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TEMPLE-INLAND

1997 ANNUAL REPORT

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Temple-Inland Inc. is a holding company with operations in corrugated packaging, bleached paperboard, building products and financial services.

The Paper Group consists of two operations: corrugated packaging and bleached paperboard. Corrugated packaging includes the manufacture of a complete line of corrugated containers and packaging, as well as point-of-purchase displays and intricate die-cut containers. The bleached paperboard operation produces various grades and weights of coated and uncoated paperboard for use in paper cups, plates, file folders, annual reports, paperback book covers, folding cartons and many other products.





The Building Products Group manufactures a wide range of building products, including lumber, plywood, particleboard, gypsum wallboard and fiberboard.

Forest resources include approximately 2.2 million acres of timberland located in Texas, Louisiana, Georgia and Alabama.





The Financial Services Group consists of savings bank activities, mortgage banking, real estate development and insurance brokerage.

Based in Diboll, Texas, Temple-Inland is a Delaware corporation that was organized in 1983. Its principal subsidiaries include Inland Paperboard and Packaging, Inc.; Temple-Inland Forest Products Corporation; Temple-Inland Financial Services Inc.; Guaranty Federal Bank, F.S.B.; and Temple-Inland Mortgage Corporation.

Temple-Inland's common stock is listed on the New York Stock Exchange and the Pacific Exchange under the ticker symbol TIN.

This annual report contains forward-looking statements that involve risks and uncertainties. The actual results achieved by Temple-Inland may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include general economic market or business conditions; the opportunities (or lack thereof) that may be presented to and pursued by Temple-Inland and its subsidiaries; the availability and price of raw materials used by Temple-Inland and its subsidiaries; competitive actions by other companies; changes in laws or regulations; and other circumstances, many of which are beyond the control of Temple-Inland and its subsidiaries.

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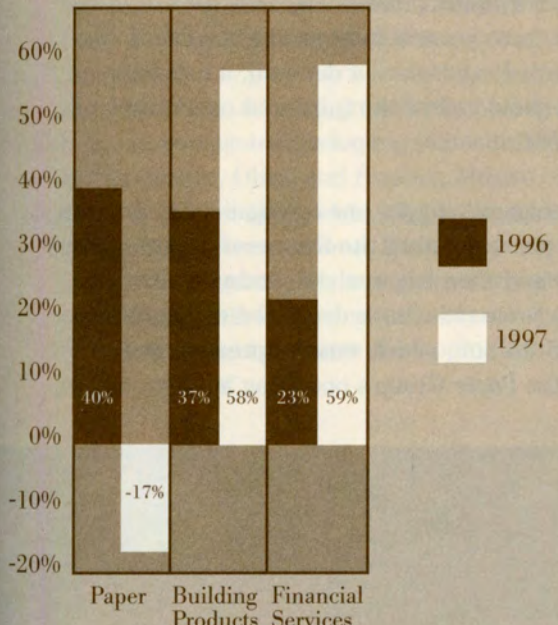
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FINANCIAL HIGHLIGHTS

	1997	1996	Percent Change
(in millions, except per share data)			
Total Revenues	**$3,625**	$ 3,460	5 %
Manufacturing Net Sales	**$2,680**	$ 2,645	1 %
Combined Operating Earnings	**$ 224**	$ 278[a]	(19)%
Net Income	**$ 51**	$ 133	(62)%
Earnings Per Share:			
Basic	**$ .91**	$ 2.39	(62)%
Diluted	**$ .90**	$ 2.39	(62)%
Dividends Per Share	**$ 1.28**	$ 1.24	3 %
Shareholders' Equity	**$2,045**	$ 2,015	2 %
Book Value Per Share	**$ 36.31**	$ 36.34	—
Weighted Average Shares Outstanding:			
Basic	**56.0**	55.5	1 %
Diluted	**56.2**	55.6	1 %
Common Shares Outstanding at Year End	**56.3**	55.4	2 %

COMBINED OPERATING EARNINGS



SELECTED BUSINESS SEGMENT DATA

	1997	1996	Percent Change
(in millions)			
MANUFACTURING NET SALES			
Paper	**$2,063**	$ 2,082	(1)%
Building Products	**$ 617**	$ 563	10 %
COMBINED OPERATING EARNINGS			
Paper	**$ (39)**	$ 113	(135)%
Building Products	**$ 131**	$ 102	28 %
Financial Services	**$ 132**	$ 63[a]	110 %

[a] *Includes one-time SAIF assessment of $44 million.*

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The Paper Group provides customers with total packaging solutions, including high-quality graphics. Our package for Kodak's new Advantix film system won the 1997 President's Award from the National Paperboard Packaging Competition.

TO OUR SHAREHOLDERS

The results of 1997 were disappointing, with the adverse market conditions experienced by our Paper Group offsetting the growth in our other segments. The continued slow growth of the world's economies did not generate sufficient demand to absorb the record level of production in the paper industry. Extreme price discounting occurred in the first half of the year before recovery began late in the third quarter. Consequently, the Paper Group experienced the first loss in its history. The Financial Services Group had record earnings and the Building Products Group had another distinguished year. However, our consolidated earnings per share decreased to $0.90 per diluted share, a 62 percent decline from 1996. A complete financial review and analysis begins on page 25 of this report.

Over the past three years, substantial new worldwide capacity has been added in containerboard, the product used to make corrugated boxes. As this production reached maximum levels, capacity outstripped demand. Accordingly, it became necessary to moderate production in order to maintain inventory levels, especially in the first half of 1997. Demand escalated in the second half of the year, allowing production to return to normal levels. Capacity growth in the next three years is forecasted to be below the expected expansion of demand, a development that should allow the improved operating levels to continue.

Average pricing for our corrugated boxes declined $50 per ton during the first seven months of the year and then began a slow recovery. For the year, price reductions decreased revenues by $165 million, which was the primary reason for the Paper Group's operating loss.

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Corrugated box prices have now recovered to a level slightly above January 1997 prices and should continue to strengthen during the year if markets improve as expected. This will allow increasingly favorable margins, compared with those of 1997, as the year progresses.

Moderated production also had an adverse effect on our cost structure, although this was offset somewhat by increased productivity from our continuous improvement programs. Fiber prices for both wood and old corrugated containers (OCC) increased, resulting in $29 million of additional cost. The wood fiber cost would have been even higher had it not been for the resources of our 2.2 million acres of Southern timberland. These forestlands provided approximately 58 percent of the fiber requirements for our lumber and plywood operations and 56 percent of fiber needs (including both pulp and chips) for our paper operations.

Even in the face of the difficulties we experienced in 1997, we achieved substantial progress in our strategic objectives. We continued to build on the goal to become a more market-driven supplier, rather than being fiber driven. We also continued our progress in becoming a supplier of a broader mix of packaging to a selected group of customers rather than merely supplying more boxes to be sold as commodities.

As part of our selected growth plan, we opened two new corrugated packaging plants in 1997 — in Streetsboro, Ohio, and Sinaloa, Mexico. Both plants will allow us to improve service to customers in these regions. With completion of the Sinaloa plant, we have three corrugated packaging plants in Mexico and are now the third-largest manufacturer of shipping containers in that country.



Our Building Products Group produces a variety of quality gypsum wallboard and other products for the construction industry. "The Home of the Future," a prototype home developed by Builder *and* Home *magazines, used our gypsum wallboard exclusively.*

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We also continued the development of our specialty packaging operation. The litho-laminate facility in Ontario, California, further improved its level of operation, allowing us to produce this high-quality packaging on both coasts. The remainder of the specialty group, including the Graphics Resource Center in Indianapolis, Indiana, made substantial progress in achieving the goal of providing improved graphics for retail packaging. The growth of these markets was somewhat disappointing last year, but the trends are favorable.

Again in 1998, we will improve the quality of products and service to our customers. Capital expenditures will be allocated almost entirely to improved productivity, rather than additional capacity. In recent years, we have added substantial paperboard manufacturing capacity and must now convert this additional capability to increased financial returns. We anticipate these efforts will require less capital than our historical levels.

Bleached paperboard operations experienced another difficult year. Due to the productivity improvements achieved, however, this operation did return to profitability, but it still remains well below expected earnings levels.

The Building Products Group enjoyed near-record results that were achieved despite absorbing the start-up inefficiencies of our new particleboard plant in Hope, Arkansas, and the temporary closure of existing particleboard plants in Diboll, Texas, and Thomson, Georgia, for major renovations. As we enter 1998, all of our particleboard plants have been upgraded to operate more efficiently and manufacture higher quality products. Results to date are encouraging, and improved profitability should be achieved this year.

Gypsum wallboard markets improved in 1997 as the strength of construction markets, including commercial and multifamily activity, created record demand. The continued development of specialty products to serve selected markets improved our profitability and allowed record production.

Because of gypsum wallboard's unique characteristics, including fire retardation, its usage is forecasted to grow faster than many other products we manufacture. Raw gypsum, a key material in gypsum wallboard, is an ore located primarily in the Western United States. Because transportation of the raw material and the finished product is very expensive, we have been researching alternative sourcing to provide low-cost wallboard to other regions of the country.

As an example of alternative sourcing, many coal-burning electrical power plants produce synthetic gypsum as a by-product of their operation. In the past few years, we have used this resource for a portion of our needs at our West Memphis, Arkansas, facility and have obtained a long-term supply agreement for synthetic gypsum from the Tennessee Valley Authority (TVA) electrical plant near Cumberland City, Tennessee. We are currently building a new gypsum facility, adjacent to the TVA plant, that will use 100 percent synthetic ore as its raw material. This joint-venture facility will give us a low-cost entry into the growing construction markets in the Southeast, particularly the Atlanta, Georgia, area.

Two other joint ventures — a medium density fiberboard plant and a cement fiberboard facility — are scheduled to start up this year. Both products are expansions of current building material lines and will be marketed by our existing sales organization, giving us a broader group of alternative products for the residential construction market.

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Our bank, Guaranty Federal Bank, and its mortgage banking subsidiary, Temple-Inland Mortgage Corporation, enjoyed another record year of growth and profitability. The bank expanded its deposit gathering to include California through the acquisition of California Financial Holding Company, which owned Stockton Savings Bank. This acquisition allowed the bank to end the year with assets exceeding $10 billion and increased geographic market coverage.

The loan portfolio continued to grow during the year and is now approaching our desired ratio of loans to securities. The portfolio has outstanding credit characteristics that should allow the continuation of strong profitability in 1998.

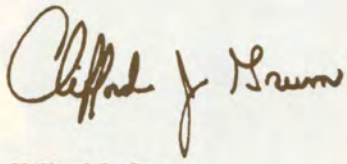
The mortgage bank furthered its expansion program with internally generated loans and selected acquisitions, including Knutson Mortgage Corporation of Minneapolis, Minnesota. During the year, we increased the level of mortgages that we are servicing by almost 50 percent, finishing the year with approximately $26 billion. More importantly, our cost to service these loans continues to decline, improving profitability.

In summary, it is clear that last year was the most difficult period in our history, with financial returns declining to their lowest levels since we became a public entity. Process improvement is not a new idea for our 15,000 employees; it is part of our culture. However, the degree of deterioration in the Paper Group's profitability has emphasized the need to eliminate wasted efforts and accelerate our endeavors to focus operations on increased productivity to serve customers' needs. We are in the process of addressing changes that will leverage returns to improved profitability as markets recover.

Largely because of increased dividends from the Financial Services Group, we were able to decrease debt during the year by $89 million and repurchase almost one million shares of Temple-Inland stock at an average cost of approximately $59.00 per share. With the expectation of improvement in internally generated cash flow in 1998, we should be able to continue to repurchase shares and reduce outstanding debt.

As we move into 1998, we are optimistic that the earnings contribution from the Paper Group will improve and our other business areas will experience another good year. We appreciate the dedication of our employees, who are committed to providing value to you, our shareholders.

Sincerely,



Clifford J. Grum
Chairman and Chief Executive Officer
January 30, 1998

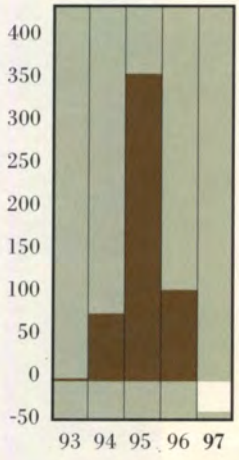


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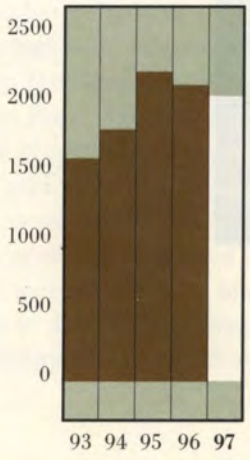
PAPER



Operating Profit
(Millions)



Net Sales
(Millions)



Temple-Inland's Paper Group experienced an extremely difficult year as industry overcapacity resulted in continued price erosion. Some incremental price increases for both paperboard and corrugated packaging were successfully instituted during the second half of the year as domestic consumption and exports strengthened.

However, these adjustments were not enough to offset the discounts that occurred during the first six months of 1997, and profit margins were negatively affected for the entire year. The group recorded a loss of $39 million for 1997, compared with operating earnings of $113 million in 1996.

Despite the difficulties presented by marketplace dynamics, 1997 was a year of foundation building for the Paper Group. For example, two state-of-the-art corrugated packaging plants began start-up operations during the year — one in Sinaloa, Mexico, the other in Streetsboro, Ohio. Additionally, by concentrating a larger percentage of marketing efforts on high-value products and total-system approaches to customer needs, the Paper Group continued its strategic shift from a fiber-driven supplier to a provider of market-driven, margin-focused solutions, positioning itself to realize improved earnings as markets recover.

CORRUGATED PACKAGING OPERATIONS AFFECTED BY MARKET PRESSURES

As a result of the additional industry capacity that came on line in 1996, inventory levels were excessive in early 1997, causing further market deterioration as prices for corrugated containers declined during the first seven months of the year. The Paper Group operated its mills at below

The Paper Group's innovative "slide pack" carton for Coors Brewing Company was designed to accommodate continuous, high-speed packaging operations for the company's 12-pack cases of bottles. The new system helped the customer significantly increase productivity at two plants, in Colorado and Virginia, allowing it to better meet heightened consumer demand. The added protection of corrugated has also reduced breakage and makes the new carton feel stronger than the previous non-corrugated package.

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The Paper Group works closely with customers throughout the life of a project. In the case of Hewlett-Packard's manufacturing operations in Mexico, employees at the Paper Group's facility in Guanajuato monitor the application of preprinted sheets to the corrugated substrate (left). Quality assurance inspectors (below) test the product's strength and ease of assembly before the corrugated packaging is shipped to the customer and on to the retail outlets.





optimum production levels during the first half of 1997 to control inventories. Demand increased in the second half of the year, and the mills returned to higher operating levels. Inventories decreased to normal levels by year end.

Growth in corrugated packaging is driven primarily by the movement of nondurable goods, and demand within this segment in the United States increased by about 2.6 percent during the year. While durable goods represent a smaller percentage of the Paper Group's total business, this segment experienced substantial growth, particularly in business equipment, which is shipped primarily in corrugated packaging.

As a direct result of employees' commitment to continuous improvement, each of the Paper Group's seven kraft paper mills performed well during the year in terms of quality and throughput. At the group's mill in Maysville, Kentucky, for example, employee teams have implemented a number of innovative improvements to the production flow, including debottlenecking and process changes. In fact, since 1992, the mill has been able to take its daily volume 40 percent higher than the levels for which its equipment was originally rated.

Old corrugated containers (OCC) make up approximately 44 percent of the containerboard mills' total fiber needs. During the year, prices for OCC remained high, unfavorably affecting the company's costs. Total OCC costs for 1997 were approximately $23 million higher than 1996 levels as prices escalated sharply during the year before retreating somewhat by the end of 1997. The other major source of fiber for the mills is virgin pulpwood. The cost of pulpwood was slightly higher in 1997, compared with 1996.

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Strong worldwide demand for OCC from the United States is expected to keep pricing volatile for the foreseeable future. The Paper Group, however, has entered into some long-term contracts for OCC, which should reduce the temporary impact of these price changes.

NEW PACKAGING PLANTS ADD TO FOUNDATION FOR THE FUTURE

In 1997, the Paper Group started up two state-of-the-art corrugated packaging plants to continue providing the best customer service possible.

The Paper Group's new 170,000-square-foot facility in Sinaloa, Mexico, replaces a smaller sheet plant it had operated since 1996. With targeted output of approximately 50,000 tons per year, the facility adds to the group's ability to serve customers in Mexico. This plant will greatly enhance the competitive position of the company in that country's Western states, which form the heart of Mexico's fast-growing agricultural sector.

The second plant — a 250,000-square-foot facility in Streetsboro, Ohio — also represents an important strategic location. In this case, management decided to replace a plant in Erie, Pennsylvania, after a significant segment of the company's customer base had shifted manufacturing operations from the Northeastern states to the Great Lakes region. The Streetsboro plant has the capability to produce 100,000 tons of corrugated packaging per year and represents a continuation of the Paper Group's strategy of upgrading its U.S. box-plant system to the most cost efficient in the industry.

BLEACHED PAPERBOARD PROFITS AND PRODUCT-MIX UPGRADES CONTINUE

In addition to its containerboard mills, the Paper Group operates a large bleached paperboard mill in Evadale, Texas. During the year, the mill continued its start-up from a major expansion program. Average tons-per-day output ran consistently high in 1997, up 11.3 percent over 1996 levels, and additional progress was made in lowering operating costs, improving quality and developing new markets.

Particular progress was made in sales of TexCover II™ premium-grade cover stock and poly-coated cup stock. Marketing efforts were also targeted at more highly profitable market segments; specifically, those requiring total packaging solutions that are based on strength, durability and the use of high-end graphics.

Additionally, exports of bleached paperboard products increased by approximately 40 percent during the year, compared with the industry average of 19 percent. This was primarily the result of the Paper Group's continued focus on strengthening its international distribution networks, including those in Latin America and the Far East, as well as entering markets in the Middle East, South Africa and Australia.



The graphics capabilities of TexCover II™ premium-grade cover stock continued to make it the paper of choice for many greeting card companies that manufacture high-quality cards for countless special occasions.

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The Paper Group developed a special "two-pack" packaging design for Liquid Plumr aimed at the large discount and superstore outlets. Through this inventive marketing technique, the customer was delighted to discover that consumers readily purchased two bottles of the product.

HORIZONTAL SELLING IS KEY TO VALUE-ADDED RELATIONSHIPS

In its first full year of operating as a unified, organization-wide sales team, the Global Solutions Group clearly demonstrated the many benefits of providing customers one consistent source to manage a wide range of packaging needs. Through its efforts, the Paper Group continued to position itself as a seamless provider of total packaging solutions, not just individual products.

Additionally, at whatever point a customer comes in contact with the Paper Group — at the mill, plant or design level — the customer works with teams that are knowledgeable about the client's business as well as the services that other teams within the company are providing to that customer.

This approach also serves to foster long-term relationships based on a mutual investment for the future: The customer receives innovative and value-added products, while the Paper Group gains higher margin opportunities in return.

