INTERNATIONAL PAPER CO /NEW/
Form 10-K/A
March 07, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Amendment No. 1 to Form 10-K)

(Mark One)

x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Fiscal Year Ended December 31, 2005

or

¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to

COMMISSION FILE NO. 1-3157

INTERNATIONAL PAPER COMPANY

(Exact name of registrant as specified in its charter)

New York	**13-0872805**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

400 Atlantic Street

Stamford, Connecticut

(Address of principal executive offices)

06921

(Zip Code)

Registrant s telephone number, including area code: 203-541-8000

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

Title of each class	Name of each exchange on which registered
Common Stock, $1 per share par value	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act: None

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of the Company s outstanding common stock held by non-affiliates of the registrant, computed by reference to the closing price as reported on the New York Stock Exchange, as of the last business day of the registrant s most recently completed second fiscal quarter (June 30, 2005) was approximately $14,817,960,984.

The number of shares outstanding of the Company s common stock, as of March 1, 2006 was 492,595,905.

Documents incorporated by reference:

Portions of the registrant s proxy statement filed within 120 days of the close of the registrant s fiscal year in connection with registrant s 2006 annual meeting of shareholders are incorporated by reference into Parts III and IV of this Form 10-K/A.

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EXPLANATORY NOTE

This Amendment on Form 10-K/A (this Amendment) constitutes Amendment No. 1 to the registrant s Annual Report on Form 10-K (the Form 10-K) for the fiscal year ended December 31, 2005, filed on March 6, 2006. Due to a clerical error, the opinions of Deloitte & Touche LLP included with the Form 10-K contained the word tentative next to the signature line. The Company is filing this Amendment to correct this and other non-substantive clerical errors. The Amendment is otherwise identical to the Form 10-K.

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INTERNATIONAL PAPER COMPANY

Index to Annual Report on Form 10-K/A

For the Year Ended December 31, 2005

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PART I.

ITEM 1. BUSINESS

GENERAL

International Paper Company (the Company or International Paper, which may be referred to as we or us), is a global forest products, paper and packaging company that is complemented by an extensive North American merchant distribution system, with primary markets and manufacturing operations in the United States, Europe, South America and Asia. We are a New York corporation, incorporated in 1941 as the successor to the New York corporation of the same name organized in 1898. Our home page on the Internet is www.internationalpaper.com. You can learn more about us by visiting that site.

In the United States at December 31, 2005, the Company operated 23 pulp, paper and packaging mills, 93 converting and packaging plants, 25 wood products facilities and six specialty chemicals plants. Production facilities at December 31, 2005, in Europe, Asia, Latin America and South America included eight pulp, paper and packaging mills, 55 converting and packaging plants, two wood products facility, two specialty panels and laminated products plants and five specialty chemicals plants. We distribute printing, packaging, graphic arts, maintenance and industrial products principally through over 270 distribution branches located primarily in the United States. At December 31, 2005, we owned or managed approximately 6.5 million acres of forestlands in the United States, mostly in the South, approximately 1.3 million acres in Brazil and had, through licenses and forest management agreements, harvesting rights on government-owned forestlands in Russia. Substantially all of our businesses have experienced, and are likely to continue to experience, cycles relating to industry capacity and general economic conditions.

For management and financial reporting purposes, our businesses are separated into six segments: Printing Papers; Industrial Packaging; Consumer Packaging; Distribution; Forest Products; and Specialty Businesses and Other. A description of these business segments can be found on pages 17 and 18 of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. A discussion of the Company s recently announced Transformation Plan to concentrate on two key global platform businesses, Uncoated Papers (including Distribution) and Packaging, can be found on page 27 of Item 7.

From 2001 through 2005, International Paper s capital expenditures approximated $5.3 billion, excluding mergers and acquisitions. These expenditures reflect our continuing efforts to improve product quality and envi

ronmental performance, lower costs and improve forestlands. Capital spending for continuing operations in 2005 was approximately $1.2 billion and is expected to be approximately $1.2 billion in 2006. This amount is below our expected annual depreciation and amortization expense of $1.4 billion. You can find more information about capital expenditures on page 24 of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Discussions of acquisitions can be found on page 24 of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

You can find discussions of restructuring charges and other special items on pages 15 and 16 of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Throughout this Annual Report on Form 10-K/A, we incorporate by reference certain information in parts of other documents filed with the Securities and Exchange Commission (SEC). The SEC permits us to disclose important information by referring to it in that manner. Please refer to such information. Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, along with all other reports and any amendments thereto filed with or furnished to the SEC, are publicly available free of charge on the Investor Relations section of our Internet Web site at www.internationalpaper.com as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information contained on or connected to our Web site is not incorporated by reference into this Form 10-K/A and should not be considered part of this or any other report that we filed with or furnished to the SEC.

FINANCIAL INFORMATION CONCERNING INDUSTRY SEGMENTS

The financial information concerning segments is set forth on pages 36 and 37 of Item 8. Financial Statements and Supplementary Data.

FINANCIAL INFORMATION ABOUT INTERNATIONAL AND DOMESTIC OPERATIONS

The financial information concerning international and domestic operations and export sales is set forth on page 37 of Item 8. Financial Statements and Supplementary Data.

COMPETITION AND COSTS

Despite the size of the Company s manufacturing capacity for paper, paperboard, packaging and pulp products, the markets in all of the cited product lines are large and highly fragmented. The markets for wood and specialty products are similarly large and fragmented. There are numerous competitors, and the major mar -

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kets, both U.S. and non-U.S., in which the Company sells its principal products are very competitive. These products are in competition with similar products produced by other forest products companies, and in some instances, with products produced by other industries from other materials.

Many factors influence the Company s competitive position, including prices, costs, product quality and services. You can find more information about the impact of prices and costs on operating profits on pages 11 through 23 of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. You can find information about the Company s manufacturing capacities on page A-4 of Appendix II.

MARKETING AND DISTRIBUTION

The Company sells paper, packaging products, building materials and other products directly to end users and converters, as well as through resellers and paper distributors, including our own merchant distribution network, and agents. We own a large merchant distribution business that sells products made both by International Paper and by other companies making paper, packaging and supplies. Sales offices are located throughout the United States as well as internationally. We market our U.S. production of lumber and plywood through independent distribution centers, as well as direct to the retail and industrial market. Specialty products are marketed through various channels of distribution.

DESCRIPTION OF PRINCIPAL PRODUCTS

The Company s principal products are described on pages 17 through 18 of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

SALES VOLUMES BY PRODUCT

Sales volumes of major products for 2005, 2004 and 2003 were as follows:

Sales Volumes by Product (1) (2)

	2005	2004	2003
Printing Papers *(In thousands of tons)*			
Brazil Uncoated Papers	**447**	461	447
Europe & Russia Uncoated Papers and Bristols	**1,419**	1,409	1,352
U.S. Uncoated Papers and Bristols	**4,261**	4,614	4,439
Uncoated Papers and Bristols	**6,127**	6,484	6,238
Coated Papers	**2,109**	2,173	2,113
Market Pulp (3)	**1,588**	1,422	1,379
Packaging *(In thousands of tons)*			
Container of the Americas	**3,061**	2,821	2,264
European Container (Boxes)	**1,073**	1,049	1,031
Other Industrial and Consumer Packaging	**1,041**	1,064	1,088
Industrial and Consumer Packaging	**5,175**	4,934	4,383
Containerboard	**1,937**	2,090	1,946
Bleached Packaging Board	**1,412**	1,495	1,348
Kraft	**608**	605	606
Forest Products *(In millions)*			
Panels (sq. ft. 3/8 basis)	**1,606**	1,563	1,580
Lumber (board feet)	**2,596**	2,456	2,345

(1) Includes third-party and inter-segment sales.
(2) Sales volumes for divested businesses are included through the date of sale, except for discontinued operations.
(3) Includes internal sales to mills.

RESEARCH AND DEVELOPMENT

The Company operates its primary research and development center at Loveland, Ohio, with smaller facilities in Savannah, Georgia, a regional center for applied forest research in Bainbridge, Georgia, and several product laboratories. Additionally, the Company has approximately a 1/3 interest in ArborGen, LLC, a joint venture with certain other forest products and biotechnology companies formed for the purpose of developing and commercializing improvements to increase growth rates and improve wood and pulp quality. We direct research and development activities to short-term, long-term and technical assistance needs of customers and operating divisions; to process, equipment and product innovations; and to improve profits through tree generation and propagation research. Activities include studies on improved forest species and management; innovation and improvement of pulping, bleaching, chemical recovery, papermaking and coating

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processes; packaging design and materials development; reduction of environmental discharges; re-use of raw materials in manufacturing processes; recycling of consumer and packaging paper products; energy conservation; applications of computer controls to manufacturing operations; innovations and improvement of products; and development of various new products. Our development efforts specifically address product safety as well as the minimization of solid waste. The cost to the Company of its research and development operations was $63 million in 2005, $67 million in 2004, and $71 million in 2003.

We own numerous patents, copyrights, trademarks and trade secrets relating to our products and to the processes for their production. We also license intellectual property rights to and from others where necessary. Many of the manufacturing processes are among our trade secrets. Some of our products are covered by U.S. and non-U.S. patents and are sold under well known trademarks. We derive a competitive advantage by protecting our trade secrets, patents, trademarks and other intellectual property rights, and by using them as required to support our businesses.

ENVIRONMENTAL PROTECTION

Information concerning the effects of the Company s compliance with federal, state and local provisions enacted or adopted relating to environmental protection matters is set forth on pages 32 and 33 of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

EMPLOYEES

As of December 31, 2005, we had approximately 68,700 employees, 47,200 of whom were located in the United States. Of the U.S. employees, approximately 30,100 are hourly, with unions representing approximately 18,000 employees. Approximately 14,000 of the union employees are represented by the United Steel Workers (USW), the successor union to PACE, under individual location contracts.

During 2005, new labor agreements were ratified at three paper mills, with one paper mill contract carrying over and settling in early 2006. During 2006, labor agreements are scheduled to be negotiated at four paper mill operations including Franklin, Virginia; Riegelwood, North Carolina; Roanoke Rapids, North Carolina; and Terre Haute, Indiana.

During 2005, 19 labor agreements were settled in non-paper mill operations. Settlements included paper converting, chemical, distribution, consumer packaging and woodlands operations. During 2006, 35 labor agreements are scheduled to be negotiated in 33 non-paper mill operations, five of which are carry-overs from past years.

EXECUTIVE OFFICERS OF THE REGISTRANT

John V. Faraci, 56, chairman and chief executive officer since 2003. Prior to this, Mr. Faraci was president since 2003, and executive vice president and chief financial officer from 2000 to 2003. Mr. Faraci joined International Paper in 1974.

Robert M. Amen, 56, president since 2003. Previously, Mr. Amen served as executive vice president responsible for the Company s paper business, technology and corporate marketing from 2000 to 2003. Mr. Amen will retire from the Company on March 31, 2006.

Newland A. Lesko, 60, executive vice president-manufacturing and technology since 2003. Mr. Lesko previously served as senior vice president-industrial packaging from 1998 to 2003. Mr. Lesko joined International Paper in 1967.

Marianne M. Parrs, 61, executive vice president since 1999 and chief financial officer since 2005. Ms. Parrs previously served as executive vice president-administration since 1999 responsible for information technology, investor relations and global sourcing. She continues to oversee those areas in her current role. Ms. Parrs joined International Paper in 1974.

John N. Balboni, 58, senior vice president and chief information officer since 2005. He previously served as vice president and chief information officer from 2003 to 2005, and vice president-ebusiness from 2000 to 2003. Mr. Balboni joined the Company in 1988.

Michael J. Balduino, 55, senior vice president of the Company and president of our Shorewood subsidiary since 2000. Mr. Balduino joined International Paper in 1992.

H. Wayne Brafford, 54, senior vice president-printing and communications papers since 2005. Previously, Mr. Brafford served as senior vice president-industrial packaging from 2003, and as vice president and general manager-converting, specialty and pulp from 1999 to 2003. Mr. Brafford joined International Paper in 1975.

Jerome N. Carter, 57, senior vice president-human resources since 1999. Since 2005, he also is responsible for overseeing the communications function of the Company. Mr. Carter joined International Paper in 1999.

