



DISCOVERY

THE QUARTERLY NEWSLETTER OF KOCH INDUSTRIES

APRIL 2007

The Right Chemistry

Flint Hills Resources is preparing to make its largest chemicals acquisition ever: the purchase of Huntsman's North American polymers and base chemicals assets.

The sale, expected to close this summer, includes five manufacturing facilities, 600 miles of pipeline and about 900 employees.

Three of those assets are in Texas. The other two are in Illinois and Michigan.

Vision

"Our vision is focused on refining, chemical and related process industries," said Brad Razook, FHR's president. "So this is a natural extension of our petrochemical manufacturing and marketing capabilities."

The acquisition also fits well with FHR's vision of value creation and growth.

"We already have a well-established aromatics business," Razook explained, "but

this will give us a totally new platform for growth in the olefins segment."

Olefins, such as ethylene and propylene, are the building blocks for many of the world's most popular plastics. They are also some of the biggest global commodities in the chemicals industry.

"This business already sells quite a bit of polyethylene to Georgia-Pacific and is a major cyclohexane supplier to INVISTA."

Familiar turf

Following the acquisition, Jeff Ramsey will be commercial leader for the new assets.

"The olefin crackers are operated much like our Corpus Christi facility and the polymer plants are very similar to our plant in Joliet," Ramsey said. "So this is a great opportunity for applying our core capabilities."

FHR also looks forward to new technical, product application and marketing capabilities.

The most significant asset in the transaction is the olefin cracker at Port Arthur, Texas. That unit suffered a major fire last April and has been under repair ever since.

FHR's acquisition is contingent on a successful rebuild and start-up of the cracker. If all goes as planned, the unit will be operational this summer.

Volatility

Commodity chemical producers face plenty of change, such as new competition from China, Iran and the Middle East.

According to Tony Sementelli, FHR's chief financial officer, "the past few years have been some of the best commodity chemical markets we've seen in a long time. However, these markets are very volatile, which helps explain why Huntsman, which is now a public company, wanted to divest."

Sementelli also believes that having the Port Arthur facility out of commission helped create a unique sales process. "We know other companies had an interest in these assets, but the fact we could move quickly and pay cash was a real competitive advantage for us."

"Our vision calls for investing in assets that are advantaged or undervalued by public markets. You could say Huntsman qualifies on both counts."

Sementelli believes the acquisition has significant potential.

"FHR gains some key assets, Koch Pipeline will become the new operator of the pipelines supporting Port Arthur, and GP and INVISTA can look forward to enhanced supply agreements."

"That is a lot of potential value for a lot of Koch companies." ■



Odessa, Texas – This polymer plant is included in the FHR acquisition.

THIS ISSUE...

- | | | | |
|----------------------|------|---------------------------|------|
| ■ Science of Success | Pg 2 | ■ Economics in One Lesson | Pg 7 |
| ■ Floating Tanks | Pg 3 | ■ Q&A with Charles Koch | Pg 8 |

Thank you for the signed copy of *The Science of Success*. I have read it several times.

As I have said to you before, I am only sorry that you did not come along sooner in my career. I can only imagine how much better an executive I would have been with the benefit of your teachings.

Pete Correll
Retired chairman and CEO
Georgia-Pacific Corp.
Atlanta, Ga.

Yesterday our plant manager gave employees a copy of Mr. Koch's book.

When I got home last night, my nine-year-old told me the librarian at his school was talking about a book by Charles Koch. (I'm not sure how she knew.)

My boy proudly told her "My dad works for him!" and proceeded to get plenty of attention in class.

My son was amazed to see that I actually had a copy of the book. He took it with him to his sister's basketball game and showed it to parents, explaining that his dad works for the man that wrote it.

He also requested that I give it to him next Wednesday so he can show the librarian.

I live in a very small community, so if the middle school librarian knows, the word is definitely out.

Craig Doelling
KCBX field supervisor
Chicago, Ill.

I am enjoying your recently published book. Your concepts are clear, concise and simple. That is always the way wisdom presents itself.

