in 1997 and \$120 million in 1996. Operating profit in 1998 declined nearly 60% and was one third that of 1996. Both sales and profits were severely hurt by oil and gas prices. Oil prices, adjusted for inflation, were at 50-year lows. In 1998, average oil prices fell by 35%, and gas prices by 18%. Price declines necessitated write-downs of our oil and gas properties in 1998. See the section titled “Special Items Including Restructuring and Business Improvement Actions” for further details. If oil and gas prices continue to fall, additional write-downs may be required in 1999. The Company’s exploration program, which is focused on West Texas, the Gulf Coast and the Gulf of Mexico, yielded new reserves in 1998 that exceeded production by 40%. Earnings in 1999 will depend mainly on oil and gas pricing.

Forest Products

Forest Products sales were \$2.5 billion in 1998, down from \$2.7 billion in 1997 and flat with 1996. Operating profit of \$505 million improved from \$475 million in 1997 and \$390 million in 1996 as stronger forestland operations more than offset weakness in our building materials businesses.

Forest Resources revenues increased 8% to \$450 million in 1998 from \$410 million in 1997. Sales in 1996 were \$450 million. 1998 operating profit increased nearly 30% over year-earlier levels. The increase reflects the completion in 1998 of a series of sales of partnership interests involving over 100,000 acres of forestlands in Pennsylvania and New York. Results also benefited from higher average sawtimber prices, which were 4% above 1997, and lower minority interest expense because of the repurchase of IP Timberlands, Ltd.'s publicly traded Class A Units in March. As planned, 1998 harvest volumes were slightly lower than in 1997 due to the age class limitations of our timber holdings.

As 1999 began, sawtimber prices were slightly above early-1998 levels. On average, we expect prices in 1999 to be lower than in 1998. Our harvest volumes will be lower too, again reflecting the age of our forests. However, we project that our harvest will increase significantly over the next decade as high-yield plantations reach maturity. We will continue to sell nonstrategic forestlands when a tract's sales value represents a premium over its hold-and-operate value and the tract is not a critical supply factor to our mills.

Wood Products sales declined nearly 9% to \$950 million in 1998 and were down from \$1 billion in 1997. 1996 sales were \$835 million. Profits for this business weakened significantly. Most of the decline was the result of considerably lower lumber prices, caused by soft export markets, especially in Asia, and an increase in Canadian imports. Conversely, oriented strand board markets strengthened and prices reached record levels during the year. Plywood pricing was flat with 1997. Lower sales prices, as well as higher fiber costs, were offset to some extent by better operations, improved yields and a higher margin sales mix. During the year, several high-cost plants in the U.S. industry were forced to close. By year-end the supply/demand balance improved and lumber markets began to stabilize.

Masonite sales were \$500 million in 1998, which was 12% below 1997 sales of \$565 million. 1996 sales were \$590 million. The decline was caused in part by industry capacity additions and weak Asian demand during 1998, which reduced pricing for door facings. For the same reasons, operating profit fell below 1997 levels to about one half of 1996.

Decorative Products sales were \$620 million in 1998 as compared with \$635 million in 1997 and \$670 million in 1996. Operating profit declined slightly in 1998 after falling 11% in 1997. In 1998, weak sales of both high- and low-pressure laminates were largely offset by improvements in other product lines. During the year, we closed 2 unprofitable medium-density fiberboard plants.

In 1999, we expect higher building materials earnings to come mainly from higher volumes and internal cost reduction initiatives.

Carter Holt Harvey

International Paper's results for this segment differ from those reported by Carter Holt Harvey in New Zealand in four major respects:

1. Carter Holt Harvey's reporting period is a fiscal year ending March 31. Our segment results are for the calendar year.
2. Our segment earnings include only our share of Carter Holt Harvey's operating earnings. Segment sales, however, represent 100% of Carter Holt Harvey's sales.
3. Carter Holt Harvey reports in New Zealand dollars but our segment results are reported in U.S. dollars. The weighted average currency exchange rate used to translate New Zealand dollars to U.S. dollars was .54 in 1998, .66 in 1997 and .69 in 1996.

4. Carter Holt Harvey reports under New Zealand accounting standards but our segment results comply with U.S. generally accepted accounting principles. The major differences relate to cost of timber harvested, COPEC and start-up costs. These differences reduced segment earnings by about \$40 million in 1998 and \$30 million in each of the years 1997 and 1996.

Carter Holt Harvey's segment sales of \$1.5 billion in 1998 were below 1997 sales of \$2.0 billion. The translation effect of the weakening New Zealand dollar accounted for 76% of the decline. Also, Carter Holt Harvey sold its building products business in April 1998. 1996 sales were \$2.1 billion. Results were severely impacted by the weakness in Asian economies during this period as well as that of New Zealand, which depressed pricing and demand for logs, timber, pulp and paper products. Earnings were also adversely affected by downtime associated with the modernization of the Kinleith pulp and paper mill and related start-up costs. Segment operating profit declined to \$20 million in 1998 from \$90 million in 1997 and \$130 million in 1996.

Forests results were negatively impacted by volume and price declines resulting from the near collapse of the Korean log markets early in 1998 and the slowdown of the Japanese economy. However, log exports, although remaining below 1997, improved sharply in the fourth quarter. For 1998, under U.S. accounting principles after adjusting for cost of timber harvested, Forests operated at a loss. Wood products earnings were only slightly below 1997 as operations in Australia performed strongly, but were offset by weakness in New Zealand. Carter Holt Harvey's Pulp, Paper and Tissue group reported a 88% decline in earnings caused by substantially lower prices for pulp and paper, as well as a loss of production due to downtime associated with the Kinleith project. However, the tissue business is performing well, with slightly higher earnings from volume increases associated with market share gains and productivity improvements. Packaging earnings were below those of 1997 due to significant erosion of both prices and volumes caused by the weak New Zealand economy and competitive pressure. Two 1998 acquisitions in Australia performed well: a joint-venture cup business with International Paper and the folding carton business of Riverwood International. The distribution business reported a loss in both 1998 and 1997, but its performance had returned to break-even by the fourth quarter of 1998. Earnings from Carter Holt Harvey's equity investments, primarily COPEC, were also down significantly principally due to lower pulp sales volumes and prices and the weakening of the Chilean peso against the U.S. dollar.

Carter Holt Harvey made significant progress in 1998 to reduce costs. The "Genesis" margin improvement program continues to make a significant contribution to earnings. The EBIT contribution from "Genesis" in 1998 was \$30 million and the annual run rate for projects now underway is \$50 million. Our share, about half, is included in these segment results.

Looking forward to 1999, Carter Holt Harvey anticipates improved economic conditions in New Zealand and in some Asian markets. As the year began, log and pulp markets have improved from their low levels. Linerboard and pulp prices are showing some signs of recovery. Furthermore, a lower cost structure and the benefits of the Kinleith mill modernization are expected to improve results in 1999.

LIQUIDITY & CAPITAL RESOURCES

Cash Provided by Operations

Cash provided by operations totaled \$1.7 billion for 1998 compared with \$1.2 billion in 1997 and \$1.7 billion in 1996. The increase over 1997 was primarily due to working capital changes. After adjusting for noncash special items on an after-tax basis, net earnings were about even with 1997 and about \$125 million below 1996. Depreciation and amortization expense was \$1.2 billion for 1998 compared with \$1.3 billion in 1997 and \$1.2 billion in 1996. A decrease in working capital added about \$45 million to 1998 operating cash flow. Working capital reduced operating cash flow by \$400 million in 1997 and \$50 million in 1996.

Investment Activities

Capital spending was \$1.0 billion in 1998, slightly lower than 1997 spending of \$1.1 billion and substantially below 1996 spending of \$1.4 billion. Capital spending is expected to be just under \$1.0 billion in 1999. The following table presents capital spending by each of our business segments.

Capital Spending by Industry Segment

<u>In millions for the years ended December 31</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
U.S. and European Papers	\$ 262	\$ 273	\$ 452
Industrial and Consumer Packaging	259	239	273
Distribution	19	20	14
Specialty Products	136	106	120
Forest Products	165	178	261
Carter Holt Harvey	166	230	161
Subtotal	1,007	1,046	1,281
Corporate and other	42	65	113
Total	<u>\$1,049</u>	<u>\$1,111</u>	<u>\$1,394</u>

Under a 1997 business improvement plan, we undertook the sale of \$1 billion of nonstrategic assets. This program was substantially completed in 1998. Divestitures completed during 1998 included the Imaging printing and graphic arts businesses, the label business, the Veratec nonwovens division and Carter Holt Harvey's building products business. Substantially all of these proceeds were used to reduce debt or for general corporate purposes.

In December 1998, we acquired OAO Svetogorsk, a pulp and paper business based in Russia, which should enhance our ability to serve growing market demand in Russia and Eastern Europe. We acquired the Zellerbach distribution business in August 1998 for \$261 million in cash and integrated it into **xpedx**, our distribution operation. In April 1998, Weston Paper and Manufacturing Company, which operates a corrugated medium mill and 11 container plants in the central and southeastern U.S., was acquired by exchanging about 4.7 million International Paper common shares valued at approximately \$232 million, in a noncash transaction. Carter Holt Harvey also acquired Riverwood International, an Australia-based folding carton business for approximately \$46 million in cash early in the 1998 second quarter. In February 1998, we entered into a joint venture with Olmuksa in Turkey for \$37 million for the manufacture of containerboard and corrugated boxes for markets in Turkey and surrounding countries. Also, Carter Holt Harvey and International Paper jointly acquired Australia-based Continental Cup in February 1998 for \$18 million and the paper cup division of Marinetti S.A. based in Chile for \$12 million in December 1998. These acquisitions will allow Carter Holt Harvey and International Paper's Foodservice division to offer a full line of foodservice products in the Australian and South American markets.

Acquisitions in 1997 included Merbok Formtec, an Asian door facings company, and Taussig Graphics Supply, Inc., a distributor of graphic arts products, which complemented our distribution business.

In March 1996, International Paper merged with Federal Paper Board, a paper and forest products company with facilities in the U.S. and the U.K. Federal shareholders received, at their election and subject to certain limitations, either \$55 in cash or a combination of cash and International Paper common stock worth \$55 for each Federal common share. In total, Federal shares were acquired for approximately \$1.3 billion in cash and \$1.4 billion in International Paper common stock, and \$800 million of debt was assumed. Other 1996 acquisitions included Forchem, a tall oil and turpentine processor in Finland, and Forwood Products, a timber-processing business in Australia, each acquired for about \$100 million.

Financing Activities

Financing activities during 1998 included a \$1.8 billion net reduction primarily of short-term debt, and the issuance of \$1.5 billion of preferred securities of subsidiaries. In March 1998, Timberlands Capital Corp. II, a wholly owned consolidated subsidiary, issued \$170 million of 7.005% preferred securities as part of the financing to repurchase the outstanding units of IP Timberlands, Ltd. In June 1998, IP Finance (Barbados) Limited, a wholly owned consolidated non-U.S. subsidiary, issued \$550 million of preferred securities with a dividend payment that is based on LIBOR. In September 1998, International Paper Capital Trust III, a wholly owned consolidated subsidiary, issued \$805 million of 7⁷/₈% mandatorily redeemable preferred securities. Proceeds from the latter two preferred securities issuances were used primarily to reduce short-term borrowings.

Long-term debt and notes payable on our consolidated balance sheet were \$7.5 billion compared with \$9.4 billion in 1997 and \$10 billion in 1996. However, after adjusting for foreign exchange, acquisitions and restructuring activities, total debt was reduced by approximately \$1.9 billion and \$220 million in 1998 and 1997, respectively, on a cash flow basis. During 1998, one of the corporate debt rating agencies, Standard & Poor, downgraded our long-term debt rating from A- to BBB+.

Financing activities during 1997 included the issuance of environmental and industrial development bonds for various capital projects, repayment of \$164 million of Federal 10% debentures, and a net reduction in commercial paper and short-term bank borrowings.

Financing activities in 1996 included short-term borrowings of \$1.3 billion to acquire Federal, the issuance of \$741 million of notes with maturities ranging from 3 to 7 years, and borrowings by IP Timberlands, Ltd. of \$450 million due in 1999.

Unless otherwise noted, the proceeds of all of the financings described above were used to reduce short-term debt or for general corporate purposes.

Dividend payments were \$306 million in 1998, \$302 million in 1997 and \$291 million in 1996. In each year, the dividend was \$1.00 per common share.

Capital Resources Outlook for 1999

The Company's financial condition continues to be strong. We anticipate that cash flow from operations, supplemented as necessary by short- or long-term borrowings, will be adequate to fund our capital expenditures, to service existing debt, and to meet working capital and dividend requirements during 1999.

Other Financial Statement Items

Net interest expense in 1998 was \$496 million, about even with 1997 but below the \$530 million reported in 1996, reflecting lower borrowing costs and higher tax-related interest income.

Minority interest expense declined to \$76 million in 1998 from \$129 million in 1997 and \$169 million in 1996. The main reason for the decrease over the period was the sharp decline in Carter Holt Harvey's results. Also, the acquisition of the publicly traded Class-A depository units of IP Timberlands, Ltd. in March 1998 reduced minority interest by \$37 million compared with 1997. The sale of West Coast partnership interests added \$32 million to the 1996 amount. Also included in the minority interest expense are distributions related to preferred securities of subsidiaries. Increases in these distributions partially offset the other declines.

Our equity investments consist primarily of Scitex and Carter Holt Harvey's 30% ownership in COPEC, which it holds through a joint venture. Both Scitex and COPEC are publicly traded companies. At

December 31, 1998, the carrying amounts of these investments and their market values based on the closing per share amounts were as follows (in millions):

	<u>Scitex</u>	<u>COPEC</u>
Carrying Amount	\$30	\$880
Market Value	\$67	\$840

For various reasons, the market values based on the closing per share amounts may be either higher or lower than the amount that could be realized if these investments were sold.

Special Items Including Restructuring and Business Improvement Actions

Special items reduced 1998 net earnings by \$72 million, 1997 net earnings by \$461 million and 1996 net earnings by \$131 million. The following tables and discussion present the impact of special items for 1998, 1997 and 1996:

<u>In millions</u>	1998	
	<u>Earnings (Loss) Before Taxes and Minority Interest</u>	<u>Earnings (Loss) After Taxes and Minority Interest</u>
Before special items	\$521	\$308
Oil and gas impairment charges	(111)	(68)
Restructuring and other charges	(121)	(66)
Gain on sale of business	20	12
Reversals of reserves no longer required	<u>83</u>	<u>50</u>
After special items	<u>\$392</u>	<u>\$236</u>

During 1998, we recorded \$111 million of oil and gas impairment charges (\$68 million after taxes). Of this amount, \$56 million (\$35 million after taxes) was recorded in the fourth quarter and \$55 million (\$33 million after taxes) was recorded in the third quarter. The Company has oil and gas exploration and production operations in West Texas, the Gulf Coast and the Gulf of Mexico. The Securities and Exchange Commission's regulations for companies that use the full-cost method of accounting for oil and gas activities require companies to perform a ceiling test on a quarterly basis. As a result of low oil and gas prices, the value of our properties were written down through these noncash charges.

Also in 1998, we recorded a \$105 million pre-tax restructuring charge (\$56 million after taxes and minority interest) consisting of \$56 million of asset write-downs and \$49 million of severance costs and we recorded pre-tax charges of \$16 million (\$10 million after taxes) related to our share of write-offs taken by Scitex, a 13% investee company, related to in-process research and development of an acquisition and its exit from the digital video business. The Scitex items are reflected as equity losses from the investment in Scitex in the consolidated statements of earnings. In addition, we recorded a \$20 million pre-tax gain (\$12 million after taxes) on the sale of our Veratec nonwovens division, and an \$83 million pre-tax gain (\$50 million after taxes) from the reversal of previously established reserves that were no longer required. These reserves were established in 1996 and 1997 and were primarily associated with the Veratec and Imaging businesses. The sales of these businesses were completed in 1998 and those reserves not required were returned to earnings.

The following table and discussion presents additional detail related to the \$105 million restructuring charge (in millions):

		<u>Asset Write-downs</u>	<u>Severance</u>	<u>Total</u>
Distribution	(a)	\$ 20	\$ 10	\$ 30
U.S. Papers	(b)	13	14	27
Carter Holt Harvey	(c)	15	3	18
Industrial Packaging	(d)	8	7	15
Other	(e)		15	15
Total		<u>\$ 56</u>	<u>\$ 49</u>	<u>\$105</u>

- (a) After the acquisition of Zellerbach, management of **xpedx** decided to terminate certain software projects that were in process and to use Zellerbach's systems in certain of its regions. Accordingly, we wrote off related deferred software costs on these projects, resulting in a \$20 million charge. As part of the Zellerbach integration plan, management determined that a significant part of the personnel reduction related to the termination of employees at the Company's duplicate facilities and locations. The \$10 million severance charge represents the costs for terminating 274 **xpedx** employees.
- (b) The Company's U.S. Papers business shut down equipment at the Mobile, Ala., mill and announced the termination of 750 employees at the Mobile, Ala., Lock Haven, Pa., and Ticonderoga, N.Y., mills. At the Mobile mill, International Paper permanently closed a paper machine and related equipment with a net book value of \$13 million. These assets were written down to their estimated fair market value of zero. The severance charge associated with the employee reductions at the 3 mills was \$14 million.
- (c) This charge primarily consists of a \$15 million asset write-down associated with the closure of two Carter Holt Harvey facilities, Myrtleford and Taupo. Myrtleford, a tissue pulp mill located in Australia, was closed due to excess capacity in its tissue pulp system. Carter Holt Harvey will be able to produce the volume at lower costs at its Kawerau tissue pulp mill located in New Zealand. Carter Holt Harvey also decided to close the Taupo, New Zealand, sawmill due to excess capacity in its sawmill system as the result of recent productivity improvements. The \$3 million severance charge represents the cost for terminating 236 employees. Our consolidated financial statements included revenues of \$21 million, \$36 million and \$34 million and operating income of \$1 million, \$3 million and \$3 million from these facilities in 1998, 1997 and 1996, respectively.
- (d) Management decided to close the Gardiner, Ore., mill because of excess capacity in International Paper's containerboard system. As a result, the net plant, property and equipment assets of this mill were reduced from \$13 million to the estimated salvage value of \$5 million. In connection with the third-quarter decision to close this mill, the Company terminated 298 employees at the mill and recorded a severance charge of \$7 million. This mill had revenues of \$78 million, \$105 million and \$55 million and operating losses of \$16 million, \$1 million and \$9 million in 1998, 1997 and 1996, respectively.
- (e) The \$15 million severance charge was recorded as a result of an announcement by International Paper of a plan to consolidate its land and timber and logging and fiber supply divisions into a new division called Forest Resources and the consolidation of the Consumer Packaging group. Of the \$15 million charge, \$10 million related to a headcount reduction of 200 employees in the Forest Resources group and the remaining \$5 million was based on a personnel reduction of 210 employees in the Consumer Packaging group.

The following table is a roll forward of the severance costs included in the 1998 restructuring plan (in millions):

	<u>Severance</u>
Opening Balance (third quarter 1998)	\$49
1998 Activity	
Cash charges	<u>(11)</u>
Balance, December 31, 1998	<u>\$38</u>

The severance reserve recorded in the 1998 third quarter related to 1,968 employees. As of December 31, 1998, 945 employees had been terminated.

<u>In millions</u>	<u>1997</u>	
	<u>Earnings (Loss) Before Taxes and Minority Interest</u>	<u>Earnings (Loss) After Taxes and Minority Interest</u>
Before special items	\$ 656	\$ 310
Provision for legal reserve	(150)	(93)
Restructuring and other charges	(660)	(465)
Gain on sale of business	<u>170</u>	<u>97</u>
After special items	<u>\$ 16</u>	<u>\$(151)</u>

In June 1997, a \$535 million pre-tax business improvement charge (\$385 million after taxes) was established under a plan to improve the Company's financial performance through closing or divesting of operations that no longer met financial or strategic objectives. It included approximately \$230 million for asset write-downs, \$210 million for the estimated losses on sales of businesses and \$95 million for severance and other expenses. At this point, the anticipated pre-tax earnings improvement of \$100 million from the 1997 restructuring actions has been largely realized. The earnings improvement consists of \$25 million of lower depreciation expense and \$75 million of lower cash costs.