C. Cato Ealy, 49, senior vice president-corporate development since 2003. He previously served as vice president-corporate development from 1996 to 2003. Mr. Ealy joined International Paper in 1992.

Thomas E. Gestrich, 59, senior vice president and president-IP Asia since 2005. Previously, Mr. Gestrich served as senior vice president-consumer packaging since 2001. Prior to that, he served as vice president and general manager-beverage packaging from 1999 to 2001. Mr. Gestrich joined International Paper in 1990.

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Paul Herbert, 56, senior vice president-strategic initiatives since 2005. He previously served as senior vice president-printing and communications papers from 2000 to 2005. Mr. Herbert joined International Paper in 1992.

Thomas G. Kadien, 49, senior vice president and president-xpedx since 2005. Previously, Mr. Kadien served as senior vice president-Europe from 2003 to 2005, and as vice president-commercial printing and imaging papers from 2001 to 2003. Additionally, from 2000 to 2001, Mr. Kadien served as vice president-fine papers. He joined International Paper in 1978.

Andrew R. Lessin, 63, senior vice president-internal audit since 2002. Mr. Lessin previously served as vice president-finance from 2000 to 2002. He joined International Paper in 1977.

Maximo Pacheco, 53, senior vice president since 2005 and president-IP do Brasil since 2004. Previously, Mr. Pacheco served as senior vice president of IP do Brasil from 2003 to 2004. Prior to that, he was president-IP Latin America from 2000 to 2003. Mr. Pacheco joined International Paper in 1994.

Carol L. Roberts, 46, senior vice president-IP packaging solutions since 2005. She previously served as vice president-container of the Americas from 2000. Ms. Roberts joined International Paper in 1981.

Maura A. Smith, 50, senior vice president, general counsel and corporate secretary since 2003. Since 2005, Ms. Smith is also responsible for overseeing public affairs for the Company. From 1998 to 2003, she served as senior vice president, general counsel and corporate secretary of Owens Corning and in addition, from 2000 to 2003, as chief restructuring officer of Owens Corning. Ms. Smith joined International Paper in 2003.

Robert J. Grillet, 50, vice president-finance and controller since 2003. He previously served as group senior vice president-xpedx from 2000 to 2003. Mr. Grillet joined International Paper in 1976.

Mary A. Laschinger, 45, vice president and president-IP Europe since 2005. Ms. Laschinger previously served as vice president-wood products from 2004 to 2005 and as vice president-pulp from 2001 to 2004. Prior to that, she served as the general manager-industrial papers from 1999 to 2001. Ms. Laschinger joined International Paper in 1992.

RAW MATERIALS

For information on the sources and availability of raw materials essential to our business, see Item 2. Properties.

FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K/A, and in particular, statements found in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, that are not historical in nature, may constitute forward-looking statements. These statements are often identified by the words, will, may, should, continue, anticipate, believe, expect, plan, appear, project, estimate, similar nature. Such statements reflect the current views of International Paper with respect to future events and are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied in these statements. Below, we have listed specific risks and uncertainties that you should carefully read and consider. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 1A. RISK FACTORS

In addition to the risks and uncertainties discussed elsewhere in this Annual Report on Form 10-K/A (particularly in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations), or in the Company s other filings with the Securities and Exchange Commission, the following are some important factors that could cause the Company s actual results to differ materially from those projected in any forward-looking statement.

RISKS RELATING TO INDUSTRY CONDITIONS

Changes in the cost or availability of raw material and energy. We rely heavily on certain raw materials (principally wood fiber, caustic soda and polyethylene) and energy sources (principally natural gas, coal and fuel oil) in our manufacturing process. Our ability to increase earnings has been, and will continue to be, affected by changes in the costs and availability of such raw materials and energy sources. We may not be able to fully offset the effects of higher raw material or energy costs through hedging arrangements, price increases, productivity improvements or cost reduction programs.

Changes in transportation costs. Our business depends on the transportation of a large number of products, both domestically and internationally. In the United States, an increase in transportation rates or fuel surcharges and/or a reduction in transport availability in truck and rail could negatively impact our ability to provide products to our customers in a timely manner. While we have benefited from supply chain initiatives that provide adequate transportation availability, there is no assurance that such availability can continue to be effectively managed in the future.

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Competition. We face intense competition, both domestically and internationally, for our products in all of our current operating segments, including the two key platform businesses under our previously announced Transformation Plan, uncoated papers and packaging. Because our outlook depends on a forecast of our share of industry sales, an unexpected reduction in that share due to pricing or product strategies pursued by competitors, unanticipated product or manufacturing difficulty, a failure to price our products competitively, competition from producers of substitute materials or other similar factors could negatively impact our revenues and financial results.

Product mix. Our results may be affected by a change in the Company s sales mix. Our outlook assumes a certain volume mix of sales as well as a product mix of sales. If actual results vary from this projected volume and product mix of sales, our operations (for example, by way of lack-of-order downtime) and our results could be negatively impacted.

Pricing. Our outlook assumes that we will be successful in implementing previously announced price increases as well as other price increases that we may in the future deem necessary and/or appropriate. Also, delays in acceptance of these price increases would negatively impact our results. Moreover, price discounting, if required to maintain our competitive position, could result in lower than anticipated price realizations.

Demand for our products. Demand for our products is affected by general economic conditions in North America, Europe, South America and Asia. Changes in industrial non-durable goods production, consumer spending, commercial printing and advertising activity, white-collar employment levels, new home construction and repair and remodeling activity, interest rates and currency exchange rates may adversely affect our businesses and the results of operations.

RISKS RELATING TO MARKET AND ECONOMIC FACTORS

Changes in credit ratings issued by nationally recognized statistical rating organizations. Maintaining an investment grade credit rating for our long-term debt continues to be an important element in our overall financial strategy. Our debt ratings are, from time to time, reviewed by the rating organizations and remain subject to change. For example, in 2005, Moody s downgraded our debt from Baa2 to Baa3.

Pension and health care costs. Our pension and health care benefits are dependent upon numerous factors resulting from actual plan experience and assumptions of future experience. Pension plan assets are primarily made up of equity and fixed income investments. Fluctuations in actual equity market returns as well as changes in general interest rates may result in

increased or decreased pension costs in future periods. Likewise, changes in assumptions regarding current discount rates and expected rates of return on plan assets could also increase or decrease pension costs. Future pension funding requirements, and the timing of funding payments, could be affected by legislation currently being considered in the U.S. Congress.

Natural disasters. The occurrence of a natural disaster, such as a hurricane, tropical storm, earthquake, tornado, flooding or other unanticipated problems, could cause operational disruptions which could impair our profitability.

Changes in international conditions. Our results could be substantially affected by foreign market risks in the countries in which we have manufacturing facilities or sell our products. Specifically, Brazil, Russia, Poland, China and South Korea, where substantial manufacturing facilities exist, are developing countries subject to economic and political instability. Downturns in economic activity, adverse foreign tax consequences or any change in social, political or labor conditions in any of these countries or regions could negatively affect our financial results.

Changes in currency exchange rates. We are impacted by the movement of various currencies relative to the U.S. dollar. From time to time, we may hedge a portion of the risk from our transactions and commitments denominated in non-U.S. dollar currencies when we deem it appropriate to do so. There can, however, be no assurance that we will be able to fully protect ourselves against substantial foreign currency fluctuations.

RISKS RELATING TO THE COMPANY S TRANSFORMATION PLAN

Ability to accomplish the Transformation Plan. On July 19, 2005, the Company announced a three-part plan (the Transformation Plan) to transform its business portfolio to improve returns, strengthen the balance sheet and return cash to shareholders. The Transformation Plan includes narrowing the Company s business portfolio to two key global platform businesses: uncoated papers (including the xpedx distribution business) and packaging. Among the uncertainties that exist to completing the Transformation Plan are uncertainties relating to the Company s ability to divest or spin-off the businesses under evaluation as well as the timing, terms and net proceeds of any such transactions.

Impact of the Transformation Plan on the Company s relationships with its employees. The Company has taken steps to incent and retain employees during the transformation, and has entered into retention agreements with certain key employees who would not remain with the

Company if their respective businesses are sold.

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Ability to realize anticipated profit improvement from the Transformation Plan. The profitability of the Company s two platform businesses, uncoated papers and packaging, is subject to variable demand and the Company s ability to execute internal profit initiatives, including ongoing supply chain and overhead initiatives and volume/mix improvements. There can be no assurance that profit improvements will be achieved.

RISKS RELATING TO LEGAL PROCEEDINGS AND COMPLIANCE COSTS

Unanticipated expenditures related to the cost of compliance with environmental and other governmental regulations. Our operations are subject to significant regulation by federal, state and local environmental and safety authorities, both domestically and internationally. There can be no assurance that the costs of compliance with existing and new regulations will not require significant capital expenditures, or that existing reserves will be adequate to cover future unanticipated costs.

Results of legal proceedings. The costs and other effects of pending litigation against the Company and related insurance recoveries cannot be determined with certainty. Although the disclosure in Item 3. Legal Proceedings contains management s current views of the impact such litigation will have on our financial results, there can be no assurance that the outcome of such proceedings will be as expected.

This discussion of uncertainties is by no means exhaustive, but is designed to highlight important factors that may impact our outlook. Obvious general economic factors throughout the world (such as inflation, a sudden drop in consumer or business confidence, or an unexpected collapse in stock markets) do not warrant further discussion, but are noted to further emphasize the myriad of contingencies that may cause our actual results to differ from those currently anticipated.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

FORESTLANDS

The principal raw material used by International Paper is wood in various forms. As of December 31, 2005, the Company or its subsidiaries owned or managed approximately 6.5 million acres of forestlands in the United States, 1.3 million acres in Brazil, and, through licenses and forest management agreements,

maintained harvesting rights on government-owned forestlands in Russia. A discussion of possible sales or spin-offs of segments or potentially all of the Company s U.S. forestlands under the Company s Transformation Plan can be found on page 27 of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

During 2005, the Company s U.S. forestlands supplied 12.7 million tons of roundwood to its U.S. facilities, representing approximately 20% of its wood fiber requirements. The balance of our fiber requirements come from residual chips supplied by our Wood Products operations, other chips purchased from other suppliers, and from other private industrial and nonindustrial forestland owners, with only an insignificant amount coming from public lands of the U. S. government. In addition, in 2005, 3.4 million tons of wood were sold to other users.

As one of the largest private landowners in the world, International Paper employs professional foresters and wildlife biologists to manage our forestlands with great care in compliance with the rigorous standards of the Sustainable Forestry Initiative program (SFI™). SFI™ includes an independent certification system to ensure the sustainable planting, growing and harvesting of trees while protecting wildlife, plants, soil, water and air quality. All of our U.S. forestlands are certified as complying with SFI™ standards by an independent third party, and most of our forestlands outside of the United States comply with similar local or regional sustainable forestry programs as well.

MILLS AND PLANTS

A listing of our production facilities, the vast majority of which we own, can be found in Appendix I hereto, which is incorporated herein by reference.

The Company s facilities are in good operating condition and are suited for the purposes for which they are presently being used. We continue to study the economics of modernization or adopting other alternatives for higher cost facilities.

CAPITAL INVESTMENTS AND DISPOSITIONS

Given the size, scope and complexity of our business interests, we continuously examine and evaluate a wide variety of business opportunities and planning alternatives, including possible acquisitions and sales or other dispositions of properties. You can find a discussion about the level of planned capital investments for 2006 on page 26, and dispositions and restructuring activities as of December 31, 2005, on pages 15 and 16 of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, and on pages 51 through 57 of Item 8. Financial Statements and Supplementary Data. A discussion of businesses being

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considered for possible sale or spin-off under the Company s Transformation Plan can be found on page 27 of Item 7.

ITEM 3. LEGAL PROCEEDINGS

Information concerning the Company s legal proceedings is set forth on pages 32 and 33 of Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, and on pages 59 through 64 of Item 8. Financial Statements and Supplementary Data.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2005.

PART II.

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

Dividend per share data on the Company s common stock and the high and low sales prices for the Company s common stock for each of the four quarters in 2005 and 2004 are set forth on page 78 of Item 8. Financial Statements and Supplementary Data. Information concerning the exchanges on which the Company s common stock is listed is set forth on the back cover. As of March 1, 2006, there were approximately 26,340 record holders of common stock of the Company.