During the year, the Global Solutions Group initiated different ways to establish new customer relationships. For example, it now conducts more in-depth discussions with prospective clients during the initial stages of the relationship, rather than the traditional method of developing and submitting a standard proposal. This allows the group to provide solutions, not just for today's needs but for customer requirements over the long term.

Benefits of this unified and multidisciplinary approach were seen on several fronts during the year, especially as the trend toward supplier consolidation continued to be a driving market force. As increasingly more customers seek to leverage their purchasing strength, the Paper Group continues to position itself solidly by establishing strategic supplier alliances based on its ability to handle all aspects of packaging, including design, testing, quality certification, inventory control and just-in-time delivery.

The Paper Group is also well positioned to participate in the globalization trend, given its operations in Mexico and South America, as well as through its European alliance with AssiDomän Packaging AB, Europe's third-largest integrated corrugated producer. During 1997, a number of joint marketing and sales efforts were implemented between the two companies, targeting multinational companies headquartered both in North America and Europe.

CONSUMER PACKAGING AND DISPLAY DELIVERS SEAMLESS SOLUTIONS TO MOVE MORE PRODUCTS

Last year marked the complete integration of the Paper Group's consumer packaging and display operations, including Inland Rand-Whitney Packaging; CB Displays, Inc.; Pakway Container Corporation and Crockett Container Corporation. Crockett will continue to operate under that name.

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The success of the Paper Group's consumer packaging ope ations is based on involving the customer in every step of t process. A customer works closely with a press operator a account manager at the division's state-of-the-art facility i Ontario, California, checking a press proof of the customer actual packaging.

The combined merchandising unit focuses on partnering with customers' marketing departments to bring seamless graphics solutions, whether packaging, point-of-purchase (POP) displays or promotional items are required. The bottom line is to provide high value to the customer by helping to sell more product at the retail level.

For instance, knowing that approximately one-third of all POP displays are never assembled in the store because they do not meet the local retailer's requirements, the unit conducts intensive research into different retail environments. Additionally, it takes a highly targeted, "micro-marketing" approach to rolling out new packaging and POP systems, tailoring the displays in an effort to meet the preferences of each mass merchandiser. The Paper Group's commitment to serving the needs of the customer's customer is key to maximizing results of the overall marketing campaigns.

The merchandising unit brings a comprehensive array of options and solutions to customers. Creative design and customer service centers are located coast to coast and regionalized to address the immediate needs of customers. The unit also offers one of the industry's broadest arrays of options — including preprint, enhanced post-print and lithography laminate — matching specific processes to specific needs, thereby maximizing customer value.

PRODUCT DEVELOPMENT CAPABILITIES AND EFFORTS ACCELERATED

The foundation for continuously providing innovative, integrated solutions is a well-stocked new-product pipeline. During the year, the Paper Group continued to build its organization devoted to product development and quality — which supports the containerboard, packaging and bleached paperboard operations — by researching and testing better coatings and enhanced printing substrates, and improving product performance and strength.

Initial efforts have already reaped promising returns as several bleached paperboard products continued to make major inroads in the retail packaging sector, particularly for computers, beverages and "club packs" — larger food packaging sold in discount or superstore outlets.

Another good example of this department's coordinated efforts is the development of a laminated process that applies film, foil or paper to give a corrugated package a metallic look. This new offering helps to move the traditional brown paperboard into the special aesthetics category, designed to maximize consumer appeal and promote sales.

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Major strides were also made in the area of total quality enhancement — not just in the continuous improvement of manufacturing processes and final product, but in the detailed cost-benefit analysis of pursuing certain market trends, customer needs and prospective customer accounts.

Temple-Inland's Paper Group continues to build on the value-added foundation it has established in an industry that is experiencing major change. The Paper Group's market-driven, margin-focused strategy is working as the group is poised to take advantage of the expected recovery in paper markets and make good on its mission: To deliver to customers the best value for their money by providing the most innovative paperboard and packaging solutions.



When Kodak launched its new Advantix film technology, it was looking for high-end shelf appeal and maximum flexibility. Consumer packaging's solution not only included vibrant and eye-catching color, the flexibility of the packaging system accommodated several different camera models and battery sizes, as well as the labeling requirements for numerous international markets. This project won the 1997 President's Award, the National Paperboard Packaging Competition's highest honor.



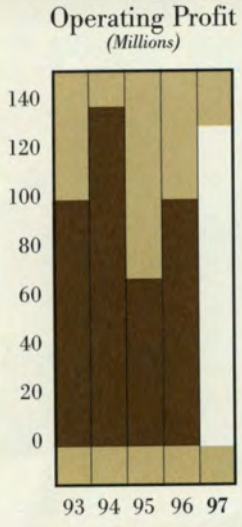
A creative and eye-catching point-of-purchase display design helped Reckitt & Colman, Inc., launch its new Lysol Antibacterial Hand Gel. The display features high-impact color graphics, a sample bottle that lets shoppers try the product at the point of sale, and free brochures that highlight the benefits of the product, further motivating the shopper to purchase the hand gel.

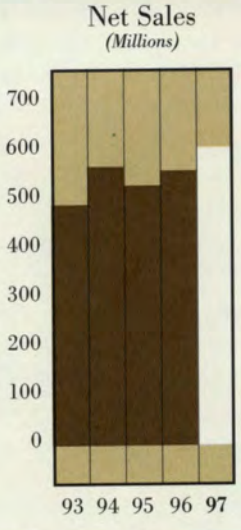
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The high quality of today's ready-to-assemble furniture is dependent o the properties of the particleboard used. As one of the nation's leading manufacturers of particleboard, Temple-Inland works closely with the furniture manufacturers to ensure the highest quality and consistency of the product, shipment after shipment.

BUILDING PRODUCTS







By manufacturing a wide range of building products, including lumber, plywood, particleboard, gypsum wallboard and fiberboard — and committing to high customer-service standards — Temple-Inland's Building Products Group benefited greatly from the strength of the construction markets in the United States.

The group recorded $131 million in operating earnings for the year, up 28 percent from 1996, the second-most profitable year in the group's history. Net sales for 1997 were $617 million, compared with $563 million in 1996.

ECONOMIC MIX IS RIGHT FOR BUILDING MATERIALS

The group benefited from healthier-than-forecasted market conditions during 1997, including attractive lending rates and strong residential housing starts, particularly in the construction of larger and higher-quality homes. The home-remodeling market also recovered, enabling the Building Products Group to benefit from sales of products designed for use in this market.

To offset somewhat the tight margins between lumber prices and timber costs, the group focused on developing several new products, as well as a continued shift to appearance-grade wood products. This category of lumber, featuring an improved and more finished appearance than common-grade lumber, is increasingly in demand by large mass merchandisers such as Home Depot and Lowe's.

Although lumber prices decreased somewhat during the latter half of the year, average prices remained higher in 1997, compared with 1996. A major advantage is the company's 2.2 million acres of

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timberland, which provided approximately 58 percent of the raw material needed for the company's solid wood operations. This gives the Building Products Group a fixed, low-cost source for a significant portion of its timber requirements and plays a key role in its long-term strategy of greater self-sufficiency.

PARTICLEBOARD OPERATION MAINTAINS INDUSTRY LEADERSHIP POSITION

Significant progress was made during the year in strengthening the company's particleboard operations. The company's new particleboard plant in Hope, Arkansas, came fully on line in 1997, and operations improved as the year progressed. Major renovations were made to two other plants during the year — one in Diboll, Texas, and the other in Thomson, Georgia.

The new plant and the two plant renovation projects, combined with the modernization of the Monroeville, Alabama, plant in 1996, have allowed Temple-Inland to increase its particleboard production capacity by 50 percent over the past two years. Kitchen cabinet makers and ready-to-assemble furniture manufacturers remained the two most active and profitable market segments for this business.

Progress continued on the construction of a new medium density fiberboard plant in El Dorado, Arkansas. Scheduled for completion by the second quarter of 1998, the joint-venture facility is expected to produce 150 million square feet annually and will target the fast-growing laminated floor segment, molding and millwork producers, as well as traditional furniture markets.

GYPSUM BENEFITS FROM STRONG DEMAND AND HIGHER PRICES

Last year's healthy construction market, including heightened activity in the multifamily and commercial segments, greatly benefited the company's gypsum wallboard operations. Although the market remains highly competitive, Temple-Inland maintained its industry position by continuing to offer high-quality specialty gypsum products.

The company's Stretch 54® wallboard product remained in great demand because it is easier and more cost efficient to use in houses with 9-foot-high ceilings. Specialty board production, which includes Stretch 54 and fire-rated wallboard, now accounts for 39 percent of this operation's total output.



Diversifying its product mix, Temple-Inland produces a range of lumber grades for all construction needs. Appearance-grade lumber, featuring fewer knots and imperfections, is increasingly in demand by large mass merchandisers that cater to do-it-yourselfers.

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The company also completed the integration of its 50 percent interest in a gypsum wallboard plant acquired in 1996. Located in McQueeney, Texas, the facility makes products that are marketed by Temple-Inland, enabling the company to better serve the South Texas markets, particularly Houston, San Antonio and Austin.

In the fourth quarter, the company, through this same joint venture, began construction of a new gypsum wallboard plant near Cumberland City, Tennessee, that will provide a low-cost entry into the growing construction markets in the Southeast, particularly the Atlanta area. This joint-venture facility will use 100 percent synthetic gypsum as its raw material. Synthetic gypsum is a by-product of coal-burning electrical power plants, and the company has obtained a long-term supply agreement for this synthetic material from the TVA electrical plant that is located adjacent to the new gypsum wallboard plant.

In 1997, Temple-Inland was involved with "The Home of the Future," a 4,600-square-foot prototype house that spotlights new technology, construction techniques and design elements that experts predict will be utilized in new construction five to seven years from now.

Developed by *Builder* and *Home* magazines, the house was built in a Dallas suburb with the involvement of more than 30 selected suppliers. Temple-Inland's Stretch 54 was the gypsum wallboard of choice based on its ability to provide a flatter, smoother wall with fewer seams than traditional 48-inch wallboard. Additionally, the project was an ideal showcase for the company's 1/4-inch gypsum used in the rounded turrets in the home. "The Home of the Future" is designed to provide flexible living for families, and many rooms can be converted as needs change — for example, from a home office to an in-law suite.

NEW FIBER SIDING COMPLEMENTS PRODUCT LINE

Demand for the company's hardboard siding product remained strong during the year, but the company's fiberboard products experienced intense pricing pressures as alternative sheathing products continued to gain market share.

Sales of TrimCraft™, an engineered wood trim, continued to increase in 1997, particularly in



Temple-Inland's Stretch 54® was the gypsum wallboard of choice for "The Home of the Future," a prototype house built in a Dallas suburb to demonstrate new construction techniques and design elements. The product was especially noted for its ability to provide flatter, smoother walls with fewer seams. The home also features a number of rounded turrets, which provided an ideal showcase for the company's 1/4-inch wallboard. Other Temple-Inland products used in the home included a water-resistant gypsum wallboard and the company's 5/8-inch gypsum wallboard for the ceilings.

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Consumers seeking beautiful, high-quality, yet affordable kitchen cabinets helped drive demand and increased profitability for the company's superior particleboard products.

the new construction and remodeling markets. With its defect-free design and 16-foot length, this product helps ensure less waste, faster application and fewer joints than standard trim.

To capitalize on changing builder and homeowner preferences, Temple-Inland is moving into a new product category — cement fiberboard siding. This product offers a number of performance advantages, including superior weatherability, insect- and fire-resistant characteristics, and low maintenance requirements for the homeowner.

Construction of a new cement fiberboard siding plant in Waxahachie, Texas, remained on schedule for completion by the third quarter of 1998. When fully operational, the joint-venture facility should produce approximately 120 million square feet of cement fiberboard siding and related products per year.

Beyond these strategic partnerships and significant investments for the future, the Building Products Group remains committed to delivering total quality to customers through superior service. This translates to even higher shareholder value as the group successfully applies continuous improvement principles to increase quality, reduce waste and extract more value from fiber.

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FINANCIAL SERVICES



Guaranty Federal Bank's success as one of the nation's largest regional banking institutions goes beyond its progressive consumer deposit and mortgage banking operations. Guaranty's more than 440 tellers personify the bank's commitment to excellence in customer service — each individual contributing to the long-term customer relationships that the bank enjoys.

Temple-Inland's Financial Services Group had an exceptional year in 1997, marked by substantial increases in its loan portfolio, the expansion of its mortgage banking operations and several strategic acquisitions by its operating units.

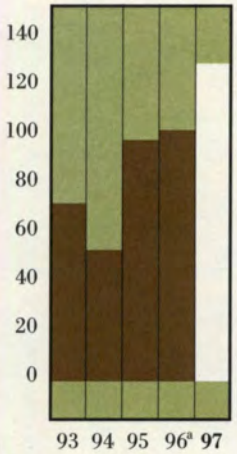
Engaged in banking, mortgage lending, real estate development and insurance services, the Financial Services Group had record operating earnings of $132 million in 1997, compared with 1996 operating earnings of $107 million. This excludes a $44 million assessment made in 1996 in connection with the recapitalization of the Savings Association Insurance Fund.

The improved earnings resulted primarily from greater interest income from Guaranty Federal Bank, F.S.B., growth in the loan servicing portfolio, continued low levels of operating expenses and initial contributions from acquisitions completed during the year.

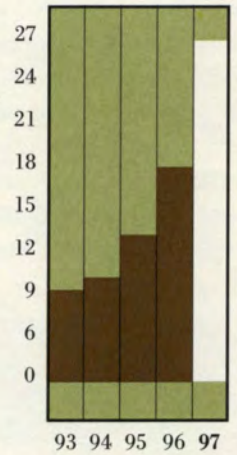
GUARANTY EXPANDS ITS CALIFORNIA OPERATIONS

Guaranty significantly expanded its California operations during the second quarter of the year by acquiring Stockton Savings Bank and its $1.4 billion of assets. The 25 branches acquired from Stockton are located in the state's Central Valley region, which is experiencing high

Operating Profit
(Millions)



Mortgage Servicing Portfolio
(Billions)



[a] *Excludes SAIF assessment of $44 million*

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The acquisition of Stockton Savings Bank gives Guaranty an additional 25 bank branches located in the fast-growing Central Valley region of California, including the bank branch shown here in Lodi, California, which is designated as a point of historical interest in the National Register of Historic Places.



population and business growth and is one of the nation's major agricultural centers. The region offers many benefits, including attractive growth potential for consumer deposits and single-family mortgage loans in an area of California in which Guaranty was not previously active.

Guaranty is a full-service banking institution operating 135 banking centers in Texas and California. It is the largest Texas-based financial institution not owned by an out-of-state holding company. Its Texas operations are concentrated in the metropolitan areas of Dallas/Fort Worth, Houston, Austin and San Antonio, as well as in the Central and Eastern regions of the state.

In California, the bank's deposit and lending activities are concentrated in the Central Valley area of the state, with additional lending operations in Los Angeles and San Diego.

The bank's lending groups have established themselves nationally as major participants in their respective areas. Both real estate and mortgage warehouse lending expanded during the year, serving customers coast to coast, with major concentrations in Texas, Arizona, California, Colorado, Georgia, Illinois and Florida. The bank's Corporate Banking Group has begun establishing itself as a major middle-market lender to Texas-based companies.

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As part of Guaranty's commitment to community reinvestment, the bank helps finance the rehabilitation of apartment units. Projects, such as this South Dallas apartment complex shown before and after rehabilitation, provide affordable housing and stimulate other economic development in the area.

The bank also continued to focus on lowering its operating expenses. The ratio of non-interest expense, net of fee income, is approximately 0.9 percent — among the lowest in the industry.

MORTGAGE BUSINESS EXPANDS IN THE MIDWEST

Temple-Inland Mortgage Corporation (TIMC), one of the nation's largest lenders to single-family home buyers, emphasizes both the origination and servicing of mortgage loans. Building on its successful growth strategies, TIMC continued to acquire high-quality servicing during the year.

In 1997, TIMC acquired Knutson Mortgage Corporation, a full-service mortgage bank based in Minneapolis, Minnesota. Knutson, which has a servicing portfolio of $6.4 billion, has mortgage production offices located primarily in the Midwest. As a result of increasing internal production and acquisitions, TIMC's total servicing portfolio grew to a record $26.1 billion, an increase of 46 percent over 1996. This growth, and continued cost-effective operations, have enabled the company to increase profitability.

The Financial Services Group has an extensive community reinvestment program that is designed to provide opportunities for home ownership and economic development. Key components of this program are the financing provided by TIMC and Guaranty's "Affordable Neighborhood Mortgage" product, which is made available to low- and moderate-income home buyers.

At year-end 1997, Guaranty had total assets of approximately $10.4 billion and deposits of $7.8 billion. New single-family loans added during the year totaled $1.6 billion. These loans, including financing provided to mortgage companies to temporarily inventory single-family loans, represent approximately 42 percent of the bank's total assets.

Guaranty's total loan portfolio, including mortgage loans securitized, increased by roughly $1.8 billion during 1997 to approximately $8 billion, or about 79 percent of earning assets. This targeted level was achieved two years earlier than planned, with no sacrifice of credit quality.

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Temple-Inland is one of the nation's largest lenders to single-family home buyers. Emphasizing close, personal contact, loan officers pride themselves on helping young families through the sometimes complicated process of buying a home.



In 1997, Guaranty secured grants totaling more than $1.1 million to assist the housing needs of low- and moderate-income families. More than 230 families received assistance with down payments, closing costs, or funds for construction or rehabilitation of affordable housing. The total number of loans to these families was 152 in 1997, an increase of approximately 59 percent over 1996 levels.

INSURANCE AND REAL ESTATE UNITS CONTINUE TO GROW AND DIVERSIFY

The Financial Services Group's insurance brokerage operation, Timberline Insurance Managers, Inc., is the third-largest insurance agency in Texas and is ranked in the top 1 percent nationally with total premiums of $290 million in 1997, an increase of 8 percent over 1996.

Timberline completed several acquisitions during the year, significantly strengthening its position in Texas. The insurance unit offers a full range of products, including personal and commercial lines, annuities, life and health insurance, and risk advisory services. Timberline also provides risk management services to Temple-Inland, reducing the company's combined casualty insurance costs approximately 28 percent over the past three years.

The group's real estate development unit, Lumbermen's Investment Corporation, focuses primarily on the development and sale of residential subdivisions. During 1997, it continued to expand its holdings in Texas while diversifying into other states, including Colorado, Florida and California. Lumbermen's also owns two hotels: a 368-room Holiday Inn in Corpus Christi, Texas, and a 280-room Radisson Hotel in Austin, Texas. Plans for the Radisson include adding 135 suites.

The Financial Services Group's record performance in 1997 and the increases in Guaranty's loan portfolio and TIMC's servicing levels provide a strong foundation for continued growth in 1998. The group has begun expanding the Austin headquarters facilities, which will allow future consolidation of operations and reduction of operating costs. The group's focus on acquiring high-quality, low-risk loans; increasing its servicing portfolio; and improving cost efficiencies enhances its earning potential and the ability to increase shareholder value.

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FORESTS



Temple-Inland's 2.2 million acres of owned and leased timberland, located in Texas, Louisiana, Georgia and Alabama, represent an invaluable reserve — both as a sustainable resource for the company's solid wood and paper mill operations and in keeping with the public's interest of maintaining these forestlands as multiple-resource assets.