The \$230 million write-down of assets that International Paper recorded in the second quarter of 1997 consisted primarily of write-downs associated with assets to be sold or shut down as follows (in millions):

Shutdown of European Papers facilities	(a) \$105
Shutdown of U.S. Papers and Fine Papers facilities	(b) 101
Write-off of Haig Point real estate development	(c) 13
Other shutdowns	<u>11</u>
	<u>\$230</u>

- (a) In the second quarter of 1997, management committed to sell the Lancey, France, mill to an employee group. The Company wrote down the net carrying amount of the mill at June 30, 1997 by \$65 million and established a reserve of \$30 million to cover a retained exposure. This remaining exposure should be resolved in 1999 at which time we will complete our accounting for this sale. The sale closed in October 1997. Lancey had revenues of \$52 million and \$81 million and operating losses of \$7 million and \$9 million in 1997 and 1996, respectively. The Corimex, France, mill produces coated thermal fax paper, which is a market that weakened in the mid-1990s. During the second quarter of 1997, management concluded that it would continue to operate this mill but that the assets were impaired. Based on an analysis of expected future cash flows completed in accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets To Be Disposed Of" (SFAS No. 121), the Company reduced the carrying value of the Corimex mill from \$12 million to \$2 million, resulting in a \$10 million charge. Corimex had operating losses of \$2 million during 1997.

- (b) The \$101 million reserve related to the restructuring of the Fine Papers manufacturing operations in the Northeast (\$51 million) and the shutdown of the deinking facility at the Lock Haven, Pa., mill (\$50 million). The restructuring of the Fine Papers operations included the shutdown of the Woronoco, Mass., paper mill and three small paper machines at the Erie, Pa., mill. In the 1997 second quarter, we decided to close the deinking facility. Given that each of these actions represented the permanent shutdown of equipment or facilities, International Paper wrote-down the net carrying amount of the assets to zero. The Woronoco, Mass., mill had revenues of \$46 million and \$50 million and operating earnings of \$5 million and \$1 million in 1997 and 1996, respectively.
- (c) The Company is the developer of a residential golf community named Haig Point at Daufuskie Island, S.C. As the developer, International Paper was responsible for operating this community until a specified number of lots were sold, at which time it would turn the community over to the homeowners. The net book value of our investment in Haig Point was \$13 million at June 30, 1997. Given the continuing operating losses, \$5 million in 1997, an updated marketing study, and the inability to find a buyer for this investment, we concluded that the investment was permanently impaired and wrote it down to zero. The operating loss in 1998 was \$500,000.

The \$210 million loss that the Company recorded in connection with sales or anticipated sales related to the following businesses (in millions):

Imaging	(a)	\$150
Veratec	(b)	25
Decorative Products	(c)	20
Label	(d)	<u>15</u>
		<u>\$210</u>

- (a) The Company decided to sell its Imaging businesses in the second quarter of 1997. Based on discussions with its investment banker and meetings with potential buyers, the Company believed that the most likely outcome was to realize approximately \$325 million. The Company established a reserve of \$150 million which represented the estimated loss on the sale of the Imaging businesses. The Company expected to complete the sale of the Imaging businesses within one year. The Imaging businesses had revenues of \$690 million and \$713 million and operating earnings of \$9 million and \$1 million in 1997 and 1996, respectively.
- (b) The Veratec division had developed a business that was based on an interspun technology for treating fabrics. The net carrying value of this business was \$25 million at June 30, 1997. In June 1997, the Company decided to shut down this business and recorded a reserve of \$25 million. Prior to the shutdown, this business had revenues of \$2 million and \$1 million and operating losses of \$7 million and \$8 million in 1997 and 1996, respectively.
- (c) In the second quarter of 1997, management decided to sell the medium-density fiberboard, low-pressure laminates and particleboard businesses. The Company estimated the expected sales prices for each of these businesses and recorded a reserve of \$20 million to reduce the net carrying amounts to these levels. The Company expected to complete the sales of these businesses within one year. These businesses had revenues of \$196 million and \$215 million in 1997 and 1996, respectively, and operating losses of \$1 million in 1997 and operating earnings of \$5 million in 1996.
- (d) In the second quarter of 1997, management committed to a plan to sell the label business. The estimated loss on the label business sale included in the second-quarter 1997 restructuring charge was \$15 million. The Company expected to complete the sale of the label business within one year. The label business had revenues of \$24 million and \$39 million in 1997 and 1996, respectively and an operating loss of \$2 million in 1997 and operating earnings \$1 million in 1996.

The \$95 million of severance and other expenses consists of the following (in millions):

Severance	(a)	\$42
Write-off of deferred software costs	(b)	18
Lease buyouts at warehouses	(c)	9
Write-off of deinking process license	(d)	4
Other exit costs	(e)	<u>22</u>
		<u>\$95</u>

- (a) The \$42 million severance charge relates to programs initiated and approved in the 1997 second quarter in the U.S. and European Papers, Industrial and Consumer Packaging segments and corporate staff groups to reduce headcount by 3,015 employees under the Company's existing ongoing severance plans. We recorded the charge in the second quarter as (1) management had committed to the plan of termination, (2) the benefit arrangement had been communicated to the employees, (3) the number of employees, their functions and locations had been identified, and (4) all terminations were to be completed within approximately one year. As of December 31, 1998, 2,446 employees had been terminated under these programs.
- (b) The \$18 million charge for the write-off of deferred software costs relates to two items as follows: (1) during the 1997 second quarter, the Company decided to abandon a human resources software project for which \$11 million of deferred software costs had been recorded and (2) as a result of the decision to sell certain businesses in the second quarter of 1997, the Company decided to terminate enterprise software projects in these businesses, for which it had recorded \$7 million of deferred software costs.
- (c) The \$9 million charge represents the cost to buy out obligations under existing warehouse leases. The Company decided to close these warehouses in the second quarter of 1997.
- (d) The \$4 million charge represents the write-off of the net carrying value of the deinking process license that the Company acquired from a third party. International Paper permanently shut down this operation in the 1997 second quarter. Accordingly, it wrote the license down to zero.
- (e) The charge of \$22 million relates to other exit costs.

In December 1997, an additional pre-tax charge of \$125 million (\$80 million after taxes) was recorded for anticipated losses associated with the sale of the remaining Imaging businesses. Such amount was determined after consideration of the sales of certain of the Imaging businesses that had been completed and the estimated proceeds from the businesses remaining to be sold. The remaining Imaging businesses were sold in 1998.

Also included in the 1997 special items was a \$150 million provision to increase our legal reserves as a result of a settlement by Masonite Corporation, a wholly owned subsidiary, of a class-action lawsuit relating to its hardboard siding product. A more detailed discussion of this legal settlement is included in Note 11 to the consolidated financial statements. The Company also recorded a gain of \$170 million on the redemption of certain retained West Coast partnership interests and the release of a related debt guaranty.

The following table is a roll forward of the severance and other costs included in the 1997 restructuring plan (in millions):

	<u>Severance and Other</u>
Opening Balance (second quarter 1997)	\$ 95
1997 Activity	
Asset write-downs	(18)
Cash charges	<u>(15)</u>
Balance, December 31, 1997	62
1998 Activity	
Asset write-downs	(4)
Reserve reversals	(9)
Cash charges	<u>(40)</u>
Balance, December 31, 1998	<u>\$ 9</u>

The \$9 million of reserves remaining are to complete the 1997 restructuring plan.

<u>In millions</u>	<u>1996</u>	
	<u>Earnings (Loss) Before Taxes and Minority Interest</u>	<u>Earnings (Loss) After Taxes and Minority Interest</u>
Before special items	\$890	\$434
Restructuring and other charges	(670)	(461)
Scitex restructuring charge	(10)	(6)
Gain on sale of business	<u>592</u>	<u>336</u>
After special items	<u>\$802</u>	<u>\$303</u>

In the first quarter of 1996, management initiated several actions to restructure and strengthen existing businesses that resulted in a pre-tax charge to earnings of \$515 million (\$362 million after taxes). The charge included \$305 million for the write-down of certain assets, \$100 million for asset impairments (related to the adoption of the provisions of SFAS No. 121), \$80 million in associated severance costs and \$30 million of other expenses, including the cancellation of leases.

The major components of the \$305 million asset write-down were as follows (in millions):

Consolidation and shutdown of Imaging facilities	(a)	\$192
Shutdown of Cordele OSB composite siding business	(b)	43
Write-off of Georgetown recovery unit	(c)	25
Shutdown of Veratec facilities	(d)	19
Impairment of INTAMASA business	(e)	15
Other shutdowns		<u>11</u>
		<u>\$305</u>

- (a) In the first quarter of 1996, management decided to consolidate the Imaging division's manufacturing and sales operations, which resulted in a write-down of the assets associated with these facilities. The planned facility shutdowns included the Swiss manufacturing plants, the Lyon, France, facility and several European sales companies. As the Company was planning to close these facilities, it determined the fair value to be zero. In addition, the Company determined that the long-lived assets associated with its Binghamton, N.Y., Holyoke, Mass., and several U.K. facilities were impaired based on an analysis of future cash flows from these businesses. The cash flow analysis, which was completed in accordance with SFAS No. 121, indicated that future cash flows from these operations would be break-even and, accordingly, the Company wrote down the long-lived assets to their estimated fair value of zero. The Imaging division had revenues of \$713 million and operating earnings of \$1 million during 1996.
- (b) International Paper's Cordele, Ga., facility produced both oriented strand board substrate and composite wood siding. The carrying amount of the equipment related solely to the manufacture of composite wood siding was \$43 million. The Company decided to stop manufacturing composite wood siding and to exit this business. As we shut down the equipment, the assets' fair values were determined to be zero.
- (c) In the first quarter of 1996, the Company permanently closed an enhanced kraft recovery unit in its Georgetown, S.C., facility because of its failure to operate effectively. The carrying amount of this asset was \$25 million. As the equipment was shut down, the Company determined its fair value to be zero.
- (d) The Company decided to permanently close its Veratec Belgium facility and 5 thermal bond machines in its Lewisburg, Ky., facility during the first quarter of 1996. The carrying amounts of these assets were \$12 million and \$7 million, respectively. As these facilities and machines were being closed, the Company determined their fair values to be zero.
- (e) In the first quarter of 1996, the Company committed to sell the Masonite INTAMASA business located in Cella, Spain. The Company wrote down its carrying amount of \$41 million to \$26 million, which represented the estimated selling price of this business. This business had revenues of \$25 million and operating earnings of \$3 million during 1996.

In the first quarter of 1996, International Paper recorded an impairment charge of \$100 million consisting of the following (in millions):

Gardiner mill	(a)	\$ 42
Hardboard siding facilities	(b)	26
Mineral deposits	(c)	14
Haig Point real estate development	(d)	8
Other		<u>10</u>
		<u>\$100</u>

- (a) The Gardiner, Ore., mill produces containerboard and is the Company's only West Coast mill. In early 1996, management announced an extended shutdown of the mill. As a result of the shutdown, International Paper determined that a triggering event had occurred, and it wrote down the mill's assets to the estimated fair value.
- (b) The Masonite division had hardboard siding operations at its Laurel, Miss., Towanda, Pa., and Ukiah, Calif., plants. Based on expected declines in demand, management believed that a triggering event under SFAS No. 121 had occurred in the first quarter of 1996. The Company would continue to hold and use these assets, but it projected that the future cash flows of this business would be negative. Accordingly, it wrote down the \$26 million carrying amount of these assets to zero.
- (c) The Petroleum and Minerals division had two mineral investments that it determined to be impaired in the first quarter of 1996. First, based on a consultant's analysis, the Company estimated the fair value of its lignite reserves to be \$3 million, thereby requiring a write-down of \$11 million. Second, an analysis of its zinc reserves indicated a fair value of \$500,000, requiring a write-down of \$3 million. The triggering event for these write-downs was the analysis of these reserves on a stand-alone basis.
- (d) International Paper holds an investment in a residential golf community named Haig Point at Daufuskie Island, S. C. As the developer, the Company is responsible for operating this community until a specified number of lots have been sold, at which time it would turn the community over to the homeowners. The net book value of the Company's investment in Haig Point was \$21 million at December 31, 1995. The Company concluded in the first quarter of 1996 that its investment was impaired. The triggering event was the analysis of the 1995 results and the 1996 forecast, combined with the decision to sell this business. Haig Point's estimated fair value was \$13 million, resulting in an \$8 million charge.

The Company's 1996 charge included \$80 million of severance costs. The charge relates to programs initiated and approved in the first quarter of 1996 to reduce headcount by 1,955 employees under our existing ongoing severance plan. The businesses impacted by this charge include Imaging (\$45 million), Veratec (\$12 million), Zanders (\$10 million), and corporate staff groups and other businesses (\$13 million). Under this plan, there have been headcount reductions of 1,597 employees.

The Company's 1996 charge also included \$30 million of other expenses. The major components of this charge were the lease termination costs incurred by the Imaging businesses as a result of the decision to close several European locations. The lease termination costs resulted from the termination of leases in London, the U.K. depot facilities, and the Benelux and Germany sales offices.

The following is a roll forward of the 1996 severance and other costs included in the restructuring and impairment program (in millions):

	<u>Severance and Other</u>
Opening Balance (first quarter 1996)	\$110
1996, 1997 and 1998 Activity	
Reserve reversals (1998)	(29)
Cash charges	<u>(81)</u>
Balance, December 31, 1998	<u>\$ —</u>

In the fourth quarter of 1996, a \$155 million pre-tax charge (\$99 million after taxes) was recorded for the write-down of the investment in Scitex to current market value. At such time, the Company determined that its investment in Scitex of 5.7 million shares was permanently impaired and began efforts, thus far unsuccessful, to dispose of its investment. We wrote our investment in Scitex down to \$10 per share based on the closing prices of Scitex shares during the period from November 14, 1996 to December 31, 1996.

The Company also recorded a \$10 million pre-tax charge (\$6 million after taxes) related to our share of a restructuring charge taken by Scitex. This item is reflected as an equity loss from the investment in Scitex in the consolidated statement of earnings.

The Company also completed the sale of a 98% general partnership interest in a subsidiary partnership that owned approximately 300,000 acres of forestlands in Oregon and Washington. Included in the net assets of the partnership interest sold were forestlands, roads and \$750 million of long-term debt. As a result of this transaction, International Paper recognized a \$592 million pre-tax gain.

Ongoing Profit Improvement Review

International Paper continually evaluates its operations for improvement. When any such plans are finalized, the Company may incur costs or charges in future periods related to improvement plans when and if such plans are implemented. During 1999, up to \$20 million in severance costs may be required to implement the next phase of the U.S. Papers program to improve the cost position of its mills.

Income Taxes

Before special items, the 1998 effective tax rate was 25% of pre-tax earnings, declining from 34% in 1997 and 36% in 1996. The decline in the 1998 tax rate was due primarily to the impact of state tax credits, changes in the geographic mix of our overall taxable earnings, and permanent tax benefits on sales of non-U.S. businesses and non-strategic timberland assets. After special items, the effective tax rate was 20%, 238% and 41% for 1998, 1997 and 1996, respectively. We estimate that the 1999 effective tax rate will be approximately 30% based on expected earnings and business conditions, which are subject to change.

The following tables present the impact of the special items on the effective tax rate for the three years. Taxes on special charges were provided at statutory rates except for those charges that represent tax deductions that management does not believe will be realized.

<u>Effective Tax Rate (in millions)</u>	1998		
	Earnings (Loss) Before Taxes and Minority Interest	Tax Expense (Benefit)	Effective Tax Rate
Before special items	\$ 521	\$ 130	25%
Oil and gas impairment charges	(111)	(43)	39%
Restructuring and other charges	(121)	(48)	40%
Gain on sale of business	20	8	40%
Reversals of reserves no longer required	83	33	40%
After special items	<u>\$ 392</u>	<u>\$ 80</u>	20%

<u>Effective Tax Rate (in millions)</u>	1997		
	Earnings (Loss) Before Taxes and Minority Interest	Tax Expense (Benefit)	Effective Tax Rate
Before special items	\$ 656	\$ 223	34%
Provision for legal reserve	(150)	(57)	38%
Restructuring and other charges	(660)	(195)	30%
Gain on sale of business	170	67	39%
After special items	<u>\$ 16</u>	<u>\$ 38</u>	238%

<u>Effective Tax Rate (in millions)</u>	1996		
	<u>Earnings (Loss) Before Taxes and Minority Interest</u>	<u>Tax Expense (Benefit)</u>	<u>Effective Tax Rate</u>
Before special items	\$ 890	\$ 319	36%
Restructuring and other charges	(670)	(209)	31%
Scitex restructuring charge	(10)	(4)	36%
Gain on sale of business	592	224	38%
After special items	<u>\$ 802</u>	<u>\$ 330</u>	41%

Recent Accounting Pronouncements

In the fourth quarter of 1998, the Company adopted Statement of Financial Accounting Standards No. 131, "Disclosure about Segments of an Enterprise and Related Information," which requires the presentation of segment information on a basis consistent with that used by management for operating decisions and sets forth quarterly and annual disclosure requirements. The Company's industry segment and geographic area financial information for 1998, 1997 and 1996 appearing on pages 42 through 45 has been restated accordingly. The major change to previously reported segment data is to present Carter Holt Harvey as a distinct business segment, rather than to report it on a product-line basis.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Statement establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured by its fair value. The Statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement and requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting. The Statement is effective for fiscal years beginning after June 15, 1999. A company may also implement the Statement as of the beginning of any fiscal quarter after issuance. The Statement cannot be applied retroactively and must be applied to (a) derivative instruments and (b) certain derivative instruments embedded in hybrid contracts that were issued, acquired or substantively modified after December 31, 1997 (and at a company's election, before January 1, 1998).

We have not yet quantified the impact of adopting this Statement on our consolidated financial statements and have not determined the timing or method of our adoption. However, adoption of the provisions of the Statement could increase volatility in earnings and other comprehensive income.

Legal and Environmental Issues

International Paper operates in an industry subject to extensive federal and state environmental regulation. Controlling pollutants discharged into the air, water and groundwater to avoid adverse impacts on the environment, making continual improvements in environmental performance, and achieving 100% compliance with applicable laws and regulations are continuing goals of International Paper. A total of \$100 million was spent in 1998 for capital projects to control environmental releases into the air and water and to assure environmentally sound management and disposal of waste. We expect to spend approximately \$80 million in 1999 for similar capital projects, including the costs to comply with the Environmental Protection Agency's (EPA) Cluster Rule regulations. Amounts to be spent for environmental control projects in future years will depend on new laws and regulations and changes in legal requirements and environmental concerns. Taking these uncertainties into account, our preliminary estimate for 2000 and

2001 is approximately \$230 million in total. On April 15, 1998, the EPA issued final Cluster Rule regulations that established new requirements regarding air emissions and wastewater discharges from pulp and paper mills to be met over the next 3 to 8 years. One of the requirements of the Cluster Rule is that pulp and paper mills use only elemental chlorine-free technology (ECF) in the pulp bleaching process. We have spent \$206 million through 1998 to convert 15 of our U.S. and European bleached mills to this technology and for certain other projects related to the Cluster Rule regulations. The additional cost related to the Cluster Rule regulations for the years 1999 through 2001 is estimated to be \$194 million. Projected costs for the following 5 years are in the range of \$120 million to \$180 million. The final cost depends on the outcome of Cluster Rule water regulations for pulp and paper categories other than bleached kraft. Regulations for these categories are not likely to become final until late 2000 or 2001. We now estimate that annual operating costs, excluding depreciation, will increase approximately \$20 million when these regulations are fully implemented.

International Paper has been named as a potentially liable party in a number of environmental remediation actions under various federal and state laws, including the Comprehensive Environmental Response, Compensation and Liability Act. Related costs are recorded in the financial statements when they are probable and reasonably estimable. Completion of these actions is not expected to have a material adverse effect on the Company's financial condition or results of operations.

Three nationwide class-action lawsuits filed against International Paper have been settled. The first suit alleged that hardboard siding manufactured by Masonite fails prematurely, allowing moisture intrusion that in turn causes damage to the structure underneath the siding. The class consisted of all U.S. property owners having Masonite hardboard siding installed on or incorporated into buildings between 1980 and January 15, 1998. Final approval of the settlement was granted by the Court on January 15, 1998. The settlement provides for monetary compensation to class members meeting the settlement requirements for a period of up to 10 years. It also provides for the payment of attorneys' fees equaling 15% of the settlement amounts paid to class members, with a nonrefundable advance of \$47.5 million plus \$2.5 million in costs.