(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
March 1, 2005 March 31, 2005	3,494 [a]	$38.86	0	0

(a) Represents shares tendered in connection with stock option exercises.
No activity occurred in months not presented above.

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International Paper Company

ITEM 6. SELECTED FINANCIAL DATA

FIVE-YEAR FINANCIAL SUMMARY (a)

Dollar amounts in millions, except per share amounts and stock prices	**2005**	2004	2003	2002	2001
RESULTS OF OPERATIONS					
Net sales	**$ 24,097**	$ 23,359	$ 22,138	$ 22,359	$ 24,010
Costs and expenses, excluding interest	**22,918**	21,925	21,148	21,306	24,373
Earnings (loss) from continuing operations before income taxes and minority interest	**586**(b)	724(e)	285(h)	340(k)	(1,226)(n)
Minority interest expense, net of taxes	**12**	26	83	47	144
Discontinued operations	**241**(c)	(491)(f)	57	(247)	(8)
Extraordinary items					(46)(o)
Cumulative effect of accounting changes			(13)(i)	(893)(l)	(17)(o)
Net earnings (loss)	**1,100**(b-d)	(35)(e-g)	302(h-j)	(880)(k-m)	(1,204)(n,o)
Earnings (loss) applicable to common shares	**1,100**(b-d)	(35)(e-g)	302(h-j)	(880)(k-m)	(1,204)(n,o)
FINANCIAL POSITION					
Working capital	**$ 2,565**	$ 5,252	$ 4,908	$ 4,850	$ 4,691
Plants, properties and equipment, net	**11,801**	12,216	12,138	12,319	13,129
Forestlands	**2,190**	2,157	2,332	2,402	2,923
Total assets	**28,771**	34,217	35,525	33,792	37,177
Notes payable and current maturities of long-term debt	**1,181**	222	1,776		832
Long-term debt	**11,023**	13,632	13,127	12,329	11,751
Common shareholders equity	**8,351**	8,254	8,237	7,374	10,291
BASIC PER SHARE OF COMMON STOCK					
Earnings (loss) from continuing operations	**$ 1.77**	$ 0.94	$ 0.54	$ 0.54	$ (2.35)
Discontinued operations (c)	**0.49**	(1.01)	0.12	(0.51)	(0.02)
Extraordinary items					(0.09)
Cumulative effect of accounting changes			(0.03)	(1.86)	(0.04)
Net earnings (loss)	**2.26**	(0.07)	0.63	(1.83)	(2.50)
DILUTED PER SHARE OF COMMON STOCK					
Earnings (loss) from continuing operations	**$ 1.74**	$ 0.93	$ 0.53	$ 0.54	$ (2.35)
Discontinued operations (c)	**0.47**	(1.00)	0.13	(0.51)	(0.02)
Extraordinary items					(0.09)
Cumulative effect of accounting changes			(0.03)	(1.85)	(0.04)
Net earnings (loss)	**2.21**	(0.07)	0.63	(1.82)	(2.50)
Cash dividends	**1.00**	1.00	1.00	1.00	1.00
Common shareholders equity	**17.03**	16.93	16.97	15.21	21.25
COMMON STOCK PRICES					
High	**$ 42.59**	$ 45.01	$ 43.32	$ 46.19	$ 43.25
Low	**26.97**	37.12	33.09	31.35	30.70
Year-end	**33.61**	42.00	43.11	34.97	40.35
FINANCIAL RATIOS					
Current ratio	**1.5**	1.7	1.5	1.7	1.6
Total debt to capital ratio	**58.8**	62.1	63.0	61.2	54.1

Return on equity	**13.2**(b-d)	(0.4)(e-g)	3.9(h-j)	(8.8)(k-l)	(10.6)(n,o)
Return on investment from continuing operations	**5.2**(b-d)	3.7(e-g)	2.9(h-j)	2.7(k,l)	(1.6)(n)
CAPITAL EXPENDITURES	**$ 1,172**	$ 1,213	$ 1,031	$ 913	$ 937
NUMBER OF EMPLOYEES	**68,700**	79,400	82,800	91,000	100,100

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ITEM 6. SELECTED FINANCIAL DATA

FINANCIAL GLOSSARY

Current ratio

current assets divided by current liabilities.

Total debt to capital ratio

long-term debt plus notes payable and current maturities of long-term debt divided by long-term debt, notes payable and current maturities of long-term debt, minority interest and total common shareholders equity.

Return on equity

net earnings divided by average common shareholders equity (computed monthly).

Return on investment

the after-tax amount of earnings from continuing operations before interest and minority interest divided by the average of total assets minus accounts payable and accrued liabilities (computed monthly).

FOOTNOTES TO FIVE-YEAR FINANCIAL SUMMARY

(a) All periods presented have been restated to reflect the Carter Holt Harvey Limited and the Weldwood of Canada Limited businesses as discontinued operations.

2005:

(b) Includes restructuring and other charges of $358 million before taxes ($225 million after taxes), including a $274 million charge before taxes ($174 million after taxes) for organizational restructuring and other charges principally associated with the Company s Transformation Plan, a $57 million charge before taxes ($35 million after taxes) for early extinguishment of debt, and a $27 million charge before taxes ($16 million after taxes) for legal reserves. Also included are a $258 million pre-tax credit ($151 million after taxes) for net insurance recoveries related to the hardboard siding and roofing litigation, a $4 million credit before taxes ($3 million after taxes) for the net reversal of restructuring reserves no longer required, a pre-tax charge of $111 million ($73 million after taxes) for net losses on sales and impairments of businesses sold or held for sale, and interest income of $54 million before taxes ($33 million after taxes), including $43 million before taxes ($26 million after taxes) related to a settlement with the U.S. Internal Revenue Service concerning the 1997 through 2000 U.S. federal income tax audit, and $11 million before taxes ($7 million after taxes) related to the collection of a note receivable from the 2001 sale of a business.

(c) Includes a gain of $29 million before taxes ($361 million after taxes and minority interest) from the 2005 sale of Carter Holt Harvey Limited.

(d) Includes a $446 million reduction in the income tax provision, including a reduction of $627 million from a settlement reached with the U.S. Internal Revenue Service concerning the 1997 through 2000 U.S. federal income tax audit, a charge of $142 million for deferred taxes related to earnings repatriations under the American Jobs Creation Act of 2004, and $39 million of other tax charges.

2004:

(e) Includes restructuring and other charges of $166 million before taxes ($103 million after taxes), including a $64 million charge before taxes ($40 million after taxes) for organizational restructuring programs, a $92 million charge before taxes ($57 million after taxes) for early debt extinguishment costs, and a $10 million charge before taxes ($6 million after taxes) for legal settlements. Also included are pre-tax credits of $123 million ($76 million after taxes) for net insurance recoveries related to the hardboard siding and roofing litigation, a $36 million credit before taxes ($22 million after taxes) for the net reversal of restructuring reserves no longer required, and a pre-tax charge of $139 million ($125 million after taxes) for net losses on sales and impairments of businesses sold or held for sale.

(f) Includes a gain of $268 million before taxes and minority interest ($90 million after taxes and minority interest) from the 2004 sale of the Carter Holt Harvey Tissue business, and a pre-tax charge of $323 million ($711 million after taxes) from the 2004 sale of Weldwood of Canada Limited.

(g) Includes a $32 million net increase in the income tax provision reflecting an adjustment of deferred tax balances.

2003:

(h) Includes restructuring and other charges of $286 million before taxes ($180 million after taxes), including a $224 million charge before taxes ($140 million after taxes) for asset shutdowns of excess internal capacity and cost reduction actions, a $63 million charge before taxes ($39 million after taxes) for legal reserves, and a $1 million credit before taxes ($1 million charge after taxes) for early debt retirement costs. Also included are a pre-tax charge of $34 million ($33 million after taxes) for net losses on sales and impairments of businesses held for sale, and a credit of $39 million before taxes ($24 million after taxes) for the net reversal of restructuring reserves no longer required.

(i) Includes a charge of $10 million after taxes for the cumulative effect of an accounting change for the adoption of SFAS No. 143, Accounting for Asset Retirement Obligations, and a charge of $3 million after taxes for the cumulative effect of an accounting change related to the adoption of FIN 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51.

(j) Includes a $110 million reduction of the income tax provision recorded for significant tax events occurring in 2003.

2002:

(k) Includes restructuring and other charges of $667 million before taxes ($425 million after taxes), including a $176 million charge before taxes ($121 million after taxes) for asset shutdowns of excess internal capacity and cost reduction actions, a $450 million pre-tax charge ($278 million after taxes) for additional exterior siding legal reserves, and a charge of $41 million before taxes ($26 million after taxes) for early debt retirement costs. Also included are a credit of $38 million before taxes ($100 million after taxes) to adjust accrued costs of businesses sold or held for sale, and a pre-tax credit of $68 million ($43 million after taxes) for the reversal of 2001 and 2000 reserves no longer required.

(l) Includes an $893 million charge for the cumulative effect of an accounting change for the adoption of SFAS No. 142, Goodwill and Other Intangible Assets.

(m) Reflects a decrease of $46 million in income tax provision for a reduction of deferred state income tax liabilities.

2001:

(n) Includes restructuring and other charges of $1.1 billion before taxes ($749 million after taxes), including an $882 million charge before taxes ($603 million after taxes) for asset shutdowns of excess internal capacity and cost reduction actions, and a $225 million pre-tax charge ($146 million after taxes) for additional exterior siding legal reserves. Also included are a net pre-tax charge of $629 million ($587 million after taxes) related to dispositions and asset impairments of businesses held for sale, a $42 million pre-tax charge ($28 million after taxes) for Champion merger integration costs, and a $17 million pre-tax credit ($11 million after taxes) for the reversal of excess 2000 and 1999 restructuring reserves.

(o) Includes an extraordinary pre-tax charge of $73 million ($46 million after taxes) related to the impairment of the Masonite business and the divestiture of the Petroleum and Minerals assets, and a charge of $28 million before taxes ($17 million after taxes) for the cumulative effect of a change in accounting for derivatives and hedging activities.

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

EXECUTIVE SUMMARY

International Paper s operating results in 2005 were strongly impacted by significantly higher costs for energy, wood, caustic soda and other raw materials which reduced operating profits compared with 2004 by $586 million. Lower sales volumes were also a negative factor versus 2004 as we took a significant amount of lack-of-order downtime in our U.S. uncoated paper and containerboard mills, and downtime in our Eastern European operations to rebuild paper machines in Poland and Russia to add needed uncoated paper and paperboard capacity. We were able to partially offset some of these negative impacts through operational improvements in our manufacturing operations, improved average pricing for our paper and packaging grades, a more favorable product mix, and higher earnings from forestland and real estate sales.

Looking forward to 2006, we expect operating profits for the first quarter to be flat with the 2005 fourth quarter. Sales volumes should be seasonally slow in the quarter, but should show some improvement as the quarter progresses. Price realizations should also improve as previously announced price increases are implemented. While energy, wood and raw material price movements are mixed, their impact for the quarter is expected to be flat.

However, we see favorable signs of positive momentum for the remainder of 2006. We anticipate that demand in North America for both uncoated paper and industrial packaging products will be stronger, and that we will realize 2005 fourth-quarter and 2006 first-quarter announced price increases. Additionally, operating rates should improve in 2006 reflecting announced industry capacity reductions in uncoated papers and containerboard. We are also starting to see some reductions in natural gas and southern wood costs that, if the trend continues, should benefit operations as the year progresses.

In connection with our overall strategic direction, we are evaluating options for the possible sale or spin-off of certain of our businesses as previously announced in our Transformation Plan, with decisions on certain businesses anticipated during 2006. We also will continue to improve our key operations in North America by realigning our uncoated and packaging mill operations to reduce costs, improve our products and improve our overall profitability.

Results of Operations

Industry segment operating profits are used by International Paper s management to measure the earnings performance of its businesses. Management believes

that this measure allows a better understanding of trends in costs, operating efficiencies, prices and volumes. Industry segment operating profits are defined as earnings before taxes and minority interest, interest expense, corporate items and corporate special items. Industry segment operating profits are defined by the Securities and Exchange Commission as a non-GAAP financial measure, and are not GAAP alternatives to net income or any other operating measure prescribed by accounting principles generally accepted in the United States.