To maximize the volume of pulpwood, provide clear fiber for high-value lumber and foster improved growth of its trees, the company employs the most advanced forestry practices available. Additionally, long-term management strategies consider the total forest environment, including wildlife, aesthetic and biodiversity concerns.

While the maximum rate of fiber growth of trees usually occurs at approximately 20 years, the dollar value of the growth may not be maximized until the tree reaches 35 years of age. In 1997, the company began utilizing sophisticated computer software that catalogues every company-owned tree and provides daily information on the conversion values, either as pulpwood or sawtimber, as well as the most strategically located mill to maximize the value of the trees.

The company aligns this data with information on emerging markets being targeted by the Building Products Group. Currently, the company is studying the production capabilities of its wood products facilities so that the appropriate capital-investment plans can be made to convert the forest resources more efficiently into new and promising lumber products.

The company's commitment to creating "perpetual forests" includes carefully nurturing seedlings in numerous nurseries to ensure that the timberlands of the future will grow more trees than today's forests.

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Temple-Inland takes proactive, voluntary measures to maintain the highest environmental standards. The company routinely tests the water from creeks and rivers that lace its forestlands, helping to ensure that its forestry practices have minimal impact on the overall environment.

Pine fiber remains a critical source of fiber for all of the company's operations and serves as a hedge against future market forces. This renewable resource currently provides approximately 60 percent of the fiber requirements necessary to operate its paper and solid wood converting operations. The company expects this level of self-sufficiency to be even higher in the future as it continues to build upon and enhance these forestlands to supply its facilities.

Hardwood also plays an important role in Temple-Inland's mix of fiber sources, particularly for the fiber needs of the bleached paperboard mill in Evadale, Texas. Since native hardwood trees take a relatively long time to mature, the company has supplemented its holdings with eucalyptus plantations in Mexico. First planted on reclaimed ranch land in 1994, these stands are showing good progress to date and should represent a significant source of fiber beginning in approximately five years.

NEW ORGANIZATION TO HELP ENSURE "PERPETUAL FORESTS"

During 1997, the company reorganized its forestry unit's management structure into three key areas: forest management, harvesting and allocation, and procurement. This restructuring was designed to better align management activities with these business processes, as well as to improve planning, and reduce duplication and waste.

One of the most important objectives of the restructured organization is to ensure the highest



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standards of forest stewardship. Temple-Inland's comprehensive forestry guidelines commit the company to operating procedures that attain fiber production goals in the most environmentally responsible manner possible. Management sees this initiative as a strategic tie-in to the company's long-term objectives, and the guidelines are being closely followed by all forest employees in their daily activities.

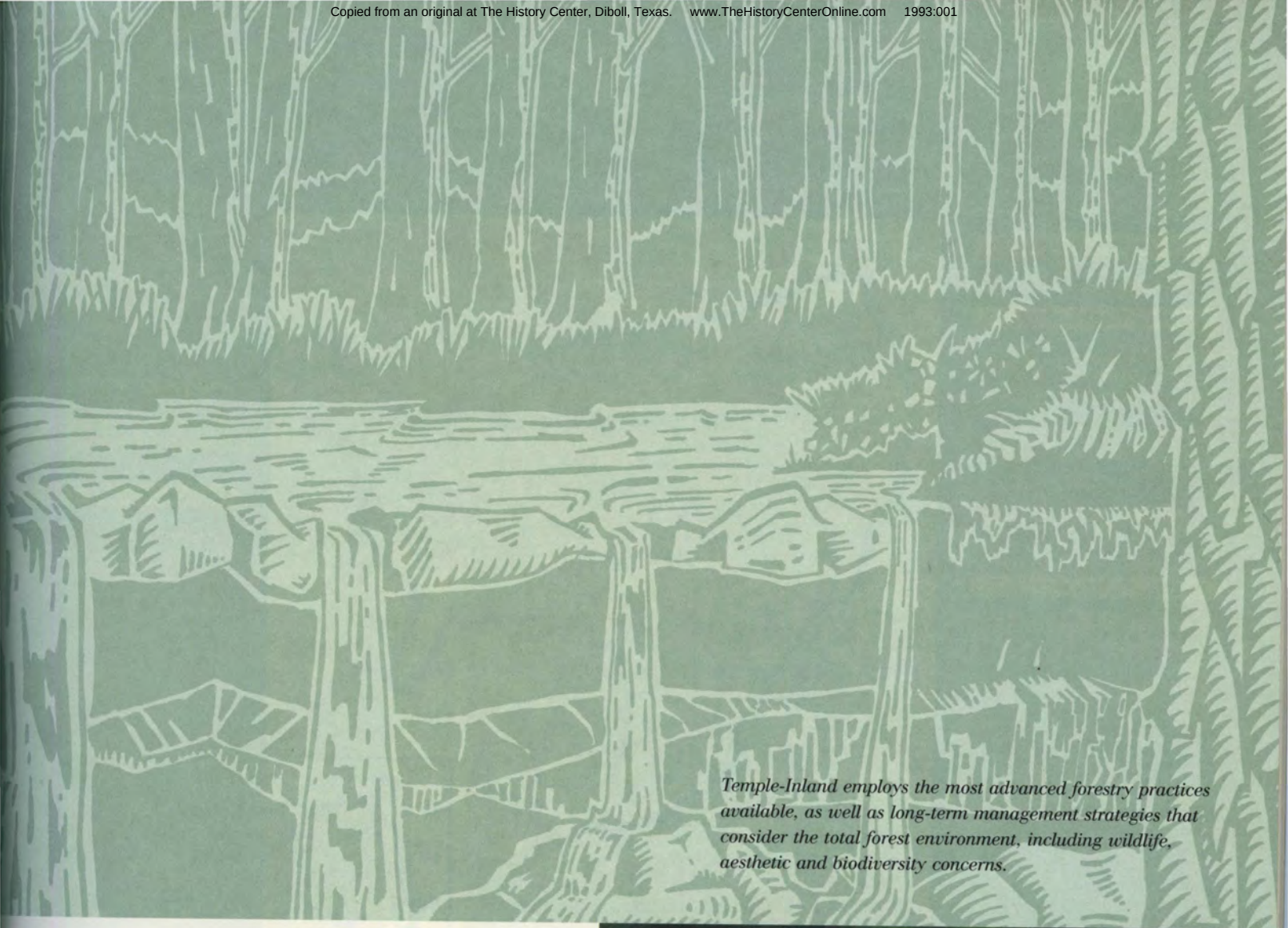
FERTILIZATION AND RESEARCH ENHANCE PRODUCTIVITY

Temple-Inland continued its aerial application of environmentally safe nitrogen and phosphorus supplements to nearly 50,000 acres of company-owned lands. The goal is to double fiber production over the next growth cycle by using fertilization and other intensive management techniques.

Several smaller research projects were initiated during the year, including a concept known as "fertigation," which combines fertilization and irrigation techniques. The company is also investigating a new drip-fertilization process in which the optimum balance of water and nutrients is provided to each tree.

As a responsible steward of its forestlands, the company balances its fiber needs with the ecological requirements of wildlife. A Temple-Inland wildlife biologist is shown here creating an artificial cavity in a tree, which will provide a safe nesting environment for the endangered red-cockaded woodpecker. The company has set aside 21,870 acres to house 86 clusters of red-cockaded woodpeckers.

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Temple-Inland employs the most advanced forestry practices available, as well as long-term management strategies that consider the total forest environment, including wildlife, aesthetic and biodiversity concerns.

Advanced genetics research and biotechnology also play an important part in the company's pine plantation management program. These efforts focus on selecting and breeding trees that grow faster and stronger and are less susceptible to insects and disease.

Temple-Inland's forestlands remain a significant asset and a perfect platform on which to continue building value. By maintaining a continuous balance between maximizing fiber yields and sustaining an environmentally healthy forest, the company will continue to lead the industry in perpetual forest management for generations to come.



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TEMPLE-INLAND FACILITIES

CORPORATE HEADQUARTERS •

Diboll, Texas

SUBSIDIARY HEADQUARTERS •

Inland Paperboard and Packaging, Inc.
Indianapolis, Indiana

Temple-Inland Forest Products Corporation
Diboll, Texas

Temple-Inland Financial Services Inc.
Austin, Texas

BUILDING PRODUCTS •

Fiberboard Operations
Diboll, Texas

Gypsum Operations
West Memphis, Arkansas
Fletcher, Oklahoma
McQueeney, Texas
(50 percent joint venture)

Lumber Operations
Rome, Georgia
DeQuincy, Louisiana
Buna, Texas
Diboll, Texas
Pineland, Texas

Particleboard Operations
Monroeville, Alabama
Hope, Arkansas
Thomson, Georgia
Diboll, Texas

Plywood Operation
Pineland, Texas

PAPERBOARD MILLS •

Linerboard
Ontario, California
Rome, Georgia
Maysville, Kentucky
Orange, Texas

Corrugating Medium
Newark, California
Newport, Indiana
New Johnsonville, Tennessee

Bleached Paperboard
Evadale, Texas



United States and Mexico Operations

Argentina and Chile Operations

PACKAGING PLANTS •

Corrugated Packaging
Fort Smith, Arkansas (2)
Bell, California
El Centro, California
Newark, California
Ontario, California
Sante Fe Springs, California
Tracy, California
Wheat Ridge, Colorado
Orlando, Florida
Rome, Georgia
Chicago, Illinois
Crawfordsville, Indiana
Evansville, Indiana
Garden City, Kansas
Kansas City, Kansas
Louisville, Kentucky
Minden, Louisiana
Minneapolis, Minnesota
Hattiesburg, Mississippi
St. Louis, Missouri
Spotswood, New Jersey
Middletown, Ohio
Streetsboro, Ohio
Biglerville, Pennsylvania
Hazleton, Pennsylvania
Lexington, South Carolina
Rock Hill, South Carolina
Elizabethton, Tennessee (2)
Dallas, Texas
Edinburg, Texas
Petersburg, Virginia
Vega Alta, Puerto Rico
Buenos Aires, Argentina
Santiago, Chile
San Jose Iturbide, Guanajuato, Mexico
Monterrey, Leon, Mexico
Los Mochis, Sinaloa, Mexico

Consumer Packaging
Buena Park, California
Ontario, California
Sante Fe Springs, California (2)
(Crockett Container Corporation)
Harrington, Delaware
Indianapolis, Indiana (2)
Leominster, Massachusetts
Rural Hall, North Carolina

Rexford Paper Company
Milwaukee, Wisconsin

FINANCIAL SERVICES •

Consumer Banking Regions
Central Valley of California
Austin, Texas, and Adjacent Cities
Dallas, Texas, and Adjacent Cities
East Texas
Houston, Texas, and Adjacent Cities
San Antonio, Texas, and Adjacent Cities

Mortgage Banking Operations
Arizona
Arkansas
California
Colorado
Florida
Georgia
Illinois
Kansas
Louisiana
Massachusetts
Michigan
Minnesota
Missouri
Montana
Nevada
New Jersey
New York
North Carolina
Ohio
Oklahoma
Oregon
Pennsylvania
South Dakota
Texas
Washington
Wisconsin

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Results of Operations and Financial Condition

Results of operations, including information regarding the principal business segments, are shown below.

BUSINESS SEGMENTS

For the year *(in millions)*	**1997**	1996	1995	1994	1993	1992	1991	1990	1989	1988
REVENUES										
Paper	**$2,063**	$2,082	$2,198	$1,740	$1,572	$1,610	$1,519	$1,517	$1,506	$1,429
Building products	**617**	563	533	575	497	409	311	305	320	312
Other activities	**—**	—	—	20	58	77	68	70	68	33
Manufacturing net sales	**2,680**	2,645	2,731	2,335	2,127	2,096	1,898	1,892	1,894	1,774
Financial services	**945**	815	764	632	635	638	609	509[b]	49	40
Total revenues	**$3,625**	$3,460	$3,495	$2,967	$2,762	$2,734	$2,507	$2,401	$1,943	$1,814
INCOME BEFORE TAXES										
Paper	**$ (39)**	$ 113	$ 357	$ 74	$ 6	$ 135	$ 156	$ 250	$ 323	$ 304
Building products	**131**	102	67	139	102	40	5	9	24	25
Other activities	**—**	—	—	1	(2)	(2)	1	(2)	(1)	1
Operating profit	**92**	215	424	214	106	173	162	257	346	330
Financial services	**132**	63[a]	98	56	68	64	54	52[b]	(2)	—
	224	278	522	270	174	237	216	309	344	330
Corporate expense	**(25)**	(17)	(22)	(14)	(11)	(15)	(16)	(21)	(13)	(20)
Parent Company interest - net	**(110)**	(110)	(73)	(67)	(69)	(48)	(38)	(26)	(26)	(23)
Other income	**6**	5	4	4	2	3	5	7	7	17
Income before taxes	**$ 95**	$ 156	$ 431	$ 193	$ 96	$ 177	$ 167	$ 269	$ 312	$ 304

[a] *Includes a one-time assessment of $44 million to recapitalize the Savings Association Insurance Fund (SAIF).*
[b] *Includes operating results from the consolidation of Guaranty Federal Bank, F.S.B., beginning January 1, 1990.*

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PAPER

The Paper Group is composed of two units: corrugated packaging and bleached paperboard. The following table provides information on the operating earnings of this group.

For the year*	1997	1996	1995
(in millions)			
Corrugated packaging	**$ (11.0)**	$ 165.6	$ 386.3
Bleached paperboard	**15.3**	(8.2)	24.7
Group administration	**(43.3)**	(44.4)	(54.4)
Operating Earnings	**$ (39.0)**	$ 113.0	$ 356.6

**Food Service operating earnings reclassified to corrugated packaging from bleached paperboard.*

CORRUGATED PACKAGING

The corrugated packaging operation manufactures linerboard and corrugating medium at seven paper mills and converts it into corrugated packaging at 39 box plants located throughout the United States, Puerto Rico, Mexico and South America. In addition, it operates nine specialty converting plants. Operation of the Erie, Pennsylvania, box plant was discontinued in the second half of 1997. During 1997, two state-of-the-art corrugated packaging plants began operations—one in Sinaloa, Mexico; the other in Streetsboro, Ohio.

Before administrative costs, the corrugated packaging operation lost $11.0 million in 1997, compared with $165.6 million earned in 1996. Revenues for this operation decreased 4 percent in 1997, compared with 1996, as average product prices continued to decline from 1996 levels. Revenues for 1996 were down 8 percent, compared with 1995. Increased sales volumes in both 1997 and 1996 were able to offset some of the effect of significantly lower product prices.

The weak demand for corrugated packaging that developed in late 1995 and additional industry capacity completed in 1996 resulted in unstable market conditions throughout 1996. As a result, box prices declined by 19 percent on average in 1996. Although demand improved in the second half of 1996, markets were unable to stabilize and inventories were higher than normal in early 1997. Pricing continued to decline in 1997 with an additional 8 percent reduction by August before beginning a slow rebound. By year end, box prices had almost recovered from the deterioration that occurred earlier in the year.

Tons of boxes sold were up 4.1 percent in 1997, slightly ahead of the 3.5 percent increase in 1996. While the 1997 earnings decline was moderated by the increased sales volume, the cost of old corrugated containers (OCC), the principal raw material used in approximately 44 percent of the group's containerboard production, more than offset this gain. The cost of OCC was up $16 per ton in 1997, compared with 1996. This increase followed a $71 per ton decrease in 1996 versus 1995.

As indicated in the table below, mill production totaled 2,761,000 tons in 1997, a 184,000-ton increase in production over 1996. Production of containerboard exceeded internal box plant usage by 336,000 tons in 1997, 275,000 tons in 1996, and 317,000 tons in 1995. Excess production was sold in the domestic and export markets. The company curtailed production by approximately 35,000 tons in 1997 and 120,000 tons in 1996 to control inventory levels.

For the year	1997	1996	1995
MILL PRODUCTION			
(in tons)	**2,761,000**	2,577,000	2,514,000

Box production at the Mexican, Puerto Rican and South American converting facilities increased by 50,000 tons to 174,000 tons in 1997. While volumes increased in Chile and Argentina, competitive pricing pressures contributed to continued operating losses at these plants. Additionally, the Sinaloa, Mexico, box plant was unprofitable. The operations of the other two Mexican plants, in Guanajuato and Monterrey, were stabilized in 1997 and reported improved earnings. The net operating losses in Argentina, Chile and Sinaloa, Mexico, served to increase the effective tax rate for the corporation, since the company did not accrue a tax benefit for these losses.

The following table shows the quarterly sales of the corrugated packaging operation in tons and dollars. The totals presented include not only boxes sold, but also open market sales of linerboard and related products.

CORRUGATED PACKAGING

For the year	1997	1996	1995
UNIT SALES			
(in thousands of tons)			
1st Quarter	**647**	575	602
2nd Quarter	**719**	608	614
3rd Quarter	**706**	636	564
4th Quarter	**697**	616	553
	2,769	2,435	2,333
NET SALES*			
(in millions)			
1st Quarter	**$ 411.9**	$ 469.7	$ 452.8
2nd Quarter	**432.6**	453.4	499.5
3rd Quarter	**421.3**	423.3	487.9
4th Quarter	**428.2**	414.2	470.1
	$1,694.0	$1,760.6	$1,910.3

**Reclassified to include Food Service sales for 1996 and 1995.*

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In October 1997, the company sold substantially all of the operating assets of its subsidiary, Temple-Inland Food Service Corporation (Food Service), for approximately book value. Food Service had revenues of $66.3 million, $84.1 million and $80.9 million during 1997, 1996 and 1995, respectively.

BLEACHED PAPERBOARD

The bleached paperboard operation manufactures bleached paperboard at one mill in Evadale, Texas. Its products are sold to commercial printers and paperboard converters, including those serving packaging, food service and office product markets.

The mill completed a major modernization and expansion program during 1995. The cornerstone of this project was a new 550-ton-per-day paperboard machine capable of producing low-density, lightweight bleached paperboard and bleached bristols. Other key elements of the expansion project included major technological upgrades on three existing paperboard machines, a pine fiberline, a coating plant, a power boiler, an extruder plant, a lime kiln and a concentrator. One of the mill's recovery boilers was also rebuilt.

Before administrative costs, the bleached paperboard operation reported income of $15.3 million in 1997, compared with a loss of $8.2 million in 1996. Average prices for bleached paperboard were basically flat in 1997, compared with 1996, after having declined by 12 percent in 1996. Paperboard sales volume increased by 21 percent in 1997 versus 1996 as demand improved. Paperboard sales volume increased 31 percent in 1996. Production in both 1997 and 1996 was limited to control inventory levels.

Most of the earnings improvement in 1997 was achieved through a reduction in manufacturing costs of $16 per ton as the efficiencies from the increased level of production and the effect of a cost-reduction program were realized. Manufacturing costs for 1996 were relatively unchanged from 1995 levels.

The following table lists the quarterly sales of the bleached paperboard operation in tons and dollars. Changes in product mix from period to period may make historical comparisons difficult.