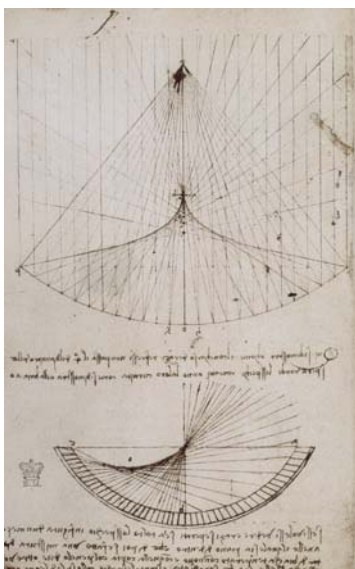
The concept of "virtue and talents" has resonated with me. A talented man without virtue will find himself down a path of destruction that is his

own making. A virtuous man without talent at least has a solid foundation of character to stand upon.

Rodney Miller, Dean
College of Fine Arts
Wichita State University
Wichita, Kan.



Wichita – Charles Koch at an employee book-signing event March 5. Whenever possible, Mr. Koch will also sign books at other Koch company locations. These employee events will be announced in advance.



What is the drawing on the front of the book? Is it by Leonardo da Vinci?

Dick Anderson
Flint Hills Resources
Wichita, Kan.

Yes, it is. Leonardo's drawing of light reflected from a mirror (above) was chosen for the cover by the publisher.

Last week I read Charles Koch's book, *The Science of Success*, and must say I enjoyed it very much. I like how the author distills his thoughts and ideas in a way most people would find easy to grasp.

Not surprisingly, many management titles are the exact

opposite. They tend to contain lots of instantly forgettable consultant-type nonsense, but very little insight or valuable knowledge.

Lucas Wilk
Marketing manager
John Wiley & Sons
Toronto, Ontario

The Science of Success will be a featured title throughout May at all Barnes & Noble stores.

Wiley, the publisher of Koch's book, recently sold the rights for an audio version, available in 2008.

The Science of Success reached #34 on Amazon.com before that site ran out of copies. The book has been widely reviewed by publications such as *Forbes* and the *Wall Street Journal*.

DISCOVERY

APRIL 2007 VOLUME 13 NUMBER 2

Editorial Board

Rich Fink	Charles Koch
Jeff Gentry	Jim Mahoney
Dale Gibbens	Dave Robertson
Mary Beth Jarvis	Katie Stavinoha

Cover photos: Chris Lee, courtesy the NSO; Huntsman Chemicals.

Questions? Comments? Reprints?
Contact: Rod Learned
(316) 828-6136
learnedr@kochind.com

Publication design:
Richard Bachman
Koch Creative Group

©2007, Koch Industries, Inc.
<http://www.kochind.com>
<http://www.kochehs.com>
Koch is an EOE. M/F/D/V

KOCH
INDUSTRIES INC

★ **Singapore** - What should you do when a well-established, profitable business begins to decline? In his new book, Charles Koch suggests a one-word solution: innovation.

"Innovation," writes Koch, "is the key to long-term success."

In keeping with that advice, Koch Supply & Trading has developed an innovative approach for its fuel oil business in Asia.

"KS&T had distinguished itself by delivering quality products, on time at a competitive price," said Brady Cook, managing director of Far East trading. "But margins were dropping, so we started to re-think how to serve that market."

KS&T began by investigating the possibilities of leasing storage tanks and adding a blending capability.

Unfortunately, there was no tank space available for immediate lease. Even if there had been, KS&T soon realized that leasing tanks solely for blending was uneconomical.

As it started reworking its mental models, the group began thinking about adapting KS&T's successful model for Gulf Coast crude oil and gasoline markets.

"Gulf Coast and Singapore markets are comparable in many ways. Both rely on imports, have similar logistic challenges and tend to have more demand than supply. And their supplies often fail to meet customer specifications."

The team began thinking about a tank strategy in broader terms. "Having access to a

tank is like owning an option on any of the activities that can be performed in the tank," Cook said. "That includes blending and storage, but also the option to participate farther up and down the value chain."

KS&T decided to lease several storage tanks being built in Singapore, even though those tanks were not scheduled for completion until a year later.

How could KS&T speed up that timeline and increase the size of the experiment?

By thinking of tanker ships as floating storage tanks instead of just transportation.

"We time-chartered a 180,000-ton vessel for floating storage at the end of 2006."

That charter enabled KS&T to implement its new tank strategy on a larger scale and more quickly.

This innovative tactic has already yielded unexpected benefits.

"Instead of trying to create value by predicting market prices, we've found the spot market will price the most-valued tank activity for us, whether it's storage, blending or whatever. We simply respond accordingly."