International Paper operates in six segments: Printing Papers, Industrial Packaging, Consumer Packaging, Distribution, Forest Products, and Specialty Businesses and Other.

The following table shows the components of net earnings (loss) for each of the last three years:

In millions	**2005**	2004	2003
Industry segment operating profits	**$ 1,923**	$ 2,040	$ 1,734
Corporate items	**(597)**	(469)	(466)
Corporate special items*	**(147)**	(142)	(281)
Interest expense, net	**(593)**	(710)	(705)
Minority interest	**(12)**	(21)	(80)
Income tax benefit (provision)	**285**	(242)	56
Discontinued operations	**241**	(491)	57
Accounting changes			(13)

Net earnings (loss)	**$ 1,100**	$ (35)	$ 302

** Special items include restructuring and other charges, net losses on sales and impairments of businesses held for sale, insurance recoveries and reversals of reserves no longer required.*

Industry segment operating profits were $117 million lower in 2005 due principally to the impact of higher energy and raw material costs ($586 million), lower sales volume ($251 million), and unfavorable foreign currency translation rates ($27 million) which more than offset the benefits from higher average prices ($478 million), cost reduction initiatives, improved operating performance and a more favorable product mix ($235 million), and higher earnings from land sales ($158 million). The impact of divestitures ($32 million), principally the Fine Papers and Industrial Papers businesses, and other items ($36 million) also had a negative impact in 2005.

Segment Operating Profit

(in millions)

The principal changes in operating profit by segment were as follows: *Printing Papers* profits were $29 million lower as the impacts of higher energy and raw material costs, lower sales volume and unfavorable foreign currency translation rates more than offset the effects of higher average sales prices, improved sales mix and lower operating and overhead costs. *Industrial Packaging* s profits were down by $150 million reflecting higher energy and raw material costs, lower sales volume, an unfavorable mix of products sold and the impact of the sale of the Industrial Papers business. These effects were somewhat offset by benefits from higher sales prices. *Consumer Packaging* s profits were $35 million lower as the impacts of higher energy and raw material costs and lower sales volume more than offset contributions from higher sales prices and lower operating and overhead costs. *Forest Products* profits were $134 million higher. Increased earnings from land sales, an improved product mix and lower overhead costs more than offset the effect of higher energy and raw material costs, lower harvest volumes and special items. *Distribution* s profits were $3 million lower in 2005 than in 2004.

Corporate items of $597 million of expense in 2005 were higher than the $469 million in 2004 and $466 million in 2003 due to higher pension and supply chain initiative costs and increased inventory-related costs, partially offset by lower overhead costs.

Corporate special items, including restructuring and other charges, losses on sales and impairments of businesses held for sale, insurance recoveries and reversals of reserves no longer required, increased to $147 million from $142 million in 2004, but were lower than the $281 million in 2003. The increase in 2005 versus 2004 reflects an increase in restructuring charges, relating principally to our Transformation Plan, offset by higher insurance recoveries relating to hardboard siding and roofing matters. Compared with 2003, the decrease reflects higher insurance recoveries and lower losses on sales and impairments of businesses held for sale in 2005.

Interest expense, net, of $593 million in 2005 includes a pre-tax credit of $43 million related to an agreement reached with the Internal Revenue Service concerning the Company s 1997 through 2000 federal income tax audits, and a pre-tax credit of $11 million related to the collection of a note receivable from the 2001 sale of the Flexible Packaging business. Excluding these items, interest expense, net, of $647 million decreased from $710 million in 2004 and $705 million in 2003 reflecting lower average debt balances from debt refinancing and repayments in 2004 and 2005.

The 2005 income tax benefit of $285 million includes a $446 million tax benefit related to 2005 tax special items. The $242 million tax provision in 2004 included a $32 million tax provision related to tax

special items. The tax benefit of $56 million in 2003 included $110 million of benefits related to special items occurring in 2003. See Income Taxes on pages 14 and 15 for a further discussion of these items.

During the 2005 third quarter, International Paper completed the sale of the Carter Holt Harvey Limited business. During 2004, International Paper completed the sale of its Weldwood of Canada Limited business in the fourth quarter. The operating results of these businesses and the gains or losses on the sales are reported in discontinued operations for all periods presented.

Accounting changes included a charge of $13 million in 2003 for the adoption of new accounting pronouncements regarding asset retirement obligations and variable interest entities.

Liquidity and Capital Resources

For the year ended December 31, 2005, International Paper generated $1.5 billion of cash flow from continuing operations, down from $2.1 billion in 2004. Capital spending from continuing operations for the year totaled $1.2 billion, or 84% of depreciation and amortization expense. We repaid approximately $1.7 billion of debt during the year, including various higher coupon rate debt, that will result in lower interest charges in future years. Our liquidity position remains strong, supported by approximately $3.2 billion of unused, committed credit facilities that we believe are adequate to meet future short-term liquidity requirements. Maintaining an investment grade credit rating for our long-term debt continues to be an important element in our overall financial strategy.

Our focus in 2006 will be to continue to maximize our financial flexibility and preserve liquidity while further reducing our long-term debt as our previously announced Transformation Plan progresses. Capital spending for 2006 is targeted at $1.2 billion, or about 80% of depreciation and amortization.

Transformation Plan

In July 2005, International Paper announced a Transformation Plan to focus on two key global platform businesses: Uncoated Papers (including Distribution) and Packaging. In connection with this plan, the Company is exploring strategic alternatives for other businesses including Coated and Supercalendered Papers, Beverage Packaging, Kraft Papers, Arizona Chemical, Wood Products, and segments or potentially all of its

6.5 million acres of U.S. forestlands. This evaluation process is underway, with decisions anticipated for some of these businesses in 2006. While the exact use of any proceeds from potential future sales is dependent upon various factors, the Company remains committed to using its free cash flow in 2006 to pay down debt, to return value to shareholders, and for selective high-return investments.

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Critical Accounting Policies and Significant Accounting Estimates

Accounting policies that may have a significant effect on our reported results of operations and financial position, and that can require judgments by management in their application, include accounting for contingent liabilities, impairments of long-lived assets and goodwill, pensions and postretirement benefit obligations and income taxes.

In recent years, the assumption estimates used for pensions have resulted in increases in reported pension charges. Pension expenses for our U.S. plans increased to $243 million in 2005 from $111 million in 2004 due principally to an increase in the amortization of unrecognized actuarial losses and a reduction in the assumed discount rate. A further increase of approximately $130 million is expected in 2006, reflecting a change in the mortality assumption to use a more recent mortality table, an increase in the amortization of unrecognized actuarial losses and a further reduction in the assumed discount rate. Our pension funding policy continues to be to fully fund actuarially determined costs, generally equal to the minimum amounts required by the Employee Retirement Income Security Act (ERISA). Unless changes are made to our funding policy, it is unlikely that any contributions to our U.S. qualified plan will be required in 2006. Funding requirements in later years will depend upon current pending legislation, investment performance and changes in discount rates.

Legal

Payments relating to the hardboard exterior siding class action settlement exceeded our projections for the year, but payments related to the other two class actions continue to be in line with projections made in 2002. The Company settled with all of its insurance carriers, except one, related to the hardboard siding claims, and settled all but one of the small opt-out cases in the linerboard antitrust litigation. Additional information on these and other matters is included in Note 10 of the Notes to Consolidated Financial Statements in Item 8.

CORPORATE OVERVIEW

While the operating results for International Paper s various business segments are driven by a number of business-specific factors, changes in International Paper s operating results are closely tied to changes in general economic conditions in the United States, Europe, South America and Asia. Factors that impact the demand for our products include industrial non-durable goods production, consumer spending, commercial printing and advertising activity, white-collar employment levels, new home construction and repair and remodeling activity, and movements in currency exchange rates.

Product prices also tend to follow general economic trends, and are also affected by inventory levels, currency movements and changes in worldwide operating rates. In addition to these revenue-related factors, net earnings are impacted by various cost drivers, the more significant of which include changes in raw material costs, principally wood fiber and chemical costs, energy costs, salary and benefits costs, including pensions, and manufacturing conversion costs.

The following is a discussion of International Paper s results of operations for the year ended December 31, 2005, and the major factors affecting these results compared to 2004 and 2003.

RESULTS OF OPERATIONS

For the year ended December 31, 2005, International Paper reported net sales of $24.1 billion, compared with $23.4 billion in 2004 and $22.1 billion in 2003. International net sales (including U.S. exports) totaled $5.7 billion, or 24% of total sales in 2005. This compares to international net sales of $5.7 billion in 2004 and $5.4 billion in 2003.

Full year 2005 net income totaled $1.1 billion ($2.21 per share), compared with a net loss of $35 million ($0.07 per share) in 2004 and a net income of $302 million ($0.63 per share) in 2003. Amounts include results of discontinued operations and the cumulative effect of accounting changes.

Earnings from continuing operations in 2005 were $859 million compared with $456 million in 2004 and $258 million in 2003. However, included in earnings from continuing operations in 2005 was an incremental benefit of $497 million compared with 2004 from the special items discussed on pages 15 and 16. Excluding this benefit, earnings in 2005 were $94 million lower than in 2004. This decline was driven by higher energy and raw material costs, lower sales volumes, and higher corporate and other charges, principally pension and supply chain initiative costs, that more than offset the positive effects of higher sales prices, cost reduction initiatives, improved mill operations, increased earnings from land sales and lower interest expense.

See Industry Segment Results on pages 18 through 23 for a discussion of the impact of these factors by segment.

Earnings From Continuing Operations

(after tax, in millions)

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The following table presents a reconciliation of International Paper s net earnings (loss) to its operating profit:

In millions	**2005**	2004	2003
Net Earnings (Loss)	**$1,100**	$(35)	$302
Add back (deduct):			
Discontinued operations:			
Loss (earnings) from operations	**120**	(130)	(57)
(Gain) loss on sales or impairments	**(361)**	621	
Cumulative effect of accounting changes			13
Earnings From Continuing Operations	**859**	456	258
Add back (deduct): Income tax provision (benefit)	**(285)**	242	(56)
Add back: Minority interest expense, net of taxes	**12**	26	83
Earnings From Continuing Operations Before Income Taxes and Minority Interest	**586**	724	285
Interest expense, net	**593**	710	705
Minority interest included in operations		(5)	(3)
Corporate items	**597**	469	466
Special items:			
Restructuring and other charges	**298**	166	286
Insurance recoveries	**(258)**	(123)	
Net losses on sales and impairments of businesses held for sale	**111**	135	34
Reversals of reserves no longer required, net	**(4)**	(36)	(39)
	$1,923	$2,040	$1,734
Industry Segment Operating Profit			
Printing Papers	**$552**	$581	$464
Industrial Packaging	**230**	380	264
Consumer Packaging	**126**	161	183
Distribution	**84**	87	80
Forest Products	**927**	793	720
Specialty Businesses and Other	**4**	38	23
Total Industry Segment Operating Profit	**$1,923**	$2,040	$1,734

Discontinued Operations and Cumulative Effect of Accounting Changes

During the 2005 third quarter, the sale of the Company s majority share of Carter Holt Harvey Limited (CHH) was completed resulting in a $361 million after-tax gain. This amount, together with an $80 million net charge principally reflecting that portion of a third-quarter agreement reached with the U.S. Internal Revenue Service that relates to CHH, is included in earnings from discontinued operations. In the fourth quarter of 2004, International Paper sold its Weldwood of Canada Limited (Weldwood) business for approximately $1.1 billion. As a result of the sale, a $323 million pre-tax loss on the sale was recorded ($711 million after taxes) as a discontinued operations charge. In the 2004 second quarter, a $90 million after-tax and minority interest discontinued operations gain was recorded from the sale of the Carter Holt Harvey Tissue business.

Prior period results have been restated to present the operating results of these businesses as earnings from discontinued operations, including a net loss of $120 million in 2005, and earnings of $130 million and $57 million in 2004 and 2003, respectively. The $120 million net loss in 2005 includes charges of $98 million for the CHH portion of an audit agreement reached with the U.S. Internal Revenue Service, and charges related to cash repatriations from non-U.S. subsidiaries related to CHH.