BLEACHED PAPERBOARD

For the year	**1997**	1996	1995
UNIT SALES *(in thousands of tons)*			
PAPERBOARD			
1st Quarter	**155**	108	120
2nd Quarter	**178**	125	97
3rd Quarter	**169**	149	83
4th Quarter	**133**	142	100
	635	524	400
PULP	**2**	100	99
NET SALES *(in millions)*			
PAPERBOARD			
1st Quarter	**$ 87.6**	$ 66.1	$ 70.7
2nd Quarter	**95.0**	73.6	56.8
3rd Quarter	**96.9**	83.3	54.4
4th Quarter	**86.5**	77.5	67.1
	$ 366.0	$ 300.5	$ 249.0
PULP AND OTHER	**$ 2.9**	$ 21.2	$ 39.1

The Paper Group's administrative costs were down slightly in 1997, compared with 1996. These costs decreased $10 million in 1996 from 1995, primarily because the company paid significantly lower bonuses to its managers in 1996 as a result of the lower level of profitability.

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BUILDING PRODUCTS

The Building Products Group manufactures a diversified line of construction and commercial grade building materials at 13 facilities (including one joint-venture facility) located in Texas, Louisiana, Oklahoma, Arkansas, Alabama and Georgia. In 1997, almost 82 percent of its revenues were generated from wood-based materials made from Southern Pine logs or log residues. These products, sold to both residential and commercial market segments, include lumber, plywood, fiber products and particleboard. The non-wood-based business unit manufactures a variety of gypsum wallboard products that are sold to the same market segments as wood-based materials.

The group earned $131.1 million in 1997, the second-highest earnings level in its history, following earnings of $139 million in 1994. Net manufacturing revenues in 1997 increased $54 million, or 10 percent, over 1996. This 10 percent increase followed a 6 percent increase in 1996. As a result of improved residential and commercial construction levels, prices advanced in 1997 across all product lines, except for particleboard and plywood.

During 1997, the group completed its exit from the retail building products distribution business. Retail operations accounted for less than 1 percent of group net revenues in 1997, compared with about 3 percent in 1996 and 10 percent in 1995. The group began its exit from this business during the fourth quarter of 1995 by selling its two major Houston-area retail locations. Late in 1996, two of the three remaining locations were sold and the last location was sold in December 1997.

The following table provides information on unit sales volumes and net sales for each business unit.

BUILDING PRODUCTS

For the year	**1997**	1996	1995
UNIT SALES*			
Pine lumber	**639**	605	582
Fiber products	**402**	457	422
Particleboard	**470**	399	329
Plywood	**281**	259	217
Gypsum wallboard	**843**	838	813
NET SALES *(in millions)*			
Pine lumber	**$ 262.1**	$ 217.4	$ 190.1
Fiber products	**66.2**	73.3	59.7
Particleboard	**125.0**	112.2	99.1
Plywood	**55.2**	52.1	49.3
Gypsum wallboard	**104.6**	90.2	83.1
Retail distribution	**4.2**	17.1	51.3
Other	**—**	0.3	0.3
	$ 617.3	$ 562.6	$ 532.9

**Unit sales amounts shown are in millions of square feet, except pine lumber, which is in millions of board feet.*

Pine lumber shipments of 639 million board feet increased 6 percent over 1996. Lumber prices improved during the first three quarters of the year, ranging from 11 percent in the third quarter to 26 percent in the first quarter, above the same periods in 1996. By the fourth quarter, the price level was virtually identical to the level sustained in the fourth quarter of 1996. However, the average selling price experienced for the year was 12 percent higher than the average selling price for 1996.

Fiber products revenues decreased 10 percent from 1996 due to a 12 percent decrease in shipments. Shipments were lower due to a shift in product mix in order to manufacture more siding products rather than traditional sheathing. TrimCraft™, the company's alternative lumber trim product, continued to gain market acceptance, and shipments of this product advanced 4 percent over 1996 levels. Shipment of TrimCraft increased 30 percent in 1996, compared with 1995.

During 1997, construction continued on a new medium density fiberboard (MDF) plant in El Dorado, Arkansas. The $97 million facility, a joint-venture operation, is designed to produce 150 million square feet of MDF annually and is projected to begin operations in the second quarter of 1998. MDF products are high-grade composite panels that serve as suitable alternatives to high-quality millwork lumber and as flooring substrates.

Also during 1997, the group, through a joint venture, began construction on a new cement fiberboard plant in Waxahachie, Texas. This $60 million facility is designed to produce 126 million square feet of cement fiberboard annually. This plant is expected to start operations during the third quarter of 1998. Cement fiberboard is a weather-stable product with increasing acceptance for applications such as exterior sidings, tile backing and roofing.

Using by-products of lumber processing, the group manufactures particleboard at four plants in Texas, Alabama, Arkansas and Georgia. The Arkansas plant, completed late in the fourth quarter of 1995 at a cost of $65 million, increased overall particleboard capacity by about 50 percent. Particleboard shipments increased 18 percent over 1996, despite lost production at the Texas and Georgia plants, each of which incurred a ten-week outage for a major modernization. Due to the increase in shipments, the particleboard group's revenues rose $13 million, or 11 percent, from 1996, despite an average price decline of 6 percent from 1996 levels. In 1996, shipments were 21 percent above, and prices were 6 percent below, 1995 levels.

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Record earnings were achieved by the group's gypsum wallboard operation in 1997 as prices continued the recovery begun in 1994, and the mix of products manufactured continued to improve. Gypsum wallboard shipments of 843 million square feet were slightly above 1996 levels, but revenues increased by $14 million due to a 15 percent increase in average sales price. Gypsum wallboard demand improved in both 1996 and 1997 as a result of the increased level of construction, including both residential and commercial. In addition to a strong market, specialty products, including the group's Stretch 54® product, pre-sized to reduce material waste and application labor in houses with nine-foot-high ceilings, continued to gain market share. Specialty panels in 1997 accounted for 40 percent of total shipments, compared with 38 percent in 1996.

In 1997, plans were announced to construct another gypsum wallboard plant near Cumberland City, Tennessee. The plant will be operated by the Standard Gypsum LLC joint venture, of which a subsidiary of the company is a 50 percent partner. This state-of-the-art plant is expected to produce in excess of 700 million square feet of gypsum wallboard annually, and will utilize 100 percent flue gas desulphurization (synthetic) gypsum. This plant will be adjacent to the Cumberland Fossil Plant, the Tennessee Valley Authority's (TVA) largest coal-fired steam electric plant, which will supply 100 percent of the synthetic gypsum for use in the production of the wallboard at this facility. The synthetic gypsum is produced as a by-product of the TVA plant's air-cleaning system. Construction of this $60 million facility will begin in 1998, and production is expected to begin by 2000.

TIMBER AND TIMBERLANDS

The company controls approximately 2.2 million acres of timberland in Texas, Louisiana, Georgia and Alabama. In 1997, this renewable resource provided approximately 58 percent of the company's sawtimber requirements and roughly 57 percent of the fiber necessary to operate the company's paper, particleboard and fiberboard converting operations.

FINANCIAL SERVICES

The company's Financial Services Group includes savings bank, mortgage banking, real estate development and insurance operations. The following selected financial information provides a detailed description of these operations.

FINANCIAL SERVICES GROUP SELECTED FINANCIAL INFORMATION

For the year or at year end *(in millions)*	**1997**	1996	1995
INCOME			
Savings bank	**$ 106.6**	$ 37.5[a]	$ 78.1
Mortgage banking	**24.0**	23.0	20.3
Real estate	**(3.4)**	(1.7)	(3.8)
Insurance	**4.8**	4.3	3.5
Income before taxes	**132.0**	63.1	98.1
Taxes on income	**20.6**	24.3	27.3
Net income	**$ 111.4**	$ 38.8	$ 70.8
ASSETS			
Savings bank	**$ 10,370.6**	$ 8,945.9	$ 8,881.7
Mortgage banking	**385.6**	241.4	157.0
Real estate	**280.4**	287.4	238.4
Insurance	**32.4**	26.3	19.1
Other activities	**—**	0.1	1.6
Eliminations	**(284.3)**	(166.0)	(86.7)
Total assets	**$ 10,784.7**	$ 9,335.1	$ 9,211.1
LIABILITIES			
Savings bank	**$ 9,798.1**	$ 8,509.9	$ 8,405.2
Mortgage banking	**303.4**	177.1	113.5
Real estate	**222.0**	204.7	156.2
Insurance	**19.7**	17.7	13.2
Other activities	**—**	(0.1)	4.6
Preferred stock issued by subsidiary	**150.0**	—	—
Eliminations	**(284.3)**	(166.0)	(86.7)
Total liabilities	**$ 10,208.9**	$ 8,743.3	$ 8,606.0
EQUITY			
Savings bank	**$ 422.5**	$ 436.0	$ 476.5
Mortgage banking	**82.2**	64.3	43.5
Real estate	**58.4**	82.7	82.2
Insurance	**12.7**	8.6	5.9
Other activities	**—**	0.2	(3.0)
Total equity	**$ 575.8**	$ 591.8	$ 605.1

[a] *Includes a one-time SAIF assessment of $43.9 million.*

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SAVINGS BANK

The company's savings bank, Guaranty Federal Bank, F.S.B. (Guaranty), conducts its business through 135 banking centers in Texas and California. The Texas operations are concentrated in the metropolitan areas of Houston, Dallas/Fort Worth, San Antonio and Austin, as well as the Central and Eastern regions of the state. All of Guaranty's deposit locations in California are in the Central Valley area. The primary business of Guaranty is to attract savings deposits from the general public, to invest in loans secured by real estate mortgages, to be a major construction lender to the commercial and residential real estate industry, and to provide a variety of loan products to consumers and businesses.

GUARANTY FEDERAL BANK, F.S.B. SELECTED FINANCIAL INFORMATION

For the year	**1997**	1996	1995
(dollars in millions)			
INCOME AND EXPENSE			
Net interest income	**$ 222.3**	$ 193.0	$ 179.5
Noninterest income	**17.8**	22.2	37.7
Noninterest expense	**128.5**	163.9[a]	124.6
Minority interest in income of subsidiary	**6.5**	—	—
Income before taxes	**106.6**	37.5	78.1
AVERAGE BALANCE SHEET			
Total earning assets	**9,919.1**	8,889.0	8,819.5
Loans receivable and mortgage loans held for sale	**6,530.9**	5,215.1	4,453.6
Mortgage-backed and investment securities	**2,721.6**	3,204.3	3,647.1
Covered assets	**—**	—	298.6
Deposits	**7,090.5**	6,423.9	6,721.3
Securities sold under repurchase agreements and FHLB advances	**2,573.9**	2,113.5	1,873.0
KEY RATIOS			
Yield on earning assets	**7.06%**	6.96%	6.87%
Cost of funds	**4.95%**	4.91%	4.96%
Net interest spread	**2.11%**	2.05%	1.91%

[a]*Includes a one-time SAIF assessment of $43.9 million.*

At year end 1997, loans receivable comprised 71 percent of earning assets, compared with 67 percent in the prior year. For increased flexibility during 1997, Guaranty securitized a portion of its mortgage loans held in its portfolio. At year end 1997, the ratio of loans receivable to earning assets, with the inclusion of the balance of $768 million in loans securitized, was 79 percent.

Net interest income for 1997 increased $29.3 million from 1996. This was a result of an increase in average earning assets of $1 billion from 1996, principally due to the acquisition of Stockton Savings Bank, F.S.B. (SSB) discussed below, combined with the improved asset mix of loans.

Net interest income for 1996 increased $13.5 million from 1995. Although the average balance of total earning assets remained virtually constant with 1995, the improved mix of loans receivable to securities improved the net interest spread by 14 basis points.

When new loans are originated, an estimated allowance for losses is provided. Thereafter, this provision is adjusted for actual net charge-off experience and other factors. The provision for loan loss decreased $15.5 million during 1997, compared with 1996, primarily related to the securitization of about $1 billion of mortgage loans, payoff of other notes, as well as favorable net charge-off experience.

Noninterest income is composed primarily of fees collected, including service charges on deposits. Losses on the sale of certain mortgage securities resulted in a net noninterest income reduction of $4.4 million. In 1995, Guaranty recognized a $9 million gain, representing its portion of gains on certain asset dispositions (see Note C on page 44 for additional information). Excluding the gain recognized in 1995, noninterest income decreased by $6.5 million in 1996.

Excluding $43.9 million related to the 1996 one-time Savings Association Insurance Fund (SAIF) assessment discussed below, noninterest expense for 1997 increased $8.5 million from 1996. The assessment reduced insurance premiums on deposits by $9.8 million in 1997. Primarily as the result of new operations in California, other noninterest expense was up $18.3 million in 1997, compared with a decrease of $4.6 million in 1996.

BIF/SAIF Legislation

On September 30, 1996, President Clinton signed the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (the Act). Among its many provisions, the Act provided for (i) the recapitalization of the SAIF to an amount sufficient to increase the SAIF's net worth to 1.25 percent of SAIF-insured deposits, (ii) the reduction of SAIF insurance assessments to parity with those of the Bank Insurance Fund (BIF), and (iii) the eventual merger of the SAIF and BIF. Specifically, the statute required a one-time special assessment of SAIF members, calculated at 65.7 basis points of insured deposits, or $43.9 million for Guaranty.

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Effective January 1, 1997, Guaranty is not required to pay any deposit insurance assessments, but is required to pay approximately 6.5 basis points on its insured deposits annually to repay certain Financial Corporation (FICO) bond obligations. Prior to the special assessment, Guaranty was paying 23 basis points of insured deposits for insurance premiums, as compared with the approximate 6.5 basis points of insured deposits currently being paid to repay FICO bond obligations.

Acquisitions

On June 27, 1997, the company acquired all of the outstanding stock of California Financial Holding Company, the parent company of Stockton Savings Bank, F.S.B. (SSB), and merged the operations of SSB into Guaranty. The consideration for the transaction was $143.4 million, consisting of approximately 1,614,000 shares of Temple-Inland Inc. common stock and cash of $47.3 million. SSB operated 25 banking centers in the Central Valley area of California and had assets at acquisition totaling approximately $1.4 billion, consisting primarily of loans and securities.

Liquidity, Interest Rate Risk Management and Capital

Guaranty is required by the Office of Thrift Supervision (OTS) to maintain average daily balances of statutorily defined liquid assets. During 1997, the liquid assets requirement was decreased from 5 percent to 4 percent of net withdrawable deposits and short-term borrowings.

The operations of Guaranty are subject to a risk of interest rate fluctuation to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in differing amounts. Because approximately 94 percent of Guaranty's assets at year end 1997 have adjustable rates, this risk is significantly mitigated. A substantial portion of Guaranty's investments in adjustable-rate mortgage-backed securities have annual or lifetime caps that subject Guaranty to interest rate risk should rates rise above certain levels. To optimize net interest income while maintaining acceptable levels of interest rate and liquidity risk, Guaranty, from time to time, will enter into various interest rate contracts for purposes other than trading. See Note L on page 48 for additional information.

On May 28, 1997, a newly formed subsidiary of Guaranty that qualifies as a real estate investment trust (REIT) issued $150 million of noncumulative floating rate preferred stock in a private placement. The preferred stock qualifies for inclusion in regulatory capital, subject to certain limitations.

OTS regulations require savings institutions to maintain certain minimum levels of capital. Guaranty's regulatory capital exceeded all applicable capital requirements at year end 1997. Note M on page 49 contains additional information concerning Guaranty's capital requirements.

MORTGAGE BANKING

Mortgage banking is conducted through Temple-Inland Mortgage Corporation (TIMC). TIMC arranges financing of single-family mortgage loans, then sells the loans into the secondary market (primarily FNMA, FHLMC and GNMA securities). TIMC generally retains the servicing of these loans.

A summary of selected financial information is provided below.

MORTGAGE BANKING OPERATIONS SUMMARY

For the year *(dollars in millions)*	**1997**	1996	1995
Revenues	**$ 136**	$ 95	$ 71
Income before taxes	**24**	23	20
PORTFOLIO ROLL-FORWARD *(Including loans serviced for affiliates)*			
Beginning servicing	**$ 17,851**	$ 13,460	$ 10,068
Purchased servicing	**9,497**	4,888	3,782
New loans added, net of servicing released	**2,600**	2,265	948
Run-off	**(3,866)**	(2,762)	(1,338)
Ending servicing	**$26,082**	$ 17,851	$ 13,460
Portfolio growth rate	**46.1%**	32.6%	33.7%
Run-off factor	**16.8%**	15.9%	10.9%
Ending number of loans serviced	**351,600**	225,700	184,800

The servicing portfolio grew from both internal production and acquisition to a record $26.1 billion during 1997. Servicing totaling $9.5 billion was acquired during 1997, of which $6.4 billion is associated with the acquisition of Knutson Mortgage Corporation (KMC). Servicing totaling $4.9 billion was acquired during 1996, a portion of which was acquired subject to a call option. At the end of 1997, $1.6 billion of the servicing portfolio was subject to the call option. The call option price, if exercised, would exceed the carrying value. The mortgage origination network increased during 1997 from 41 branch offices to 80. The volume of originations increased to $3.2 billion.

REAL ESTATE GROUP

Real estate operations conducted by Lumbermen's Investment Corporation include development of residential subdivisions, as well as management and sale of income properties. Land development projects include 34 residential subdivisions in Texas, Arizona, California, Colorado, Florida, Georgia, Missouri, Tennessee and Utah. At the end of 1997, land development inventory included 2,190 residential lots (1,437 under contract) and 5,664 acres of land. Lot sales for 1997 were 1,422, compared with 1,082 in 1996, and 467 in 1995.

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The company owns 12 commercial properties consisting of two hotels, two office buildings, one retail center, two business parks and five parcels of commercial land. The company is also a financial partner in joint ventures that are constructing six apartment projects.

Selected financial information related to these activities is shown below.

REAL ESTATE GROUP OPERATIONS SUMMARY

For the year	**1997**	1996	1995
(in millions)			
REVENUES			
Residential	**$ 43.4**	$ 35.9	$ 12.7
Commercial	**21.4**	18.2	19.4
Interest and other	**3.7**	7.0	4.9
Total	**$ 68.5**	$ 61.1	$ 37.0
INCOME (LOSS) BEFORE TAXES			
Residential	**$ 2.2**	$ 3.0	$ (1.9)
Commercial	**4.5**	2.2	2.0
Interest and other	**(10.1)**	(6.9)	(3.9)
Total	**$ (3.4)**	$ (1.7)	$ (3.8)

INSURANCE

Timberline Insurance Managers, Inc. (Timberline), one of the largest insurance agencies in Texas, operates as a general agency selling a full range of insurance products, including automobile, homeowners, business insurance, annuities, and life and health products. The agency also acts as the risk management department of the company. Timberline currently has offices in Austin, Houston, El Paso and San Antonio, Texas.

A summary of revenues and income before taxes is shown below.

INSURANCE OPERATIONS SUMMARY

For the year	**1997**	1996	1995
(in millions)			
REVENUES	**$ 30.4**	$ 24.9	$ 16.5
INCOME BEFORE TAXES	**4.8**	4.3	3.5

ENVIRONMENTAL MATTERS

The company is committed to protecting the health and welfare of its employees, the public and the environment, and strives to maintain compliance with all state and federal environmental regulations in a cost-effective manner. In the construction of new facilities and the modernization of existing facilities, the company installed state-of-the-art technology for controlling air and water emissions. These forward-looking programs should minimize the impact that changing regulations have on capital expenditures for environmental compliance.