Improved information flow has also improved KS&T's ability to understand the drivers of supply and demand. "That has helped us improve our paper trading activities."

As far as KS&T president Steve Mawer is concerned, the



innovation is just beginning.

"Our trading activities around all of this will continue to evolve," Mawer said, "but we're already very pleased with what we've learned and with the performance so far."

★ **Quebec** - Tulsa-based John Zink Co. has acquired Coen Co., a combustion supplier with operations in Quebec and near Mexico City as well as joint venture interests in India and the Netherlands.

John Zink has also acquired EEC-Luxembourg, a company that services vapor control products throughout Europe. Those systems are a major product category for John Zink.

Privately held Coen was founded in 1912 and is based in Woodland, Calif. Its 270 North American employees design, manufacture and service burner equipment and combustion systems.

Coen is best known for its industrial boiler burners. Its ultra-low NOx watertube boiler burners are especially popular with utility companies.

According to Southern California Gas Co., a Coen customer, industrial boilers that produce steam are the single largest energy consumer in the U.S.

John Zink, the world leader in combustion technology, is wholly owned by Koch Chemical Technology Group, LLC. ■



This 180,000-ton vessel serves as a stationary, floating storage tank.

Growth Rings

The largest acquisition in the history of Koch Industries – the \$21 billion purchase of Georgia-Pacific – was completed Dec. 23, 2005.

GP exceeded expectations during its first full year as a Koch company and is off to a strong start in 2007, despite challenging markets.

In the past 16 months, GP employees have faced plenty of challenges and changes.

The change to private own-

ership, for example, has provided greater access to capital. Even more important, GP now has a leadership team fully focused on creating long-term value rather than meeting quarterly expectations. As for challenges, GP's biggest challenge probably has been – and still is – getting up to speed with an entirely new management philosophy: MBM®.

“There has been a steep learning curve regarding MBM. Changes in the compensation framework, development of an

Differences

Moeller sees some important differences between the acquisition of GP and KII's second-biggest acquisition, INVISTA. Moeller was president and chief operating officer of KII when INVISTA was purchased from DuPont for \$4.2 billion in 2004.

“The biggest difference was buying all of GP versus just a part of DuPont. GP has nearly three times as many employees and at least 250 more plant sites than INVISTA.

“Plus, we had just three months to prepare for GP and integrating Cellulose. Consequently, we've got work to do on our vision development process.”

As part of that process, Moeller is insisting on more than just extending GP's existing businesses. “We also want to leverage and broaden the underlying platforms.”

Visions for success

In an April 16 speech to Atlanta's Rotary Club, Charles Koch, KII's chairman and CEO, reiterated the reasons for acquiring GP and his confidence in its future:

“Given our capabilities and guided by MBM, we saw the opportunity to change the way GP competed and, thereby, greatly improve its profitability.

“As a private company that reinvests 90 percent of its earnings, we have the flexibility and resources to pursue strategies and opportunities that Georgia-Pacific couldn't as a public company.



Sales of popular GP building products such as Plytanium® are affected by changes in the rate of new housing construction.

“This progress is just the beginning,” Koch said, “because we view GP as more than just a high-quality investment. We view it as a whole new set of growth platforms.

“Our vision is to generate the same kind of growth for GP that KII has enjoyed over the last 40 years.”

GP platforms

In keeping with Koch's expectations, Jim Hannan, GP's president and COO, sees several promising indicators of growth and value creation.

“Earlier this year, we acquired five significant sites from International Paper,” Hannan said. “As a public company, we wouldn't have acquired those assets when we did, with building products markets in a down cycle, because of the effect it would have had on our stock price.”

Hannan also points to the recent acquisition of Insulair – maker of a patented triple-walled cup – as an example of how much today's GP values innovation.

“GP's historical approach was to be a fast follower in most markets. Now, we want to accelerate and drive innovation so we can be a leader in our markets.

“We're in the process of implementing a framework, somewhat similar to those at other Koch companies, where ideas come not only from our people, but more diverse sources outside the company.”



Atlanta – Georgia-Pacific headquarters.



Joe Moeller (left) and Jim Hannan at GP's 2007 kickoff for the Komen Race For The Cure.

Investments

Hannan points out that GP is making significant investments in much-needed equipment for its existing businesses.

"We've committed more than \$200 million to add premium air-dried paper capacity at our Wauna, Ore., mill. That investment supports our premium towel strategy for important customers such as Wal-Mart and Costco."