The second suit made similar allegations with regard to Omniwood siding manufactured by Masonite (the "Omniwood Lawsuit"). The class consists of all U.S. property owners having Omniwood siding installed on or incorporated into buildings from January 1, 1992 to January 6, 1999. The third suit alleged that Woodruf roofing manufactured by Masonite is defective and causes damage to the structure underneath the roofing (the "Woodruf Lawsuit"). The class consists of all U.S. property owners on which Masonite Woodruf roofing has been incorporated and installed from January 1, 1980 to January 6, 1999.

Final approval of the settlements of the Omniwood and Woodruf Lawsuits was granted by the Court on January 6, 1999. The settlements provide for monetary compensation to class members meeting the settlement requirements on a claims-made basis, and provides for payment of attorneys' fees equaling 13% of the settlement amounts paid to class members, with a nonrefundable advance of \$1.7 million plus \$75,000 in costs for each of the two cases.

In the second quarter of 1997, we recorded a \$150 million provision to increase our legal reserves. While the total cost of these three settlements is not presently known with certainty, we believe that our legal reserves, totaling \$129 million at December 31, 1998, are adequate to cover any amounts to be paid. The reserve balance is net of \$58 million of expected insurance recoveries. Through December 31, 1998, settlement payments of \$91 million, including the \$49 million of non-returnable advances of attorneys' fees discussed above have been made. Also, we have received \$19 million from our insurance carriers. The settlements are not expected to have a material adverse effect on our consolidated financial position or results of operations. International Paper and Masonite have the right to terminate each of the settlements after 7 years from the dates of final approval.

While any proceeding or litigation has an element of uncertainty, the Company believes that the outcome of any lawsuit or claim that is pending or threatened, or all of them combined, will not have a material

adverse effect on its consolidated financial position or results of operations. For a further discussion of legal issues, see pages 67 and 68 of Item 8. Financial Statements and Supplementary Data, Note 11. Commitments and Contingent Liabilities.

Impact of Euro

The introduction of the euro for noncash transactions took place on January 1, 1999, with 11 countries participating in the first wave: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain. There has been an irrevocable locking of exchange rates between each of the participating countries' national currencies and the new euro currency, which became a currency in its own right. The euro has begun trading on world currency exchanges and may be used in business transactions. On January 2, 2002, new euro-denominated bills and coins will be issued and legacy currencies will be completely withdrawn from circulation that year. In general, the euro is expected to increase price transparency for our products in Europe. The major impact to International Paper will be to its businesses within the euro zone, which make up approximately 17% of sales. Each of our European businesses has a plan in place to deal with the introduction of the euro.

Over the three-year transition period, our computer systems will be updated to ensure euro compliance. Also, we are reviewing our marketing and operational policies and procedures to ensure our ability to continue to successfully conduct all aspects of our business in this new market. In general, our product lines are likely to become somewhat more international, with some leveling of prices that is not expected to significantly impact our operations. We anticipate that the total costs in connection with the euro conversion will not be material. Further, we do not anticipate that the conversion from the legacy currencies to the euro will have a material adverse effect on our consolidated financial position or results of operations.

Year 2000 Readiness

The Year 2000 problem concerns the inability of systems to properly recognize and process date-sensitive information beyond January 1, 2000.

We have a program in place designed to bring our systems into Year 2000 compliance in time to minimize any significant detrimental effects on operations. The program covers information systems infrastructure, financial and administrative systems, process control and manufacturing operating systems. It also includes readiness assessment of significant vendors and customers, and contingency planning.

The Company has adopted a 9-step process toward Year 2000 readiness: (1) planning and awareness; (2) inventory; (3) triage (assess risks and prioritize efforts); (4) detailed assessment (identification of where failures may occur, solutions and workarounds, and plans to repair or replace); (5) resolution (repair, replace or retire systems that cannot properly process Year 2000 dates; create bridges to other systems and perform unit testing); (6) test planning; (7) test execution (some manufacturing systems require scheduling of equipment downtime); (8) deployment of compliant systems; and (9) fallout (remove bridges and patches; recertify). The first 4 steps, planning and awareness, inventory, triage and detailed assessment, are largely complete. Steps 5 through 9 were approximately 25% complete at the end of 1998. We reached 50% at the end of February 1999 and expect to complete these efforts by the end of June 1999.

Based on the results of the detailed assessment step completed during the fourth quarter of 1998, we have lowered our estimate of the incremental Year 2000-related costs from \$135 million plus or minus 30% to \$100 million plus or minus 10%, exclusive of software and systems that are being replaced or upgraded in the normal course of business. The majority of these costs relate to production facility systems. The availability of lower cost approaches and alternatives to address facility system issues, and efficiencies achieved in our central business system testing process, were the principal contributors to the reduced estimate. Spending through the end of 1998 totaled \$32 million. The remaining costs are expected to be incurred during the first half of 1999. Our policy is to expense as incurred information system maintenance

and modification costs and to capitalize the cost of new software and amortize it over the assets' useful lives.

We are utilizing internal personnel, contract programmers and vendors to identify Year 2000 noncompliance problems, modify code and test the modifications. In some cases, noncompliant software and hardware will be replaced.

We rely on third-party suppliers for raw materials, water, utilities, transportation and other key services. Interruption of supplier operations due to Year 2000 issues could affect Company operations. An ongoing program is in place to evaluate the status of suppliers' efforts and to determine alternatives and contingency plan requirements. This program includes both written correspondence with suppliers and visits to supplier facilities to assess their readiness. We are receiving assurances from our supplier base that they will be able to handle the transition to the Year 2000. These activities are intended to provide a means of managing risk, but cannot entirely eliminate the potential for disruption due to third-party failure. Approaches to reduce the risks of interruption due to supplier failures vary by business and facility. Contingency options include identification of alternate suppliers and accumulation of inventory to assure production capability where feasible or warranted. We believe that no individual vendor is material to our total business.

We are also dependent upon our customers for sales and cash flow. Year 2000 interruptions in our customers' operations could result in reduced sales, increased inventory or receivable levels, and cash flow reductions. While these events are possible, our customer base is broad enough to minimize the effects of a single occurrence. We are, however, monitoring the status of our customers through discussions and correspondence as a means of determining risks and alternatives. We believe that no individual customer is material to our total business. None of our major customers are significant as defined by the provisions of Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information."

Our manufacturing facilities (mills and converting plants) rely on control systems that include production monitoring, power, emissions and safety. The 46 pulp and paper mills operated by the Company utilize various complex control systems to monitor and regulate power, emissions and production operations. Failure to identify, correct and test Year 2000-sensitive systems at any one of these facilities could result in manufacturing interruptions, possible environmental contamination or safety hazards. Annual sales for our larger U.S. mills range from approximately \$100 million to \$500 million at each site.

Control systems used at the 219 converting facilities cover comparable operations. The production impact of a Year 2000-related interruption varies significantly between facilities, but would be typically much smaller in terms of sales than a comparable event at a pulp and paper mill.

While comparable control systems are used, specific facility-related configurations exist to meet the needs of production equipment at each of our mills and plants. If a failure were to occur, the potential impact would be isolated to the affected facility. Also, in many cases, we have the capability of manufacturing the same product at different facilities.

The consequences of a Year 2000-related event could range from an orderly shutdown of one or more facilities to a sudden halt at one or more facilities, with possible safety, environmental and equipment impact. The likelihood of either type of event, or the related financial impact, is not reasonably predictable. Our contingency planning efforts include consideration of reduced operations or shutdowns over the new year. Decisions regarding the need or feasibility of such actions are not expected to be made until later in 1999.

Production facility systems represent our greatest area of risk, and plans are in place to reduce the risk of noncompliance of these systems, including contingency planning. While we believe our efforts will provide reasonable assurance that material disruptions will not occur due to internal failure, the potential for interruption still exists. Production facility shutdowns could have a material adverse effect on the

Company's results of operations, financial condition and cash flows. Recovery under existing insurance policies should be available depending upon the circumstances of a Year 2000-related event and the type of facility involved. Generally, no recovery would be available in the event of an orderly shutdown that does not result in damage to a facility. Potential recoveries in the event of facility damage, including business interruption, would be subject to deductibles that range from \$100,000 to \$10 million.

We also rely on various administrative and financial applications (e.g., order processing and collection systems) that require correction to properly handle Year 2000 dates. In the event that one of these systems was not corrected, our ability to capture, schedule and fulfill customer demands could be impaired. Likewise, if a collection processing system were to fail, we may not be able to properly apply payments to customer balances or correctly determine cash balances. Centrally controlled administrative applications are approximately 60% complete, with the remainder in the process of code correction or testing. Various non-centrally controlled systems are also utilized by our businesses. The impact of a failure of these systems would be limited to the business using the affected system, and then only to the extent that manual or other alternate processes were not able to meet processing requirements. Such an occurrence is not expected to have a significant adverse impact on the Company.

THE ESTIMATES AND CONCLUSIONS HEREIN CONTAIN FORWARD-LOOKING STATEMENTS AND ARE BASED ON MANAGEMENT'S BEST ESTIMATES OF FUTURE EVENTS. RISKS TO COMPLETING THE PLAN INCLUDE THE AVAILABILITY OF RESOURCES, OUR ABILITY TO DISCOVER AND CORRECT THE POTENTIAL YEAR 2000 PROBLEMS THAT COULD HAVE A SERIOUS IMPACT ON SPECIFIC FACILITIES, AND THE ABILITY OF SUPPLIERS TO BRING THEIR SYSTEMS INTO YEAR 2000 COMPLIANCE

Effect of Inflation

General inflation has had minimal impact on our operating results in the last three years. Sales prices and volumes are more strongly influenced by supply and demand factors in specific markets and by exchange rate fluctuations than by inflationary factors.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

We use financial instruments, including fixed and variable rate debt, to finance operations, for capital spending programs and for general corporate purposes. Additionally, financial instruments, including swap and forward contracts, are used to hedge exposures to interest rate and foreign currency risks. We do not use financial instruments for trading purposes.

Our exposure to market risk for changes in interest rates relates primarily to investments in marketable securities, and short- and long-term debt obligations. We invest in high-credit-quality securities with major international financial institutions while limiting exposure to any one issuer. Our debt obligations outstanding as of December 31, 1998, expressed in U.S. dollar equivalents, are summarized as to their principal cash flows and related weighted average interest rates by year of maturity in the following table. Our investments at December 31, 1998 were not significant.

Short- and Long-Term Debt (in millions)

Outstanding as of December 31, 1998	1999	2000	2001	2002	2003	Thereafter	Total	Fair Value
U.S. commercial paper and bank notes—5.6% average interest rate	\$ 527						\$ 527	\$ 527
New Zealand dollar commercial paper and bank notes—4.7% average interest rate	385						385	385
Australian dollar commercial paper and bank notes—5.1% average interest rate	165						165	165
French franc bank notes—3.8% average interest rate	46						46	46
German mark bank notes—4.4% average interest rate	17						17	17
Japanese yen bank notes—4.0% average interest rate	20						20	20
New Zealand dollar notes payable—5.0% average interest rate	178						178	178
Fixed rate debt—7.9% average interest rate	16	\$331	\$256	\$256	\$205	\$2,487	3,551	3,816
5 ⁷ / ₈ % Swiss franc debentures			82				82	88
Floating rate notes—6.2% average interest rate	450						450	450
Medium-term notes—7.4% average interest rate	282	8	121	79	30	52	572	596
Environmental and industrial development bonds—5.6% average interest rate	16	13	81	48	4	868	1,030	1,077
German mark fixed rate borrowings—4.6% average interest rate	24	24	44	44	19	4	159	159
Other	98	43	31	79	12	36	299	302
Total Debt	<u>\$2,224</u>	<u>\$419</u>	<u>\$615</u>	<u>\$506</u>	<u>\$270</u>	<u>\$3,447</u>	<u>\$7,481</u>	<u>\$7,826</u>

For debt obligations, the table presents principal cash flows and related weighted average interest rates by year of maturity. Variable interest rates disclosed represent the weighted average rates at the end of the period. For financial statement classification, \$1.4 billion of short-term debt has been classified as long-term pursuant to line of credit agreements.

We use cross-currency and interest rate swap agreements to manage the composition of our fixed and floating rate debt portfolio. Amounts to be paid or received as interest under these agreements are recognized over the life of the swap agreements as adjustments to interest expense. The impact on earnings and our net liability under these agreements were not significant. Our cross-currency and interest rate swap agreements outstanding as of December 31, 1998, expressed in U.S. dollar equivalents, by year of maturity are presented in the following table.

Interest Rate and Currency Swaps (in millions)

<u>Outstanding as of December 31, 1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>Thereafter</u>	<u>Total</u>	<u>Fair Value</u>
U.S. dollar variable to fixed rate swaps	\$525			\$ 45		\$1,000	\$1,570	(\$187)
Average pay rate 7.1%								
Average receive rate 5.2%								
Australian dollar variable to fixed rate swaps	40	\$45	\$45	15	\$30		175	(3)
Average pay rate 6.3%								
Average receive rate 4.9%								
New Zealand dollar variable to fixed rate swaps	13	24	26	26	26		115	(2)
Average pay rate 7.1%								
Average receive rate 4.6%								
U.S. dollar fixed to variable rate swaps				45		1,250	1,295	190
Average pay rate 5.1%								
Average receive rate 7.5%								
U.S. dollar to Australian dollar cross-currency swap				150			150	14

COPEC, a Chilean equity investment of Carter Holt Harvey, has approximately \$1.5 billion of U.S. dollar-denominated debt. The remeasurement of this debt as the Chilean peso and U.S. dollar exchange rate fluctuates is recorded in earnings. Based on the relative ownership, a 3% movement in that exchange rate would result in approximately a \$.02 per share earnings impact for International Paper.

We also transact business in many currencies and are subject to currency exchange rate risk. We address this risk through a risk management program that involves financing a portion of our investments in overseas operations with borrowings denominated in the same currency as the investment or by entering into currency exchange contracts in tandem with U.S. dollar borrowings. These contracts are effective in providing hedges against fluctuations in currency exchange rates. Additionally, we utilize currency exchange contracts to hedge certain transactions that are denominated in foreign currencies, primarily export sales and equipment purchased from nonresident vendors. These contracts serve to protect us from currency fluctuations between the transaction and settlement dates.

The following table presents information about our foreign currency forward contracts outstanding as of December 31, 1998, expressed in U.S. dollar equivalents. All contracts have maturities of less than 12 months. This information should be read in conjunction with Note 14 of Item 8. Financial Statements and Supplementary Data, which can be found on pages 70 through 72.

Foreign Currency Forward Contracts (dollars in millions)

<u>Outstanding as of December 31, 1998</u>	<u>Contract Amount</u>	<u>Weighted Average Exchange Rate</u>	<u>Unrealized Gain (Loss)</u>
Receive Belgian francs / Pay British pounds	\$ 28	57.25	
Receive Swedish kronas / Pay U.S. dollars	50	8.07	
Receive German marks / Pay U.S. dollars	305	1.68	\$ 3
Receive British pounds / Pay Belgian francs	32	57.36	
Receive New Zealand dollars / Pay U.S. dollars	431	1.02	(8)
Receive New Zealand dollars / Pay Australian dollars	176	1.40	4
Receive Australian dollars / Pay New Zealand dollars	30	0.84	(1)
Receive Swiss francs / Pay New Zealand dollars	85	0.67	(12)
Receive U.S. dollars / Pay New Zealand dollars	105	0.50	(10)
Receive U.S. dollars / Pay Australian dollars	65	0.63	3

The Company has an additional \$44 million in a number of smaller contracts to purchase or sell other currencies with a related net unrealized immaterial gain.

VALUE AT RISK

Value at risk is used to describe an approach for measuring market risk exposure that utilizes statistical models that are based on historical price and volatility patterns to estimate the probability of the value of a financial instrument falling above or below a specified amount at a specified confidence level and over a given time period. Our analysis uses variance-covariance statistical modeling techniques and includes substantially all interest rate-sensitive debt and swaps, and currency exchange contracts. The model estimates the potential loss in fair market value or earnings the Company could incur from adverse changes in interest rates or currency exchange rates. The results of our analysis at a 95% confidence level were not significant to our consolidated common shareholders' equity, earnings or daily change in market capitalization.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Industry Segment and Geographic Area Information

The industry segment and geographic area financial information has been restated in accordance with the provisions of Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information," which the Company adopted in the 1998 fourth quarter. This statement requires that industry segments be reported using the management approach rather than grouped along industry product lines, as had been reported in prior years. The Statement allows for combination of segments that have similar economic characteristics or where segments fall below a 10% materiality threshold.

The most significant segment reporting change is that Carter Holt Harvey, our 50.3% owned consolidated New Zealand-based forest products company, is now disclosed as a separate segment. In the past, Carter Holt Harvey results were allocated to the product line segments. For an explanation of major differences between results reported by the Company for this segment and those reported by Carter Holt Harvey in New Zealand, see pages 21 and 22 of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

For information about our industry segments, see the "Description of Industry Segments" included in Management's Discussion and Analysis.

For management purposes, we report the operating performance of each business based on earnings before interest and income taxes ("EBIT") excluding special items and gains or losses on sales of businesses. Our Carter Holt Harvey segment includes our share, about half, of Carter Holt Harvey's operating earnings adjusted for U.S. generally accepted accounting principles. The remaining half is included in minority interest adjustment. Intersegment sales and transfers are recorded at current market prices. Corporate sales includes the Imaging and Veratec businesses that were sold in 1998 and 1997. Corporate operating profit also includes these businesses as well as corporate expenses. Corporate assets includes these businesses for the applicable years in addition to other assets not allocated to our segments. Sales for these businesses were \$220 million in 1998 and \$938 million and \$980 million in 1997 and 1996, respectively. These businesses recorded an operating loss of \$2 million in 1998 and operating profits of \$27 million and \$12 million in 1997 and 1996, respectively.

External Sales By Major Product is determined by aggregating sales from each segment based on similar products or services. External sales are defined as those that are made to parties outside the Company's consolidated group whereas sales by segment in the Net Sales table are determined by the management approach and include intersegment sales.

Capital Spending by Industry Segment is reported on page 23 of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Financial Information by Industry Segment

NET SALES

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
U.S. and European Papers	\$ 4,865	\$ 5,200	\$ 5,155
Industrial and Consumer Packaging	4,600	4,415	4,275
Distribution	5,545	4,555	4,545
Specialty Products	1,320	1,425	1,425
Forest Products	2,520	2,655	2,550
Carter Holt Harvey	1,505	1,955	2,080
Corporate and Intersegment Sales (1)	(814)	(109)	113
Net Sales	<u>\$19,541</u>	<u>\$20,096</u>	<u>\$20,143</u>

ASSETS

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
U.S. and European Papers	\$ 6,779	\$ 6,740	\$ 7,548
Industrial and Consumer Packaging	5,308	4,880	4,772
Distribution	1,712	1,174	1,101
Specialty Products	1,299	1,414	1,433
Forest Products	3,030	3,237	2,968
Carter Holt Harvey (2)	4,475	4,953	5,733
Corporate (1)	3,753	4,356	4,697
Assets	<u>\$26,356</u>	<u>\$26,754</u>	<u>\$28,252</u>

OPERATING PROFIT

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
U.S. and European Papers	\$ 135	\$ 170	\$ 180
Industrial and Consumer Packaging	265	170	375
Distribution	80	85	100
Specialty Products	125	155	175
Forest Products	505	475	390
Carter Holt Harvey (3)	20	90	130
Operating Profit	<u>1,130</u>	<u>1,145</u>	<u>1,350</u>
Interest expense, net	(496)	(490)	(530)
Minority interest adjustment (3)	45	149	172
Corporate items, net (1)(5)	(158)	(148)	(102)
Provision for legal reserve		(150)	
Restructuring and other charges	(216)	(660)	(670)
Scitex restructuring and other charges	(16)		(10)
Reversals of reserves no longer required	83		
Gains on sales of businesses	20	170	592
Earnings Before Income Taxes and Minority Interest	<u>\$ 392</u>	<u>\$ 16</u>	<u>\$ 802</u>

Financial Information by Industry Segment (continued)

RESTRUCTURING AND OTHER CHARGES

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
U.S. and European Papers	\$ 27	\$ 186	\$ 50
Industrial and Consumer Packaging	20	48	55
Distribution	30	16	
Specialty Products	111	29	18
Forest Products	10	66	95
Carter Holt Harvey	18		
Corporate		315	452
Restructuring and Other Charges	<u>\$ 216</u>	<u>\$ 660</u>	<u>\$ 670</u>

DEPRECIATION, DEPLETION AND AMORTIZATION

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
U.S. and European Papers	\$ 429	\$ 470	\$ 467
Industrial and Consumer Packaging	288	298	260
Distribution	22	19	19
Specialty Products	92	94	90
Forest Products	181	185	137
Carter Holt Harvey	201	202	192
Corporate	133	148	150
Depreciation, Depletion and Amortization	<u>1,346</u>	<u>1,416</u>	<u>1,315</u>
Less: Depletion (4)	<u>(160)</u>	<u>(158)</u>	<u>(121)</u>
Depreciation and Amortization	<u>\$ 1,186</u>	<u>\$ 1,258</u>	<u>\$ 1,194</u>

EXTERNAL SALES BY MAJOR PRODUCT

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Printing Papers	\$ 4,120	\$ 4,520	\$ 4,525
Packaging	4,970	4,765	4,785
Distribution	5,510	4,470	4,690
Specialty Products	1,665	1,810	1,815
Forest Products	3,020	3,440	3,195
Corporate Sales (1)	256	1,091	1,133
Net Sales	<u>\$19,541</u>	<u>\$20,096</u>	<u>\$20,143</u>

- (1) Includes results or assets as applicable from operations that were disposed of in 1998 and 1997.
- (2) Includes an equity investment (in millions) of \$956 in 1998, \$974 in 1997, and \$988 in 1996.
- (3) Includes equity earnings (in millions) of \$20 in 1998, \$65 in 1997, and \$65 in 1996. Half of these equity earnings amounts are in the Carter Holt Harvey segment and half are in minority interest adjustment.
- (4) Depletion consists of Cost of Timber Harvested and is included in the Forest Products and Carter Holt Harvey segments.
- (5) Includes goodwill amortization related to Federal Paper Board of \$39 million in 1998 and 1997 and \$31 million in 1996.