Future expenditures for environmental-control facilities will depend on changing laws and regulations and technological advances. Given these uncertainties, the company estimates that capital expenditures for environmental purposes during the period 1998 through 2000 will average $15 million each year, exclusive of the expenditures for the Cluster Rule compliance discussed below.

On November 14, 1997, the U.S. Environmental Protection Agency (EPA) issued extensive regulations governing air and water emissions from the pulp and paper industry (the Cluster Rule). According to the EPA, the technology standards in the Cluster Rule will cut the industry's toxic air pollutant emissions by almost 60 percent from current levels and virtually eliminate all dioxin discharged from pulp, paper and paperboard mills into rivers and other surface waters. The rule also provides incentives for individual mills to adopt technologies that will lead to further reductions in toxic pollutant discharges. The EPA estimates that the industry will need to invest approximately $1.8 billion in capital expenditures and approximately $277 million per year in operating expenditures to comply with the Cluster Rule. The initial compliance period is three years from the date the regulations are published in the Federal Register. The estimated expenditures disclosed above do not include expenditures that may be needed to comply with the Cluster Rule. Based upon its interpretation of the Cluster Rule as issued, the company currently estimates that compliance with the rule may require modifications at several facilities. Some of these modifications can be included in modernization projects that will provide economic benefits to the company. Excluding these investments, environmental expenditures are not expected to exceed $110 million over the next three years.

CAPITAL RESOURCES AND LIQUIDITY

The company's financial condition continues to be strong. Internally generated funds, existing credit facilities and the capacity to issue long-term debt are sufficient to fund projected capital expenditures, to service existing debt, to pay dividends and to meet normal working capital requirements.

A summary of capital expenditures is shown below.

For the year	**1997**	1996	1995
(in millions)			
CAPITAL EXPENDITURES			
Paper	**$ 155.8**	$ 147.7	$ 299.1
Building products	**53.4**	52.0	67.6
Timber and timberlands	**20.5**	74.7	19.1
Other activities	**3.0**	0.9	0.3
Total manufacturing group	**$ 232.7**	$ 275.3	$ 386.1

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Capital expenditures of approximately $250 million are projected for 1998. Commitments on construction projects totaled $31.6 million at the end of 1997.

Net interest expense incurred by the Parent Company is shown below.

For the year	**1997**	1996	1995
(in millions)			
PARENT COMPANY			
INTEREST - NET			
Interest expense	**$ 112.3**	$ 112.9	$ 111.3
Capitalized interest	**(2.0)**	(3.3)	(38.6)
Interest expense - net	**$ 110.3**	$ 109.6	$ 72.7

Interest expense increased in 1996, compared with 1995, due to the levels of debt outstanding. The higher amount of capitalized interest in 1995 was due to higher levels of construction in progress associated primarily with the modernization and expansion project at Evadale, Texas. Since this project was completed in 1995, capitalized interest in 1997 and 1996 decreased to $2.0 million and $3.3 million, respectively. Parent Company interest paid during 1997, 1996 and 1995 was $104.5 million, $105.9 million and $95.4 million, respectively.

In August 1995, the Board of Directors approved a stock repurchase program allowing the company to repurchase up to 2.5 million shares. At year end 1997, approximately 75 percent of this program had been completed.

INCOME TAXES

The effective tax rate for the year was 46 percent, compared with a normalized rate of 35 percent in the previous year. The increase in the annual tax rate was primarily attributable to a decrease in the book benefit of Federal Deposit Insurance Corporation assistance, increased taxes incurred on non-deductible goodwill associated with the disposition of Temple-Inland Food Service and losses in foreign operations for which no financial benefit was recognized.

IMPACT OF YEAR 2000 ISSUES

In 1996, the company began to address the forthcoming millennium date and what is frequently referred to in data processing as the "year 2000 problem." Discussions were initiated with major suppliers, customers and financial institutions to ensure that those parties have appropriate plans to remediate year 2000 issues, where their systems interface with the company's systems or otherwise impact its operations.

Comprehensive year 2000 initiatives are being directed and managed by both internal and external resources. These initiatives are designed to effect an orderly transition into the new millennium without adversely affecting the company's core operations and to ensure that transactions with customers, suppliers and financial institutions are fully supported.

The company is well under way with its project plans and expects to complete business systems corrections by December 31, 1998. Test environments are fully operational and will be available for testing to begin in 1998 and continue into 1999 in order to implement ongoing business and manufacturing changes with no negative impact on previous year 2000 corrections.

The company has evaluated the year 2000 readiness of the control systems used in manufacturing. No significant problems were discovered, but work plans have been detailed with tasks and resources identified for becoming year 2000 ready in these operations.

The total cost of year 2000 readiness is expected to be $12.8 million, of which $2.2 million has been expended. This cost is not material to the company's results of operations or financial position.

PENDING ACCOUNTING POLICY CHANGES

In June 1997, the Financial Accounting Standards Board (FASB) issued Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, which establishes new standards for reporting information about operating segments in both annual and interim financial statements. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. The company will adopt the new requirements retroactively in 1998. Management has not completed its review of Statement 131, but does not anticipate that the adoption of this statement will have a significant effect on the company's reported segments.

In June 1997, the FASB issued Statement 130, *Reporting Comprehensive Income*, which establishes new rules for the reporting and display of comprehensive income and its components, effective first quarter 1998. Under the new statement, the company would be required to include unrealized gains or losses on the company's available-for-sale securities and foreign currency translation adjustments that are currently reported in shareholders' equity, in other comprehensive income and to disclose the total comprehensive income. If the company adopted Statement 130 for the year 1997, the total of other comprehensive income would be $55 million.

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SELECTED FINANCIAL DATA

For the year	1997*	1996	1995	1994	1993	1992	1991	1990	1989	1988
(dollars in millions, except per share data)										
Total revenues	**$ 3,625**	$ 3,460	$ 3,495	$ 2,967	$ 2,762	$ 2,734	$ 2,507	$ 2,401[a]	$ 1,943	$ 1,814
Manufacturing net sales	**2,680**	2,645	2,731	2,335	2,127	2,096	1,898	1,892	1,894	1,774
Net income	**51**	133	281	131	117[b]	147	138	232[a]	207	199
Capital expenditures:										
Manufacturing	**233**	275	386	463	340	359	378	324	260	219
Financial services	**18**	15	34	20	14	11	9	4	9	4
Depreciation and depletion:										
Manufacturing	**255**	244	208	200	191	167	158	140	126	112
Financial services	**13**	10	8	8	6	5	4	5	2	2
Earnings per share:										
Basic	**0.91**	2.39	5.02	2.35	2.12[b]	2.66	2.53	4.24[a]	3.78	3.61
Diluted	**0.90**	2.39	5.01	2.35	2.11[b]	2.65	2.51	4.20[a]	3.75	3.58
Dividends per common share	**1.28**	1.24	1.14	1.02	1.00	0.96	0.88	0.80	0.58	0.42
Weighted average shares outstanding:										
Basic	**56.0**	55.5	56.0	55.8	55.3	55.1	54.8	54.9	54.9	55.2
Diluted	**56.2**	55.6	56.1	55.9	55.5	55.5	55.2	55.4	55.3	55.7
Common shares outstanding at year end	**56.3**	55.4	55.7	56.0	55.5	55.2	54.9	54.6	54.9	55.2
AT YEAR END										
Total assets	**$ 14,364**	$12,947	$12,764	$12,251	$11,959	$10,766	$10,068	$ 7,834[c]	$ 2,380	$ 2,247
Long-term debt:										
Parent Company	**1,438**	1,522	1,489	1,316	1,045	964	864	501	399	417
Financial services	**167**	133	113	82	76	99	76	94	30	25
Preferred stock issued by subsidiary	**150**	—	—	—	—	—	—	—	—	—
Ratio of total debt to total capitalization - Parent Company	**41%**	43%	43%	43%	38%	38%	36%	26%	24%	29%
Shareholders' equity	**2,045**	2,015	1,975	1,783	1,700	1,633	1,532	1,439	1,259	1,096

*Includes effects of acquiring Stockton Savings Bank and Knutson Mortgage Company.
[a]Includes operating results from consolidation of Guaranty Federal Bank, F.S.B., beginning January 1, 1990.
[b]Includes a credit of $50 million or $0.90 per share from cumulative effect of accounting changes.
[c]Includes savings bank assets from consolidation of Guaranty Federal Bank, F.S.B., beginning January 1, 1990.

COMMON STOCK PRICES AND DIVIDEND INFORMATION

	1997			1996		
	Price Range			Price Range		
	High	Low	Dividends	High	Low	Dividends
1st Quarter	**$ 57**	**$ 52**	**$ 0.32**	$ 48-1/4	$ 39-3/4	$ 0.30
2nd Quarter	**62-1/8**	**49-5/8**	**0.32**	51-7/8	45-1/2	0.30
3rd Quarter	**69-7/16**	**56-1/8**	**0.32**	53-1/8	47	0.32
4th Quarter	**65-7/8**	**49-11/16**	**0.32**	55-3/8	48-3/8	0.32
For the year	**$69-7/16**	**$ 49-5/8**	**$ 1.28**	$ 55-3/8	$ 39-3/4	$ 1.24

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SUMMARIZED STATEMENTS OF INCOME

Parent Company (Temple-Inland Inc.)

For the year *(in millions)*	**1997**	1996	1995
REVENUES			
Net sales	**$ 2,680**	$ 2,645	$ 2,731
Financial services earnings	**132**	63	98
	2,812	2,708	2,829
COSTS AND EXPENSES			
Cost of sales	**2,348**	2,198	2,067
Selling and administrative	**265**	249	262
	2,613	2,447	2,329
OPERATING INCOME	**199**	261	500
Interest expense - net	**(110)**	(110)	(73)
Other	**6**	5	4
INCOME BEFORE TAXES	**95**	156	431
Taxes on income	**44**	23	150
NET INCOME	**$ 51**	$ 133	$ 281

See the notes to the Parent Company summarized financial statements.

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SUMMARIZED BALANCE SHEETS

Parent Company (Temple-Inland Inc.)

At year end *(in millions)*	**1997**	1996
ASSETS		
CURRENT ASSETS		
Cash	**$ 13**	$ 14
Receivables, less allowances of $9 in 1997 and $9 in 1996	**281**	295
Inventories:		
Work in process and finished goods	**109**	107
Raw materials	**230**	220
	339	327
Prepaid expenses	**15**	13
Total current assets	**648**	649
INVESTMENT IN TEMPLE-INLAND FINANCIAL SERVICES	**576**	592
PROPERTY AND EQUIPMENT		
Buildings	**554**	516
Machinery and equipment	**3,689**	3,576
Less allowances for depreciation	**(2,086)**	(1,882)
	2,157	2,210
Construction in progress	**115**	106
	2,272	2,316
Timber and timberlands - less depletion	**507**	503
Land	**34**	31
Total property and equipment	**2,813**	2,850
OTHER ASSETS	**163**	161
TOTAL ASSETS	**$ 4,200**	$ 4,252
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	**$ 135**	$ 143
Accrued expenses	**150**	140
Employee compensation and benefits	**23**	28
Current portion of long-term debt	**3**	8
Total current liabilities	**311**	319
LONG-TERM DEBT	**1,438**	1,522
DEFERRED INCOME TAXES	**252**	234
POSTRETIREMENT BENEFITS	**140**	136
OTHER LIABILITIES	**14**	26
SHAREHOLDERS' EQUITY	**2,045**	2,015
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$ 4,200**	$ 4,252

See the notes to the Parent Company summarized financial statements.



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SUMMARIZED STATEMENTS OF CASH FLOWS

Parent Company (Temple-Inland Inc.)

For the year *(in millions)*	**1997**	1996	1995
CASH PROVIDED BY (USED FOR) OPERATIONS			
Net income	**$ 51**	$ 133	$ 281
Adjustments to reconcile net income to net cash:			
Depreciation and depletion	**255**	244	208
Deferred taxes	**18**	(29)	29
Unremitted earnings from financial services	**(111)**	(39)	(71)
Receivables	**7**	(11)	(42)
Inventories	**(30)**	23	(71)
Accounts payable and accrued expenses	**(7)**	(27)	(46)
Other	**(12)**	19	(2)
	171	313	286
CASH PROVIDED BY (USED FOR) INVESTMENTS			
Capital expenditures	**(233)**	(275)	(386)
Proceeds from sale of property and equipment	**52**	5	15
Acquisitions and joint ventures, net of cash acquired	**(9)**	(27)	(2)
Capital contributions to financial services	**(25)**	—	(35)
Acquisition of California Financial Holding Company, net of cash acquired	**(22)**	—	—
Dividends from financial services	**275**	50	50
	38	(247)	(358)
CASH PROVIDED BY (USED FOR) FINANCING			
Additions to debt	**36**	213	175
Payments of debt	**(125)**	(198)	(15)
Purchase of stock for treasury	**(59)**	(16)	(24)
Cash dividends paid to shareholders	**(71)**	(69)	(64)
Other	**9**	3	2
	(210)	(67)	74
Net increase (decrease) in cash	**(1)**	(1)	2
Cash at beginning of year	**14**	15	13
Cash at end of year	**$ 13**	$ 14	$ 15

See the notes to the Parent Company summarized financial statements.

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NOTES TO THE PARENT COMPANY (TEMPLE-INLAND INC.) SUMMARIZED FINANCIAL STATEMENTS

NOTE A - Summary of Significant Accounting Policies

BASIS OF PRESENTATION

The summarized financial statements include the accounts of the Parent Company (Temple-Inland Inc.) and its manufacturing subsidiaries. Temple-Inland Financial Services, including the savings bank, mortgage banking and real estate development operations, is reflected in the summarized financial statements on the equity basis, except that related earnings are presented before tax to be consistent with the consolidated financial statements. Refer to pages 40 through 49 for Temple-Inland Financial Services' summarized financial statements. All material intercompany amounts and transactions have been eliminated. These financial statements should be read in conjunction with Temple-Inland Inc.'s consolidated financial statements.

INVENTORIES

Inventories are stated at the lower of cost or market.

Cost of inventories amounting to $118.5 million at year end 1997 and $112.8 million at year end 1996 was determined by the last-in, first-out method (LIFO). The cost of the remaining inventories was determined principally by the average cost method, which approximates the first-in, first-out method (FIFO).

If the FIFO method of accounting had been applied to those inventories that were costed on the LIFO method, inventories would have been $19.3 million and $18.4 million higher than reported at year end 1997 and 1996, respectively.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost, less allowances for accumulated depreciation and depletion. Depreciation is generally provided on the straight-line method based on estimated useful lives as follows:

CLASSIFICATION	ESTIMATED USEFUL LIVES
Buildings	15 to 40 years
Machinery and equipment:	
Manufacturing and production equipment	3 to 25 years
Transportation equipment	3 to 10 years
Office and other equipment	2 to 10 years

Certain equipment is being depreciated based on operating hours because depreciation occurs primarily through use rather than through elapsed time.

Timberlands are stated at cost, less accumulated cost of timber harvested. The portion of the cost of timberlands attributed to standing timber is charged against income, as timber is harvested at rates determined annually, based on the relationship of unamortized timber costs to the estimated volume of recoverable timber. The cost of seedlings and reforestation of timberlands is capitalized.

The cost of additions and betterments is capitalized, and the cost of maintenance and repairs is expensed.

START-UP COSTS

Start-up costs associated with major new facilities are deferred and amortized on a straight-line basis over a five-year period. The unamortized balances of these costs were approximately $4.6 million and $6.7 million, at the end of 1997 and 1996, respectively.

ENVIRONMENTAL LIABILITIES

Environmental expenditures resulting in additions to property and equipment are capitalized, while other environmental expenditures are expensed. Environmental remediation liabilities are recorded on an undiscounted basis when environmental assessments or cleanups are probable and the costs can be reasonably estimated. These costs are adjusted as further information develops or circumstances change. The estimated costs to close and remediate company-operated landfills are accrued over the estimated useful life of the landfill.

REVENUE RECOGNITION

Revenue is recognized upon passage of title to the customer, which is generally at the time of shipment.

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NOTE B - Long-Term Debt

Long-term debt consists of the following:

At year end *(in millions)*	**1997**	1996
Commercial Paper — Average interest rate was 5.66% in 1997 and 5.36% in 1996	**$ 13.5**	$ 124.7
8.85% to 9.0% Notes Payable due 1998	**90.0**	95.0
9.0% Notes Payable due 2001	**200.0**	200.0
8.125% to 8.38% Notes Payable due 2006	**100.0**	100.0
7.25% Notes Payable due 2004	**100.0**	100.0
8.25% Debentures due 2022	**150.0**	150.0
Private placement debt — 6.59% to 7.31% Notes due 1998 through 2007	**338.0**	338.0
Term Note due 2002 — Average interest rate was 5.86% in 1997 and 5.69% in 1996	**200.0**	200.0
Revenue Bonds due 2007 through 2028 — Average interest rate was 3.94% in 1997 and 3.74% in 1996	**191.1**	189.9
Other indebtedness due through 2006 — Average interest rate was 6.37% in 1997 and 7.40% in 1996	**58.0**	31.9
	1,440.6	1,529.5
LESS:		
Current portion of long-term debt	**(2.5)**	(8.0)
	$1,438.1	$1,521.5

At January 3, 1998, the company had multiyear revolving credit agreements with banks totaling $580 million, with final maturities at various dates in 2000 that support commercial paper and other short-term borrowings. Commercial paper totaling $13.5 million and current maturities of medium-term notes totaling $170 million are classified as long-term debt in accordance with the company's intent and ability to refinance such obligations on a long-term basis.

Maturities of the Parent Company's long-term debt during the next five years are as follows (in millions): 1998—$173; 1999—$74; 2000—$101; 2001—$204; and 2002—$258.
For an analysis of net interest expense, see page 33.

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SUMMARIZED STATEMENTS OF INCOME

Financial Services Group

For the year *(in millions)*	**1997**	1996	1995
INTEREST INCOME			
Loans receivable and mortgage loans held for sale	**$ 526**	$ 426	$ 369
Mortgage-backed and investment securities	**161**	184	209
Other earning assets, including covered assets in 1996 and 1995	**22**	21	41
Total interest income	**709**	631	619
INTEREST EXPENSE			
Deposits	**331**	308	313
Borrowed funds	**157**	127	121
Total interest expense	**488**	435	434
NET INTEREST INCOME	**221**	196	185
Provision for loan losses	**(2)**	14	15
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	**223**	182	170
NONINTEREST INCOME			
Loan origination, marketing and servicing fees	**127**	87	59
Other	**109**	97	86
Total noninterest income	**236**	184	145
NONINTEREST EXPENSE			
Compensation and benefits	**134**	105	91
Other	**186**	154	126
SAIF assessment expense	**—**	44	—
Total noninterest expense	**320**	303	217
INCOME BEFORE TAXES AND MINORITY INTEREST	**139**	63	98
Minority interest in income of consolidated subsidiary	**(7)**	—	—
INCOME BEFORE TAXES	**132**	63	98
Taxes on income	**21**	24	27
NET INCOME	**$ 111**	$ 39	$ 71

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SUMMARIZED BALANCE SHEETS

Financial Services Group

At year end *(in millions)*	**1997**	1996
ASSETS		
Cash and cash equivalents	**$ 175**	$ 214
Mortgage loans held for sale	**439**	244
Loans receivable	**6,451**	5,414
Mortgage-backed and investment securities	**2,806**	2,783
Other assets	**914**	680
TOTAL ASSETS	**$10,785**	$ 9,335
LIABILITIES		
Deposits	**$ 7,375**	$ 6,263
Securities sold under repurchase agreements	**270**	959
Federal Home Loan Bank advances	**1,685**	1,033
Other borrowings	**167**	133
Other liabilities	**562**	355
Preferred stock issued by subsidiary	**150**	—
TOTAL LIABILITIES	**10,209**	8,743
SHAREHOLDERS' EQUITY	**576**	592
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$10,785**	$ 9,335

See the notes to Financial Services Group summarized financial statements.