Net earnings for 2003 included after-tax charges of $3 million and $10 million for the cumulative effect of accounting changes for the adoption of the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, and Statement of Financial Accounting Standards (SFAS) No. 143, Accounting for Asset Retirement Obligations, respectively.

Income Taxes

The Company recorded an income tax benefit for 2005 of $285 million, including a $446 million net tax benefit related to special items, consisting of a tax benefit of $627 million resulting from an agreement reached with the U.S. Internal Revenue Service concerning the 1997 through 2000 U.S. federal income tax audit, a $142 million charge for deferred taxes related to earnings repatriations under the American Jobs Creation Act of 2004 and $39 million of other tax charges. Excluding the impact of special items, the tax provision was $203 million, or 27.5% of pre-tax earnings before minority interest.

The income tax provision for 2004 was $242 million, or 33% of pre-tax earnings from continuing operations before minority interest. This included a $32 million tax provision related to an adjustment of deferred tax balances. Excluding the impact of special items, the tax provision was $226 million, or 26% of pre-tax earnings before minority interest.

While the Company reported pre-tax income in 2003, a net income tax benefit of $56 million was recorded reflecting decreases totaling $110 million in the provision for income taxes for special items. These included a $60 million reduction in the third quarter reflecting a favorable revision of estimated tax accruals upon filing the 2002 federal income tax return and increased research and development credits, and a $50 million reduction in the second quarter reflecting a favorable tax audit settlement and benefits from a government sponsored overseas tax program. Excluding the year-to-date tax effects of special items, the effective tax rate for 2003 was 26%.

Corporate Items and Interest Expense

Minority interest expense, net of taxes, decreased to $12 million in 2005 compared with $26 million in 2004 and $83 million in 2003. The decreases in 2005 and 2004 reflect a reduction in minority interest related to preferred securities that were replaced by debt obligations in 2004 and 2003.

Interest expense, net, of $593 million includes a pre-tax credit of $43 million for interest related to the agreement reached with the U.S. Internal Revenue Service concerning the Company s 1997 through 2000 U.S. federal income tax audits, and a pre-tax credit of $11 million related to the collection of a note receivable from the 2001 sale of the Flexible Packaging business. Excluding these items, interest expense, net, of $647 million decreased from $710 million in 2004 and $705 million in 2003 reflecting lower average debt balances and lower interest rates from debt refinancing and repayments in 2005 and 2004.

For the twelve months ended December 31, 2005, corporate items totaled $597 million of expense compared with $469 million in 2004 and $466 million in 2003. The increased expenses in 2005 compared with both 2004 and 2003 are due to higher pension, supply chain initiative and inventory-related costs, offset in part by lower overhead administrative costs. Lower gains from energy hedging transactions were also a factor in 2005 and 2004.

Our supply chain initiative, begun in late 2002, is a corporate-wide project to improve customer service capabilities and implement best practice supply chain business processes for order management, supply and demand planning, product scheduling and tracking, transportation and warehousing, and procurement. Expenses related to this program in 2006 should be approximately $50 million above 2005 levels. The associated benefits are reflected in business earnings as the programs are implemented.

SPECIAL ITEMS

Restructuring and Other Charges

International Paper continually evaluates its operations for improvement opportunities targeted to (a) focus our portfolio on our core businesses, (b) rationalize and realign capacity to operate fewer facilities with the same revenue capability and close high cost facilities, and (c) reduce costs. Annually, strategic operating plans are developed by each of our businesses to demonstrate that they will achieve a return at least equal to their cost of capital over an economic cycle. If it subsequently becomes apparent that a facility s plan will not be achieved, a decision is then made to (a) invest additional capital to upgrade the facility, (b) shut down the facility and record the corresponding charge, or (c) evaluate the expected recovery of the carrying value of the facility to determine if an impairment of the asset value of the facility has occurred under SFAS No. 144. In recent years, this policy has led to the shutdown of a number of facilities and the recording of significant asset impairment charges and severance costs. It is possible that additional charges and costs will be incurred in future periods in our core businesses should such triggering events occur.

2005: During 2005, total restructuring and other charges of $358 million before taxes ($225 million after taxes) were recorded. These charges included a $274 million charge before taxes ($174 million after taxes) for organizational restructuring programs, principally costs associated with the Company s previously announced Transformation Plan, a $57 million charge before taxes ($35 million after taxes) for early debt extinguishment costs and a $27 million charge before taxes ($16 million after taxes) for litigation settlements. Charges of $298 million relating to Corporate programs are included as Corporate items, with $60 million of business-specific charges included in the respective business s operating results. Earnings also included a $258 million pre-tax credit ($151 million after taxes) for net insurance recoveries related to the hardboard siding and roofing litigation, and a $4 million credit before taxes ($3 million after taxes) for the net reversal of restructuring reserves no longer required. Additionally, included in interest income was a credit of $54 million before taxes ($33 million after taxes), which included $43 million before taxes ($26 million after taxes) related to a settlement with the U.S. Internal Revenue Service, and $11 million before taxes ($7 million after taxes) related to the collection of a note from the 2001 Flexible Packaging business sale.

2004: During 2004, restructuring and other charges before taxes of $166 million ($103 million after taxes) were recorded. These charges included a $64 million charge before taxes ($40 million after taxes) for organizational restructuring programs, a $92 million charge before taxes ($57 million after taxes) for early debt retirement costs, and a $10 million charge before taxes ($6 million after taxes) for a litigation settlement. Also in 2004, a $123 million credit before taxes ($76 million after taxes) was recorded for insurance recoveries related to the hardboard siding and roofing litigation, and a $36 million credit before taxes ($22 million after taxes) was recorded for the net reversal of restructuring reserves no longer required.

2003: During 2003, restructuring and other charges before taxes of $286 million ($180 million after taxes) were recorded. These charges included a $224 million charge before taxes ($140 million after taxes) for asset shutdowns of excess internal capacity and cost reduction actions, a $63 million charge before taxes ($39 million after taxes) for legal reserves, and a $1 million credit before taxes ($1 million charge after taxes) for early debt retirement costs. In addition, a $39 million credit before taxes ($24 million after taxes) was recorded for the net reversal of restructuring reserves no longer required.

A further discussion of restructuring, business improvement and other charges can be found in Note 6 of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

Net Losses on Sales and Impairments of Businesses Held for Sale

Net losses on sales and impairments of businesses held for sale totaled $111 million in 2005, $135 million in 2004 and $34 million in 2003. The principal components of these gains/losses were:

2005: In the 2005 fourth quarter, a pre-tax charge of $46 million ($30 million after taxes) was recorded to write down the assets of the Polyrey business to estimated fair value and to adjust losses on businesses previously sold.

In the third quarter of 2005, charges totaling $5 million before taxes ($3 million after taxes) were recorded for adjustments of losses on businesses previously sold.

During the second quarter of 2005, a net pre-tax credit of $19 million ($12 million after taxes) was recorded including a $25 million credit before taxes ($15 million after taxes) from the collection of a note receivable from the 2001 sale of the Flexible Packaging business, and final charges related to the sale of Fine Papers and Industrial Papers. In addition, interest income of $11 million before taxes ($7 million after taxes) was collected on the Flexible Packaging business note, which is included in Interest expense, net.

During the first quarter of 2005, International Paper announced an agreement to sell its Fine Papers and In

dustrial Papers businesses. As a result, a $73 million pre-tax loss ($48 million after taxes) was recorded in the first quarter to write down the net assets of these businesses to their estimated net realizable value. Also in the first quarter of 2005, charges totaling $6 million before taxes ($4 million after taxes) were recorded for adjustments to estimated losses on sales of certain smaller operations.

2004: In December 2004, International Paper committed to plans for the sale in 2005 of its Fine Papers business and its Maresquel mill and Papeteries de France distribution business in Europe, resulting in charges of $56 million before taxes ($54 million after taxes) to write down the assets of these entities to their estimated fair values less costs to sell. In October 2004, International Paper sold two box plants located in China, resulting in a pre-tax loss of $14 million ($4 million after taxes).

In the 2004 third quarter, a charge of $38 million before and after taxes was recorded for losses associated with the sale of Scaldia Papier B.V. and its subsidiary Recom B.V. ($34 million) and to adjust the estimated loss on sale of Papeteries de Souche L.C. ($4 million).

In the 2004 second quarter, a charge of $27 million before and after taxes was recorded to write down the assets of Papeteries de Souche L.C. to their estimated realizable value.

In addition, the 2004 second quarter included a loss of $4 million before taxes ($2 million after taxes) to write down the assets of Food Pack S.A. to their estimated realizable value, which was included in the Consumer Packaging segment.

2003: In the fourth quarter of 2003, International Paper recorded a $34 million pre-tax charge ($34 million after taxes) to write down the assets of its Polyrey business to estimated fair value. In addition, a $13 million pre-tax gain ($8 million after taxes) was recorded to adjust estimated gains/losses of businesses previously sold.

Pre-tax charges of $13 million ($7 million after taxes) were recorded in the first three quarters of 2003 to adjust previously estimated gains/losses of businesses previously sold.

Industry Segment Operating Profit

Industry segment operating profits of $1.9 billion in 2005 were slightly lower than $2.0 billion in 2004, but above the $1.7 billion reported in 2003. Significantly higher energy, wood, caustic soda and other raw material costs ($586 million), lower sales volumes including lack-of-order downtime in our U.S. uncoated paper and containerboard mills and downtime in our Eastern European operations to rebuild paper machines in Poland and Russia to add needed uncoated paper and pa -

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perboard capacity ($251 million), and the effect of unfavorable foreign currency rates ($27 million) more than offset the favorable effects of higher average prices ($478 million), cost reduction initiatives, improved operating performance and a more favorable product mix ($235 million), and higher earnings from forestland and real estate sales ($158 million).

Lack-of-order downtime in 2005 increased to approximately 830,000 tons, compared with only 70,000 tons in 2004 and 585,000 tons in 2003, as the Company adjusted production in line with customer demand. The 2005 total included approximately 290,000 tons related to uncoated paper machines at our mills in Pensacola, Florida; Jay, Maine; and Bastrop, Louisiana; that were permanently closed in the fourth quarter.

Looking forward to the first quarter of 2006, we expect operating profits to be about flat with the 2005 fourth quarter. Sales volumes should be seasonally slow in the quarter, but should show some improvement as the quarter progresses. Price realizations should also improve as previously announced price increases are implemented. While energy, wood and raw material price movements are mixed, their impact for the quarter is expected to be flat.

DESCRIPTION OF INDUSTRY SEGMENTS

International Paper s industry segments discussed below are consistent with the internal structure used to manage these businesses. All segments are differentiated on a common product, common customer basis consistent with the business segmentation generally used in the Forest Products industry.

Printing Papers

International Paper is one of the world s leading producers of printing and writing papers. Products in this segment include uncoated and coated papers, market pulp and bristols.

Uncoated Papers: This business produces papers for use in desktop and laser copiers and digital imaging printing as well as in advertising and promotional materials such as brochures, pamphlets, greeting cards, books, annual reports and direct mail publications. Uncoated Papers also produces a variety of grades that are converted by our customers into envelopes, tablets, business forms and file folders. Uncoated papers are sold under private label and International Paper brand names that include *Hammermill, Springhill, Great White, Ballet* and *Rey*. The mills producing uncoated papers are located in the United States, Scotland, France, Poland and Russia. These mills have uncoated paper production capacity of approximately 5.4 million tons annually. International Paper sold the Fine Papers business on April 30, 2005. Prior to its sale, they produced papers used in high-

quality text, cover, business correspondence and artist papers and sold under brand names *Strathmore* and *Beckett*.

Coated Papers: This business produces coated papers used in a variety of printing and publication end uses such as catalogs, direct mailings, magazines, inserts and commercial printing. Products include coated free sheet, coated groundwood and supercalendered groundwood papers. Production capacity in the United States amounts to approximately 1.9 million tons annually.

Market Pulp: Market pulp is used in the manufacture of printing, writing and specialty papers, towel and tissue products and filtration products. Pulp is also converted into products such as diapers and sanitary napkins. Pulp products include fluff, southern softwood pulp, as well as northern, southern and birch hardwood paper pulps. These products are produced in the United States, France, Poland and Russia, and are sold around the world. International Paper facilities have annual dried pulp capacity of about 1.6 million tons.