GP is also spending \$120 million to expand its Savannah, Ga., gypsum plant, allowing for further growth in sales of its popular ToughRock®, DensArmor® and DensGlass Gold® products.

"Many of our biggest and best customers want to see certain changes to our products," Hannan said.

"Those changes, innovations and improvements can only be delivered by making these kinds of investments."

The financial ability to make such investments is especially important in today's environment of industry consolidation.

"That consolidation is only going to increase," Moeller said, "which is good news for us, because we'll probably see many more opportunities, given our ability to invest and grow."

Seeing overseas

Last year, GP considered selling its international consumer products division, which makes and markets popular

brands such as Lotus® in France and Colhogar® in Spain.

"We decided to keep the business," Moeller said, "and its results began improving in the second half of last year. That positive trend has continued into 2007."

Moeller is especially eager to leverage trading knowledge

– a core capability of Koch companies – at Georgia-Pacific.

"As we work through our point of view on international markets, we are likely to identify even more opportunities, especially in trading."

Trading capability

Moeller believes many of the same concepts that helped build Koch Mineral Services' successful physical commodity trading organization can be applied to GP's products such as plywood. This emphasis on a trading mentality is a new approach for most of GP.

"We also have a new energy-trading capability to help us better understand our positions and to think about options and the risks associated with our energy contracts," Moeller said.

"This is a new way of thinking that can help us optimize our assets here in the U.S. and make the most of our opportunities overseas."

Forecast

Moeller and Hannan see a mixed bag for GP in 2007.

"Our consumer products business is still very strong," Hannan said. "We feel very good about where we are today in our markets."

"The packaging business is under some pressure due to current economic trends, but it

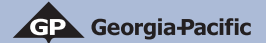
continues to perform well. And, as Joe mentioned earlier, our international consumer products business is improving."

GP's building products business, which is highly cyclical, faces several challenges and is more of a concern, though solidly profitable. "Housing starts hit a 10-year low in January," Hannan said, "so this will be a tougher year for us than we expected."

"The good news is, overall, our first year was better than we expected and we're confident we can deal with the deep cyclical downturn in building products."

Perhaps the best forecast of GP's future comes from Charles Koch, who concluded his Atlanta Rotary Club remarks by saying:

"GP's growth will continue to be driven by our philosophy of Principled Entrepreneurship™: Maximize long-term profitability by creating real value in society while always acting lawfully and with integrity." ■



GP at a glance

HQ: Atlanta, Ga.

Employees: 50,000

Locations: 300

Annual production: 10 billion square feet of structural panels (plywood and oriented strand board)

6.5 billion square feet of gypsum wallboard

4 million tons of tissue

4 million tons of containerboard (liner and medium)

2.3 billion board feet of lumber

2 million tons of paper (communication and kraft paper, bleached board)

Major customers: Wal-Mart, Costco, Target, Home Depot, Sam's Club, Lowe's, Kroger, General Mills, Proctor & Gamble



GP's high-visibility sponsorships include four-time NASCAR Cup Series champion Jeff Gordon and the Extreme Stunt Show at Disney-MGM Studios.



Last year, volunteers removed more than 2,600 bags of trash from the Anacostia and Potomac Rivers.

The southeast section of Washington, D.C. has been called one of the most impoverished and polluted neighborhoods in America.

There, the Anacostia River is often cluttered with trash, ranging from wastepaper and garbage to discarded furniture.

Four years ago, Koch Industries took the lead in sponsoring a cleanup effort of the Anacostia and Potomac Rivers in Washington, D.C. That event, called Capital River Relief, was based on the success of a similar project near Pine Bend refinery in Minnesota two years earlier.

“Capital River Relief is a privately funded, all-volunteer coalition of local and national environmental groups, businesses, government and community organizations,” said Matt Schlapp, executive director of federal affairs for KII.

“These groups work with Living Lands and Waters, which coordinates efforts on the ground, and Koch Industries, lead sponsor for the event, to help clean up these rivers every year.”

Logistics

As it has been from the beginning, Koch Industries was lead sponsor for this year’s event. And once again it was Living Lands and Water, led by Chad Pregracke, that provided the barge that eventually is piled high with trash bags full of items removed the rivers and their riverbanks.