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SUMMARIZED STATEMENTS OF CASH FLOWS

Financial Services Group

For the year *(in millions)*	**1997**	1996	1995
CASH PROVIDED BY (USED FOR) OPERATIONS			
Net income	**$ 111**	$ 39	$ 71
Adjustments to reconcile net income to net cash:			
Provision for amortization, depreciation and accretion	**43**	33	27
Gain on sales of securities available-for-sale	**3**	—	(2)
Receivable from FDIC	**—**	7	(18)
Mortgage loans held for sale	**(99)**	(88)	24
Collections and remittances on loans serviced for others, net	**193**	(7)	96
Other	**(70)**	(72)	(9)
	181	(88)	189
CASH PROVIDED BY (USED FOR) INVESTMENTS			
Purchases of securities available-for-sale	**(121)**	(4)	(54)
Maturities of securities available-for-sale	**210**	98	12
Maturities and redemptions of securities held-to-maturity	**308**	322	391
Loans originated or acquired, net of principal collected on loans	**(1,084)**	(672)	(1,009)
Proceeds from sale of securities available-for-sale	**844**	206	192
Reduction in covered assets	**—**	—	343
Acquisitions	**(13)**	(11)	—
Capital expenditures	**(18)**	(15)	(34)
Other	**28**	2	(22)
	154	(74)	(181)
CASH PROVIDED BY (USED FOR) FINANCING			
Net increase (decrease) in deposits	**128**	(112)	(217)
Securities sold under repurchase agreements and short-term borrowings, net	**(609)**	285	239
Additions to debt	**411**	68	181
Payments of debt	**(204)**	(151)	(150)
Capital contributions from Parent Company	**25**	—	35
Proceeds from sale of subsidiary preferred stock	**150**	—	—
Dividends paid to Parent Company	**(275)**	(50)	(50)
Other	**—**	(7)	(5)
	(374)	33	33
Net increase (decrease) in cash and cash equivalents	**(39)**	(129)	41
Cash and cash equivalents at beginning of year	**214**	343	302
Cash and cash equivalents at end of year	**$ 175**	$ 214	$ 343

See the notes to Financial Services Group summarized financial statements.

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NOTES TO FINANCIAL SERVICES GROUP SUMMARIZED FINANCIAL STATEMENTS

NOTE A - Summary of Significant Accounting Policies

BASIS OF PRESENTATION

Temple-Inland Financial Services Group (group) summarized financial statements include savings bank, mortgage banking, real estate development activities and insurance operations. All material intercompany amounts and transactions have been eliminated. These financial statements should be read in conjunction with Temple-Inland Inc.'s consolidated financial statements.

MORTGAGE LOANS HELD FOR SALE

Mortgage loans originated and intended for sale are carried at the lower of cost or estimated market in the aggregate. Net unrealized losses are recognized in a valuation allowance by charges to income.

LOANS RECEIVABLE

Loans receivable are stated at unpaid principal balances, less the allowance for loan losses and net deferred loan origination fees and costs. The allowance for loan losses is increased by charges to income and by the portion of the purchase price related to credit risk on bulk purchases of loans, and decreased by charge-offs, net of recoveries. Management's periodic evaluation of the adequacy of the allowance is based on the group's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and current economic conditions.

Interest on loans receivable is credited to income as earned. The accrual of interest ceases when collection becomes doubtful. When interest accrual ceases, uncollected interest previously credited to income is reversed. Certain loan fees and direct loan origination costs are deferred. These net fees or costs, as well as premiums and discounts on loans, are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments. Any unamortized loan fees or costs, premiums or discounts are taken to income in the event a loan is sold or repaid.

MORTGAGE-BACKED AND INVESTMENT SECURITIES

The group determines the appropriate classification of mortgage-backed and investment securities at the time of purchase and confirms such designation as of each balance sheet date. Debt securities are classified as held-to-maturity and stated at amortized cost when the group has both the intent and ability to hold the securities to maturity. Otherwise, debt securities and marketable equity securities are classified as available-for-sale and are stated at fair value with any unrealized gains and losses, net of tax, reported as a component of shareholders' equity.

The cost of securities classified as held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts by a method that approximates the interest method over the estimated lives of the securities. Should any such assets be sold, gains and losses are recognized based on the specific-identification method.

DERIVATIVE FINANCIAL INSTRUMENTS

The operations of Guaranty Federal Bank (Guaranty) are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in differing amounts. To maintain acceptable levels of interest rate and liquidity risk, Guaranty enters into various types of interest rate contracts for purposes other than trading.

The net amount payable or receivable on interest rate contracts is recorded as an adjustment to interest income or expense (the accrual accounting method). Premiums paid for purchased interest rate cap agreements, net of premiums received for those sold, are included in the carrying value of the related interest-earning assets or interest-bearing liabilities, and amortized as an adjustment to the yield of the designated assets or liabilities over the contract periods. These interest rate contracts had no significant impact on the group's effective interest yield for the years 1997, 1996 and 1995.

REAL ESTATE

Real estate consists primarily of land and commercial properties held for development and sale, although the company also holds certain properties for the production of income. Interest on indebtedness and property taxes during the development period, as well as improvements and other development costs, are generally capitalized. The cost of land sales is determined using the relative sales value method. Real estate also includes properties acquired through loan foreclosure by Guaranty and Temple-Inland Mortgage Corporation (TIMC).

Real estate held for future development and real estate projects that are being developed are evaluated for impairment in accordance with the recognition and measurement provisions governing long-lived assets to be held and used in operations. Real estate projects that are substantially completed and ready for their intended use are measured at the lower of carrying amount or estimated fair value, less cost to sell, in accordance with the provisions governing long-lived assets to be disposed of.

MORTGAGE LOAN SERVICING RIGHTS

The group allocates a portion of the cost of originating a mortgage loan to the mortgage servicing right based on its fair value relative to the loan as a whole. Capitalized mortgage loan servicing rights are amortized in proportion to, and over the period of, estimated net servicing revenues.

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The fair market value of originated mortgage servicing rights is estimated using buyers' quoted prices for servicing rights with similar attributes, such as loan type, size, escrow and geographic location. Purchased mortgage servicing rights are recorded at cost.

To evaluate for possible impairment of mortgage servicing rights, the portfolio is periodically stratified based on predominant risk characteristics and the capitalized basis of each stratum is compared to fair value. Predominant risk characteristics considered include, among others, loan type and interest rate. Should the capitalized mortgage servicing rights, net of amortization, exceed fair value, impairment is recognized through a valuation allowance.

FEDERAL INCOME TAXES

The group is included in the consolidated income tax return filed by the Parent Company. Under an agreement with the Parent Company, current federal income taxes are allocated to the group in proportion to its contribution to consolidated taxable income after consideration of certain tax attributes. The group's reduced 1997 effective tax rate reflects benefits from the Parent Company's low overall current tax rate. Deferred income taxes are recorded by the group.

NOTE B - Acquisitions

On June 27, 1997, the Parent Company acquired all of the outstanding stock of California Financial Holding Company, the parent company of Stockton Savings Bank, F.S.B. (SSB), and merged the operations of SSB into Guaranty. Total assets and liabilities of SSB at acquisition were approximately $1.4 billion (primarily loans and securities) and $1.3 billion (primarily deposits and FHLB advances), respectively. At closing, the company issued approximately 1,614,000 shares of common stock valued at $96.1 million and paid approximately $47.3 million in cash. The excess of purchase price over the fair market value of net assets acquired, of approximately $63 million, is being amortized on the straight-line method over 25 years.

Effective May 31, 1997, TIMC acquired 100 percent of the common stock of Knutson Mortgage Corporation, a corporation engaged in mortgage banking activities, for a purchase price of approximately $14.6 million. Effective February 1, 1996, TIMC acquired all of the stock of Western Cities Mortgage Corporation, a California-based mortgage banking entity, for a purchase price of $11.5 million. These transactions in 1997 and 1996 increased the production branch network by a total of 50 branches and the principal balance of the loan servicing portfolio by approximately $6.4 billion and $875 million, respectively.

These acquisitions were accounted for under the purchase method of accounting and, accordingly, the acquired assets and liabilities were adjusted to their estimated fair values at the date of the acquisitions. The operating results are included in the accompanying summarized financial statements from the acquisition dates. The unaudited pro forma results of operations, assuming the acquisitions had been effected as of the beginning of the applicable fiscal year, would not have been materially different from those reported.

NOTE C - Termination Agreements

In connection with the acquisition of Guaranty in 1988, the company entered into an assistance agreement (Assistance Agreement) with the Federal Savings and Loan Insurance Corporation (FSLIC). Pursuant to the Assistance Agreement, the FSLIC agreed to provide continuing financial assistance to Guaranty consisting of notes from the FSLIC, guaranteed yield on the book value of assets acquired from the FSLIC (Covered Assets), and protection against losses on the book value of the Covered Assets. Pursuant to the Assistance Agreement, the company also received various tax benefits to be shared with the Federal Deposit Insurance Corporation (FDIC) when the cash benefits were realized by the company. During the term of the Assistance Agreement, the company recorded these tax-sharing liabilities on an undiscounted basis.

On October 31, 1995, the company and Guaranty entered into a series of agreements (Termination Agreements) with the FDIC, terminating the Assistance Agreement. Pursuant to the Termination Agreement, Guaranty received approximately $208 million in payment for the difference between the transfer value of certain of the Covered Assets and the amount owed by Guaranty for the present value of the tax benefits received from the Assistance Agreement. Guaranty also received an additional payment of $9 million representing its portion of the gain-sharing on asset dispositions, as provided in the Assistance Agreement. The remainder of the Covered Assets were retained by Guaranty without any ongoing assistance.

NOTE D - Loans Receivable

Loans receivable consisted of the following:

At year end	**1997**	1996
(in millions)		
Real estate mortgage	**$ 4,414.1**	$4,198.5
Construction and development (including residential)	**2,975.1**	2,152.4
Commercial and business	**1,253.0**	658.8
Consumer and other	**590.2**	467.2
	9,232.4	7,476.9
LESS:		
Unfunded portion of loans	**2,709.7**	2,002.8
Unamortized purchase premiums and discounts	**(21.3)**	(11.8)
Net deferred fees	**2.0**	3.6
Allowance for loan losses	**91.1**	68.4
	2,781.5	2,063.0
	$ 6,450.9	$5,413.9

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Real estate and construction loans are secured primarily by one- to four-family residential or commercial properties located in Texas and California. At year end 1997, the group had commitments to originate or purchase primarily variable-rate loans totaling $818 million. The amount to be ultimately funded is uncertain.

Activity in the allowance for loan losses was as follows:

For the year	1997	1996	1995
(in millions)			
Balance, beginning of year	$ 68.4	$ 65.5	$ 53.9
Provision for loan losses	(1.7)	13.8	14.6
Additions related to acquisitions and bulk purchases of loans, net of adjustments	30.4*	(0.7)	4.2
Charge-offs, net of recoveries	(6.0)	(10.2)	(7.2)
Balance, end of year	$ 91.1	$ 68.4	$ 65.5

**Principally related to the acquisition of the loan portfolio of Stockton Savings Bank, F.S.B.*

NOTE E - Mortgage-Backed and Investment Securities

The amortized cost and fair values of mortgage-backed and investment securities consisted of the following:

At year end **1997**	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(in millions)				
HELD-TO-MATURITY				
Mortgage-backed securities:				
FNMA certificates	$ 924.8	$ 0.1	$ (27.3)	$ 897.6
FHLMC certificates	186.9	—	(5.7)	181.2
GNMA certificates	—	—	—	—
Collateralized mortgage obligations	253.1	—	(8.7)	244.4
Private issuer pass-through securities	403.5	—	(10.1)	393.4
	1,768.3	0.1	(51.8)	1,716.6
AVAILABLE-FOR-SALE				
Mortgage-backed securities:				
FNMA certificates	892.3	2.8	(5.7)	889.4
FHLMC certificates	2.3	—	—	2.3
GNMA certificates	0.1	—	—	0.1
Collateralized mortgage obligations	1.0	0.1	—	1.1
Private issuer pass-through securities	57.8	—	(2.6)	55.2
	953.5	2.9	(8.3)	948.1
Debt securities:				
Corporate securities	3.0	—	—	3.0
Equity securities, primarily Federal Home Loan Bank stock	85.8	0.4	—	86.2
	$1,042.3	$ 3.3	$ (8.3)	$1,037.3

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At year end 1996	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(in millions)				
HELD-TO-MATURITY				
Mortgage-backed securities:				
FNMA certificates	$1,041.1	$ —	$ (35.7)	$1,005.4
FHLMC certificates	212.0	—	(7.2)	204.8
Collateralized mortgage obligations	309.1	—	(14.6)	294.5
Private issuer pass-through securities	521.5	—	(18.8)	502.7
	2,083.7	—	(76.3)	2,007.4
AVAILABLE-FOR-SALE				
Mortgage-backed securities:				
FNMA certificates	533.7	—	(8.3)	525.4
FHLMC certificates	53.5	—	(0.7)	52.8
GNMA certificates	0.2	—	—	0.2
Collateralized mortgage obligations	1.1	—	—	1.1
Private issuer pass-through securities	67.9	—	(3.5)	64.4
	656.4	—	(12.5)	643.9
Debt securities:				
Corporate securities	3.0	—	—	3.0
Equity securities, primarily Federal Home Loan Bank stock	52.7	0.2	—	52.9
	$ 712.1	$ 0.2	$ (12.5)	$ 699.8

The mortgage loans underlying mortgage-backed securities have adjustable interest rates and generally have contractual maturities ranging from 15 to 40 years, with principal and interest installments due monthly. The actual maturities of mortgage-backed securities may differ from the contractual maturities of the underlying loans because issuers or mortgagors may have the right to call or prepay their securities or loans.

Certain mortgage-backed and investment securities are guaranteed directly or indirectly by the U.S. government or its agencies. Other mortgage-backed securities, which are not guaranteed by the U.S. government or its agencies, are senior subordinated securities considered investment-grade quality by third-party rating agencies. The collateral underlying these securities is primarily residential properties located in California. During 1997, Guaranty securitized $962 million of mortgage loans previously held in portfolio. At year end 1997, the group held $768 million in such securities.

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NOTE F - Deposits

Deposits consisted of the following:

At year end	1997		1996	
	Stated Rate	Amount	Stated Rate	Amount
(dollars in millions)				
Noninterest-bearing demand	—	$ 160.0	—	$ 123.7
Interest-bearing demand	2.55%	1,107.7	2.70%	970.6
Savings deposits	2.27%	205.9	2.29%	174.8
Time deposits	5.63%	5,900.3	5.53%	4,992.8
		7,373.9		6,261.9
Deposit premium		0.9		1.2
		$7,374.8		$6,263.1

Scheduled maturities of time deposits at year end 1997 are as follows:

Time deposits	$100,000 or more	Less than $100,000	Total
(in millions)			
3 months or less	$ 160.8	$ 870.7	$ 1,031.5
Over 3 through 6 months	158.4	1,069.6	1,228.0
Over 6 through 12 months	198.1	1,220.0	1,418.1
Over 12 months	295.7	1,927.0	2,222.7
	$ 813.0	$5,087.3	$5,900.3

A summary of interest paid by the group is shown below:

For the year	1997	1996	1995
(in millions)			
Interest on deposits	$ 333.4	$ 310.8	$ 317.7
Interest on borrowed funds	160.5	128.7	115.9
	$ 493.9	$ 439.5	$ 433.6

At year end 1997, time deposits maturity dates were as follows (in millions): 1998—$3,677.6; 1999—$1,227.9; 2000—$400.2; 2001—$336.6; 2002—$253.5; 2003 and thereafter—$4.5.

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NOTE G - Securities Sold Under Repurchase Agreements

Securities sold under repurchase agreements were delivered to brokers/dealers who retained such securities as collateral for the borrowings and have agreed to resell the same securities back to Guaranty at the maturities of the agreements. The agreements generally mature within 30 days.

Information concerning borrowings under repurchase agreements is summarized as follows:

	1997	1996
(dollars in millions)		
At year end		
Weighted average interest rate	**5.90%**	5.49%
Mortgage-backed securities pledged to secure the agreements:		
Carrying value	**$ 287.8**	$1,017.3
Estimated market value	**281.3**	988.3
For the year		
Average daily balance	**1,297.1**	1,484.3
Maximum month-end balance	**1,696.6**	1,992.4

NOTE H - Federal Home Loan Bank Advances

Pursuant to collateral agreements with the Federal Home Loan Bank of Dallas (FHLB), advances are secured by a blanket floating lien on Guaranty's assets and by securities on deposit at the FHLB. The weighted average interest rate of the advances was 6.01 percent and 5.66 percent at year end 1997 and 1996, respectively. At year end 1997, the advances had calendar year maturity dates as follows (in millions): 1998—$1,216.4;1999—$441.6; 2000—$10.0; 2001—$5.0; 2002—$0; 2003 and thereafter—$12.0.

NOTE I - Other Borrowings

Other borrowings, which represent borrowings of non-savings bank entities, consisted of the following:

At year end	1997	1996
(in millions)		
Long-term debt with an average rate of 7.16% and 6.97% during 1997 and 1996, respectively, due through 2000	**$ 147.0**	$ 114.0
Long-term debt at various rates which approximate prime, secured primarily by real estate	**20.5**	19.4
	$ 167.5	$ 133.4

At year end 1997, a non-savings bank subsidiary had a $192 million credit facility that expires in 2000, with $45 million remaining unused.

Maturities of other borrowings are as follows (in millions): 1998—$5.0; 1999—$18.4; 2000—$132.6; 2001—$1.2; 2002—$0.8; 2003 and thereafter—$9.5.

NOTE J - Preferred Stock Issued By Subsidiary

In May 1997, Guaranty formed a real estate investment trust for the purpose of acquiring, holding and managing real estate mortgage assets. The subsidiary issued 150,000 shares of noncumulative floating-rate preferred stock, with quarterly cash dividends at a floating rate based on LIBOR (7.2% at year end 1997). The preferred stock has a liquidation preference of $1,000 per share. The stock is currently callable at a premium and, in certain limited circumstances, is convertible to Guaranty preferred stock. The preferred stock qualifies for inclusion in regulatory capital, subject to certain limitations.