Brazilian Paper: Brazilian operations function through International Paper do Brasil, Ltda and subsidiaries, that own or manage 1.3 million acres of forestlands in Brazil. Our annual production capacity in Brazil is approximately 680,000 tons of coated and uncoated papers. Our uncoated papers are primarily sold under the brand name *Chamex*. The Company also operates a wood chip business that sells eucalyptus and pine chips and pine timber on a global basis with eucalyptus and pine lumber sold in Brazilian markets.

Industrial Packaging

Industrial Packaging: With production capacity of about 4.8 million tons annually, International Paper is the third largest manufacturer of containerboard in the United States. Over one-third of our production consists of specialty grades, such as *BriteTop*. About 70% of our production is converted domestically into corrugated boxes and other packaging by our 67 U.S. container plants. Additionally, we operate two recycled containerboard mills and 33 container plants outside the United States. Our container plants are supported by regional design centers, which offer total packaging solutions and supply chain initiatives. We have the capacity to produce around 515,000 tons of kraft paper each year for use in multi-wall, retail bags and saturated kraft. The Industrial Papers business, which was sold on May 31, 2005, manufactured lightweight and pressure sensitive papers and converted products in four domestic facilities and one in the Netherlands.

Consumer Packaging

Consumer Packaging: International Paper is the world s largest producer of solid bleached sulfate packaging

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board with annual U.S. production capacity of about 1.8 million tons. On a global basis, across our businesses we work closely with our customers to understand their needs and create profitable business opportunities sourced from our broad base of packaging solutions: substrates and barrier board technologies combined with our printing expertise, graphics and structural design, filling equipment and service, *ASURYS* technologies (formerly called Smart Packaging) and marketing services. All are tailored to create packaging that appeals to consumers while building customer brand equity. Our *Everest, Fortress* and *Starcote* brands are used in packaging applications for everyday products such as juice, milk, food, cosmetics, pharmaceuticals, computer software and tobacco products. Approximately 32% of our bleached board production is converted into packaging products in our own plants. Our Beverage Packaging business, made up of 17 facilities worldwide, offers complete packaging systems. From paper to filling machines, using proprietary technologies including *Tru-Taste* brand barrier board technology for premium long-life juices, our expertise is utilized to produce creative customer solutions and value. Shorewood Packaging Corporation utilizes emerging technologies in its 18 facilities worldwide to produce world-class packaging with high-impact graphics for a variety of markets, including home entertainment, tobacco, cosmetics, general consumer and pharmaceuticals. The Foodservice business offers cups, lids, food containers and plates through three domestic plants and six international facilities.

Distribution

Through *xpedx*, our North American merchant distribution business, we service the commercial printing market with printing papers and graphic art supplies and equipment, high traffic/away-from-home markets with facility supplies and equipment, and various manufacturers and processors with packaging supplies and equipment. *xpedx* is the leading wholesale distribution marketer in these customer and product segments in North America, operating 125 warehouse locations and 145 retail stores in the United States and Mexico, and *xpedx.com*, a leading business to business e-commerce site.

Forest Products

Forest Resources: International Paper owns or manages approximately 6.5 million acres of forestlands in the United States, mostly in the South. All lands are independently third-party certified under the operating standards of the Sustainable Forestry Initiative (SFI™). In 2005, these forestlands supplied about 20% of the wood fiber requirements of our other businesses. Our forestlands are managed as a portfolio to optimize the economic value to our shareholders. Principal revenue-

generating activities include the sale of trees for harvest, the sale of forestlands to investment funds and other buyers for various uses, real estate development and the leasing of our properties for third-party recreational and commercial uses. The mix of these activities varies based on the fiber requirements of our mills and wood products plants, prevailing stumpage prices, supply and demand for forestlands, and market preferences for timber and forestlands. When stumpage prices are depressed relative to land values, forestland sales tend to comprise a larger part of our portfolio mix. Conversely, when stumpage prices are high, stumpage sales may be the best alternative to maximize the value of our forestland holdings.

Wood Products: International Paper owns and operates 25 plants producing lumber, plywood, engineered wood products and utility poles in the southern United States. Through these, we produce approximately 2.5 billion board feet of lumber and 1.6 billion square feet of plywood annually.

Specialty Businesses and Other

Chemicals: Arizona Chemical is a leading producer of specialty resins based on crude tall oil, a byproduct of the wood pulping process. These products, used in adhesives and inks, are made at 11 plants in the United States and Europe.

European Distribution: International Paper exited the European Distribution business with the sale of Papeteries de France in the second quarter of 2005.

Products and brand designations appearing in italics are trademarks of International Paper or a related company.

INDUSTRY SEGMENT RESULTS

Printing Papers

Demand for Printing Papers products is closely correlated with changes in commercial printing and advertising activity, direct mail volumes and, for uncoated cut-size products, with changes in white-collar employment levels that affect the usage of copy and laser printer paper. Market pulp is further affected by changes in currency rates that can enhance or disadvantage producers in different geographic regions. Principal cost drivers include manufacturing efficiency and raw material and energy costs.

Printing Papers net sales for 2005 increased 2% from 2004 and 8% from 2003. Operating profits in 2005 were 5% lower than in 2004 but 19% higher than in 2003. Compared with 2004, U.S. coated paper and market pulp earnings improved, but this was offset by earnings declines in U.S. uncoated papers, European Papers and Brazilian Papers. Benefits from improved mill operations and lower overhead costs ($129 million) and higher average sales prices in the United States ($371 million), were more than offset by higher raw material and energy costs ($312 million), increased market related downtime ($187 million) and other items ($30 million). Compared with 2003, higher 2005 earnings in the Brazilian Papers, U.S. coated papers and U.S. market pulp businesses were offset by lower earnings in the U.S. uncoated papers and the European Papers businesses. The Printing Papers segment took 995,000 tons of downtime in 2005, including 540,000 tons of lack-of-order downtime to align production with customer demand. This compared with 525,000 tons of downtime in 2004, of which 65,000 tons related to lack-of-orders.

Printing Papers

In millions	**2005**	2004	2003
Sales	**$7,860**	$7,670	$7,280
Operating Profit	**$552**	$581	$464

Uncoated Papers sales totaled $4.8 billion in 2005 compared with $5.0 billion in 2004 and 2003. Sales price realizations in the United States averaged 4.4% higher in 2005 than in 2004, and 4.6% higher than 2003. Favorable pricing momentum which began in 2004 carried over into the beginning of 2005. Demand, however, began to weaken across all grades as the year progressed, resulting in lower price realizations in the second and third quarters. However, prices stabilized as the year ended. Total shipments for the year were 7.2% lower than in 2004 and 4.2% lower than in 2003. To continue matching our productive capacity with customer demand, the business announced the permanent closure of three uncoated freesheet machines and took significant lack-of-order downtime during the period. Demand showed some improvement toward the end of the year, bolstered by the introduction our new line of vision innovation paper products (VIP Technologies™), with improved brightness and whiteness. Mill operations were favorable compared to last year, and the rebuild of the No. 1 machine at the Eastover, South Carolina mill was completed as planned in the fourth quarter. However, the favorable impacts of improved mill operations and lower overhead costs were more than offset by record high input costs for energy and wood and higher transportation costs compared to 2004. The earnings decline in 2005 compared with 2003 was principally due to lower shipments, higher downtime and increased costs for wood, energy and transportation, partially offset by lower overhead costs and favorable mill operations.

Average sales price realizations for our European operations remained relatively stable during 2005, but averaged 1% lower than in 2004, and 6% below 2003 levels. Sales volumes rose slightly, up 1% in 2005 compared with 2004 and 5% compared to 2003. Earnings were lower than in 2004, reflecting higher wood and

energy costs and a compression of margins due to unfavorable foreign currency exchange movements. Earnings were also adversely affected by downtime related to the rebuild of three paper machines during the year.

Coated Papers sales in the United States were $1.6 billion in 2005, compared with $1.4 billion in 2004 and $1.3 billion in 2003. The business reported an operating profit in 2005 versus a small operating loss in 2004. The earnings improvement was driven by higher average sales prices and improved mill operations. Price realizations in 2005 averaged 13% higher than 2004. Higher input costs for raw materials and energy partially offset the benefits from improved prices and operations. Sales volumes were about 1% lower in 2005 versus 2004.

Market Pulp sales from our U.S. and European facilities totaled $757 million in 2005 compared with $661 million and $571 million in 2004 and 2003, respectively. Operating profits in 2005 were up 86% from 2004. An operating loss had been reported in 2003. Higher average prices and sales volumes, lower overhead costs and improved mill operations in 2005 more than offset increases in raw material, energy and chemical costs. U.S. softwood and hardwood pulp prices improved through the 2005 first and second quarters, then declined during the third quarter, but recovered somewhat toward year end. Softwood pulp prices ended the year about 2% lower than 2004, but were 15% higher than 2003, while hardwood pulp prices ended the year about 15% higher than 2004 and 10% higher than 2003. U.S. pulp sales volumes were 12% higher than in 2004 and 19% higher than in 2003, reflecting increased global demand. European pulp volumes increased 15% and 2% compared with 2004 and 2003, respectively, while average sales prices increased 4% and 11% compared with 2004 and 2003, respectively.

Brazilian Paper sales were $684 million in 2005 compared with $592 million in 2004 and $540 million in 2003. Sales volumes for uncoated freesheet paper, coated paper and wood chips were down from 2004, but average price realizations improved for exported uncoated freesheet and coated groundwood paper grades. Favorable currency translation, as yearly average Real exchange rates versus the U.S. dollar were 17% higher in 2005 than in 2004, positively impacted reported sales in U.S. dollars. Average sales prices for domestic uncoated paper declined 4% in local currency versus 2004, while domestic coated paper prices were down 3%. Operating profits in 2005 were down 9% from 2004, but were up 2% from 2003. Earnings in 2005 were negatively impacted by a weaker product and geographic sales mix for both uncoated and coated papers, reflecting increased competition and softer demand, particularly in the printing, commercial and editorial market segments.

Entering 2006, earnings in the first quarter are expected to improve compared with the 2005 fourth quarter due principally to higher average price realizations, reflecting announced price increases. Product demand for the first quarter should be seasonally slow, but is expected to strengthen as the year progresses, supported by continued economic growth in North America, Asia and Eastern Europe. Average prices should also improve in 2006 as price increases announced in late 2005 and early 2006 for uncoated freesheet paper and pulp continue to be realized. Operating rates are expected to improve as a result of industry-wide capacity reductions in 2005. Although energy and raw material costs remain high, there has been some decline in both natural gas and delivered wood costs, with further moderation expected later in 2006. We will continue to focus on further improvements in our global manufacturing operations, implementation of supply chain enhancements and reductions in overhead costs during 2006.

Industrial Packaging

Demand for Industrial Packaging products is closely correlated with non-durable industrial goods production in the United States, as well as with demand for processed foods, poultry, meat and agricultural products. In addition to prices and volumes, major factors affecting the profitability of Industrial Packaging are raw material and energy costs, manufacturing efficiency and product mix.

Industrial Packaging s net sales for 2005 increased 2% compared with 2004, and were 18% higher than in 2003, reflecting the inclusion of International Paper Distribution Limited (formerly International Paper Pacific Millennium Limited) beginning in August 2005. Operating profits in 2005 were 39% lower than in 2004 and 13% lower than in 2003. Sales volume increases ($24 million), improved price realizations ($66 million), and strong mill operating performance ($27 million) were not enough to offset the effects of increased raw material costs ($103 million), higher market related downtime costs ($50 million), higher converting operating costs ($22 million), and unfavorable mix and other costs ($67 million). Additionally, the May 2005 sale of our Industrial Papers business resulted in a $25 million lower earnings contribution from this business in 2005. The segment took 370,000 tons of downtime in 2005, including 230,000 tons of lack-of-order downtime to balance internal supply with customer demand, compared to a total of 170,000 tons in 2004, which included 5,000 tons of lack-of-order downtime.