Financial Information by Geographic Area

NET SALES (1)

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
United States (2)	\$14,810	\$14,422	\$14,215
Europe	2,894	3,326	3,484
Pacific Rim (3)	1,647	2,129	2,263
Other	190	219	180
Net Sales	<u>\$19,541</u>	<u>\$20,096</u>	<u>\$20,142</u>

EUROPEAN SALES BY INDUSTRY SEGMENT

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
U.S. and European Papers	\$ 1,423	\$ 1,512	\$ 1,542
Industrial and Consumer Packaging	628	627	686
Distribution	323	322	334
Specialty Products	252	279	244
Forest Products	208	192	241
Other Businesses	60	394	437
European Sales	<u>\$ 2,894</u>	<u>\$ 3,326</u>	<u>\$ 3,484</u>

LONG LIVED ASSETS (4)

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
United States	\$ 9,918	\$ 9,940	\$10,172
Europe	1,892	1,893	2,323
Pacific Rim (3)	2,751	3,010	3,486
Other	79	98	100
Corporate	234	397	478
Long Lived Assets	<u>\$14,874</u>	<u>\$15,338</u>	<u>\$16,559</u>

(1) Revenues are attributed to countries based on location of seller.

(2) Export sales to unaffiliated customers (in billions) were \$1.2 in 1998, \$1.4 in 1997 and \$1.4 in 1996.

(3) Operations in New Zealand and Australia account for most of the Pacific Rim amounts.

(4) Long Lived Assets includes Forestlands and Plants, Properties and Equipment, Net.

REPORT OF MANAGEMENT ON FINANCIAL STATEMENTS

The management of International Paper Company is responsible for the fair presentation of the information contained in the financial statements in this annual report. The statements are prepared in accordance with generally accepted accounting principles and reflect management's best judgment as to the Company's financial position, results of operations and cash flows.

The Company maintains a system of internal accounting controls designed to provide reasonable assurance that transactions are properly recorded and summarized so that reliable financial records and reports can be prepared and assets safeguarded.

An important part of the internal controls system is the Company's ethics program: including its long-standing policy on Ethical Business Conduct, which requires employees to maintain the highest ethical and legal standards in their conduct of Company business; a toll-free telephone compliance line whereby any employee may report suspected violations of law or Company policy; and a newly established office of ethics and business practices. The internal controls system further includes careful selection and training of supervisory and management personnel, appropriate delegation of authority and division of responsibility, dissemination of accounting and business policies throughout the Company, and an extensive program of internal audits with management follow-up.

The independent public accountants provide an objective, independent review of management's discharge of its responsibility for the fairness of the Company's financial statements. They review the Company's internal accounting controls and conduct tests of procedures and accounting records to enable them to form the opinion set forth in their report.

The Board of Directors monitors management's administration of the Company's financial and accounting policies and practices, and the preparation of these financial statements. The Audit Committee, which consists of four nonemployee directors, meets regularly with representatives of management, the independent public accountants and the internal Auditor to review their activities. The Audit Committee recommends that the shareholders approve the appointment of the independent public accountants to conduct the annual audit.

The independent public accountants and the internal Auditor both have free access to the Audit Committee and meet regularly with the Audit Committee, with and without management representatives in attendance.

Marianne M. Parrs
Executive Vice President-Administration and Chief Financial Officer

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of International Paper Company:

We have audited the accompanying consolidated balance sheets of International Paper Company (a New York corporation) and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of earnings, common shareholders' equity and cash flows for each of the three years ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of International Paper Company and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years ended December 31, 1998 in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

New York, N.Y.
February 9, 1999

CONSOLIDATED STATEMENT OF EARNINGS

In millions, except per share amounts, for the years ended December 31

	1998	1997	1996
Net Sales	\$19,541	\$20,096	\$20,143
Costs and Expenses			
Cost of products sold	14,761	14,974	14,883
Selling and administrative expenses	1,532	1,581	1,509
Depreciation and amortization	1,186	1,258	1,194
Distribution expenses	865	933	925
Taxes other than payroll and income taxes	181	205	194
Oil and gas impairment charges	111		
Provision for legal reserve		150	
Equity (earnings) losses from investment in Scitex	15	(1)	28
Restructuring and other charges	105	660	670
Total Costs and Expenses	18,756	19,760	19,403
Reversals of reserves no longer required	83		
Gains on sales of businesses	20	170	592
Earnings Before Interest, Income Taxes and Minority Interest	888	506	1,332
Interest expense, net	496	490	530
Earnings Before Income Taxes and Minority Interest	392	16	802
Income tax provision	80	38	330
Minority interest expense, net of taxes	76	129	169
Net Earnings (Loss)	\$ 236	\$ (151)	\$ 303
Earnings (Loss) Per Common Share	\$.77	\$ (.50)	\$ 1.04
Earnings (Loss) Per Common Share—Assuming Dilution	\$.77	\$ (.50)	\$ 1.04

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

CONSOLIDATED BALANCE SHEET

In millions, at December 31

	1998	1997
Assets		
Current Assets		
Cash and temporary investments	\$ 477	\$ 398
Accounts and notes receivable, less allowances of \$97 in 1998 and \$93 in 1997	2,469	2,404
Inventories	2,719	2,760
Other current assets	345	383
Total Current Assets	6,010	5,945
Plants, Properties and Equipment, Net	12,079	12,369
Forestlands	2,795	2,969
Investments	1,075	1,166
Goodwill	2,625	2,557
Deferred Charges and Other Assets	1,772	1,748
Total Assets	\$26,356	\$26,754
Liabilities and Common Shareholders' Equity		
Current Liabilities		
Notes payable and current maturities of long-term debt	\$ 1,074	\$ 2,212
Accounts payable	1,525	1,338
Accrued payroll and benefits	304	283
Other accrued liabilities	733	1,047
Total Current Liabilities	3,636	4,880
Long-Term Debt	6,407	7,154
Deferred Income Taxes	2,860	2,681
Other Liabilities	1,138	1,236
Minority Interest	1,608	1,643
International Paper—Obligated Mandatorily Redeemable Preferred Securities of Subsidiaries Holding International Paper Debentures—Note 8	1,805	450
Commitments and Contingent Liabilities—Note 11		
Common Shareholders' Equity		
Common stock, \$1 par value, 1998—307.7 shares, 1997—302.9 shares	308	303
Paid-in capital	3,877	3,654
Retained earnings	5,116	5,186
Accumulated other comprehensive income (loss)	(375)	(396)
	8,926	8,747
Less: Common stock held in treasury, at cost, 1998—0.6 shares, 1997—0.7 shares	24	37
Total Common Shareholders' Equity	8,902	8,710
Total Liabilities and Common Shareholders' Equity	\$26,356	\$26,754

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

CONSOLIDATED STATEMENT OF CASH FLOWS

In millions, for the years ended December 31

	1998	1997	1996
Operating Activities			
Net earnings (loss)	\$ 236	\$ (151)	\$ 303
Depreciation and amortization	1,186	1,258	1,194
Deferred income tax provision (benefit)	139	(90)	107
Restructuring and other charges	105	660	670
Restructuring charges and write-off of acquired in-process research and development costs by Scitex	16		10
Provision for legal reserve		150	
Payments related to restructuring and legal reserves	(82)	(103)	(34)
Oil and gas impairment charges	111		
Reversals of reserves no longer required	(83)		
Gains on sales of businesses	(20)	(170)	(592)
Other, net	18	92	133
Changes in current assets and liabilities			
Accounts and notes receivable	81	(53)	192
Inventories	48	(150)	174
Accounts payable and accrued liabilities	(70)	(201)	(399)
Other	(14)		(19)
Cash Provided by Operations	1,671	1,242	1,739
Investment Activities			
Invested in capital projects	(1,049)	(1,111)	(1,394)
Mergers and acquisitions, net of cash acquired	(498)	(80)	(1,527)
Proceeds from divestitures	523	322	
Other	(22)	16	(59)
Cash Used for Investment Activities	(1,046)	(853)	(2,980)
Financing Activities			
Issuance of common stock	94	142	100
Issuance of preferred securities by subsidiaries	1,525		
Issuance of debt	267	531	1,909
Reduction of debt	(2,144)	(752)	(375)
Change in bank overdrafts	68	29	(23)
Dividends paid	(306)	(302)	(291)
Other	(50)	6	(40)
Cash (Used for) Provided by Financing Activities	(546)	(346)	1,280
Effect of Exchange Rate Changes on Cash		3	1
Change in Cash and Temporary Investments	79	46	40
Cash and Temporary Investments			
Beginning of the year	398	352	312
End of the year	\$ 477	\$ 398	\$ 352

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

CONSOLIDATED STATEMENT OF COMMON SHAREHOLDERS' EQUITY

In millions, except share amounts in thousands

	Common Stock Issued		Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total Common Shareholders' Equity
	Shares	Amount				Shares	Amount	
Balance, January 1, 1996	263,261	\$263	\$2,164	\$5,627	\$(201)	2,253	\$ 56	\$7,797
Issuance of stock for merger	35,348	35	1,368					1,403
Issuance of stock for various plans	2,215	3	67			(2,567)	(70)	140
Repurchase of stock						868	36	(36)
Cash dividends—Common stock (\$1.00 per share)				(291)				(291)
Comprehensive income								
Net earnings				303				303
Change in cumulative foreign currency translation adjustment (less tax expense of \$36)					28			28
Total comprehensive income								331
Balance, December 31, 1996	<u>300,824</u>	<u>301</u>	<u>3,599</u>	<u>5,639</u>	<u>(173)</u>	<u>554</u>	<u>22</u>	<u>9,344</u>
Issuance of stock for various plans	2,086	2	55			(2,345)	(106)	163
Repurchase of stock						2,517	121	(121)
Cash dividends—Common stock (\$1.00 per share)				(302)				(302)
Comprehensive income (loss)								
Net loss				(151)				(151)
Change in cumulative foreign currency translation adjustment (less tax expense of \$200)					(246)			(246)
Realized foreign currency translation adjustment related to divestitures (less tax benefit of \$6)					23			23
Total comprehensive income (loss)								(374)
Balance, December 31, 1997	<u>302,910</u>	<u>303</u>	<u>3,654</u>	<u>5,186</u>	<u>(396)</u>	<u>726</u>	<u>37</u>	<u>8,710</u>
Issuance of stock for merger	4,683	5	227					232
Issuance of stock for various plans	108		(4)			(2,694)	(128)	124
Repurchase of stock						2,520	115	(115)
Cash dividends—Common stock (\$1.00 per share)				(306)				(306)
Comprehensive income (loss)								
Net earnings				236				236
Minimum pension liability adjustment (less tax benefit of \$5)					(8)			(8)
Change in cumulative foreign currency translation adjustment (less tax benefit of \$2)					22			22
Realized foreign currency translation adjustment related to divestitures (less tax benefit of \$4)					7			7
Total comprehensive income								257
Balance, December 31, 1998	<u>307,701</u>	<u>\$308</u>	<u>\$3,877</u>	<u>\$5,116</u>	<u>\$(375)</u>	<u>552</u>	<u>\$ 24</u>	<u>\$8,902</u>

The cumulative foreign currency translation adjustment (in millions) was \$(367), \$(396) and \$(173) at December 31, 1998, 1997 and 1996, respectively, and is included as a component of accumulated other comprehensive income (loss).

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Nature of the Company's Business

The Company is a global forest products, paper and packaging company that is complemented by an extensive distribution system, with primary markets and manufacturing operations in the United States, Europe and the Pacific Rim. Substantially all of the Company's businesses have experienced and are likely to continue to experience cycles relating to available industry capacity and general economic conditions. For a further discussion of the Company's business, see pages 15 through 17 of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Financial Statements

The preparation of these financial statements in conformity with generally accepted accounting principles requires the use of management's estimates. For a further discussion of significant estimates and assumptions that affect the reported amounts of assets and liabilities and results of operations, and disclosure of contingent assets and liabilities, see the legal and environmental issues section on pages 34 through 36 of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. Actual results could differ from management's estimates.

Revenue Recognition

The Company recognizes revenues when goods are shipped.

Consolidation

The consolidated financial statements include the accounts of International Paper Company and its subsidiaries. Minority interest represents minority shareholders' proportionate share of the equity in several of the Company's consolidated subsidiaries, primarily Carter Holt Harvey Limited, Zanders Feinpapier AG, Georgetown Equipment Leasing Associates, L.P. and Trout Creek Equipment Leasing, L.P. All significant intercompany balances and transactions are eliminated. Investments in affiliated companies owned 20% to 50%, and the Company's 13% investment in Scitex Corporation Ltd., where the Company has the ability to exercise significant influence, because the Company is party to a shareowners' agreement with two other entities which together with the Company own just over 39% of Scitex, are accounted for by the equity method. The Company's share of affiliates' earnings is included in the consolidated statement of earnings.

Temporary Investments

Temporary investments with an original maturity of three months or less are treated as cash equivalents and are stated at cost, which approximates market.

Inventories

Inventory values include all costs directly associated with manufacturing products: materials, labor and manufacturing overhead. These values are presented at cost or market, if it is lower. In the United States, costs of raw materials and finished pulp and paper products are generally determined using the last-in, first-out method. Other inventories are primarily stated using the first-in, first-out or average cost method.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Plants, Properties and Equipment

Plants, properties and equipment are stated at cost, less accumulated depreciation. For financial reporting purposes, the Company uses the units-of-production method for depreciating its major pulp and paper mills and certain wood products facilities and the straight-line method for other plants and equipment. Annual straight-line depreciation rates are buildings, 2½% to 8½%, and machinery and equipment, 5% to 33%. For tax purposes, depreciation is computed using accelerated methods.

Interest costs related to the development of certain long-term assets are capitalized and amortized over the related assets' estimated useful lives. The Company capitalized net interest costs of \$42 million in 1998, \$62 million in 1997 and \$67 million in 1996. Interest payments made during 1998, 1997 and 1996 were \$636 million, \$708 million and \$658 million, respectively. Total interest expense was \$588 million in 1998, \$593 million in 1997 and \$583 million in 1996.

Forestlands

The Company controlled, through domestic subsidiaries, approximately 5.9 million acres of forestlands in the United States and, through its ownership of Carter Holt Harvey, approximately 820,000 acres of forestlands in New Zealand at December 31, 1998. Forestlands are stated at cost, less accumulated depletion representing the cost of timber harvested. Forestlands include owned property as well as certain timber harvesting rights with terms of one or more years. Costs attributable to timber are charged against income as trees are cut. The depletion rate charged is determined annually based on the relationship of remaining costs to estimated recoverable volume.

Amortization of Intangible Assets

Goodwill, the cost in excess of assigned value of businesses acquired, is amortized for periods of up to 40 years. Accumulated amortization was \$431 million and \$344 million at December 31, 1998 and 1997, respectively.

Stock-Based Compensation

Stock options and other stock-based compensation awards are accounted for using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations.

Environmental Remediation Costs

Costs associated with environmental remediation obligations are accrued when such costs are probable and reasonably estimable. Such accruals are adjusted as further information develops or circumstances change. Costs of future expenditures for environmental remediation obligations are discounted to their present value when the expected cash flows are reliably determinable.

Translation of Financial Statements

Balance sheets of the Company's international operations are translated into U.S. dollars at year-end exchange rates, while statements of earnings are translated at average rates. Adjustments resulting from financial statement translations are included as cumulative translation adjustments in accumulated other comprehensive income (loss). Gains and losses resulting from foreign currency transactions are included in earnings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Reclassifications

Certain reclassifications have been made to prior-year amounts to conform with the current-year presentation.

Note 2. Earnings Per Common Share

Earnings per common share were computed by dividing net earnings by the weighted average number of common shares outstanding. Earnings per common share—assuming dilution were computed assuming that all potentially dilutive securities were converted into common shares at the beginning of each year. A reconciliation of the amounts included in the computation of earnings per common share and earnings per common share—assuming dilution is as follows:

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Net earnings (loss)	\$ 236	\$(151)	\$ 303
Effect of dilutive securities			
Preferred securities of subsidiary trust			
Net earnings (loss)—assuming dilution	<u>\$ 236</u>	<u>\$(151)</u>	<u>\$ 303</u>
Average common shares outstanding	305.9	301.6	292.1
Effect of dilutive securities			
Long-term incentive plan deferred compensation	(.9)	(.9)	(.9)
Stock options	1.3		1.4
Preferred securities of subsidiary trust			
Average common shares outstanding—assuming dilution	<u>306.3</u>	<u>300.7</u>	<u>292.6</u>
Earnings (loss) per common share	<u>\$.77</u>	<u>\$ (.50)</u>	<u>\$1.04</u>
Earnings (loss) per common share—assuming dilution	<u>\$.77</u>	<u>\$ (.50)</u>	<u>\$1.04</u>

Note: If an amount does not appear in the above table, the security was antidilutive for the period presented.

Note 3. Industry Segment Information

The industry segment and geographic area financial information has been restated in accordance with the provisions of Statement of Financial Accounting Standards No. 131, “Disclosures about Segments of an Enterprise and Related Information,” which was adopted in the 1998 fourth quarter.

Financial information by industry segment and geographic area for 1998, 1997 and 1996 is presented at the beginning of this Item on pages 42 through 45.

Note 4. Recent Accounting Developments

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, “Accounting for Derivative Instruments and Hedging Activities.” The Statement establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured by its fair value. The statement requires that changes in the derivative’s fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative’s gains and losses to offset related results of the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

hedged item in the income statement and requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

The Statement is effective for fiscal years beginning after June 15, 1999 and may be implemented as of the beginning of any fiscal quarter. The Statement cannot be applied retroactively. The Statement must be applied to (a) derivative instruments and (b) certain derivative instruments embedded in hybrid contracts that were issued, acquired or substantively modified after December 31, 1997 (and at the Company's election, before January 1, 1998).

We have not yet quantified the impact of adopting the Statement on our consolidated financial statements and have not determined the timing or method of our adoption. However, adoption of the provisions of the Statement could increase volatility in earnings and other comprehensive income.

Note 5. Mergers and Acquisitions

On November 24, 1998, the Company announced that it had reached an agreement to merge with Union Camp Corporation (Union Camp), a diversified forest products company. Under the terms of the merger agreement, the Union Camp shareholders will receive International Paper common shares worth \$71 per share for each Union Camp share. The transaction, which is valued at approximately \$6.6 billion, including assumption of debt, is subject to approval by Union Camp and International Paper shareholders. The merger is expected to close early in the second quarter of 1999 and will be accounted for as a pooling of interests.

In December 1998, the Company completed the previously announced acquisition of OAO Svetogorsk, a Russia-based pulp and paper business, which should enhance the Company's ability to serve growing market demand in Eastern Europe. Also in December 1998, Carter Holt Harvey and International Paper jointly acquired Marinetti S.A.'s paper cup division based in Chile. This acquisition will enable the foodservice business to serve markets in South America.