NOTE K - Mortgage Loan Servicing

The group services mortgage loans that are owned primarily by independent investors. The group serviced approximately 351,600 and 225,700 mortgage loans aggregating $26.1 billion and $17.9 billion in outstanding principal balance as of December 31, 1997, and 1996, respectively.

This group is required to advance, from company funds, escrow and foreclosure costs on loans that it services. The majority of these advances are recoverable, except for certain amounts for loans serviced for GNMA, which are reserved. Market risk is assumed related to disposing of certain foreclosed VA loans. No significant losses were incurred during 1997, 1996 or 1995 in connection with this risk.

Capitalized mortgage loan servicing rights, net of accumulated amortization, were as follows:

	Purchased Loan Servicing Rights, Net	Originated Loan Servicing Rights, Net
(in millions)		
Balance, beginning of year	**$ 84.1**	**$ 24.7**
Additions	**92.3**[a]	**22.8**
Amortization	**(17.0)**	**(5.2)**
Basis in servicing sold	**(0.4)**	**—**
Balance, end of year	**$ 159.0**	**$ 42.3**

[a] *Includes approximately $74 million relating to the acquisition of KMC.*

The estimated fair value of the capitalized mortgage servicing rights at year end 1997 was $223 million. Fair value was determined utilizing market-driven assumptions for prepayment speeds, discount rates and other variables.

NOTE L - Interest Rate Risk Management

Guaranty is a party to various interest rate corridor agreements to reduce the impact of increases in interest rates on its investments in adjustable-rate mortgage-backed securities that have lifetime interest rate caps. Under these agreements, with notional amounts totaling $379 million and $442 million at year end 1997 and 1996, respectively, Guaranty simultaneously purchased and sold caps whereby it receives interest if the variable rate, based on FHLB Eleventh District Cost of Funds Index (EDCOF) (4.95 percent at year end 1997), exceeds an average strike rate of 8.80 percent, and pays interest if the same variable rate exceeds a strike rate of 11.75 percent. These agreements mature through 2003.

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Guaranty is also a party to an interest rate cap agreement to reduce the impact of interest rate increases on certain adjustable rate investments with lifetime caps. Under this agreement, with a notional amount of $29 million, Guaranty would receive payments if the EDCOF exceeds the strike rate of 10 percent. The agreement matures in 2004.

The amounts potentially subject to credit risks are the streams of payments receivable by Guaranty under the terms of the contracts and not the notional amounts used to express the volumes of these transactions. Guaranty minimizes its exposure to such credit risk by entering into contracts with major U.S. securities firms.

NOTE M - Regulatory Capital Matters

Guaranty is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly discretionary, actions by regulators that, if undertaken, could have a direct material effect on Guaranty's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Guaranty must meet specific capital guidelines that involve quantitative measures of Guaranty's assets, liabilities and certain off-balance-sheet items, as calculated under regulatory accounting practices. Guaranty's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. The payment of dividends from Guaranty is subject to proper regulatory notification.

Quantitative measures established by regulation to ensure capital adequacy require Guaranty to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital to risk-weighted assets, and of Tier I capital to adjusted tangible assets. Management believes, as of year end 1997, Guaranty met all its capital adequacy requirements.

As of year end 1997, the most recent notification from regulators categorized Guaranty as well capitalized under the regulatory framework for prompt corrective action. To be so categorized as well capitalized, Guaranty must maintain minimum total risk-based, Tier I (Core) risk-based, and Tier I (Core) leverage capital ratios, as set forth in the table. There are no conditions or events since that notification that management believes have changed Guaranty's category.

Guaranty's actual capital amounts and ratios are also presented in the table below. No amounts were deducted from capital for interest rate risk at December 31, 1997, or 1996.

	Actual		*For Capital Adequacy Purposes*		*To Be Well Capitalized Under Prompt Corrective Action Provisions*	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(dollars in millions)						
At year end **1997**:						
Total Risk-Based Ratio						
(Risk-based capital/total risk-weight assets)	**$ 651.0**	**10.14%**	**≥$513.7**	**≥8.0%**	**≥$641.9**	**≥10.0%**
Tier I (Core) Risk-Based Ratio						
(Core capital/total risk-weight assets)	**$ 570.7**	**8.89%**	**≥$256.8**	**≥4.0%**	**≥$385.2**	**≥6.0%**
Tier I (Core) Leverage Ratio						
(Core capital/adjusted tangible assets)	**$ 570.7**	**5.48%**	**≥$416.4**	**≥4.0%**	**≥$520.5**	**≥5.0%**
Tangible Ratio						
(Tangible capital/tangible assets)	**$ 570.7**	**5.48%**	**≥$156.2**	**≥1.5%**	**N/A**	**N/A**
At year end 1996:						
Total Risk-Based Ratio						
(Risk-based capital/total risk-weight assets)	$ 533.8	10.39%	≥$ 411.1	≥8.0%	≥$ 513.8	≥10.0%
Tier I (Core) Risk-Based Ratio						
(Core capital/total risk-weight assets)	$ 498.2	9.70%	≥$ 205.5	≥4.0%	≥$ 308.3	≥6.0%
Tier I (Core) Leverage Ratio						
(Core capital/adjusted tangible assets)	$ 498.2	5.52%	≥$ 361.1	≥4.0%	≥$ 451.4	≥5.0%
Tangible Ratio						
(Tangible capital/tangible assets)	$ 498.2	5.52%	≥$ 135.4	≥1.5%	N/A	N/A

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CONSOLIDATED STATEMENTS OF INCOME

Temple-Inland Inc. and Subsidiaries

For the year *(in millions, except per share data)*	**1997**	1996	1995
REVENUES			
Manufacturing	**$ 2,680**	$ 2,645	$ 2,731
Financial services	**945**	815	764
	3,625	3,460	3,495
COSTS AND EXPENSES			
Manufacturing	**2,613**	2,447	2,329
Financial services	**813**	752	666
	3,426	3,199	2,995
OPERATING INCOME	**199**	261	500
Parent Company interest, net	**(110)**	(110)	(73)
Other	**6**	5	4
INCOME BEFORE TAXES	**95**	156	431
Taxes on income	**44**	23	150
NET INCOME	**$ 51**	$ 133	$ 281
EARNINGS PER SHARE:			
Basic	**$ 0.91**	$ 2.39	$ 5.02
Diluted	**$ 0.90**	$ 2.39	$ 5.01

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CONSOLIDATED STATEMENTS OF CASH FLOWS

Temple-Inland Inc. and Subsidiaries

For the year	1997	1996	1995
(in millions)			
CASH PROVIDED BY (USED FOR) OPERATIONS			
Net income	$ 51	$ 133	$ 281
Adjustments to reconcile net income to net cash:			
Depreciation and depletion	268	254	216
Deferred taxes	21	(11)	53
Amortization and accretion	29	23	18
Receivable from FDIC	—	7	(18)
Mortgage loans held for sale	(99)	(88)	24
Receivables	7	(11)	(42)
Inventories	(30)	23	(71)
Accounts payable and accrued expenses	(7)	(27)	(46)
Collections and remittances on loans serviced for others, net	193	(7)	96
Other	(81)	(70)	(36)
	352	226	475
CASH PROVIDED BY (USED FOR) INVESTMENTS			
Capital expenditures	(251)	(290)	(420)
Proceeds from sale of property and equipment	53	7	16
Purchases of securities available-for-sale	(121)	(4)	(54)
Maturities of securities available-for-sale	210	98	12
Maturities of securities held-to-maturity	308	322	391
Loans originated or acquired, net of principal collected on loans	(1,084)	(672)	(1,009)
Proceeds from sale of securities available-for-sale	844	206	192
Reduction in covered assets	—	—	343
Acquisitions and joint ventures	(22)	(38)	(2)
Acquisition of California Financial Holding Company, net of cash acquired	(22)	—	—
Other	27	(1)	(23)
	(58)	(372)	(554)
CASH PROVIDED BY (USED FOR) FINANCING			
Additions to debt	447	281	356
Payments of debt	(329)	(349)	(165)
Securities sold under repurchase agreements and short-term borrowings, net	(609)	285	239
Purchase of stock for treasury	(59)	(16)	(24)
Cash dividends paid to shareholders	(71)	(69)	(64)
Net increase (decrease) in deposits	128	(112)	(217)
Proceeds from sale of subsidiary preferred stock	150	—	—
Other	9	(4)	(3)
	(334)	16	122
Net increase (decrease) in cash and cash equivalents	(40)	(130)	43
Cash and cash equivalents at beginning of year	228	358	315
Cash and cash equivalents at end of year	$ 188	$ 228	$ 358

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CONSOLIDATING BALANCE SHEETS

Temple-Inland Inc. and Subsidiaries

At year end **1997**	Parent Company	Financial Services	Consolidated
(in millions)			
ASSETS			
Cash and cash equivalents	**$ 13**	**$ 175**	**$ 188**
Mortgage loans held for sale	**—**	**439**	**439**
Loans receivable	**—**	**6,451**	**6,451**
Mortgage-backed and investment securities	**—**	**2,806**	**2,806**
Trade and other receivables	**281**	**—**	**277**
Inventories	**339**	**—**	**339**
Property and equipment	**2,813**	**103**	**2,916**
Other assets	**178**	**811**	**948**
Investment in Financial Services	**576**	**—**	**—**
TOTAL ASSETS	**$ 4,200**	**$10,785**	**$14,364**
LIABILITIES			
Deposits	**$ —**	**$ 7,375**	**$ 7,375**
Securities sold under repurchase agreements and Federal Home Loan Bank advances	**—**	**1,955**	**1,955**
Other liabilities	**325**	**562**	**871**
Long-term debt	**1,438**	**167**	**1,605**
Deferred income taxes	**252**	**—**	**223**
Postretirement benefits	**140**	**—**	**140**
Preferred stock issued by subsidiary	**—**	**150**	**150**
TOTAL LIABILITIES	**$ 2,155**	**$10,209**	**$ 12,319**
SHAREHOLDERS' EQUITY			
Preferred stock - par value $1 per share: authorized 25,000,000 shares; none issued			**—**
Common stock - par value $1 per share: authorized 200,000,000 shares; issued 61,389,552 shares including shares held in the treasury			**61**
Additional paid-in capital			**356**
Translation and other adjustments			**(20)**
Retained earnings			**1,817**
			2,214
Cost of shares held in the treasury: 5,069,011 shares			**(169)**
TOTAL SHAREHOLDERS' EQUITY			**2,045**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY			**$14,364**

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CONSOLIDATING BALANCE SHEETS

Temple-Inland Inc. and Subsidiaries

At year end 1996 *(in millions)*	Parent Company	Financial Services	Consolidated
ASSETS			
Cash and cash equivalents	$ 14	$ 214	$ 228
Mortgage loans held for sale	—	244	244
Loans receivable	—	5,414	5,414
Mortgage-backed and investment securities	—	2,783	2,783
Trade and other receivables	295	—	292
Inventories	327	—	327
Property and equipment	2,850	81	2,931
Other assets	174	599	728
Investment in Financial Services	592	—	—
TOTAL ASSETS	$ 4,252	$ 9,335	$ 12,947
LIABILITIES			
Deposits	$ —	$ 6,263	$ 6,263
Securities sold under repurchase agreements and Federal Home Loan Bank advances	—	1,992	1,992
Other liabilities	345	355	685
Long-term debt	1,522	133	1,655
Deferred income taxes	234	—	201
Postretirement benefits	136	—	136
TOTAL LIABILITIES	$ 2,237	$ 8,743	$ 10,932
SHAREHOLDERS' EQUITY			
Preferred stock - par value $1 per share: authorized 25,000,000 shares; none issued			—
Common stock - par value $1 per share: authorized 200,000,000 shares; issued 61,389,552 shares including shares held in the treasury			61
Additional paid-in capital			305
Translation and other adjustments			(24)
Retained earnings			1,837
			2,179
Cost of shares held in the treasury: 5,940,802 shares			(164)
TOTAL SHAREHOLDERS' EQUITY			2,015
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY			$ 12,947

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Temple-Inland Inc. and Subsidiaries

(in millions)	Common Stock	Additional Paid-in Capital	Other Equity Adjustments	Retained Earnings	Treasury Stock	Total
BALANCE AT DECEMBER 31, 1994	$ 61	$ 305	$ (10)	$ 1,556	$ (129)	$ 1,783
Net income	—	—	—	281	—	281
Translation and other adjustments	—	—	(4)	—	—	(4)
Dividends paid on common stock — $1.14 per share	—	—	—	(64)	—	(64)
Stock issued for stock plans — 154,109 shares	—	1	—	—	2	3
Stock reacquired for treasury — 514,544 shares	—	—	—	—	(24)	(24)
BALANCE AT DECEMBER 30, 1995	$ 61	$ 306	$ (14)	$ 1,773	$ (151)	$ 1,975
Net income	—	—	—	133	—	133
Translation and other adjustments	—	—	(10)	—	—	(10)
Dividends paid on common stock — $1.24 per share	—	—	—	(69)	—	(69)
Stock issued for stock plans — 149,232 shares	—	(1)	—	—	3	2
Stock reacquired for treasury — 358,623 shares	—	—	—	—	(16)	(16)
BALANCE AT DECEMBER 28, 1996	$ 61	$ 305	$ (24)	$ 1,837	$ (164)	$ 2,015
Net income	—	—	—	51	—	51
Translation and other adjustments	—	—	4	—	—	4
Dividends paid on common stock — $1.28 per share	—	—	—	(71)	—	(71)
Stock issued for acquisition of California Financial Holding Company — 1,613,546 shares	—	48	—	—	48	96
Stock issued for stock plans — 253,075 shares	—	3	—	—	6	9
Stock reacquired for treasury — 994,830 shares	—	—	—	—	(59)	(59)
BALANCE AT JANUARY 3, 1998	**$ 61**	**$ 356**	**$ (20)**	**$ 1,817**	**$ (169)**	**$ 2,045**

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - Summary of Significant Accounting Policies

BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Temple-Inland Inc. and all subsidiaries in which the company has more than a 50 percent equity ownership. Investments in joint ventures and other subsidiaries in which the company has between a 20 percent and 50 percent equity ownership are reflected using the equity method. However, because certain assets and liabilities are in separate corporate entities, the consolidated assets are not available to satisfy all consolidated liabilities. All material intercompany amounts and transactions have been eliminated. Certain amounts have been reclassified to conform with current year's classification.

The preparation of the consolidated financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the amounts reported in the financial statements and accompanying notes, including disclosures related to contingencies. Actual results could differ from these estimates.

Included as an integral part of the consolidated financial statements are separate summarized financial statements and notes for the company's primary business groups, as well as the significant accounting policies unique to each group.

EARNINGS PER SHARE

In 1997, the company adopted FASB Statement No. 128, *Earnings Per Share*, which requires the presentation of basic and diluted earnings per share. Under the new statement, the dilutive effect of stock options will be excluded from basic earnings per share, but included in the computation of diluted earnings per share. Earnings per share amounts for all periods presented have been restated.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, amounts due from banks, commercial paper, agency discount notes, federal funds sold and other short-term liquid instruments with original maturities of three months or less.

TRANSLATION OF INTERNATIONAL CURRENCIES

Balance sheets of the company's international operations where the functional currency is other than the U.S. dollar are translated into U.S. dollars at year end exchange rates. Adjustments resulting from financial statement translation are reported as a component of shareholders' equity. For other international operations where the functional currency is the U.S. dollar, inventories, property, plant and equipment are translated at the historical rate of exchange, while other assets and liabilities are translated at year end exchange rates. Translation adjustments for these operations are included in earnings and are not material.

Income and expense items are translated into U.S. dollars at average rates of exchange prevailing during the year. Gains and losses resulting from foreign currency transactions are included in earnings and are not material.

INCOME TAXES

Deferred income taxes are provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes computed using current tax rates.

STOCK-BASED COMPENSATION

The company uses the intrinsic value method in accounting for its stock-based employee compensation plans.

LONG-LIVED ASSETS

Impairment losses are recognized when indicators of impairment are present, and the estimated undiscounted cash flows are not sufficient to recover the assets' carrying amount. Assets held for disposal are measured at the lower of carrying value or estimated fair value less costs to sell.

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NOTE 2 - Taxes on Income

Taxes on income from continuing operations consisted of the following:

For the year	1997	1996	1995
(in millions)			
CURRENT TAX PROVISION:			
Federal	**$ 21.9**	$ 27.2	$ 87.2
State and other	**2.2**	6.5	11.9
	24.1	33.7	99.1
DEFERRED TAX PROVISION:			
Federal	**15.2**	(16.5)	48.2
State and other	**4.9**	5.9	2.7
	20.1	(10.6)	50.9
PROVISION FOR INCOME TAXES	**$ 44.2**	$ 23.1	$ 150.0

Earnings or losses from continuing operations consisted of the following:

For the year	1997	1996	1995
(in millions)			
EARNINGS (LOSSES):			
U.S.	**$104.1**	$ 163.6	$ 435.0
Non-U.S.	**(9.1)**	(7.6)	(4.0)
	$ 95.0	$ 156.0	$ 431.0

The differences between the consolidated effective income tax rate and the federal statutory income tax rate include the following:

For the year	1997	1996	1995
(in millions)			
Taxes on income at statutory rate	**$ 33.3**	$ 54.6	$ 150.9
FDIC tax-sharing settlement	**—**	(31.5)	—
Book benefit of FDIC assistance and other permanent items	**(0.8)**	(11.6)	(12.1)
State and other taxes	**5.1**	8.1	8.9
Foreign losses not benefited	**3.2**	2.6	1.4
Goodwill	**3.4**	0.9	0.9
	$ 44.2	$ 23.1	$ 150.0

Significant components of the company's consolidated deferred tax assets and liabilities are as follows:

At year end	1997	1996
(in millions)		
DEFERRED TAX LIABILITIES:		
Depreciation	**$ 396.4**	$ 346.3
Timber and timberlands	**41.9**	36.8
Pensions	**20.6**	18.5
Other	**63.3**	42.2
Total deferred tax liabilities	**522.2**	443.8
DEFERRED TAX ASSETS:		
Alternative minimum tax credits	**264.3**	215.6
Net operating loss carryforwards	**78.0**	96.7
OPEB obligations	**54.6**	47.8
Other	**54.9**	30.0
Total deferred tax assets	**451.8**	390.1
VALUATION ALLOWANCE	**(152.9)**	(147.4)
Net deferred tax liability	**$ 223.3**	$ 201.1

The valuation allowance represents accruals for deductions that are uncertain and, accordingly, have not been recognized for financial reporting purposes. The change in the valuation allowance is primarily the result of increased foreign net operating losses, the future realization of which is not assured. Deferred taxes increased $2.5 million as a result of the current year increase in equity under SFAS No. 115 and decreased by $0.4 million due to acquisitions.

Income tax payments, net of refunds received, were $21 million, $38 million and $74 million during 1997, 1996 and 1995, respectively.

The company has domestic net operating loss carryforwards of $187 million that expire in 2009 and foreign net operating loss carryforwards of $36 million that expire from the year 2000 through the year 2007. Alternative minimum tax credits may be carried forward indefinitely.