Industrial Packaging

In millions	**2005**	2004	2003
Sales	**$4,935**	$4,830	$4,170
Operating Profit	**$230**	$380	$264

Containerboard s net sales totaled $895 million in 2005, $951 million in 2004 and $815 million in 2003. Soft market conditions and declining customer demand at the end of the first quarter led to lower average sales prices during the second and third quarters. Beginning in the fourth quarter, prices recovered as a result of increased customer demand and a rationalization of supply. Full year sales volumes trailed 2004 levels early in the year, reflecting the weak market conditions in the first half of 2005. However, volumes rebounded in the second half of the year, and finished the year ahead of 2004 levels. Operating profits decreased 38% from 2004, but were flat with 2003. The favorable impacts of increased sales volumes, higher average sales prices and improved mill operating performance were not enough to offset the impact of higher wood, energy and other raw material costs and increased lack-of-order downtime. Implementation of the new supply chain operating model in our containerboard mills during 2005 resulted in increased operating efficiency and cost savings.

Specialty Papers in 2005 included the Kraft Paper business for the full year and the Industrial Papers business for five months prior to its sale in May 2005. Net sales totaled $468 million in 2005, $723 million in 2004 and $690 million in 2003. Operating profits in 2005 were down 23% compared with 2004 and 54% compared with 2003, reflecting the lower contribution from Industrial Papers.

U.S. Converting Operations net sales for 2005 were $2.6 billion compared with $2.3 billion in 2004 and $1.9 billion in 2003. Sales volumes were up 10% in 2005 compared with 2004, mainly due to the acquisition of Box USA in July 2004. Average sales prices in 2005 began the year above 2004 levels, but softened in the second half of the year. Operating profits in 2005 decreased 46% and 4% from 2004 and 2003 levels, respectively, primarily due to increased linerboard, freight and energy costs.

European Container sales for 2005 were $883 million compared with $865 million in 2004 and $801 million in 2003. Operating profits declined 19% and 13% compared with 2004 and 2003, respectively. The increase in sales in 2005 reflected a slight increase in demand over 2004, but this was not sufficient to offset the negative earnings effect of increased operating costs, unfavorable foreign exchange rates and a reduction in average sales prices. The Moroccan box plant acquisition, which was completed in October 2005, favorably impacted fourth-quarter results.

Industrial Packaging s sales in 2005 included $104 million from International Paper Distribution Limited, our Asian box and containerboard business, subsequent to the acquisition of an additional 50% interest in August 2005.

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Entering 2006, Industrial Packaging earnings are expected to improve significantly in the first quarter compared with the fourth quarter 2005. Average price realizations should continue to benefit from price increases announced in late 2005 and early 2006 for linerboard and domestic boxes. Containerboard sales volumes are expected to drop slightly in the 2006 first quarter due to fewer shipping days, but growth is anticipated for U.S. converted products due to stronger demand. Costs for wood, freight and energy are expected to remain stable during the 2006 first quarter, approaching fourth quarter 2005 levels. The continued implementation of the new supply chain model at our mills during 2006 will bring additional efficiency improvements and cost savings. On a global basis, the European Container operating results are expected to improve as a result of targeted market growth and cost reduction initiatives, and we will begin seeing further contributions from our recent Moroccan box plant acquisition and from International Paper Distribution Limited.

Consumer Packaging

Demand and pricing for Consumer Packaging products correlate closely with consumer spending and general economic activity. In addition to prices and volumes, major factors affecting the profitability of Consumer Packaging are raw material and energy costs, manufacturing efficiency and product mix.

Consumer Packaging s 2005 net sales of $2.6 billion were flat compared with 2004 and 5% higher compared with 2003. Operating profits in 2005 declined 22% from 2004 and 31% from 2003 as improved price realizations ($46 million) and favorable operations in the mills and converting operations ($60 million) could not overcome the impact of cost increases in energy, wood, polyethylene and other raw materials ($120 million), lack-of-order downtime ($13 million) and other costs ($8 million).

Consumer Packaging

In millions	**2005**	2004	2003
Sales	**$2,590**	$2,605	$2,465
Operating Profit	**$126**	$161	$183

Bleached Board net sales of $864 million in 2005 were up from $842 million in 2004 and $751 million in 2003. The effects in 2005 of improved average price realizations and mill operating improvements were not enough to offset increased energy, wood, polyethylene and other raw material costs, a slight decrease in volume and increased lack-of-order downtime. Bleached board mills took 100,000 tons of downtime in 2005, including 65,000 tons of lack-of-order downtime, compared with 40,000 tons of downtime in 2004, none of which

was market related. During 2005, restructuring and manufacturing improvement plans were implemented to reduce costs and improve market alignment.

Foodservice net sales were $437 million in 2005 compared with $480 million in 2004 and $460 million in 2003. Average sales prices in 2005 were up 3%; however, domestic cup and lid sales volumes were 5% lower than in 2004 as a result of a rationalization of our customer base early in 2005. Operating profits in 2005 increased 147% compared with 2004, largely due to the settlement of a lawsuit and a favorable adjustment on the sale of the Jackson, Tennessee bag plant. Excluding unusual items, operating profits were flat as improved price realizations offset increased costs for bleached board and resin.

Shorewood net sales of $691 million in 2005 were essentially flat with net sales in 2004 of $687 million, but were up compared with $665 million in 2003. Operating profits in 2005 were 17% above 2004 levels and about equal to 2003 levels. Improved margins resulting from a rationalization of the customer mix and the effects of improved manufacturing operations, including the successful start up of our South Korean tobacco operations, more than offset cost increases for board and paper and the impact of unfavorable foreign exchange rates in Canada.

Beverage Packaging net sales were $597 million in 2005, $595 million in 2004 and $589 million in 2003. Average sale price realizations increased 2% compared with 2004, principally the result of the pass-through of higher raw material costs, although the implementation of price increases continues to be impacted by competitive pressures. Operating profits were down 14% compared with 2004 and 19% compared with 2003, due principally to increases in board and resin costs.

In 2006, the bleached board market is expected to remain strong, with sales volumes increasing in the first quarter compared with the fourth quarter of 2005 for both folding carton and cup products. Improved price realizations are also expected for bleached board and in our foodservice and beverage packaging businesses, although continued high costs for energy, wood and resin will continue to negatively impact earnings. Shorewood should continue to benefit from strong Asian operations and from targeted sales volume growth in 2006. Capital improvements and operational excellence initiatives undertaken in 2005 should benefit operating results in 2006 for all businesses.

Distribution

Our Distribution business, principally represented by our *xpedx* business, markets a diverse array of products and supply chain services to customers in many business segments. Customer demand is generally sensitive to changes in general economic conditions, although the commercial printing segment is also dependent on corporate advertising and promotional spending. Distribution earnings and cash flows are generally stable. Providing customers with the best choice and value in both products and supply chain services is a key competitive factor. Additionally, efficient customer service, cost-effective logistics, and focused working capital management are key factors in this segment s profitability.

Distribution

In millions	**2005**	2004	2003
Sales	**$6,380**	$6,065	$5,860
Operating Profit	**$84**	$87	$80

Distribution s 2005 net sales increased 5% from 2004 and 9% from 2003. Operating profits in 2005 were 3% lower than 2004, but were 5% higher than 2003. Sales rose, in part, as a result of higher average sales prices for paper, tissue and packaging products. Sales volumes for packaging and facility supplies increased due to xpedx s increasing success in positioning itself as a national service provider to other distributors, manufacturers and retailers. While revenues increased in 2005, operating profits decreased, reflecting increased expenses associated with initiatives targeting further penetration of faster-growing market segments and costs of facility realignments to improve the ongoing efficiency of the xpedx distribution system.

The outlook for Distribution for 2006 is favorable. Average sales prices and margins are expected to remain at or above 2005 levels, and additional market penetration is targeted in the printing, manufacturing, redistribution and retail segments. Additional benefits are also expected from prior-year programs to further reduce operating costs.

Forest Products

Forest Products manages approximately 6.5 million acres of forestlands in the United States, and operates wood products plants in the United States that produce lumber, plywood, engineered wood products and utility poles. Forest Resources operating results are largely driven by demand and pricing for softwood sawtimber, and to a lesser extent for softwood pulpwood, by the volume of merchantable timber available to be harvested from Company forestlands, and by demand and pricing for specific forestland tracts offered for sale. Wood Products operating results are driven by new housing starts and repair and remodeling activity. Fiber costs are a major factor in Wood Products profitability.

Forest Products net sales for 2005 were up 7% compared with both 2004 and 2003. Operating profits in 2005 were 17% and 29% higher than in 2004 and 2003, respectively. Earnings in 2005 compared with 2004 reflected higher earnings from forestland and real estate

sales ($159 million) and decreased forestland operating expenses ($32 million); partially offset by reduced harvest and recreational income ($12 million), and lower Wood Products earnings ($45 million) due principally to higher raw material costs.

Forest Products

In millions	**2005**	2004	2003
Sales	**$2,575**	$2,395	$2,390
Operating Profit:			
Forest Resources			
Sales of Forestlands	**$400**	$315	$462
Harvest & Recreational Income	**269**	281	268
Forestland Expenses	**(146)**	(178)	(157)
Real Estate Operations	**198**	124	71
Wood Products	**206**	251	76
Operating Profit	**$927**	$793	$720

Forest Resources sales in 2005 were $1.0 billion compared with $900 million in 2004 and $1.1 billion in 2003. Operating profits in 2005 were 33% higher than in 2004 and 12% higher than in 2003, primarily due to higher forestland sales.

Operating profits from stumpage sales and recreational income were $269 million in 2005, compared with $281 million in 2004 and $268 million in 2003. Harvest volumes declined 13% in 2005 compared with 2004, and 20% from 2003, reflecting a lower inventory of mature sawtimber in 2005. Sawtimber prices were up 9% compared to both 2003 and 2004. Operating profits from forestland sales were $400 million in 2005 compared with $315 million in 2004 and $462 million in 2003, reflecting fewer acres sold but higher sales prices per acre. Operating expenses decreased to $146 million in 2005 from $178 million in 2004 and $157 million in 2003, reflecting the effects of restructuring efforts and cost reduction initiatives. Operating profits for the Real Estate division, which principally sells higher-and-better use properties, were $198 million, $124 million and $71 million in 2005, 2004 and 2003, respectively. International Paper monetizes its forest assets in various ways, including sales of short- and long-term harvest rights, on a pay-as-cut or lump-sum, bulk-sale basis, as well as through the sales of timberlands.

For 2006, our harvest is projected to decline 14% due to a lower inventory of mature timber. However, in future years, the harvest profile is expected to improve as timber tracts mature and the benefits of higher yield-per-acre initiatives are realized. Average first-quarter 2006 southern pine pulpwood, pine sawtimber and hardwood pulpwood prices are expected to remain close to fourth-quarter 2005 levels. Forestland sales will continue to be dependent upon various factors including tract location and the level of investor interest.

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Wood Products sales in the United States in 2005 of $1.6 billion were up 3% from $1.5 billion in 2004 and 18% from $1.3 billion in 2003. Average price realizations for lumber were up 6% and 21% in 2005 compared with 2004 and 2003, respectively. Lumber sales volumes in 2005 were up 5% versus 2004 and 10% versus 2003. Average sales prices for plywood were down 4% from 2004, but were 15% higher than in 2003. Plywood sales volumes in 2005 were slightly higher than 2004 and 2003. Operating profits in 2005 were 18% lower than 2004, but nearly three times higher than 2003. Lower average plywood prices and higher raw material costs more than offset the effects of higher average lumber prices, volume increases and a positive sales mix. In 2005, log costs were up 9% versus 2004, negatively impacting both plywood and lumber profits. Lumber and plywood operating costs also reflected substantially higher glue and natural gas costs versus both 2004 and 2003.

Looking forward to the first quarter of 2006, a continued strong housing market, combined with low product inventory in the distribution chain, should translate into continued strong lumber and plywood demand. However, a possible softening of housing starts and higher interest rates later in the year could put downward pressure on pricing in the second half of 2006.

Specialty Businesses and Other

The Specialty Businesses and Other segment includes the operating results of Arizona Chemical, European Distribution and, prior to its closure in 2003, our Natchez, Mississippi chemical cellulose pulp mill. Also included are certain divested businesses whose results are included in this segment for periods prior to their sale or closure.