In July 1998, the Company acquired the Zellerbach distribution business from The Mead Corporation for approximately \$261 million in cash. Zellerbach is being integrated into **xpedx**, the Company's distribution business.

In April 1998, Weston Paper and Manufacturing Company (Weston) was acquired by exchanging about 4.7 million International Paper common shares valued at approximately \$232 million for all of the outstanding Weston shares in a noncash transaction.

Carter Holt Harvey, a subsidiary of the Company, acquired Riverwood International, an Australia-based folding carton business for approximately \$46 million in cash. The results of this acquisition are included in the consolidated financial statements beginning in April 1998.

In March 1998, IP Forest Resources Company, a wholly-owned subsidiary of International Paper, in accordance with the IP Timberlands, Ltd. partnership agreement, purchased all of the 7,299,500 publicly traded Class A Depositary Units of IP Timberlands, Ltd. for a cash purchase price of \$13.6325 per unit.

In February 1998, the Company entered into a joint venture with Olmuksa in Turkey for the manufacture of containerboard and corrugated boxes for markets in Turkey and surrounding countries. Also in February 1998, Carter Holt Harvey and International Paper jointly acquired Australia-based Continental Cup. This acquisition will allow Carter Holt Harvey and International Paper's Foodservice Division to offer a full line of food service products in the Australian and New Zealand markets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The consolidated balance sheet at December 31, 1998 includes preliminary purchase price allocations for OAO Svetogorsk, Zellerbach and Weston. Final allocations for these acquisitions will be completed in 1999.

In September 1997, the Company acquired Merbok Formtec, a company that has pioneered the development of door facing products through postforming medium-density fiberboard. In November 1997, the stock of Taussig Graphics Supply, Inc. was acquired.

In August 1996, the Company acquired Forchem, a tall oil and turpentine processor in Finland. In September 1996, Carter Holt Harvey acquired Forwood Products, the timber-processing business of the South Australian Government.

On March 12, 1996 the Company completed the merger with Federal Paper Board (Federal), a diversified paper and forest products company. Under the terms of the merger agreement, Federal shareholders received, at their election and subject to certain limitations, either \$55 in cash per share or a combination of cash and International Paper common stock worth \$55 for each share of Federal common stock. Federal shares were acquired for approximately \$1.3 billion in cash and \$1.4 billion in International Paper common stock, and approximately \$800 million of debt was assumed.

All of the acquisitions completed in 1998, 1997 and 1996 were accounted for using the purchase method. The operating results of these mergers and acquisitions have been included in the consolidated statement of earnings from the dates of acquisition.

Note 6. Restructuring and Other Charges

Special Items Including Restructuring and Business Improvement Actions

Special items reduced 1998 net earnings by \$72 million, 1997 net earnings by \$461 million and 1996 net earnings by \$131 million. The following tables and discussion present the impact of special items for 1998, 1997 and 1996:

<u>In millions</u>	1998	
	Earnings (Loss) Before Taxes and Minority Interest	Earnings (Loss) After Taxes and Minority Interest
Before special items	\$ 521	\$308
Oil and gas impairment charges	(111)	(68)
Restructuring and other charges	(121)	(66)
Gain on sale of business	20	12
Reversals of reserves no longer required	83	50
After special items	\$ 392	\$236

During 1998, we recorded \$111 million of oil and gas impairment charges (\$68 million after taxes). Of this amount, \$56 million (\$35 million after taxes) was recorded in the fourth quarter and \$55 million (\$33 million after taxes) was recorded in the third quarter. The Company has oil and gas exploration and production operations in West Texas, the Gulf Coast and the Gulf of Mexico. The Securities and Exchange Commission's regulations for companies that use the full-cost method of accounting for oil and gas activities require companies to perform a ceiling test on a quarterly basis. As a result of low oil and gas prices, the value of our properties were written down through these noncash charges.

Also in 1998, we recorded a \$105 million pre-tax restructuring charge (\$56 million after taxes and minority interest) consisting of \$56 million of asset write-downs and \$49 million of severance costs and we recorded

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

pre-tax charges of \$16 million (\$10 million after taxes) related to our share of write-offs taken by Scitex, a 13% investee company, related to in-process research and development of an acquisition and its exit from the digital video business. The Scitex items are reflected as equity losses from the investment in Scitex in the consolidated statements of earnings. In addition, we recorded a \$20 million pre-tax gain (\$12 million after taxes) on the sale of our Veratec nonwovens division, and an \$83 million pre-tax gain (\$50 million after taxes) from the reversal of previously established reserves that were no longer required. These reserves were established in 1996 and 1997 and were primarily associated with the Veratec and Imaging businesses. The sales of these businesses were completed in 1998 and those reserves not required were returned to earnings.

The following table and discussion presents additional detail related to the \$105 million restructuring charge (in millions):

		<u>Asset Write-downs</u>	<u>Severance</u>	<u>Total</u>
Distribution	(a)	\$20	\$10	\$ 30
U.S. Papers	(b)	13	14	27
Carter Holt Harvey	(c)	15	3	18
Industrial Packaging	(d)	8	7	15
Other	(e)	—	15	15
Total		<u>\$56</u>	<u>\$49</u>	<u>\$105</u>

- (a) After the acquisition of Zellerbach, management of **xpedx** decided to terminate certain software projects that were in process and to use Zellerbach's systems in certain of its regions. Accordingly, we wrote off related deferred software costs on these projects, resulting in a \$20 million charge. As part of the Zellerbach integration plan, management determined that a significant part of the personnel reduction related to the termination of employees at the Company's duplicate facilities and locations. The \$10 million severance charge represents the costs for terminating 274 **xpedx** employees.
- (b) The Company's U.S. Papers business shut down equipment at the Mobile, Ala., mill and announced the termination of 750 employees at the Mobile, Ala., Lock Haven, Pa., and Ticonderoga, N.Y., mills. At the Mobile mill, International Paper permanently closed a paper machine and related equipment with a net book value of \$13 million. These assets were written down to their estimated fair market value of zero. The severance charge associated with the employee reductions at the 3 mills was \$14 million.
- (c) This charge primarily consists of a \$15 million asset write-down associated with the closure of two Carter Holt Harvey facilities, Myrtleford and Taupo. Myrtleford, a tissue pulp mill located in Australia, was closed due to excess capacity in its tissue pulp system. Carter Holt Harvey will be able to produce the volume at lower costs at its Kawerau tissue pulp mill located in New Zealand. Carter Holt Harvey also decided to close the Taupo, New Zealand, sawmill due to excess capacity in its sawmill system as the result of recent productivity improvements. The \$3 million severance charge represents the cost for terminating 236 employees. Our consolidated financial statements included revenues of \$21 million, \$36 million and \$34 million and operating income of \$1 million, \$3 million and \$3 million from these facilities in 1998, 1997 and 1996, respectively.
- (d) Management decided to close the Gardiner, Ore., mill because of excess capacity in International Paper's containerboard system. As a result, the net plant, property and equipment assets of this mill were reduced from \$13 million to the estimated salvage value of \$5 million. In connection with the third-quarter decision to close this mill, the Company terminated 298 employees at the mill and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

recorded a severance charge of \$7 million. This mill had revenues of \$78 million, \$105 million and \$55 million and operating losses of \$16 million, \$1 million and \$9 million in 1998, 1997 and 1996, respectively.

- (e) The \$15 million severance charge was recorded as a result of an announcement by International Paper of a plan to consolidate its land and timber and logging and fiber supply divisions into a new division called Forest Resources and the consolidation of the Consumer Packaging group. Of the \$15 million charge, \$10 million related to a headcount reduction of 200 employees in the Forest Resources group and the remaining \$5 million was based on a personnel reduction of 210 employees in the Consumer Packaging group.

The following table is a roll forward of the severance costs included in the 1998 restructuring plan (in millions):

	<u>Severance</u>
Opening Balance (third quarter 1998)	\$49
1998 Activity	
Cash charges	(11)
Balance, December 31, 1998	\$38

The severance reserve recorded in the 1998 third quarter related to 1,968 employees. As of December 31, 1998, 945 employees had been terminated.

<u>In millions</u>	<u>1997</u>	
	<u>Earnings (Loss) Before Taxes and Minority Interest</u>	<u>Earnings (Loss) After Taxes and Minority Interest</u>
Before special items	\$ 656	\$ 310
Provision for legal reserve	(150)	(93)
Restructuring and other charges	(660)	(465)
Gain on sale of business (see Note 7.)	170	97
After special items	\$ 16	\$(151)

In June 1997, a \$535 million pre-tax business improvement charge (\$385 million after taxes) was recorded under a plan to improve the Company's financial performance through closing or divesting of operations that no longer met financial or strategic objectives. It included approximately \$230 million for asset write-downs, \$210 million for the estimated losses on sales of businesses and \$95 million for severance and other expenses. At this point, the anticipated pre-tax earnings improvement of \$100 million from the 1997 restructuring actions has been largely realized. The earnings improvement consists of \$25 million of lower depreciation expense and \$75 million of lower cash costs.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The \$230 million write-down of assets that International Paper recorded in the second quarter of 1997 consisted primarily of write-downs associated with assets to be sold or shut down as follows (in millions):

Shutdown of European Papers facilities	(a)	\$105
Shutdown of U.S. Papers and Fine Papers facilities	(b)	101
Write-off of Haig Point real estate development	(c)	13
Other shutdowns		<u>11</u>
		<u>\$230</u>

- (a) In the second quarter of 1997, management committed to sell the Lancey, France, mill to an employee group. The Company wrote down the net carrying amount of the mill at June 30, 1997 by \$65 million and established a reserve of \$30 million to cover a retained exposure. This remaining exposure should be resolved in 1999 at which time we will complete our accounting for this sale. The sale closed in October 1997. Lancey had revenues of \$52 million and \$81 million and operating losses of \$7 million and \$9 million in 1997 and 1996, respectively. The Corimex, France, mill produces coated thermal fax paper, which is a market that weakened in the mid-1990s. During the second quarter of 1997, management concluded that it would continue to operate this mill but that the assets were impaired. Based on an analysis of expected future cash flows completed in accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets To Be Disposed Of" (SFAS No. 121), the Company reduced the carrying value of the Corimex mill from \$12 million to \$2 million, resulting in a \$10 million charge. Corimex had operating losses of \$2 million during 1997.
- (b) The \$101 million reserve related to the restructuring of the Fine Papers manufacturing operations in the Northeast (\$51 million) and the shutdown of the deinking facility at the Lock Haven, Pa., mill (\$50 million). The restructuring of the Fine Papers operations included the shutdown of the Woronoco, Mass., paper mill and three small paper machines at the Erie, Pa., mill. In the 1997 second quarter, we decided to close the deinking facility. Given that each of these actions represented the permanent shutdown of equipment or facilities, International Paper wrote-down the net carrying amount of the assets to zero. The Woronoco, Mass., mill had revenues of \$46 million and \$50 million and operating earnings of \$5 million and \$1 million in 1997 and 1996, respectively.
- (c) The Company is the developer of a residential golf community named Haig Point at Daufuskie Island, S.C. As the developer, International Paper was responsible for operating this community until a specified number of lots were sold, at which time it would turn the community over to the homeowners. The net book value of our investment in Haig Point was \$13 million at June 30, 1997. Given the continuing operating losses, \$5 million in 1997, an updated marketing study, and the inability to find a buyer for this investment, we concluded that the investment was permanently impaired and wrote it down to zero. The operating loss in 1998 was \$500,000.

The \$210 million loss that the Company recorded in connection with sales or anticipated sales related to the following businesses (in millions):

Imaging	(a)	\$150
Veratec	(b)	25
Decorative Products	(c)	20
Label	(d)	<u>15</u>
		<u>\$210</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- (a) The Company decided to sell its Imaging businesses in the second quarter of 1997. Based on discussions with its investment banker and meetings with potential buyers, the Company believed that the most likely outcome was to realize approximately \$325 million. The Company established a reserve of \$150 million which represented the estimated loss on the sale of the Imaging businesses. The Company expected to complete the sale of the Imaging businesses within one year. The Imaging businesses had revenues of \$690 million and \$713 million and operating earnings of \$9 million and \$1 million in 1997 and 1996, respectively.
- (b) The Veratec division had developed a business that was based on an interspun technology for treating fabrics. The net carrying value of this business was \$25 million at June 30, 1997. In June 1997, the Company decided to shut down this business and recorded a reserve of \$25 million. Prior to the shutdown, this business had revenues of \$2 million and \$1 million and operating losses of \$7 million and \$8 million in 1997 and 1996, respectively.
- (c) In the second quarter of 1997, management decided to sell the medium-density fiberboard, low-pressure laminates and particleboard businesses. The Company estimated the expected sales prices for each of these businesses and recorded a reserve of \$20 million to reduce the net carrying amounts to these levels. The Company expected to complete the sales of these businesses within one year. These businesses had revenues of \$196 million and \$215 million in 1997 and 1996, respectively; and an operating loss of \$1 million in 1997 and operating earnings of \$5 million in 1996.
- (d) In the second quarter of 1997, management committed to a plan to sell the label business. The estimated loss on the label business sale included in the second-quarter 1997 restructuring charge was \$15 million. The Company expected to complete the sale of the label business within one year. The label business had revenues of \$24 million and \$39 million in 1997 and 1996, respectively and an operating loss of \$2 million in 1997 and operating earnings of \$1 million in 1996.

The \$95 million of severance and other expenses consists of the following (in millions):

Severance	(a) \$42
Write-off of deferred software costs	(b) 18
Lease buyouts at warehouses	(c) 9
Write-off of deinking process license	(d) 4
Other exit costs	(e) <u>22</u>
	<u>\$95</u>

- (a) The \$42 million severance charge relates to programs initiated and approved in the 1997 second quarter in the U.S. and European Papers, Industrial and Consumer Packaging segments and corporate staff groups to reduce headcount by 3,015 employees under the Company's existing ongoing severance plans. We recorded the charge in the second quarter as (1) management had committed to the plan of termination, (2) the benefit arrangement had been communicated to the employees, (3) the number of employees, their functions and locations had been identified, and (4) all terminations were to be completed within approximately one year. As of December 31, 1998, 2,446 employees had been terminated under these programs.
- (b) The \$18 million charge for the write-off of deferred software costs relates to two items as follows: (1) during the 1997 second quarter, the Company decided to abandon a human resources software project for which \$11 million of deferred software costs had been recorded and (2) as a result of the decision to sell certain businesses in the second quarter of 1997, the Company decided to terminate enterprise software projects in these businesses, for which it had recorded \$7 million of deferred software costs.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- (c) The \$9 million charge represents the cost to buy out obligations under existing warehouse leases. The Company decided to close these warehouses in the second quarter of 1997.
- (d) The \$4 million charge represents the write-off of the net carrying value of the deinking process license that the Company acquired from a third party. International Paper permanently shut down this operation in the 1997 second quarter. Accordingly, it wrote the license down to zero.
- (e) The charge of \$22 million relates to other exit costs.

In December 1997, an additional pre-tax charge of \$125 million (\$80 million after taxes) was recorded for anticipated losses associated with the sale of the remaining Imaging businesses. Such amount was determined after consideration of the sales of certain of the Imaging businesses that had been completed and the estimated proceeds from the businesses remaining to be sold. The remaining Imaging businesses were sold in 1998.

Also included in the 1997 special items was a \$150 million provision to increase our legal reserves as a result of a settlement by Masonite Corporation, a wholly owned subsidiary, of a class-action lawsuit relating to its hardboard siding product. A more detailed discussion of this legal settlement is included in Note 11 to the consolidated financial statements.

The following table is a roll forward of the severance and other costs included in the 1997 restructuring plan (in millions):

	Severance and Other
Opening Balance (second quarter 1997)	\$ 95
1997 Activity	
Asset write-downs	(18)
Cash charges	(15)
Balance, December 31, 1997	62
1998 Activity	
Asset write-downs	(4)
Reserve reversals	(9)
Cash charges	(40)
Balance, December 31, 1998	\$ 9

The \$9 million of reserves remaining are to complete the 1997 restructuring plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

<u>In millions</u>	1996	
	Earnings (Loss) Before Taxes and Minority Interest	Earnings (Loss) After Taxes and Minority Interest
Before special items	\$ 890	\$ 434
Restructuring and other charges	(670)	(461)
Scitex restructuring charge	(10)	(6)
Gain on sale of business (see Note 7.)	592	336
After special items	\$ 802	\$ 303

In the first quarter of 1996, management initiated several actions to restructure and strengthen existing businesses that resulted in a pre-tax charge to earnings of \$515 million (\$362 million after taxes). The charge included \$305 million for the write-down of certain assets, \$100 million for asset impairments (related to the adoption of the provisions of SFAS No. 121), \$80 million in associated severance costs and \$30 million of other expenses, including the cancellation of leases.

The major components of the \$305 million asset write-down were as follows (in millions):

Consolidation and shutdown of Imaging facilities	(a) \$192
Shutdown of Cordele OSB composite siding business	(b) 43
Write-off of Georgetown recovery unit	(c) 25
Shutdown of Veratec facilities	(d) 19
Impairment of INTAMASA business	(e) 15
Other shutdowns	11
	\$305

- (a) In the first quarter of 1996, management decided to consolidate the Imaging division's manufacturing and sales operations, which resulted in a write-down of the assets associated with these facilities. The planned facility shutdowns included the Swiss manufacturing plants, the Lyon, France, facility and several European sales companies. As the Company was planning to close these facilities, it determined the fair value to be zero. In addition, the Company determined that the long-lived assets associated with its Binghamton, N.Y., Holyoke, Mass., and several U.K. facilities were impaired based on an analysis of future cash flows from these businesses. The cash flow analysis, which was completed in accordance with SFAS No. 121, indicated that future cash flows from these operations would be break-even and, accordingly, the Company wrote down the long-lived assets to their estimated fair value of zero. The Imaging division had revenues of \$713 million and operating earnings of \$1 million during 1996.
- (b) International Paper's Cordele, Ga., facility produced both oriented strand board substrate and composite wood siding. The carrying amount of the equipment related solely to the manufacture of composite wood siding was \$43 million. The Company decided to stop manufacturing composite wood siding and to exit this business. As we shut down the equipment, the assets' fair values were determined to be zero.
- (c) In the first quarter of 1996, the Company permanently closed an enhanced kraft recovery unit in its Georgetown, S.C., facility because of its failure to operate effectively. The carrying amount of this asset was \$25 million. As the equipment was shut down, the Company determined its fair value to be zero.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- (d) The Company decided to permanently close its Veratec Belgium facility and 5 thermal bond machines in its Lewisburg, Ky., facility during the first quarter of 1996. The carrying amounts of these assets were \$12 million and \$7 million, respectively. As these facilities and machines were being closed, the Company determined their fair values to be zero.
- (e) In the first quarter of 1996, the Company committed to sell the Masonite INTAMASA business located in Cella, Spain. The Company wrote down its carrying amount of \$41 million to \$26 million, which represented the estimated selling price of this business. This business had revenues of \$25 million and operating earnings of \$3 million during 1996.

In the first quarter of 1996, International Paper recorded an impairment charge of \$100 million consisting of the following (in millions):

Gardiner mill	(a) \$ 42
Hardboard siding facilities	(b) 26
Mineral deposits	(c) 14
Haig Point real estate development	(d) 8
Other	10
	<u>\$100</u>

- (a) The Gardiner, Ore., mill produces containerboard and is the Company's only West Coast mill. In early 1996, management announced an extended shutdown of the mill. As a result of the shutdown, International Paper determined that a triggering event had occurred, and it wrote down the mill's assets to the estimated fair value.
- (b) The Masonite division had hardboard siding operations at its Laurel, Miss., Towanda, Pa., and Ukiah, Calif., plants. Based on expected declines in demand, management believed that a triggering event under SFAS No. 121 had occurred in the first quarter of 1996. The Company would continue to hold and use these assets, but it projected that the future cash flows of this business would be negative. Accordingly, it wrote down the \$26 million carrying amount of these assets to zero.
- (c) The Petroleum and Minerals division had two mineral investments that it determined to be impaired in the first quarter of 1996. First, based on a consultant's analysis, the Company estimated the value of its lignite reserves to be \$3 million, thereby requiring a write-down of \$11 million. Second, an analysis of its zinc reserves indicated a fair value of \$500,000, requiring a write-down of \$3 million. The triggering event for these write-downs was the analysis of these reserves on a stand-alone basis.
- (d) International Paper holds an investment in a residential golf community named Haig Point at Daufuskie Island, S. C. As the developer, the Company is responsible for operating this community until a specified number of lots have been sold, at which time it would turn the community over to the homeowners. The net book value of the Company's investment in Haig Point was \$21 million at December 31, 1995. The Company concluded in the first quarter of 1996 that its investment was impaired. The triggering event was the analysis of the 1995 results and the 1996 forecast, combined with the decision to sell this business. Haig Point's estimated fair value was \$13 million, resulting in an \$8 million charge.