Team Up To Clean Up

During the second week of the cleanup, Pregracke celebrated the publication of his book, *From the Bottom Up*, published by *National Geographic*. Chapter nine of that book is devoted to Capital River Relief.

This year’s cleanup ran from March 27 to April 22 and involved dozens of volunteer groups. The many participating sponsors included the Alice Ferguson Foundation and the Anacostia Watershed Society, organizations devoted to cleanup of the Chesapeake Bay and Potomac River watersheds.

Getting dirty

Without question, it is volunteers who make Capital River Relief a success. Since the event takes place in the spring,

During the four years of Koch-sponsored Capital River Relief, volunteers have removed almost 400 tons of trash.

those volunteers can experience some tough conditions out on the water.

“As if wading through muck and dealing with trash isn’t challenging enough, the weather is often the biggest challenge volunteers face,” said Catherine Haggett, KII’s associate director of federal

affairs in Washington.

“Over the years we’ve had everything from sunshine and cherry blossoms to freezing rain and snow.”

Rain or shine, it was easy to spot many of the 800 volunteers working their way up and down the rivers.

The trash they collected was bagged and loaded onto a 135-foot barge provided by Living Lands and Waters.

Celebrating success

At a closing ceremony on Earth Day, April 22, many Capital River Relief volunteers gathered to celebrate another successful cleanup.

As usual, there were stories comparing the most unusual items found in the river, including prosthetic limbs, an ATM and a surprising number of messages in bottles.

Although final numbers are not yet available, at least 60,000 pounds of trash were removed this year.

“Those are great results,” Schlapp said, “but they’re really just a beginning.

“Our next challenge is to find a way of making the cleanup of these rivers sustainable, rather than just a once-a-year event.” ■



Koch company volunteers find that discarded tires are surprisingly common along the riverbanks of Washington, D.C.



Noteworthy

Economics in One Lesson

- Henry Hazlitt.

This book, a modern classic, is subtitled “the shortest and surest way to understand basic economics.”

That’s a tall claim, but the book really is simple, straightforward and easy to read. No wonder it is enormously popular with college students and those who are just coming to grips with economic theory.

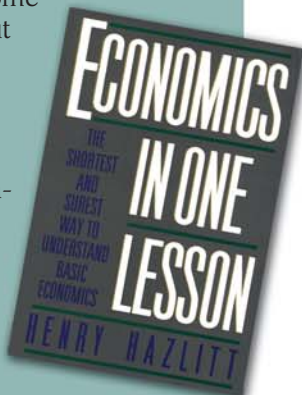
On the other hand, it has also received high praise from the economically sophisticated. Nobel Laureate and economist F.A. Hayek called it “a brilliant performance.”

Hazlitt summed up his masterwork by warning against the fallacy of isolation:

“In studying the effects of any given economic proposal we must trace not merely the immediate results but the results in the long run, not merely the primary consequences but the secondary consequences, and not merely the effects on some special group but the effects on everyone.”

(pg. 103)

Those are words to remember as lawmakers discuss policies ranging from ethanol production and trade barriers to climate change and so-called “excess profits” taxes.



Too True
 “Government has nothing to give [you] without first taking it away from somebody else – or from [you].”

— Henry Hazlitt

A Meeting With Meaning

This year marks the 40th anniversary of one of the most important board meetings in the history of Koch Industries. Back then, the company was known as Rock Island Oil & Refining.

On Nov. 22, 1967, a special meeting of the Rock Island board was held in Wichita. Five days earlier, Fred C. Koch, the company’s chairman, had suffered a fatal heart attack while hunting in Utah.

By unanimous consent, 32-year-old Charles Koch was elected as the company’s new chairman, filling the vacancy created by his father’s untimely death.

But there was also another vacancy to fill. Fred’s widow, Mary R. Koch, had tendered her resignation as a director and vice president of the company, effective that same day.

Mary Koch’s position was filled by Tom Carey, the company’s chief financial officer and board secretary. Carey served as a director for 20 of the next 22 years, retiring from Koch Industries and its board in 1989.

Lasting value

Other agenda items at that special meeting included a motion to increase the number of directors. After approving the motion, the board unanimously elected three new members.

Two of those new members, Sterling Varner and David Koch, have served on the board ever since. Sterling was 47 at the time, David was 27.

By then, Varner had already spent most of his adult life



Paris – David Koch, in 1960, age 20.

with Rock Island, supervising the company’s ranches and working in crude oil gathering.