This segment s 2005 net sales declined 18% and 26% from 2004 and 2003, respectively. Operating profits in 2005 were down substantially from both 2004 and 2003. The decline in sales principally reflects declining contributions from businesses sold or closed. Operating profits were also affected by higher energy and raw material costs in our Chemical business.

Specialty Businesses and Other

In millions	**2005**	2004	2003
Sales	**$915**	$1,120	$1,235
Operating Profit	**$4**	$38	$23

Chemicals sales were $692 million in 2005, compared with $672 million in 2004 and $625 million in 2003. Although demand was strong for most Arizona Chemical product lines, operating profits in 2005 were 84% and 83% lower than in 2004 and 2003, respectively, due to higher energy costs in the U.S, and higher prices and reduced availability for crude tall oil

(CTO). In the United States, energy costs increased 41% compared to 2004 due to higher natural gas prices and supply interruption costs. CTO prices increased 26% compared to 2004, as certain energy users turned to CTO as a substitute fuel for high-cost alternative energy sources such as natural gas and fuel oil. European CTO receipts decreased 30% compared to 2004 due to lower yields following the Finnish paper industry strike and a Swedish storm that limited CTO throughput and corresponding sales volumes.

Other businesses in this operating segment include operations that have been sold, closed, or are held for sale, principally the European Distribution business, the oil and gas and mineral royalty business, Decorative Products, Retail Packaging, and the Natchez chemical cellulose pulp mill. Sales for these businesses were approximately $223 million in 2005 (mainly European Distribution and Decorative Products) compared with $448 million in 2004 (mainly European Distribution and Decorative Products), and $610 million in 2003.

LIQUIDITY AND CAPITAL RESOURCES

Overview

A major factor in International Paper s liquidity and capital resource planning is its generation of operating cash flow, which is highly sensitive to changes in the pricing and demand for our major products. While changes in key cash operating costs, such as energy and raw material costs, do have an effect on operating cash generation, we believe that our strong focus on cost controls has improved our cash flow generation over an operating cycle. As a result, we believe that we are well positioned for improvements in operating cash flow should prices and worldwide economic conditions improve in the future.

As part of our continuing focus on improving our return on investment, we have focused our capital spending on improving our key platform businesses in North America and in geographic areas with strong growth opportunities. Spending levels have been kept below the level of depreciation and amortization charges for each of the last three years, and we anticipate continuing this approach in 2006.

With the low interest rate environment in 2005, financing activities have focused largely on the repayment or refinancing of higher coupon debt, resulting in a net reduction in debt of approximately $1.7 billion in 2005. We plan to continue this program, with additional reductions anticipated as our previously announced Transformation Plan progresses in 2006. Our liquidity position continues to be strong, with approximately $3.2 billion of committed liquidity to cover future short-term cash flow requirements not met by operating cash flows.

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Management believes it is important for International Paper to maintain an investment-grade credit rating to facilitate access to capital markets on favorable terms. At December 31, 2005, the Company held long-term credit ratings of BBB (negative outlook) and Baa3 (stable outlook) from Standard & Poor s and Moody s Investor Services, respectively.

Cash Provided By Operations

Cash provided by continuing operations totaled $1.5 billion for 2005, compared with $2.1 billion in 2004 and $1.5 billion in 2003. The major components of cash provided by continuing operations are earnings from continuing operations adjusted for non-cash income and expense items and changes in working capital. Earnings from continuing operations adjusted for non-cash items declined by $83 million in 2005 versus 2004. This compared with an increase of $612 million for 2004 over 2003.

Working capital, representing International Paper s investments in accounts receivable and inventory less accounts payable and accrued liabilities, was $2.6 billion at December 31, 2005. Cash used for working capital components increased by $591 million in 2005, compared with a $86 million increase in 2004 and an $11 million increase in 2003. The increase in 2005 was principally due to a decline in accrued liabilities at December 31, 2005.

Investment Activities

Capital spending from continuing operations was $1.2 billion in 2005, or 84% of depreciation and amortization, comparable to the $1.2 billion, or 87% of depreciation and amortization in 2004, and $1.0 billion, or 74% of depreciation and amortization in 2003.

The following table presents capital spending from continuing operations by each of our business segments for the years ended December 31, 2005, 2004 and 2003.

In millions	**2005**	2004	2003
Printing Papers	**$658**	$590	$482
Industrial Packaging	**187**	179	165
Consumer Packaging	**131**	205	128
Distribution	**9**	5	12
Forest Products	**121**	126	121
Specialty Businesses and Other	**31**	39	31
Subtotal	**1,137**	1,144	939
Corporate and other	**18**	32	54
Total from continuing operations	**$1,155**	$1,176	$993

We expect capital expenditures in 2006 to be about $1.2 billion, or about 80% of depreciation and amortization. We will continue to focus our future capital spending on improving our key platform businesses in

North America and on investments in geographic areas with strong growth opportunities.

Acquisitions

In October 2005, International Paper acquired approximately 65% of Compagnie Marocaine des Cartons et des Papiers (CMCP), a leading Moroccan corrugated packaging company, for approximately $80 million in cash plus assumed debt of approximately $40 million.

In August 2005, pursuant to an existing agreement, International Paper purchased a 50% third-party interest in IPPM (subsequently renamed International Paper Distribution Limited) for $46 million to facilitate possible further growth in Asian markets. In 2001, International Paper had acquired a 25% interest in this business. The accompanying consolidated balance sheet as of December 31, 2005 includes preliminary estimates of the fair values of the assets and liabilities acquired, including approximately $50 million of goodwill.

In July 2004, International Paper acquired Box USA Holdings, Inc. (Box USA) for approximately $400 million, including the assumption of approximately $197 million of debt, of which approximately $193 million was repaid by July 31, 2004.

Each of the above acquisitions was accounted for using the purchase method. The operating results of these acquisitions have been included in the consolidated statement of operations from the dates of acquisition.

Financing Activities

2005: Financing activities during 2005 included debt issuances of $1.0 billion and retirements of $2.7 billion, for a net debt and preferred securities reduction of $1.7 billion.

In November and December 2005, International Paper Investments (Luxembourg) S.ar.l., a wholly-owned subsidiary of International Paper, issued $700 million of long-term debt with an initial interest rate of LIBOR plus 40 basis points that can vary depending upon the credit rating of the Company, and a maturity date in November 2010. Additionally, the subsidiary borrowed $70 million under a bank credit agreement with an initial interest rate of LIBOR plus 40 basis points that can vary depending upon the credit rating of the Company, and a maturity date in November 2006.

In December 2005, International Paper used proceeds from the above borrowings, and from the sale of CHH in the third quarter of 2005, to repay approximately $190 million of notes with coupon rates ranging from 3.8% to 10% and original maturities from 2008 to 2029. The remaining proceeds from the borrowings and the CHH sale will be used for further debt reductions in the first quarter of 2006.

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Other activities in the fourth quarter of 2005 included the repatriation of $900 million of cash from certain of International Paper s European and Canadian subsidiaries under the American Jobs Creation Act of 2004. Most of the cash from the repatriation is intended for further debt reduction in 2006.

In September 2005, International Paper used some of the proceeds from the CHH sale to repay the remaining $250 million portion of a subsidiary s $650 million long-term debt with an interest rate of LIBOR plus 62.5 basis points and a maturity date of June 2007, and $312 million of commercial paper that had been issued in the same quarter. Other reductions in the third quarter of 2005 included $662 million of notes with coupon rates ranging from 4% to 7.35% and original maturities from 2009 to 2029, and the repayment of $150 million of 7.10% notes with a maturity date of September 2005.

In the second quarter of 2005, International Paper repatriated approximately $1.2 billion in cash from certain of its foreign subsidiaries, including amounts under the American Jobs Creation Act of 2004. In June 2005, International Paper repaid approximately $400 million of a subsidiary s long-term debt with an interest rate of LIBOR plus 62.5 basis points and a maturity date of June 2007.

In February 2005, the Company redeemed the outstanding $464 million aggregate principal amount of International Paper Capital Trust 5.25% convertible subordinated debentures at 100.5% of par plus accrued interest, and made early payments of approximately $295 million on notes with coupon rates ranging from 4% to 7.875% and original maturities from 2006 to 2015.

Other financing activity in 2005 included the issuance of approximately 3,006,000 common shares under various incentive plans, including stock option exercises that generated $23 million of cash.

2004: Financing activities during 2004 included debt issuances of $2.5 billion and retirements of $4.2 billion, including repayments of $193 million of debt assumed in the Box USA acquisition in July and approximately $340 million of debt that was reclassified from Minority interest in 2004 prior to repayment. Excluding these repayments, the net reduction in debt during 2004 was approximately $1.0 billion.

In December 2004, Timberlands Capital Corp. II, a former wholly-owned consolidated subsidiary of International Paper, redeemed $170 million of 4.5% preferred securities. In August 2004, International Paper repurchased $168 million of limited partnership interests in Georgetown Equipment Leasing Associates, L.P. and Trout Creek Equipment Leasing, L.P. Both of these securities had been reclassified from Minority interest to

Current maturities of long-term debt prior to their repayment.

Also in August 2004, an International Paper wholly-owned subsidiary issued 500 million euro-denominated long-term debt (equivalent to approximately $619 million at issuance) with an initial interest rate of EURIBOR plus 55 basis points and a maturity in August 2009.

In June 2004, an International Paper wholly-owned subsidiary issued $650 million of long-term debt with an interest rate of LIBOR plus 62.5 basis points and a maturity date of June 2007, which refinanced $650 million of long-term debt having an interest rate of LIBOR plus 100 basis points and a maturity date in August 2004. In April 2004, $1.0 billion of 8.125% coupon rate debt was retired using the proceeds from the March 2004 issuance of $400 million of 5.25% notes due in April 2016 and $600 million of 4.00% notes due in April 2010.

In January 2004, approximately $1.0 billion of debt with an 8.05% blended coupon rate was retired, including all of the outstanding $805 million principal amount of International Paper Capital Trust III 7.875% preferred securities, using the proceeds from the two December 2003 issuances of $500 million each of notes discussed below.

In addition to the preceding repayments, various other International Paper borrowings totaling approximately $1.0 billion were repaid in 2004.

Other financing activity in 2004 included the issuance of approximately 3,652,000 treasury shares and 2,333,000 common shares under various incentive plans, including stock option exercises that generated $164 million of cash.

2003: Financing activities during 2003 included debt and preferred security issuances of $2.2 billion and retirements totaling $1.2 billion for a net increase of $1.0 billion. The increase reflects the timing of $1 billion of borrowings in December 2003 used to retire approximately $1 billion of debt in early 2004 as discussed below. Other 2003 financing activity included the redemption of $550 million and the issuance of $150 million of preferred securities of International Paper subsidiaries.

In December 2003, $500 million of 4.25% Senior Unsecured Notes due January 2009, and $500 million of 5.50% Senior Unsecured Notes due January 2014, were issued. In January 2004, the proceeds from these issuances were used to redeem $805 million of 7.875% preferred securities of International Paper Capital Trust III that, prior to July 1, 2003, was a subsidiary of International Paper. The remaining proceeds were used for the repayment or early retirement of other debt.

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In March 2003, $300 million of 3.80% notes due in April 2008, and $700 million of 5.30% notes due in April 2015, were issued. The proceeds from these notes were used to repay approximately $450 million of commercial paper and long-term debt and to redeem $550 million of preferred securities of IP Finance (Barbados) Limited, a non-U.S. consolidated subsidiary of International Paper. In the same period, International Paper sold a minority interest in Southeast Timber, Inc., a consolidated subsidiary of International Paper, to a private investor for $150 million with future dividend payments based on LIBOR.

Other financing activity included $26 million for the repurchase of approximately 713,000 shares of International Paper common stock, and the issuance of 2,725,000 treasury shares under various incentive plans, including stock option exercises that generated $80 million of cash.

Refinancing of high coupon rate debt in the last three years is one means the Company uses to manage interest expense. Another method is the use of interest rate swaps to change the mix between fixed and variable rate debt. At December 31, 2005, International Paper had entered into interest rate swaps with a total notional amount of $1.7 billion. These swaps reduced 2005 interest expense by $10 million before taxes and minority interest, or 60 basis points, on $1.7 b