The Company's 1996 charge included \$80 million of severance costs. The charge relates to programs initiated and approved in the first quarter of 1996 to reduce headcount by 1,955 employees under our existing ongoing severance plan. The businesses impacted by this charge include Imaging (\$45 million), Veratec (\$12 million), Zanders (\$10 million), and corporate staff groups and other businesses (\$13 million). Under this plan, there have been headcount reductions of 1,597 employees.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company's 1996 charge also included \$30 million of other expenses. The major components of this charge were the lease termination costs incurred by the Imaging businesses as a result of the decision to close several European locations. The lease termination costs resulted from the termination of leases in London, the U.K. depot facilities, and the Benelux and Germany sales offices.

The following is a roll forward of the severance and other costs included in the 1996 restructuring and impairment program (in millions):

	Severance and Other
Opening Balance (first quarter 1996)	\$110
1996, 1997 and 1998 Activity	
Reserve reversals (1998)	(29)
Cash charges	(81)
Balance, December 31, 1998	\$ —

In the fourth quarter of 1996, a \$155 million pre-tax charge (\$99 million after taxes) was recorded for the write-down of the investment in Scitex to current market value. At such time, the Company determined that its investment in Scitex of 5.7 million shares was permanently impaired and began efforts, thus far unsuccessful, to dispose of its investment. We wrote our investment in Scitex down to \$10 per share based on the closing prices of Scitex shares during the period from November 14, 1996 to December 31, 1996. The Company also recorded a \$10 million pre-tax charge (\$6 million after taxes) related to our share of a restructuring charge taken by Scitex. This item is reflected as an equity loss from the investment in Scitex in the consolidated statement of earnings.

Note 7. Gains on Sales of West Coast Partnership Interests

On March 29, 1996, IP Timberlands Ltd. (IPT) completed the sale of a 98% general partnership interest in a subsidiary partnership that owned approximately 300,000 acres of forestlands located in Oregon and Washington. Included in the net assets of the partnership interest sold were forestlands, roads and \$750 million of long-term debt. As a result of this transaction, International Paper recognized in its 1996 first-quarter consolidated results a \$592 million pre-tax gain (\$336 million after taxes and minority interest expense). IPT and International Paper retained nonoperating interests in the partnership. In December 1997, these retained interests were redeemed and a related debt guaranty was released resulting in a pre-tax gain of \$170 million (\$97 million after taxes and minority interest expense). These gains are presented in the consolidated statement of earnings as gains on sales of businesses.

Note 8. Preferred Securities of Subsidiaries

In March 1998, Timberlands Capital Corp. II, Inc., a wholly-owned consolidated subsidiary of International Paper, issued \$170 million of 7.005% preferred securities as part of the financing to repurchase the outstanding units of IP Timberlands, Ltd. These securities are not mandatorily redeemable and are classified in the consolidated balance sheet as a minority interest liability.

In June 1998, IP Finance (Barbados) Limited, a non-U.S. wholly-owned consolidated subsidiary of International Paper, issued \$550 million of preferred securities with a dividend payment based on LIBOR. These preferred securities are mandatorily redeemable on June 30, 2008.

In September 1998, International Paper Capital Trust III issued \$805 million of International Paper-obligated mandatorily redeemable preferred securities. International Paper Capital Trust III is a wholly-owned consolidated subsidiary of International Paper and its sole assets are International Paper 7½%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

debentures. The obligations of International Paper Capital Trust III related to its preferred securities are fully and unconditionally guaranteed by International Paper. These preferred securities are mandatorily redeemable on December 1, 2038.

In the third quarter of 1995, International Paper Capital Trust (the Trust) issued \$450 million of International Paper—obligated mandatorily redeemable preferred securities. The Trust is a wholly-owned consolidated subsidiary of International Paper and its sole assets are International Paper 5¼% convertible subordinated debentures. The obligations of the Trust related to its preferred securities are fully and unconditionally guaranteed by International Paper. These preferred securities are convertible into International Paper common stock.

Distributions paid under all of the preferred securities noted above were \$54 million, \$24 million and \$24 million in 1998, 1997 and 1996, respectively.

Note 9. Sale of Limited Partnership Interests

During 1993, the Company contributed assets with a fair market value of approximately \$900 million to two newly formed limited partnerships, Georgetown Equipment Leasing Associates, L.P. and Trout Creek Equipment Leasing, L.P. These partnerships are separate and distinct legal entities from the Company and have separate assets, liabilities, business functions and operations. However, for accounting purposes, the Company continues to consolidate these assets, and the minority shareholders' interests are reflected as minority interest in the accompanying financial statements. The purpose of the partnerships is to invest in and manage a portfolio of assets including pulp and paper equipment used at the Georgetown, S.C., and Ticonderoga, N.Y. mills. This equipment is leased to the Company under long-term leases. Partnership assets also include floating rate notes, debentures and cash. During 1993, outside investors purchased a portion of the Company's limited partner interests for \$132 million and also contributed an additional \$33 million to one of these partnerships.

At December 31, 1998, the Company held aggregate general and limited partner interests totaling 83.5% in Georgetown Equipment Leasing Associates, L.P. and 81.2% in Trout Creek Equipment Leasing, L.P. The Company also held \$621 million and \$439 million of borrowings at December 31, 1998 and 1997, respectively, from these partnerships. These funds are being used for general corporate purposes.

Note 10. Income Taxes

The Company uses the asset and liability method of accounting for income taxes whereby deferred income taxes are recorded for the future tax consequences attributable to differences between the financial statement and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets and liabilities are revalued to reflect new tax rates in the periods rate changes are enacted.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The components of earnings before income taxes and minority interest by taxing jurisdiction were:

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Earnings (loss)			
U.S.	\$290	\$(40)	\$815
Non-U.S.	102	56	(13)
Earnings before income taxes and minority interest	<u>\$392</u>	<u>\$ 16</u>	<u>\$802</u>

The provision for income taxes by taxing jurisdiction was:

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Current tax provision (benefit)			
U.S. federal	\$(76)	\$ 84	\$158
U.S. state and local	(7)	8	1
Non-U.S.	24	36	64
	<u>(59)</u>	<u>128</u>	<u>223</u>
Deferred tax provision (benefit)			
U.S. federal	121	(49)	146
U.S. state and local	(9)	(42)	(3)
Non-U.S.	27	1	(36)
	<u>139</u>	<u>(90)</u>	<u>107</u>
Income tax provision	<u>\$ 80</u>	<u>\$ 38</u>	<u>\$330</u>

The Company made income tax payments, net of refunds, of \$110 million, \$179 million and \$286 million in 1998, 1997 and 1996, respectively.

A reconciliation of income tax expense using the statutory U.S. income tax rate compared with the Company's actual income tax expense follows:

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Earnings before income taxes and minority interest	\$392	\$16	\$802
Statutory U.S. income tax rate	35%	35%	35%
Tax expense using statutory U.S. income tax rate	137	6	281
State and local income taxes	(10)	(22)	(1)
Non-U.S. tax rate differences	22	34	37
Permanent benefits on sales of non-U.S. businesses	(33)		
Permanent benefits on sales of non-strategic timberland assets	(29)		
Nondeductible business expenses	7	52	7
Foreign sales corporation benefit	(8)	(21)	(6)
Minority interest	(31)	(23)	(37)
Goodwill	18	19	21
Net U.S. tax on non-U.S. dividends	10	11	54
Tax credits	(1)	(7)	(23)
Other, net	(2)	(11)	(3)
Income tax provision	<u>\$ 80</u>	<u>\$38</u>	<u>\$330</u>
Effective income tax rate	<u>20%</u>	<u>238%</u>	<u>41%</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The net deferred income tax liability as of December 31, 1998 and 1997 includes the following components:

<u>In millions</u>	<u>1998</u>	<u>1997</u>
Current deferred tax asset	\$ 187	\$ 238
Noncurrent deferred tax asset	169	159
Noncurrent deferred tax liability	<u>(2,860)</u>	<u>(2,681)</u>
Total	<u>\$ (2,504)</u>	<u>\$ (2,284)</u>

The tax effects of significant temporary differences representing deferred tax assets and liabilities at December 31, 1998 and 1997 were as follows:

<u>In millions</u>	<u>1998</u>	<u>1997</u>
Plants, properties and equipment	\$(2,348)	\$(2,325)
Prepaid pension costs	(359)	(314)
Forestlands	(699)	(650)
Postretirement benefit accruals	164	169
Alternative minimum and other tax credits	346	217
Non-U.S. net operating losses	135	132
Other	<u>257</u>	<u>487</u>
Total	<u>\$ (2,504)</u>	<u>\$ (2,284)</u>

The Company had net operating loss carryforwards applicable to non-U.S. subsidiaries of which \$203 million expire in years 1999 through 2005 and \$267 million can be carried forward indefinitely.

Deferred taxes are not provided for temporary differences of approximately \$253 million, \$353 million and \$361 million as of December 31, 1998, 1997 and 1996, respectively, representing earnings of non-U.S. subsidiaries that are intended to be permanently reinvested. If these earnings were remitted, the Company believes that U.S. foreign tax credits would eliminate any significant impact on future income tax provisions.

Note 11. Commitments and Contingent Liabilities

The Company leases certain property, machinery and equipment under cancelable and noncancelable lease agreements. At December 31, 1998, total future minimum rental commitments under noncancelable leases were \$479 million, due as follows: 1999—\$132 million, 2000—\$102 million, 2001—\$75 million, 2002—\$57 million, 2003—\$47 million and thereafter—\$66 million. Rent expense was \$203 million, \$210 million and \$198 million for 1998, 1997 and 1996, respectively.

Three nationwide class action lawsuits filed against the Company have been settled.

The first suit alleged that hardboard siding manufactured by Masonite fails prematurely, allowing moisture intrusion that in turn causes damage to the structure underneath the siding. The class consisted of all U.S. property owners having Masonite hardboard siding installed on and incorporated into buildings between 1980 and January 15, 1998. Final approval of the settlement was granted by the court on January 15, 1998. The settlement provides for monetary compensation to class members meeting the settlement requirements on a claims-made basis. It also provides for the payment of attorneys' fees equaling fifteen percent of the settlement amounts paid to class members, with a non-refundable advance of \$47.5 million plus \$2.5 million in costs.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The second suit made similar allegations with regard to Omniwood siding manufactured by Masonite (the "Omniwood Lawsuit"). The class consists of all U.S. property owners having Omniwood siding installed on and incorporated into buildings from January 1, 1992 to January 6, 1999. The third suit alleged that Woodruf roofing manufactured by Masonite is defective and causes damage to the structure underneath the roofing (the "Woodruf Lawsuit"). The class consists of all U.S. property owners on which Masonite Woodruf roofing has been incorporated and installed from January 1, 1980 to January 6, 1999.

Final approval of the settlements of the Omniwood and Woodruf Lawsuits was granted by the Court on January 6, 1999. The settlements provide for monetary compensation to class members meeting the settlement requirements on a claims-made basis, and provides for payment of attorneys' fees equaling thirteen percent of the settlement amounts paid to class members, with a non-refundable advance of \$1.7 million plus \$75,000 in costs for each of the two cases.

While the total cost of these three settlements is not presently known with certainty, the Company believes its reserves, totaling \$129 million at December 31, 1998, are adequate to cover any amounts to be paid and that the settlements will not have a material adverse effect on its consolidated financial position or results of operations. The reserve balance is net of \$58 million of expected insurance recoveries. Through December 31, 1998, settlement payments of \$91 million, including the \$49 million of nonrefundable advances of attorneys' fees discussed above, have been made. Also, we have received \$19 million from our insurance carriers. The Company and Masonite have the right to terminate each of the settlements after seven years from the dates of final approval.

The Company is also involved in various other inquiries, administrative proceedings and litigation relating to contracts, sales of property, environmental protection, tax, antitrust and other matters, some of which allege substantial monetary damages. While any proceeding or litigation has the element of uncertainty, the Company believes that the outcome of any lawsuit or claim that is pending or threatened, or all of them combined, will not have a material adverse effect on its consolidated financial position or results of operations.

Note 12. Supplementary Balance Sheet Information

Inventories by major category were:

	In millions at December 31	
	1998	1997
Raw materials	\$ 466	\$ 478
Finished pulp, paper and packaging products	1,536	1,466
Finished lumber and panel products	169	160
Operating supplies	402	387
Other	146	269
Inventories	<u>\$2,719</u>	<u>\$2,760</u>

The Company uses the last-in, first-out inventory method to value substantially all of its domestic inventories. Approximately 69% of the Company's total raw materials and finished products inventories were valued using this method. If the first-in, first-out method had been used, it would have increased total inventory balances by approximately \$234 million, \$253 million and \$228 million at December 31, 1998, 1997 and 1996, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Plants, properties and equipment by major classification were:

	In millions at December 31	
	1998	1997
Pulp, paper and packaging facilities		
Mills	\$16,351	\$16,030
Packaging plants	2,266	1,817
Wood products facilities	1,835	1,844
Other plants, properties and equipment	2,194	2,636
Gross cost	22,646	22,327
Less: Accumulated depreciation	10,567	9,958
Plants, properties and equipment, net	<u>\$12,079</u>	<u>\$12,369</u>

Note 13. Debt and Lines of Credit

A summary of long-term debt follows:

	In millions at December 31	
	1998	1997
8 ⁷ / ₈ % to 10.5% notes—due 1999-2012	\$ 596	\$ 653
8 ⁷ / ₈ % to 9.7% notes—due 2000-2004	600	600
8 ³ / ₈ % to 9 ¹ / ₂ % debentures—due 2015-2024	300	300
6 ⁷ / ₈ % to 7 ⁷ / ₈ % notes—due 2000-2007	1,223	1,223
6 ⁷ / ₈ % to 8 ¹ / ₈ % notes—due 2023-2024	546	545
6 ¹ / ₈ % notes—due 2003	200	199
5 ⁷ / ₈ % Swiss franc debentures—due 2001	82	80
5 ¹ / ₈ % debentures—due 2012	86	84
Floating rate notes—due 1999 ⁽¹⁾	450	450
Medium-term notes—due 1999-2009 ⁽²⁾	572	622
Environmental and industrial development bonds—due 1999-2021 ^(3,4)	1,030	1,036
Commercial paper and bank notes ⁽⁵⁾	1,150	1,094
Other ⁽⁶⁾	447	479
Total ⁽⁷⁾	<u>7,282</u>	<u>7,365</u>
Less: Current maturities	875	211
Long-term debt	<u>\$6,407</u>	<u>\$7,154</u>

(1) The weighted average interest rate on these notes was 6.2% in 1998 and 1997 and is based on LIBOR.

(2) The weighted average interest rate on these notes was 7.4% in 1998 and 1997.

(3) The weighted average interest rate on these bonds was 5.6% in 1998 and 5.8% in 1997.

(4) Includes \$274 million of bonds at December 31, 1998 and \$315 million at December 31, 1997, which may be tendered at various dates and/or under certain circumstances.

(5) Includes \$550 million in 1998 of non-U.S. dollar denominated borrowings with a weighted average interest rate of 5.2% in 1998.

(6) Includes \$36 million in 1998 and \$41 million in 1997 of French franc borrowings with a weighted average interest rate of 2.7% in 1998 and 3.0% in 1997, and \$159 million in 1998 and \$179 million in 1997 of German mark borrowings with a weighted average interest rate of 4.6% in 1998 and 5.5% in 1997.

(7) The fair market value was approximately \$7.6 billion and \$7.8 billion at December 31, 1998 and 1997, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Total maturities of long-term debt over the next five years are 1999—\$875 million, 2000—\$1.2 billion, 2001—\$551 million, 2002—\$1.1 billion and 2003—\$260 million.

At December 31, 1998 and 1997, the Company, including a non-U.S. subsidiary, classified \$1.4 billion of tenderable bonds, commercial paper and bank notes as long-term debt. The Company and this subsidiary have the intent and ability to renew or convert these obligations through 1999 and into future periods.

At December 31, 1998, the Company had unused bank lines of credit of approximately \$4.1 billion. The lines generally provide for interest at market rates plus a margin based on the Company's current bond rating. The principal line, which is cancelable only if the Company's bond rating drops below investment grade, provides for \$750 million of credit through January 2000, and has a facility fee of .10% that is payable quarterly. A non-U.S. subsidiary of the Company also has two principal lines of credit that support its commercial paper programs. A \$600 million line of credit matures in April 2002 and has a .15% facility fee that is payable quarterly, and a 250 million New Zealand dollar line of credit matures in February 2002 and has a .13% facility fee that is payable quarterly.

At December 31, 1998, notes payable classified as current liabilities included \$272 million of non-U.S. dollar-denominated debt with a weighted average interest rate of 6.4%.

At December 31, 1998, the Company's total outstanding debt included approximately \$1.3 billion of borrowings with interest rates that fluctuate based on market conditions and the Company's credit rating.

Through a public tender offer in the 1997 third quarter, the Company's wholly-owned subsidiary, Federal Paper Board, repurchased \$164 million of its 10% debentures due April 15, 2011. The earnings impact of the debt retirement was not significant.

Note 14. Financial Instruments

The Company uses financial instruments primarily to hedge its exposure to currency and interest rate risk. To qualify as hedges, financial instruments must reduce the currency or interest rate risk associated with the related underlying items and be designated as hedges by management. Gains or losses from the revaluation of financial instruments that do not qualify for hedge accounting treatment are recognized in earnings.

The Company has a policy of financing a portion of its investments in non-U.S. operations with borrowings denominated in the same currency as the investment or by entering into foreign exchange contracts in tandem with U.S. dollar borrowings. These contracts are effective in providing a hedge against fluctuations in currency exchange rates. Gains or losses from the revaluation of these contracts, which are fully offset by gains or losses from the revaluation of the net assets being hedged, are determined monthly based on published currency exchange rates and are recorded as translation adjustments in common shareholders' equity. Upon liquidation of the net assets being hedged or early termination of the foreign exchange contracts, the gains or losses from the revaluation of foreign exchange contracts would be included in earnings. Amounts payable to or due from the counterparties to the foreign exchange contracts are included in accrued liabilities or accounts receivable as applicable.

Financial instruments outstanding at December 31, 1998 used to hedge net investments in non-U.S. operations consisted of non-U.S. dollar-denominated debt totaling \$1.2 billion. Also outstanding were foreign currency forward contracts totaling \$1.0 billion, all having maturities of less than twelve months, as

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

noted in the following table expressed in U.S. dollar equivalents. The average amount of outstanding contracts during 1998 and 1997 was \$1.4 billion and \$1.7 billion, respectively.

Foreign Currency			
Forward Contracts (dollars in millions)	Contract Amount	Weighted Average Exchange Rate	Unrealized Gain (Loss)
Receive Australian dollars/Pay New Zealand dollars	\$ 27	.84	\$ (1)
Receive Swiss francs/Pay New Zealand dollars	85	.67	(12)
Receive German marks/Pay U.S. dollars	303	1.68	3
Receive New Zealand dollars/Pay Australian dollars	33	1.18	1
Receive New Zealand dollars/Pay U.S. dollars	327	.77	3
Receive Swedish kronas/Pay U.S. dollars	50	8.07	
Receive U.S. dollars/Pay Australian dollars	64	.63	3
Receive U.S. dollars/Pay New Zealand dollars	102	.50	(10)

The Company also utilizes foreign exchange contracts to hedge certain transactions that are denominated in non-U.S. currencies, primarily export sales and equipment purchased from nonresident vendors. These contracts serve to protect the Company from currency fluctuations between the transaction and settlement dates. Gains and losses from the revaluation of these contracts, based on published currency exchange rates, along with offsetting gains and losses resulting from the revaluation of the underlying transactions, are recognized in earnings or deferred and recognized in the basis of the underlying transaction when completed. Any gains or losses arising from the cancellation of the underlying transactions or early termination of the foreign currency exchange contracts would be included in earnings.