Varner was elected president and chief operating officer of Koch Industries in 1974. He retired from that role in 1987, but has remained active on the KII board.

David Koch was not yet an employee of the company when he became a director. David worked in engineering roles for other firms in New York and Cambridge, Mass., before deciding to join Koch Engineering in 1970.

David Koch is now chairman and chief executive officer of Koch Chemical Technology Group, LLC, and an executive vice president of Koch Industries. He and his brother, Charles, own more than 80 percent of the company.

In accepting their election to the board of directors, Carey, Koch and Varner acknowledged their new responsibilities by agreeing “to perform ...to the best of our ability and in accordance with the ...laws of the United States.”

The performance of Koch Industries ever since that special meeting has been a testimony to the integrity and commitment of these leaders. ■



The following are Charles Koch's answers to some employee questions about his new book, *The Science of Success*.

Q: Don't you have to be brilliant to understand and apply MBM®?

A: Certainly not. I'm not brilliant. I had plenty of college classmates who were much smarter. But I have tried to work harder.

Success in applying MBM doesn't require brilliance, it requires passion – the passion to get results from MBM.

Passion drives us to make the most of our time and opportunities. When I'm on a plane, for example, I take along work or other beneficial reading material.

In *Personal Knowledge*, Michael Polanyi wrote that becoming engrossed in a problem "is in fact the mainspring of all inventive power."

Polanyi quoted Pavlov's advice to admiring students who wanted to be like him: "Get up in the morning with your problem before you. Breakfast with it. Go to the laboratory with it. Eat your lunch with it. Keep it before you after dinner. Go to bed with it on your mind. Dream about it."

I am constantly thinking to solve problems, even when I'm not officially working.

Einstein (who really was brilliant) had absorbed himself in developing the theory of relativity for many, many months, but it was on a walk with a friend that the final piece of the puzzle fell into place.

Don't believe anyone who tells you KII's success is all due to me. No person, no matter how brilliant, can direct 80,000 employees in 60 countries. What I've done is provide a framework that has helped our people become more produc-

tive, creative and fulfilled.

* * * *

Q: What is the best way to learn more about MBM?

A: The true measure of understanding MBM is being able to apply it to get results. That understanding begins at a conceptual level. We all have to learn concepts before we can begin to apply them.

If you haven't already, I suggest you start by reading my book. Take notes so you can ask questions of your supervisor or others. Discuss MBM with your co-workers. Visit the MBM site on D-Net. If possible, attend one of our many MBM seminars.

The next step is to identify how and in which of your activities MBM can be applied to bring about the greatest results. Then, experiment with applying it. This iterative

"To be successful, we all must think and act like entrepreneurs."

process of learning concepts and applying them will gradually enable you to gain true understanding.

You will know you are making progress when your contributions increase.

* * * *

Q: What do I do if my supervisor seems to have little interest in MBM?

A: Any shortcomings a supervisor may have are no excuse for inaction.

As I wrote in Chapter 6: "Those without the authority to make certain decisions are not exempt from entrepreneurial initiative. They can still create value."

Entrepreneurs often "must persuade investors, lenders, suppliers, customers and others to fund or otherwise support their vision for a new venture. Successful entrepreneurs are not deterred by their

lack of authority to control resources."

Any supervisor worth their salt is interested in results, so a good starting place is showing your supervisor how you're getting – or could get – results by applying Market-Based Management®.

Don't be adversarial. Instead, show how MBM can help you create value. If this doesn't work with your supervisor, go to others for help and support.

* * * *

Q: What is the biggest challenge in learning to apply MBM?

A: I believe there are three requirements for successfully applying MBM. A gap or shortcoming in any one of these will hinder your success.

The first requirement is conceptual. We must develop an understanding of the principles underlying MBM.

Second, based on that understanding, we must develop or acquire the MBM tools from these principles that are suitable for our responsibilities.

Third, we must develop the art of applying those tools to get results. This, as I mentioned earlier, is an iterative process of trial and error.

If you're having trouble applying MBM, determine which gaps are holding you back.

While it is true that, from long experience, some of our employees have learned to intuitively apply MBM to get results, it is more effective to consciously know where and how we are applying it.

That understanding enables you to both improve your ability and to coach others to get results. ■

Charles Koch, KII chairman and CEO, at a recent book-signing event in Wichita.