In connection with the acquisition of Guaranty in 1988, the company entered into an assistance agreement (Assistance Agreement) with the Federal Savings and Loan Insurance Corporation. Pursuant to the Assistance Agreement, the company received various tax benefits to be shared with the FDIC when the cash benefits were realized by the company. During the term of the Assistance Agreement, the company recorded these tax-sharing liabilities on an undiscounted basis. The company and the FDIC terminated the Assistance Agreement. As a part of this termination, the company and the FDIC agreed to a one-time payment that was based on the present value of the future liabilities. In 1996, the company recognized a credit to its tax provision of $31.5 million as a result of the completion of this transaction.

As a result of the sale of Temple-Inland Food Service Corporation, the company realized a $2.3 million one-time increase in 1997 tax expense from nondeductible goodwill.

The Internal Revenue Service is examining the company's consolidated tax returns for the years 1984 through 1992. The resolution of these examinations is not expected to have a significant impact on the company's financial condition or results of operations.

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NOTE 3 - Fair Value of Financial Instruments

The carrying amounts and fair values of financial instruments were as follows:

At year end	1997		1996	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(in millions)				
FINANCIAL ASSETS				
Loans receivable	**$6,450.9**	**$6,454.9**	$5,413.9	$5,417.0
Mortgage-backed and investment securities	**2,805.7**	**2,754.0**	2,783.5	2,707.2
FINANCIAL LIABILITIES				
Deposits	**7,374.8**	**7,380.2**	6,263.1	6,262.7
FHLB advances	**1,685.0**	**1,687.9**	1,032.9	1,036.5
Long-term debt	**1,605.6**	**1,673.3**	1,654.9	1,717.1
OFF-BALANCE-SHEET INSTRUMENTS				
Commitments to extend credit	**—**	**(0.7)**	—	(1.8)

Differences between fair value and carrying amounts are due primarily to instruments that provide fixed interest rates or contain fixed interest rate elements. Inherently, such instruments are subject to fluctuations in fair value due to subsequent movements in interest rates. The fair value of cash and cash equivalents, trade and other receivables, securities sold under agreements to repurchase and mortgage loans held for sale consistently approximate the carrying amount due to their short-term nature and are excluded from the above table. The fair value of mortgage-backed and investment securities and off-balance-sheet instruments are based on quoted market prices. Other financial instruments are valued using discounted cash flows. The discount rates used represent current rates for similar instruments.

NOTE 4 - Shareholder Rights Plan

During 1989, the Board of Directors adopted a Shareholder Rights Plan in which one preferred stock purchase right (Right) was declared as a dividend for each common share outstanding. Each one-half Right entitles shareholders to purchase, under certain conditions, one-hundredth of a share of newly issued Series A Junior Participating Preferred Stock at an exercise price of $200. Rights will be exercisable only if a person or group acquires beneficial ownership of 20 percent or more of the common shares or commences a tender or exchange offer, upon consummation of which such person or group would beneficially own 25 percent or more of the common shares. The company will generally be entitled to redeem the Rights at $0.01 per Right at any time until the 10th business day following public announcement that a 20 percent position has been acquired. Rights will expire on February 20, 1999.

NOTE 5 - Employee Benefit Plans

PENSIONS

The company has pension plans covering substantially all employees. Plans covering salaried and nonunion hourly employees provide benefits based on compensation and years of service, while union hourly plans are based on negotiated benefits and years of service. The company's policy is to fund amounts on an actuarial basis to accumulate assets sufficient to meet the benefits to be paid in accordance with the requirements of ERISA. Contributions to the plans are made to trusts for the benefit of plan participants.

Net pension costs include the following:

For the year	**1997**	1996	1995
(in millions)			
CHARGES (CREDITS)			
Service cost - benefits earned during the period	**$ 13.5**	$ 12.8	$ 11.6
Interest cost on projected benefit obligation	**35.4**	32.2	30.6
Actual return on plan assets	**(125.7)**	(71.2)	(72.0)
Net amortization and deferral	**74.8**	25.3	31.0
Net pension cost (credit)	**$ (2.0)**	$ (0.9)	$ 1.2

Significant assumptions used to develop net pension cost for the defined benefit pension plans follow:

For the year	**1997**	1996	1995
Discount rate for determining projected benefit obligation	**7.50%**	8.00%	7.75%
Expected long-term rate of return on plan assets	**9.00%**	9.00%	9.00%
Average increase in compensation levels	**3.50%**	4.00%	4.75%

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The funded status of employee pension plans follows:

At year end	1997	1996
(in millions)		
Actuarial present value of projected benefit obligations:		
Vested	$ 440.4	$ 379.4
Nonvested	32.2	28.5
Accumulated projected benefit obligation	$ 472.6	$ 407.9
Plan assets at fair value, primarily stocks and bonds	$ 628.3	$ 528.2
Projected benefit obligation for service rendered to date	(507.3)	(455.0)
Plan assets in excess of projected benefit obligation	121.0	73.2
Unrecognized prior service cost	1.4	1.3
Unrecognized net gain from past experience different from that assumed	(61.1)	(9.6)
Unrecognized net asset at beginning of period, less amortization to date	(12.6)	(17.0)
Net pension asset included in the consolidated balance sheet	$ 48.7	$ 47.9

POSTRETIREMENT BENEFITS

The company provides medical and insurance benefits to certain eligible salaried and hourly employees who reach retirement age while employed by the company.

Net postretirement benefit costs include the following:

For the year	1997	1996	1995
(in millions)			
Service cost for benefits	$ 2.7	$ 2.7	$ 2.6
Interest cost	8.3	8.5	8.7
Net amortization and deferral	(1.3)	(0.4)	(0.4)
Net postretirement cost	$ 9.7	$ 10.8	$ 10.9

Significant assumptions used to develop net postretirement cost for the postretirement benefit plan follow:

For the year	1997	1996	1995
Discount rate for determining postretirement benefit obligation	7.50%	8.00%	7.75%
Health care cost trend rate	9.50%	10.00%	11.00%

Summary information for the plan follows:

At year end	1997	1996
(in millions)		
ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION		
Retirees	$ 61.8	$ 53.4
Active participants, eligible to retire	19.3	19.1
All other participants	33.8	32.4
Accrued postretirement benefit obligation	114.9	104.9
Unrecognized net gains	15.1	22.4
Unrecognized prior service cost	9.9	9.1
Postretirement benefit obligation included in the consolidated balance sheet	$ 139.9	$ 136.4

The health care trend rate of 9.5 percent in 1997 is expected to decline to 6.0 percent by 2010 and remain constant thereafter. If such rate increased by 1 percent, the accumulated postretirement obligation would increase by 7.9 percent, and the 1997 net postretirement cost would increase by 9.4 percent.

NOTE 6 - Stock Option Plans

The company has established stock option plans for key employees and directors. The plans provide for the granting of nonqualified stock options and/or incentive stock options, and, prior to 1994, the plans permitted the grant of stock appreciation rights with all or part of any options so granted. Options granted after 1995 have primarily a 10-year term and become exercisable in steps from one to five years.

A summary of stock option activity follows:

For the year	1997		1996		1995	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
(shares in thousands)						
Outstanding beginning of year	1,626	$ 45	1,404	$ 45	1,275	$ 43
Granted	201	56	456	43	326	46
Exercised	(303)	41	(144)	32	(146)	30
Forfeited	(94)	50	(90)	48	(51)	48
Outstanding end of year	1,430	$ 47	1,626	$ 45	1,404	$ 45
Weighted average fair value of options granted during the year		$18.24		$13.07		$13.55

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Options exercisable at year end were (in thousands): 1997—658; 1996—769; and 1995—718. The weighted average price for options exercisable at year end 1997 was $46 per share and $44 per share for year end 1996. Exercise prices for options outstanding at January 3, 1998, range from $12 to $66. The weighted average remaining contractual life of these options is eight years. An additional 3,283,654 and 1,065,422 shares of common stock were available for grants at year end 1997 and 1996, respectively. A restricted stock plan also provides for a maximum of 300,000 shares of restricted common stock to be reserved for awards. At year end 1997, awards of 140,532 shares of common stock were outstanding at an average price of $47.70 per share.

The fair value of the options granted in 1997,1996 and 1995 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

For the year	**1997**	1996	1995
Expected dividend yield	**2.1%**	2.6%	2.3%
Expected stock price volatility	**27.3%**	26.5%	27.0%
Risk-free interest rate	**5.6%**	6.5%	6.7%
Expected life of options	**8.0 years**	7.0 years	5.25 years

Assuming that the company had accounted for its employee stock options using the fair value method and amortized such to expense over the options' vesting period, pro forma net income and diluted earnings per share would have been $49.1 million and $0.87 per diluted share in 1997, $131.5 million and $2.37 per diluted share in 1996, and $280.4 million and $5.00 per diluted share in 1995. The pro forma disclosures may not be indicative of future amounts due to changes in subjective input assumptions and because the options vest over several years with additional future option grants expected.

NOTE 7 - Earnings Per Share

Numerators and denominators used in computing earnings per share are as follows:

For the year	**1997**	1996	1995
(in millions)			
Numerator for basic and diluted earnings per share—net income	**$ 50.8**	$ 132.8	$ 281.0
Denominator for basic earnings per share—weighted average shares outstanding	**56.0**	55.5	56.0
Dilutive effect of stock options	**0.2**	0.1	0.1
Denominator for diluted earnings per share	**56.2**	55.6	56.1

NOTE 8 - Commitments and Contingencies

As a result of allegations made by a former employee in a wrongful termination lawsuit, the Securities and Exchange Commission began a non-public investigation into the allegations. The company has denied these allegations, stating that they are without merit or grounds whatsoever, and that the resolution of such will not have an adverse effect on the company's consolidated financial statements.

There are pending against the company and its subsidiaries other lawsuits, claims and environmental matters arising in the regular course of business.

In the opinion of management, recoveries, if any, by plaintiffs or claimants that may result from the foregoing litigation and claims will not be material in relation to the consolidated financial statements of the company and its subsidiaries.

See page 33 for a discussion of commitments on construction projects.

NOTE 9 - Business Segment Information

Refer to "Business Segments" on page 25 for information relating to Revenues and Income Before Taxes, and page 32 for information relating to Capital Expenditures for the business segments for the years 1997, 1996 and 1995.

Identifiable assets by business segment are those assets specifically used in each segment's operations. The results of the timber and timberlands operations are allocated to the manufacturing groups based upon fiber usage. Corporate assets are principally cash and office buildings.

Additional business segment information is presented below:

For the year	**1997**	1996	1995
(in millions)			
IDENTIFIABLE ASSETS			
Paper	**$ 2,630.4**	$ 2,715.7	$ 2,762.4
Building products	**369.7**	346.4	297.8
Timber and timberlands	**564.5**	538.1	490.6
Corporate and other activities	**46.9**	49.0	44.7
	3,611.5	3,649.2	3,595.5
Financial services	**10,784.7**	9,335.1	9,211.1
Reclassifications and eliminations	**(32.2)**	(37.2)	(42.2)
Total	**$ 14,364.0**	$ 12,947.1	$ 12,764.4
DEPRECIATION AND DEPLETION			
Paper	**$ 203.0**	$ 197.6	$ 171.0
Building products	**32.2**	29.4	24.0
Timber and timberlands	**19.4**	16.9	12.2
Corporate and other activities	**0.6**	0.5	0.4
	255.2	244.4	207.6
Financial services	**13.2**	9.6	8.1
Total	**$ 268.4**	$ 254.0	$ 215.7

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NOTE 10 - Summary of Quarterly Results of Operations (Unaudited)

Selected quarterly financial results for the years 1997 and 1996 are summarized below:

(in millions, except per share amounts)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1997				
Total revenues	**$ 850.9**	**$ 907.9**	**$ 938.4**	**$ 928.2**
Manufacturing net sales	**649.0**	**687.1**	**678.2**	**665.9**
Manufacturing gross profit	**81.9**	**84.9**	**75.8**	**89.8**
Financial services operating income before taxes	**29.5**	**32.4**	**37.4**	**32.8**
Net income	**13.2**	**15.6**	**12.6**	**9.4**
Earnings per share*:				
Basic	**$ 0.24**	**$ 0.28**	**$ 0.22**	**$ 0.17**
Diluted	**$ 0.24**	**$ 0.28**	**$ 0.22**	**$ 0.17**
1996				
Total revenues	$ 868.7	$ 883.4	$ 862.5	$ 845.7
Manufacturing net sales	670.4	677.9	658.1	638.5
Manufacturing gross profit	137.3	124.6	97.5	87.5
Financial services operating income before taxes	24.7	29.7	(17.6)	26.3
Net income	46.4	35.4	32.7	18.3
Earnings per share*:				
Basic	$ 0.84	$ 0.63	$ 0.59	$ 0.33
Diluted	$ 0.84	$ 0.63	$ 0.59	$ 0.33

** Earnings per share amounts have been restated to comply with FASB Statement No. 128,* Earnings Per Share.

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REPORT OF MANAGEMENT

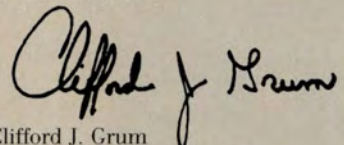
MANAGEMENT REPORT ON FINANCIAL STATEMENTS

Management has prepared and is responsible for the company's financial statements, including the notes thereto. They have been prepared in accordance with generally accepted accounting principles and necessarily include amounts based on judgments and estimates by management. All financial information in this annual report is consistent with that in the financial statements.

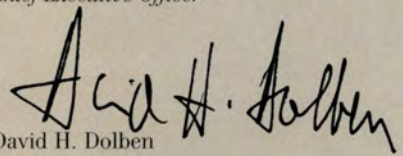
The company maintains internal accounting control systems and related policies and procedures designed to provide reasonable assurance that assets are safeguarded, that transactions are executed in accordance with management's authorization and properly recorded, and that accounting records may be relied upon for the preparation of financial statements and other financial information. The design, monitoring and revision of internal accounting control systems involve, among other things, management's judgment with respect to the relative cost and expected benefits of specific control measures. The company also maintains an internal auditing function that evaluates and formally reports on the adequacy and effectiveness of internal accounting controls, policies and procedures.

The company's financial statements have been examined by Ernst & Young LLP, independent auditors, who have expressed their opinion with respect to the fairness of the presentation of the statements.

The Audit Committee of the Board of Directors, composed solely of outside directors, meets with the independent auditors and internal auditors to evaluate the effectiveness of the work performed by them in discharging their respective responsibilities and to assure their independent and free access to the committee.



Clifford J. Grum
Chairman of the Board and
Chief Executive Officer



David H. Dolben
Vice President and
Chief Accounting Officer

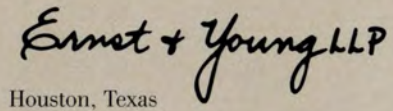
REPORT OF INDEPENDENT AUDITORS

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF TEMPLE-INLAND INC.:

We have audited the accompanying consolidated balance sheets of Temple-Inland Inc. and subsidiaries as of January 3, 1998, and December 28, 1996, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended January 3, 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 consolidated financial position of Temple-Inland Inc. and subsidiaries at January 3, 1998, and December 28, 1996, and the consolidated results of their operations and their cash flows for each of the three years in the period ended January 3, 1998, in conformity with generally accepted accounting principles.



Houston, Texas
January 30, 1998

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DIRECTORS AND OFFICERS

BOARD OF DIRECTORS
Temple-Inland Inc.

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President and Chief Operating Officer
Duke Energy Corporation

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Belvedere Capital Partners, Inc.

Clifford J. Grum (3)
Chairman and Chief Executive Officer
Temple-Inland Inc.

William B. Howes
Chairman and Chief Executive Officer
Inland Paperboard and Packaging, Inc.

Bobby R. Inman (2) (3) (4)

Herbert A. Sklenar (1) (2) (3) (4)
Chairman Emeritus
Vulcan Materials Company

Walter P. Stern (4) (6)
Chairman
Capital Group International, Inc.

Arthur Temple III (2) (6)
Chairman and Chief Executive Officer
Exeter Investment Company

Charlotte Temple (1) (5)

Larry E. Temple (1) (3) (5)
Attorney

(1) Audit Committee

(2) Management Development and Executive Compensation Committee

(3) Executive Committee

(4) Nominating Committee

(5) Public Policy/Environmental Committee

(6) Finance Committee

OFFICERS
Temple-Inland Inc.

Clifford J. Grum
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William B. Howes
Executive Vice President

Kenneth M. Jastrow, II
Group Vice President and Chief Financial Officer

Harold C. Maxwell
Group Vice President

Ted A. Owens
Group Vice President

Jack C. Sweeny
Group Vice President

Joseph E. Turk
Group Vice President

M. Richard Warner
Vice President, General Counsel and Secretary

David H. Dolben
Vice President and Chief Accounting Officer

David W. Turpin
Treasurer

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Chairman and Chief Executive Officer
Inland Paperboard and Packaging, Inc.

Ted A. Owens
Executive Vice President
Inland Paperboard and Packaging, Inc.

Joseph E. Turk
Executive Vice President
Inland Paperboard and Packaging, Inc.

BUILDING PRODUCTS GROUP

Harold C. Maxwell
Group Vice President
Temple-Inland Forest Products Corporation

FORESTS GROUP

Jack C. Sweeny
Group Vice President
Temple-Inland Forest Products Corporation

FINANCIAL SERVICES GROUP

Kenneth M. Jastrow, II
Chairman and Chief Executive Officer
Temple-Inland Financial Services Inc.

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SHAREHOLDER INFORMATION

TRANSFER AGENT AND REGISTRAR
First Chicago Trust Company of New York
P.O. Box 2500
Jersey City, New Jersey 07303-2500
201 324-1225

INDEPENDENT AUDITORS
Ernst & Young LLP
Houston, Texas

ANNUAL MEETING
The annual meeting of shareholders of Temple-Inland Inc. will be held at our corporate headquarters, 303 South Temple Drive, Diboll, Texas, on May 1, 1998, at 9:00 a.m. local time.

STOCK LISTING
Temple-Inland Inc. common stock is listed on the New York Stock Exchange and the Pacific Exchange, ticker symbol TIN.

NUMBER OF SHAREHOLDERS
As of December 31, 1997, there were 7,234 shareholders of record of the company's common stock.

DIVIDEND REINVESTMENT PLAN
Temple-Inland offers its shareholders a convenient and economical way to increase their investment in the company's common stock through the purchase of additional shares with quarterly dividends and optional cash payments. Under the Temple-Inland Inc. Dividend Reinvestment Plan, administered by First Chicago Trust Company of New York, Temple-Inland pays the brokerage fees and service charges, and the shareholder receives the benefit of larger quantity purchases and optional free custodial services. For more information about the Plan, contact First Chicago Trust Company of New York, Dividend Reinvestment Plans, P.O. Box 13531, Newark, New Jersey 07188-0001.

FORM 10-K
A copy of Temple-Inland Inc.'s annual report on Form 10-K, as filed with the Securities and Exchange Commission, will be sent without charge upon written request made to the company's Shareholder Relations Department.

MAILING ADDRESS
Temple-Inland Inc.
Drawer N
Diboll, Texas 75941
409 829-1313

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INLAND
A Temple-Inland Company

Temple
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GUARANTY
FEDERAL BANK FSB
A Temple-Inland Financial Services Company

Temple-Inland
FOREST

1999/007