Financial instruments outstanding at December 31, 1998 used to hedge transactions denominated in non-U.S. currencies consisted of foreign currency forward contracts totaling \$360 million, all having maturities of less than twelve months, as noted in the following table expressed in U.S. dollar equivalents. The average amount of outstanding contracts during 1998 and 1997 was \$534 million and \$726 million, respectively.

Foreign Currency			
Forward Contracts (dollars in millions)	Contract Amount	Weighted Average Exchange Rate	Unrealized Gain (Loss)
Receive Belgian francs/Pay British pounds	\$ 28	57.25	
Receive British pounds/Pay Belgian francs	32	57.36	
Receive New Zealand dollars/Pay Australian dollars	143	1.45	\$ 3
Receive New Zealand dollars/Pay U.S. dollars	104	1.77	(11)

Note: The Company has an additional \$53 million in a number of smaller contracts to purchase or sell other currencies with a related net immaterial unrealized loss.

The Company uses cross-currency and interest rate swap agreements to manage the composition of its fixed and floating rate debt portfolio. Amounts to be paid or received as interest under these agreements are recognized over the life of the swap agreements as adjustments to interest expense. Gains or losses from the revaluation of cross-currency swap agreements that qualify as hedges of investments are recorded as translation adjustments in common shareholders' equity. Gains or losses from the revaluation of cross-currency swap agreements that do not qualify as hedges of investments are included in earnings. The related amounts payable to or due from the counterparties to the agreements are included in accrued liabilities or accounts receivable as applicable. If swap agreements are terminated early, the resulting gain or loss would be deferred and amortized over the remaining life of the related debt. The following table

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

presents notional amounts and principal cash flows for currency and interest rate swap agreements by year of maturity expressed in U.S. dollar equivalents. The impact on earnings and the Company's net liability under these agreements were not significant.

Interest Rate and Currency Swaps (in millions)

<u>Outstanding as of December 31, 1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>Thereafter</u>	<u>Total</u>	<u>Fair Value</u>
U.S. dollar variable to fixed rate swaps	\$525			\$45		\$1,000	\$1,570	\$ (187)
Average pay rate 7.1%								
Average receive rate 5.2%								
Australian dollar variable to fixed rate swaps	40	\$45	\$45	15	\$30		175	(3)
Average pay rate 6.3%								
Average receive rate 4.9%								
New Zealand dollar variable to fixed rate swaps	13	24	26	26	26		115	(2)
Average pay rate 7.1%								
Average receive rate 4.6%								
U.S. dollar fixed to variable rate swaps				45		1,250	1,295	190
Average pay rate 5.1%								
Average receive rate 7.5%								
U.S. dollar to Australian dollar cross-currency swap				150			150	14

The Company does not hold or issue financial instruments for trading purposes. The counterparties to the Company's interest rate swap agreements and foreign exchange contracts consist of a number of major international financial institutions. The Company continually monitors its positions with and the credit quality of these financial institutions and does not expect nonperformance by the counterparties.

Note 15. Capital Stock

The authorized capital stock of the Company at December 31, 1998 and 1997 consisted of 400,000,000 shares of common stock, \$1 par value; 400,000 shares of cumulative \$4 nonredeemable preferred stock, without par value (stated value of \$100 per share); and 8,750,000 shares of serial preferred stock, \$1 par value. The serial preferred stock is issuable in one or more series by the Board of Directors without further shareholder action.

The Company has stock rights under a Shareholder Rights Plan whereby each share of common stock has one right. Each right entitles shareholders to purchase one common stock share at an exercise price of \$77.50. The rights will become exercisable 10 days after anyone acquires or tenders for 20% or more of the Company's common stock. If, thereafter, anyone acquires 30% or more of the common stock, or a 20% or more owner combines with the Company in a reverse merger in which the Company survives and its common stock is not changed, each right will entitle its holder to purchase Company common stock with a value of twice the \$77.50 exercise price. If, following an acquisition of 20% or more of the common stock, the Company is acquired in a merger or sells 50% of its assets or earnings power, each right will entitle its holder to purchase stock of the acquiring company with a value of twice the \$77.50 exercise price.

Note 16. Retirement Plans

The Company maintains pension plans that provide retirement benefits to substantially all employees. Employees generally are eligible to participate in the plans upon completion of one year of service and attainment of age 21.

The plans provide defined benefits based on years of credited service and either final average earnings (salaried employees), hourly job rates or specified benefit rates (hourly and union employees).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. Defined Benefit Plans

The Company makes contributions that are sufficient to fully fund its actuarially determined costs, generally equal to the minimum amounts required by ERISA.

Net periodic pension income for the Company's qualified and nonqualified defined benefit plans comprised the following:

<u>In millions</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Service cost	\$ (66)	\$ (62)	\$ (61)
Interest cost	(218)	(205)	(192)
Expected return on plan assets	347	322	303
Amortization of transition asset	27	27	27
Actuarial gains and losses	(2)	(1)	(1)
Amortization of prior service cost	(8)	(6)	(4)
Curtailement gain	5		
Net periodic pension income	<u>\$ 85</u>	<u>\$ 75</u>	<u>\$ 72</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the changes in benefit obligation and plan assets for 1998 and 1997 and the plans' funded status and amounts recognized in the consolidated balance sheet as of December 31, 1998 and 1997.

<u>In millions</u>	<u>1998</u>	<u>1997</u>
Change in benefit obligation:		
Benefit obligation, January 1	\$2,945	\$2,745
Service cost	66	62
Interest cost	218	205
Participants' contributions	1	1
Actuarial loss	347	116
Benefits paid	(197)	(184)
Acquisitions	53	
Divestitures	(23)	
Benefit obligation, December 31 ⁽¹⁾	<u>\$3,410</u>	<u>\$2,945</u>
Change in plan assets:		
Fair value of plan assets, January 1	\$3,729	\$3,355
Actual return on plan assets	328	542
Company and participants' contributions	16	16
Benefits paid	(197)	(184)
Acquisitions	85	
Divestitures	(25)	
Fair value of plan assets, December 31	<u>\$3,936</u>	<u>\$3,729</u>
Funded status	\$ 526	\$ 784
Unrecognized actuarial loss (gain)	325	(42)
Unamortized prior service cost	58	66
Unrecognized net transition asset ⁽²⁾	(1)	(28)
Other		(6)
Prepaid benefit cost	<u>\$ 908</u>	<u>\$ 774</u>
Amounts recognized in the consolidated balance sheet consist of:		
Prepaid benefit cost	\$ 959	\$ 834
Accrued benefit liability	(68)	(60)
Intangible asset	4	
Minimum pension liability adjustment included in accumulated other comprehensive income	13	
Net amount recognized	<u>\$ 908</u>	<u>\$ 774</u>

(1) Includes nonqualified unfunded plans with projected benefit obligations of approximately \$92 million and \$77 million at December 31, 1998 and 1997, respectively.

(2) Amortization of the transition asset, which increases annual periodic pension income, will be completed in 1999.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Plan assets are held in master trust accounts and include investments in International Paper common stock in the amounts of \$432 million and \$449 million at December 31, 1998 and 1997, respectively.

Weighted average assumptions as of December 31, 1998, 1997 and 1996 were as follows:

	1998	1997	1996
Discount rate	6.50%	7.25%	7.50%
Expected long-term return on plan assets	10.00%	10.00%	10.00%
Rate of compensation increase	4.00%	4.50%	4.50%

Non-U.S. Defined Benefit Plans

Generally, the Company's non-U.S. pension plans are funded using the projected benefit as a target, except in certain countries where funding of benefit plans is not required. Net periodic pension expense for the Company's non-U.S. pension plans was not significant for 1998, 1997 and 1996.

The plans' projected benefit obligation in excess of plan assets at fair value at December 31, 1998 and 1997 was \$50 million and \$44 million, respectively. Plan assets are composed principally of common stocks and fixed income securities.

Other Plans

The Company sponsors several defined contribution plans to provide substantially all U.S. salaried and certain hourly employees of the Company an opportunity to accumulate personal funds for their retirement. Contributions may be made on a before-tax basis to substantially all of these plans.

As determined by the provisions of each plan, the Company matches the employees' basic voluntary contributions. Company matching contributions to the plans were approximately \$47 million, \$46 million and \$42 million for the plan years ending in 1998, 1997 and 1996, respectively. The net assets of these plans approximated \$2.2 billion as of the 1998 plan year-end.

Note 17. Postretirement Benefits

The Company provides certain retiree health care and life insurance benefits covering a majority of U.S. salaried and certain hourly employees. Employees are generally eligible for benefits upon retirement and completion of a specified number of years of creditable service. A plan amendment in 1992 limits the maximum annual Company contribution for health care benefits for retirees after January 1, 1992 based on age at retirement and years of service after age 50. Amortization of this plan amendment, which reduces annual net postretirement benefit cost, will be completed in 1999. The Company does not prefund these benefits and has the right to modify or terminate certain of these plans in the future.

The components of postretirement benefit expense in 1998, 1997 and 1996 were as follows:

In millions	1998	1997	1996
Service cost	\$ 6	\$ 6	\$ 7
Interest cost	24	24	25
Actuarial gains and losses	1	1	2
Amortization of prior service cost	(21)	(21)	(19)
Net postretirement benefit cost	<u>\$ 10</u>	<u>\$ 10</u>	<u>\$ 15</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the plans' funded status as of December 31, 1998 and 1997 and changes in benefit obligation and plan assets for 1998 and 1997.

<u>In millions</u>	<u>1998</u>	<u>1997</u>
Change in benefit obligation:		
Benefit obligation, January 1	\$ 344	\$ 358
Service cost	6	6
Interest cost	24	24
Participants' contributions	14	13
Actuarial loss (gain)	13	(28)
Benefits paid	(35)	(32)
Plan amendments		3
Acquisitions	3	
Benefit obligation, December 31	<u>\$ 369</u>	<u>\$ 344</u>
Change in plan assets:		
Fair value of plan assets, January 1	\$ -	\$ -
Company contributions	21	19
Participants' contributions	14	13
Benefits paid	(35)	(32)
Fair value of plan assets, December 31	<u>\$ -</u>	<u>\$ -</u>
Funded status	<u>\$(369)</u>	<u>\$(344)</u>
Unamortized prior service cost	(41)	(61)
Unrecognized actuarial loss	58	38
Prepaid (accrued) benefit cost	<u>\$(352)</u>	<u>\$(367)</u>

Future benefit costs were estimated assuming medical costs would increase at an 8% annual rate, decreasing to a 5% annual growth rate ratably over the next five years and then remaining at a 5% annual growth rate thereafter. A 1% increase in this annual trend rate would have increased the accumulated postretirement benefit obligation at December 31, 1998 by \$21 million. A 1% decrease in the annual trend rate would have decreased the accumulated postretirement benefit obligation at December 31, 1998 by \$19 million. The effect on net postretirement benefit cost from a 1% increase or decrease would not be material. The weighted average discount rate used to estimate the accumulated postretirement benefit obligation at December 31, 1998 was 6.50% compared with 7.25% at December 31, 1997.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18. Incentive Plans

The Company has a Long-Term Incentive Compensation Plan that includes a Stock Option Plan, a Restricted Performance Share Plan and an Executive Continuity Award Plan, administered by a committee of nonemployee members of the Board of Directors who are not eligible for awards. The plan allows stock appreciation rights to be awarded, although none were awarded in 1998, 1997 or 1996.

The Company applies the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its plans and the disclosure provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123). Accordingly, no compensation cost has been recognized for the stock option plan. Had compensation cost for the Company's stock-based compensation plans been determined consistent with the provisions of SFAS No. 123, the Company's net earnings, earnings per common share and earnings per common share—assuming dilution would have been reduced to the pro forma amounts indicated below:

<u>In millions, except per share amounts</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Net Earnings (Loss)			
As reported	\$ 236	\$ (151)	\$ 303
Pro forma	217	(175)	291
Earnings (Loss) Per Common Share			
As reported	\$0.77	\$(0.50)	\$1.04
Pro forma	0.71	(0.58)	1.00
Earnings (Loss) Per Common Share—Assuming Dilution			
As reported	\$0.77	\$(0.50)	\$1.04
Pro forma	0.71	(0.58)	1.00

The effect on 1998, 1997 and 1996 pro forma net earnings, earnings per common share and earnings per common share—assuming dilution of expensing the estimated fair value of stock options is not necessarily representative of the effect on reported earnings for future years due to the vesting period of stock options and the potential for issuance of additional stock options in future years.

Stock Option Plan

Initial stock options are normally granted in January of each year. The option price is the market price of the stock at the date of grant. Options are immediately exercisable under the plan; however, the underlying shares cannot be sold and carry profit forfeiture provisions during the initial four years following grant. Upon exercise of an option, a replacement option may be granted with the exercise price equal to the current market price and with a term extending to the expiration date of the original option.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For purposes of the pro forma disclosure above, the fair value of each option grant has been estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 1998, 1997 and 1996, respectively:

	1998	1997	1996
Initial Options ⁽¹⁾			
Risk-Free Interest Rate	5.25%	6.32%	5.45%
Price Volatility	31.09%	29.50%	22.18%
Dividend Yield	2.19%	2.50%	2.72%
Expected Term in Years	4.37	4.37	4.74
Replacement Options ⁽²⁾			
Risk-Free Interest Rate	5.51%	6.31%	6.38%
Price Volatility	31.09%	29.50%	22.18%
Dividend Yield	2.17%	2.31%	2.68%
Expected Term in Years	2.12	2.22	2.97

(1) The average fair values of initial option grants during 1998, 1997 and 1996 were \$11.98, \$11.59 and \$8.37, respectively.

(2) The average fair values of replacement option grants during 1998, 1997 and 1996 were \$9.40, \$9.04 and \$6.82, respectively.

A summary of the status of the Stock Option Plan as of December 31, 1998, 1997 and 1996 and changes during the years ended on those dates is presented below:

	Options (1)	Weighted Average Exercise Price
Outstanding at January 1, 1996	9,262,113	\$35.44
Granted ⁽²⁾	4,234,695	35.42
Exercised	(2,091,942)	30.39
Forfeited	(460,321)	36.89
Outstanding at December 31, 1996	10,944,545	36.53
Granted	5,478,674	45.82
Exercised	(4,196,183)	35.42
Forfeited	(683,248)	40.66
Outstanding at December 31, 1997	11,543,788	41.09
Granted	3,440,200	46.98
Exercised	(2,566,956)	37.78
Forfeited	(904,010)	44.32
Outstanding at December 31, 1998	11,513,022	43.33

(1) This table does not include Executive Continuity Award tandem options described below. No fair value is assigned to these options under SFAS No. 123. The tandem restricted shares accompanying these options are expensed over their vesting period.

(2) At acquisition, outstanding Federal Paper Board options that were not paid in cash were converted to 797,776 options of International Paper with a fair value of \$20.58 per option. The fair value for all acquired options was included in the purchase price that has been allocated to acquired assets and liabilities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes information about stock options outstanding at December 31, 1998:

<u>Range of Exercise Prices</u>	<u>Options Outstanding and Exercisable</u>		
	<u>Options Outstanding</u>	<u>Weighted Average Remaining Life</u>	<u>Weighted Average Exercise Price</u>
\$19.43—\$38.88	2,387,071	4.50	\$35.88
\$38.93—\$41.00	2,079,050	6.70	\$39.78
\$41.12—\$42.88	3,243,637	7.70	\$42.41
\$42.93—\$51.00	2,263,898	4.10	\$47.96
\$51.06—\$59.94	1,539,366	3.00	\$54.84

Restricted Performance Share Plan

Under the Restricted Performance Share Plan, contingent awards of Company common stock are granted by the committee. Awards are earned if the Company's financial performance over a five-year period meets or exceeds that of other forest products companies using standards determined by the committee.

The following summarizes the activity of the Restricted Performance Share Plan for the three years ending December 31, 1998:

	<u>Shares</u>
Outstanding at January 1, 1996	810,964
Granted	424,264
Issued	(190,660)
Forfeited	(85,178)
Outstanding at December 31, 1996	959,390
Granted	277,815
Issued	(87,451)
Forfeited	(40,352)
Outstanding at December 31, 1997	1,109,402
Granted	320,808
Issued	(135,615)
Forfeited	(50,100)
Outstanding at December 31, 1998	<u>1,244,495</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Executive Continuity Award Plan

The Executive Continuity Award Plan provides for the granting of tandem awards of restricted stock and/or nonqualified stock options to key executives. Grants are restricted and awards conditioned on attainment of specified age and years of service requirements. Exercise of a tandem stock option results in the cancellation of the related restricted shares.

The following summarizes the activity of the Executive Continuity Award Plan for the three years ending December 31, 1998:

	Shares
Outstanding at January 1, 1996	479,000
Granted	136,650
Forfeited ⁽¹⁾	<u>(132,000)</u>
Outstanding at December 31, 1996	483,650
Granted	106,108
Issued	<u>(9,500)</u>
Outstanding at December 31, 1997	580,258
Granted	24,000
Issued	(5,500)
Forfeited	<u>(5,000)</u>
Outstanding at December 31, 1998	<u>593,758</u>

(1) Includes restricted shares canceled when tandem stock options were exercised. In 1996, 400,000 tandem stock options were exercised.

At December 31, 1998 and 1997, a total of 4.6 million and 4.8 million shares, respectively, were available for grant under the Long-Term Incentive Compensation Plan.

The compensation cost that has been charged to earnings for the performance-based plans was \$14 million, \$11 million and \$13 million for 1998, 1997 and 1996, respectively.

INTERIM FINANCIAL RESULTS (Unaudited)

In millions, except per share amounts and stock prices

	Quarter				Year
	First	Second	Third	Fourth	
1998					
Net Sales	\$4,868	\$4,707	\$4,939	\$5,027	\$19,541
Gross Margin ⁽¹⁾	1,214	1,183	1,159	1,224	4,780
Earnings Before Income Taxes and Minority Interest	141	140 ⁽²⁾	11 ⁽³⁾	100 ⁽⁴⁾	392 ^(2,3,4)
Net Earnings	75	86 ⁽²⁾	21 ⁽³⁾	54 ⁽⁴⁾	236 ^(2,3,4)
Per Share of Common Stock					
Earnings	\$.25	\$.28	\$.07	\$.17	\$.77
Earnings—Assuming Dilution	.25	.28	.07	.17	.77
Dividends	.25	.25	.25	.25	1.00
Common Stock Prices					
High	52 ⁵ / ₈	55 ¹ / ₄	49 ³ / ₈	49 ³ / ₁₆	55 ¹ / ₄
Low	40 ⁷ / ₈	42 ¹ / ₂	35 ¹ / ₂	40 ³ / ₁₆	35 ¹ / ₂
1997					
Net Sales	\$4,862	\$5,034	\$5,119	\$5,081	\$20,096
Gross Margin ⁽¹⁾	1,226	1,248	1,328	1,320	5,122
Earnings (Loss) Before Income Taxes and Minority Interest	108	(557) ⁽⁵⁾	208	257 ⁽⁶⁾	16 ^(5,6)
Net Earnings (Loss)	34	(419) ⁽⁵⁾	102	132 ⁽⁶⁾	(151) ^(5,6)
Per Share of Common Stock					
Earnings (Loss)	\$.11	\$ (1.39)	\$.34	\$.44	\$ (.50)
Earnings (Loss)—Assuming Dilution	.11	(1.39)	.34	.44	(.50)
Dividends	.25	.25	.25	.25	1.00
Common Stock Prices					
High	43 ⁵ / ₈	51 ⁷ / ₈	61	58 ¹ / ₂	61
Low	38 ³ / ₄	38 ⁵ / ₈	48 ¹ / ₄	39 ⁷ / ₈	38 ⁵ / ₈

(1) Gross margin represents net sales less cost of products sold.

(2) Includes a \$6 million pre-tax charge (\$4 million after taxes) recorded to write off in-process research and development costs related to an acquisition by Scitex, a 13% owned investee company.

(3) Includes special items totaling a pre-tax loss of \$105 million (\$56 million after taxes and minority interest). These special items include a \$10 million pre-tax charge (\$6 million after taxes) related to our share of a restructuring charge taken by Scitex. The Scitex charge is reflected as an equity loss from the investment in Scitex in the consolidated statement of earnings.

(4) Includes a \$56 million pre-tax oil and gas impairment charge (\$35 million after taxes) and a \$38 million pre-tax gain (\$23 million after taxes) from the reversals of reserves that were no longer required.

(5) Includes a pre-tax business improvement charge of \$535 million (\$385 million after taxes) and a \$150 million pre-tax provision for legal reserve (\$93 million after taxes).

(6) Includes a pre-tax charge of \$125 million (\$80 million after taxes) for anticipated losses on the sale of the imaging businesses and a pre-tax gain of \$170 million (\$97 million after taxes and minority interest expense) from the redemption of certain retained west coast partnership interests and the release of a related debt guaranty.

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

None

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The directors of the Company and their business experience are set forth on pages 11 through 14 of the Company's Notice of 1999 Annual Meeting and Proxy Statement, dated April 27, 1999 (the "Proxy Statement") to be filed on or about April 27, 1999, and are incorporated herein by reference. The discussion of executive officers of the Company is included in Part I under "Executive Officers of the Company."

ITEM 11. EXECUTIVE COMPENSATION

A description of the compensation of the Company's executive officers is set forth on pages 19 and 20 and 23 through 28 of the Proxy Statement and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The Company knows of no one owning beneficially more than five percent (5%) of the Company's common stock other than the following:

State Street Bank & Trust Co. 34,704,369 11.3%

As of December 31, 1998, State Street Bank & Trust Co. held such shares as the independent trustee in trust funds for employee savings, thrift, and similar employee benefit plans of the Company and its subsidiaries ("Company Trust Funds"). In addition, State Street Bank & Trust Co. is trustee for various third party trusts and employee benefit plans and is an Investment Adviser. As a result of its holdings in all capacities, State Street Bank & Trust Co. is the record holder of 34,704,369 shares of common stock of the Company. The trustee disclaims beneficial ownership of all such shares except 4,543,901 shares of which it has sole power to dispose or to direct the disposition. The common stock held by the Company Trust Funds is allocated to participants' accounts and such stock or the cash equivalent will be distributed to participants upon termination of employment or pursuant to withdrawal rights. The trustee votes the shares of common stock held in the Company Trust Funds in accordance with the instructions of the participants; shares for which no instructions are received are voted proportionately to those shares voted by participants.

Merrill Lynch, Pierce, Fenner & Smith, Incorporated 31,801,523 10.3%

As of February 12, 1999, Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S") was a broker-dealer registered under Section 15 of the Act. MLPF&S is a sponsor of various unit investment trusts ("UITs") which invest in equity securities of the Company. The UITs have the right to receive, or the power to direct the receipt of dividends from or the proceeds from the sale of, the securities reported herein.

Capital Research and Management Company 20,680,000 6.7%

As of December 31, 1998, Capital Research and Management Company, an investment adviser registered under Section 203 of the Investment Advisers Act of 1940 held such shares as a result of acting as investment adviser to various investment companies registered under Section 8 of the Investment Company Act of 1940.

Sanford C. Bernstein & Co., Inc. **20,365,740** **6.6%**

As of February 5, 1999, Sanford C. Bernstein & Co., Inc. had sole or shared voting power over 14,178,687 of these shares and sole dispositive power over all of them.

Morgan Stanley Dean Witter & Company **15,491,079** **5.1%**

As of February 2, 1999, Morgan Stanley Dean Witter & Company was an Investment Adviser registered under Section 203 of the Investment Advisers Act of 1940.

Common Stock Held by Directors and Directors and Executive Officers as a Group **1,790,726** **.58%**

The table showing ownership of the Company's common stock held by individual directors and by directors and executive officers as a group is set forth on page 7 of the Proxy Statement, which information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None, other than those described under Item 11.

FORWARD-LOOKING INFORMATION

THIS 1998 ANNUAL REPORT ON FORM 10-K, AND ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS AND ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK, IN PARTICULAR, CONTAINS CERTAIN FORWARD-LOOKING STATEMENTS CONCERNING PROJECTED IMPROVEMENT IN EARNINGS AT INTERNATIONAL PAPER. ACTUAL RESULTS MAY DIFFER BASED PRIMARILY ON OVERALL DEMAND AND WHETHER PRICE INCREASES FOR VARIOUS PAPER AND PACKAGING PRODUCTS CAN BE REALIZED IN 1999, AND WHETHER ANTICIPATED SAVINGS FROM RESTRUCTURING, THE BUSINESS IMPROVEMENT PROGRAM, THE MERGER WITH UNION CAMP AND OTHER INITIATIVES ARE ACHIEVED. ITEM 7A. ALSO INCLUDES CONCLUSIONS AS TO VALUE AT RISK ASSOCIATED WITH FINANCIAL INSTRUMENTS. RESULTS MAY DIFFER BASED ON ACTUAL MOVEMENTS IN INTEREST AND CURRENCY EXCHANGE RATES.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

EXHIBITS

- (11) Statement of Computation of Per Share Earnings
- (12) Computation of Ratio of Earnings to Fixed Charges
- (21) List of Significant Subsidiaries
- (22) Proxy Statement, dated April 27, 1999 (to be filed on or about April 27, 1999)
- (23) Consent of Independent Public Accountants
- (24) Power of Attorney
- (27) Financial Data Schedule
- (99) Management Incentive Plan

REPORTS ON FORM 8-K

A Current Report on Form 8-K was filed by the Company on January 5, 1999 and March 11, 1999.

FINANCIAL STATEMENT SCHEDULES

The following additional financial data should be read in conjunction with the financial statements in Item 8. Schedules not included with this additional financial data have been omitted because they are not applicable, or the required information is shown in the financial statements on notes thereto.

**ADDITIONAL FINANCIAL DATA
1998, 1997 AND 1996**

Report of Independent Public Accountants on Financial Statement Schedule	85
Consolidated Schedule:	
II-Valuation and Qualifying Accounts	86

**REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS
ON FINANCIAL STATEMENT SCHEDULE**

To International Paper Company:

We have audited in accordance with generally accepted auditing standards, the consolidated financial statements included in the Company's 1998 Annual Report on Form 10-K, and have issued our report thereon dated February 9, 1999. Our audits were made for the purpose of forming an opinion on those statements taken as a whole. The schedule listed in the accompanying index is the responsibility of the Company's management and is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. The schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

New York, N.Y.
February 9, 1999

SCHEDULE II

INTERNATIONAL PAPER COMPANY AND CONSOLIDATED SUBSIDIARIES
SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS
(In millions)

<u>Description</u>	<u>For the Year Ended December 31, 1998</u>				
	<u>Balance at Beginning of Period</u>	<u>Additions Charged to Earnings</u>	<u>Additions Charged to Other Accounts</u>	<u>Deductions from Reserves</u>	<u>Balance at End of Period</u>
Reserves Applied Against Specific Assets Shown on Balance Sheet:					
Doubtful accounts—current	\$ 93	\$ 31		\$ (27)(a)	\$ 97
Restructuring reserves	91	49		(93)(b)	47
	<u>For the Year Ended December 31, 1997</u>				
<u>Description</u>	<u>Balance at Beginning of Period</u>	<u>Additions Charged to Earnings</u>	<u>Additions Charged to Other Accounts</u>	<u>Deductions from Reserves</u>	<u>Balance at End of Period</u>
Reserves Applied Against Specific Assets Shown on Balance Sheet:					
Doubtful accounts—current	\$101	\$ 22		\$ (30)(a)	\$ 93
Restructuring reserves	76	95		(80)	91
	<u>For the Year Ended December 31, 1996</u>				
<u>Description</u>	<u>Balance at Beginning of Period</u>	<u>Additions Charged to Earnings</u>	<u>Additions Charged to Other Accounts</u>	<u>Deductions from Reserves</u>	<u>Balance at End of Period</u>
Reserves Applied Against Specific Assets Shown on Balance Sheet:					
Doubtful accounts—current	\$101	\$ 22		\$ (22)(a)	\$101
Restructuring reserves		110		(34)	76

(a) Includes write-off, less recoveries, of accounts determined to be uncollectible and other adjustments.

(b) Includes an \$83 million deduction for the reversal of previously established reserves that were no longer required. The reversal was recognized in 1998 net earnings and is a separate line item in the consolidated statement of earnings.

SIGNATURES

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

INTERNATIONAL PAPER COMPANY

By: /s/ JAMES W. GUEDRY,
Vice President and Secretary

March 31, 1999

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

<u>Name</u>	<u>Title</u>	<u>Date</u>
/s/ (JOHN T. DILLON) John T. Dillon	Chairman of the Board, Chief Executive Officer and Director	March 31, 1999
/s/ (C. WESLEY SMITH)* C. Wesley Smith	Executive Vice President and Director	March 31, 1999
/s/ (PETER I. BIJUR)* Peter I. Bijur	Director	March 31, 1999
/s/ (ROBERT J. EATON)* Robert J. Eaton	Director	March 31, 1999
/s/ (JOHN A. GEORGES)* John A. Georges	Director	March 31, 1999
/s/ (JAMES A. HENDERSON)* James A. Henderson	Director	March 31, 1999
/s/ (JOHN R. KENNEDY)* John R. Kennedy	Director	March 31, 1999
/s/ (DONALD F. MCHENRY)* Donald F. McHenry	Director	March 31, 1999
/s/ (PATRICK F. NOONAN)* Patrick F. Noonan	Director	March 31, 1999
/s/ (JANE C. PFEIFFER)* Jane C. Pfeiffer	Director	March 31, 1999
/s/ (CHARLES R. SHOEMATE)* Charles R. Shoemate	Director	March 31, 1999
/s/ (MARIANNE M. PARRS) Marianne M. Parrs	Executive Vice President-Administration and Chief Financial Officer	March 31, 1999
/s/ (ANDREW R. LESSIN) Andrew R. Lessin	Vice President and Controller and Chief Accounting Officer	March 31, 1999

By: /s/ JAMES W. GUEDRY

* (James W. Guedry, Attorney-in-Fact)

1998 Listings of Facilities

U.S. AND EUROPEAN PAPERS**Business Papers, Coated****Papers and Pulp***Domestic:*

Mobile, Alabama
 Selma, Alabama
 (Riverdale Mill)
 Camden, Arkansas
 Pine Bluff, Arkansas
 Mira Loma, California
 (C & D Center)
 Augusta, Georgia
 Bastrop, Louisiana
 (Louisiana Mill)
 Springhill, Louisiana
 (C & D Center)
 Jay, Maine
 (Androscoggin Mill)
 Sturgis, Michigan
 (C & D Center)
 Moss Point, Mississippi
 Natchez, Mississippi
 Corinth, New York
 (Hudson River Mill)
 Ticonderoga, New York
 Riegelwood, North Carolina
 Wilmington, North Carolina
 (Reclaim Center)
 Hazelton, Pennsylvania
 (C & D Center)
 Lock Haven, Pennsylvania
 Georgetown, South Carolina
 Texarkana, Texas

International:

Docelles, France
 (Lana Mill)
 Grenoble, France
 (Pont De Claix Mill)
 Maresquel, France
 Saillat, France
 Saint Die, France
 (Anould Mill)
 Strasbourg, France
 (La Robertsau Mill)

Bergisch Gladbach, Germany
 (Gorhrsmühle Mill)
 Duren, Germany
 (Reflex Mill)
 Klucze, Poland
 Kwidzyn, Poland
 Svetogorsk, Russia
 Inverurie, Scotland

INDUSTRIAL PACKAGING**Containerboard***Domestic:*

Terre Haute, Indiana
 Mansfield, Louisiana
 Pineville, Louisiana
 Vicksburg, Mississippi
 Oswego, New York
 Gardiner, Oregon

International:

Arles, France

Corrugated Container*Domestic:*

Mobile, Alabama
 Montgomery, Alabama
 Fordyce, Arkansas
 Jonesboro, Arkansas
 Russellville, Arkansas
 Carson, California
 Modesto, California
 Putnam, Connecticut
 Auburndale, Florida
 Chicago, Illinois
 North Lake, Illinois
 Fort Wayne, Indiana
 Terre Haute, Indiana
 Lexington, Kentucky
 Shreveport, Louisiana
 Springhill, Louisiana
 Detroit, Michigan
 Minneapolis, Minnesota
 Jackson, Mississippi
 Tupelo, Mississippi
 Kansas City, Missouri

Geneva, New York
 Statesville, North Carolina
 Cincinnati, Ohio
 Wooster, Ohio
 Mount Carmel, Pennsylvania
 Georgetown, South Carolina
 Columbia, Tennessee
 Nashville, Tennessee
 Dallas, Texas
 Edinburg, Texas
 El Paso, Texas
 Cedarburg, Wisconsin
 Fond du Lac, Wisconsin

International:

Las Palmas, Canary Islands
 Chalon-sur-Saone, France
 Chantilly, France
 Creil, France
 LePuy, France
 Mortagne, France
 Guadeloupe, French West
 Indies
 Bellusco, Italy
 Catania, Italy
 Pedemonte, Italy
 Pomezia, Italy
 San Felice, Italy
 Barcelona, Spain
 Bilbao, Spain
 Valladolid, Spain
 Thrapston, United Kingdom
 Winsford, United Kingdom

CONSUMER PACKAGING**Bleached board**

Pine Bluff, Arkansas
 Sprague, Connecticut
 Augusta, Georgia
 Moss Point, Mississippi
 Georgetown, South Carolina
 Riegelwood, North Carolina
 Texarkana, Texas

Beverage Packaging

Turlock, California
 Plant City, Florida
 Cedar Rapids, Iowa
 Kansas City, Kansas
 Framingham, Massachusetts
 Kalamazoo, Michigan
 Raleigh, North Carolina
 Philadelphia, Pennsylvania

International

Itu, Brazil
 Edmonton, Alberta, Canada
 London, Ontario, Canada
 Longueuil, Quebec, Canada
 Shanghai, China
 San Salvador, El Salvador
 Santiago,
 Dominican Republic
 St. Priest, France
 St. Catherine, Jamaica
 Hyogo, Japan

Retail Packaging

La Grange, Georgia
 Thomaston, Georgia
 Clinton, Iowa
 Hendersonville, North
 Carolina
 Wilmington, North Carolina
 Cincinnati, Ohio
 Richmond, Virginia

Kraft Paper

Mobile, Alabama
 Camden, Arkansas
 Moss Point, Mississippi

Plastic Packaging

Janesville, Wisconsin

Foodservice*Domestic:*

Mobile, Alabama
 Visalia, California
 Shelbyville, Illinois
 Hopkinsville, Kentucky
 Kenton, Ohio
 Jackson, Tennessee
 Menomonee Falls, Wisconsin

International:

Brisbane, Australia
 Santiago, Chile

DISTRIBUTION**Wholesale and Retail****Distribution**

(295 distribution branches)

xpedx*Domestic:*

Stores Group
 Chicago, Illinois
 180 locations nationwide
 Southeast Region
 Greensboro, NC
 23 branches in the Middle
 Atlantic States and
 Southeast
 West Region
 Denver, Colorado
 22 branches in the West
 and Midwest
 Specialty Business Group
 Erlanger, Kentucky
 3 branches nationwide
 Northeast Region
 Erlanger, Kentucky
 20 branches in New
 England, Middle Atlantic
 States and Midwest
 Midwest Region
 Olathe, Kansas
 26 branches in the West,
 Midwest and South

International:

Aussedat Rey France
 Distribution S.A., Pantin,
 France
 3 locations
 Chihuahua, Mexico
 6 locations
 Recom Papers
 Nijmegen, Netherlands
 Scaldia Papier BV,
 Nijmegen, Netherlands
 Aalbers Paper Products
 Veenendaal, Netherlands

Impap

Warsaw, Poland
 9 locations

SPECIALTY BUSINESSES**Chemicals***Domestic:*

Panama City, Florida
 Pensacola, Florida
 Port St. Joe, Florida
 Oakdale, Louisiana
 Springhill, Louisiana
 Picayune, Mississippi

International:

Oulu, Finland
 Valkeakoski, Finland
 Niort, France
 Sandarne, Sweden
 Greaker, Norway

Petroleum

Alvin, Texas
 Midland, Texas
 Orange, Texas

Fine and Industrial Papers

Thilmany
 Knoxville, Tennessee
 Kaukauna, Wisconsin
 Nicolet
 De Pere, Wisconsin

Akrosil*Domestic:*

Lancaster, Ohio
 Menasha, Wisconsin

International:

Toronto, Canada
 Limburg, Netherlands
 Jay, Maine
 (Androscoggin Mill)
 Millers Falls, Massachusetts
 West Springfield,
 Massachusetts
 Westfield, Massachusetts
 (C & D Center)
 Hamilton, Ohio
 Saybrook, Ohio
 (C & D Center)
 Erie, Pennsylvania

FOREST PRODUCTS

Forestlands

Approximately 5.9 million acres in the South and Northeast

Realty Projects

Haig Point Plantation
Daufuskie Island, South Carolina

BUILDING MATERIALS

Wood Products

Maplesville, Alabama
Tuscaloosa, Alabama
Gurdon, Arkansas
Leola, Arkansas
Whelen Springs, Arkansas
Augusta, Georgia
Cordele, Georgia
Washington, Georgia
Springhill, Louisiana
Morton, Mississippi
Wiggins, Mississippi
Joplin, Missouri
Madison, New Hampshire
Armour, North Carolina
Johnston, South Carolina
Newberry, South Carolina
Sampit, South Carolina
Henderson, Texas
Jefferson, Texas
Nacogdoches, Texas
New Boston, Texas
Slaughter
Dallas, Texas
2 branches in the Southwest and Northwest

Decorative Products

Particleboard

Stuart, Virginia
Waverly, Virginia

Specialty Panels

Domestic:

Chino, California
Glasgow, Kentucky
Odenton, Maryland
Statesville, North Carolina
Tarboro, North Carolina
Klamath Falls, Oregon
Hampton, South Carolina
Memphis, Tennessee
Oshkosh, Wisconsin

International:

Bergerac, France
(Couze Mill)
Ussel, France
Barcelona, Spain
(Durion Mill)

Masonite

Domestic:

Ukiah, California
Lisbon Falls, Maine
Laurel, Mississippi
Pilot Rock, Oregon
Towanda, Pennsylvania
Danville, Virginia

International:

Carrick-on-Shannon, Ireland
Masonite Africa Limited
Estcourt Plant

CARTER HOLT HARVEY

Forestlands

Approximately 820,000 acres in New Zealand

Wood Products

Sawmills and Processing Plants

Box Hill, Victoria, Australia
Mt. Burr, South Australia
Mt. Gambier, South Australia
Myrtleford, New South Wales, Australia
Kopu, New Zealand
Nelson, New Zealand
Putaruru, New Zealand
Rotorua, New Zealand
Taupo, New Zealand
Tokoroa, New Zealand

Timber Merchants

Box Hill, Victoria, Australia
Hamilton Central, Queensland, Australia
Sydney, New South Wales, Australia

Plywood Mills

Myrtleford, New South Wales, Australia
Nangwarry, South Australia
Tokoroa, New Zealand

Panel Production Plants

Auckland, New Zealand
Christchurch, New Zealand
Rangiora, New Zealand
Thames, New Zealand

Building Supplies Retail Outlets

Retail Outlets, 36 branches in New Zealand

Pulp and Paper

Kraft Paper, Pulp, Coated and
Uncoated Papers and Bristols
Kinleith, New Zealand
Mataura, New Zealand

Cartonboard
Whakatane, New Zealand

Containerboard
Kinleith, New Zealand
Penrose, New Zealand

Fiber Recycling Operations
Auckland, New Zealand

Tissue

Pulp and Tissue
Box Hill, Victoria, Australia
Myrtleford, New South
Wales, Australia
Kawerau, New Zealand

Conversion Sites
Box Hill, Victoria, Australia
Keon Park, Victoria,
Australia
Clayton, Victoria, Australia
Suva, Fiji
Auckland, New Zealand
(2 plants)
Te Rapa, New Zealand

Packaging

Case Manufacturing
Northern (Auckland, New
Zealand)
Central (Levin, New
Zealand)
Southern (Christchurch, New
Zealand)
Solid Fibre (Hamilton, New
Zealand)
Suva, Fiji

Carton Manufacturing
Crestmead, Queensland,
Australia
Dandenong, Victoria,
Australia
Reservoir, Victoria, Australia
Smithfield, New South
Wales, Australia
Woodville, Australia
Auckland, New Zealand
Christchurch, New Zealand

Paper Bag Manufacturing
Auckland, New Zealand

Paper Cups
Brisbane, Australia

Plastic Packaging
Sydney, Australia
Santiago, Chile
Albany, New Zealand
Hamilton, New Zealand
Hastings, New Zealand
Wellington, New Zealand

Distribution

Paper Merchant,
Warehousing and
Distribution Centers,
Australia, 3 locations
New Zealand, 16 locations

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