



DISCOVERY

THE QUARTERLY NEWSLETTER OF KOCH COMPANIES

OCTOBER 2008

Stormy Weather

Whether you've been watching weather maps, financial markets or election coverage, this has been a very stormy season.

Rapid and unexpected changes, financial ruin, physical devastation and government turmoil have become commonplace, with far-reaching effects in sometimes unexpected places.

As a result, Koch companies are being challenged to respond, adapt and plan as never before.

Worse than Katrina

Although Hurricanes Gustav and Ike were less powerful than 2005's Katrina and Rita, this year's storms caused far more trouble for Koch company employees and did much more damage to corporate assets.

Almost all of the 1,400 Koch company employees in Houston and Southeast Texas were affected by Hurricane Ike. Hardest hit were 80 employees who lost their homes.

Following Ike's landfall on Sept. 14, Flint Hills Resources' chemical plant in Port Arthur remained shut down for more than a week. INVISTA's intermediates facilities in La Porte and Orange (top photo) were also affected. The La Porte site was down for three weeks and it is likely to be months before the Orange plant can fully return to safe operation.

To a much lesser degree, Georgia-Pacific and Koch Pipeline also suffered damage following Gustav and Ike.

In addition to working directly with affected employees, Koch Industries and FHR have already donated \$1.1 million to hurricane relief efforts along the Gulf Coast.

For years, Georgia-Pacific has worked with Feed the Children, a non-profit organization, to support disaster relief.

GP shipped several pallets of products (such as cups, plates, paper towels and diapers) to Houston following Hurricane Ike, and has already donated more than \$1.2 million worth of goods and services to that organization this year.

Real money

The costs to repair hurricane damage may end up being a drop in the bucket compared to the costs of repairing American – and global – financial markets.

Hundreds of billions of dollars of value have already been destroyed. In September, for example, trading was halted when Russia's once-booming stock market plunged 24 percent in just two days.

Central banks in Europe, Japan, Russia and Canada have responded by taking extraordinary measures in hopes of staving off an even deeper crisis.

Such "cures" come at an extraordinarily high cost.

In the U.S., the potential cost to taxpayers for takeovers and bailouts is rapidly escalating from billions to trillions of dollars.



And yet, despite all this government intervention, the situation will likely get worse, not better.

Solutions?

Koch companies believe the best responses to economic challenges will be based on principled, market-based approaches, not political quick-fixes.

Unfortunately, a storm that was years in the making is not likely to end overnight.

On page four of this issue of *Discovery*, KII's chief financial officer, Steve Feilmeier, discusses how we got to this point and – even more important – what should and shouldn't be done about it. ■

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KII president and COO Dave Robertson (left) with commissioner Israel Gaither, the Salvation Army's national commander.

On behalf of The Salvation Army, I want to express our deepest appreciation to Koch Industries for your very kind and incredibly generous contribution of \$250,000 to our Hurricane Ike disaster relief effort.

Please understand how much we value the friendship that The Salvation Army has with Koch Industries. You are the army behind the Army! We could not serve without your support.

Max Feener, commissioner
Territorial commander
Atlanta, Ga.



INVISTA's plant in Orange, Texas, was heavily damaged by Hurricane Ike and remains shut down.



Volunteers from INVISTA's environment, health and safety team in Orange helped co-worker Susan Kelly with clean-up tasks at her home, which was severely damaged by Ike.

The following two letters are from employees of INVISTA's Orange, Texas, plant.

Thank you so much for your generosity, help, and support since Hurricane Ike hit our area and caused flooding damage.

Your timely support has relieved some stress and the various cleanup and recovery items have made our workload easier.

It is good to work for such a caring company. May God continue to bless you.

Bill Brimm
Operations technician

Thank you for the supplies you gave us during our time of loss due to Hurricane Ike. We both appreciate everything INVISTA has done and the quick response to our every need.

Under normal circumstances we are the ones who are there to help out those less fortunate. It was very scary not knowing who would be there for Gene and me.

When we had lost everything, our company was there to help us. I can not begin to describe what a relief it was knowing that INVISTA and its HR team were there with open arms.

Cheryl Joyner
Operations technician
Gene Skinner
Mechanical technician

A little over a year ago, I applied for and received a \$1,500 academic scholarship from the Fred C. and Mary R. Koch Foundation.

I have now graduated with distinction from the University of Western Ontario in London with a Bachelor of Science degree in Nursing.

I would like to thank you for lending a helping hand in my education and for helping me become a nurse.

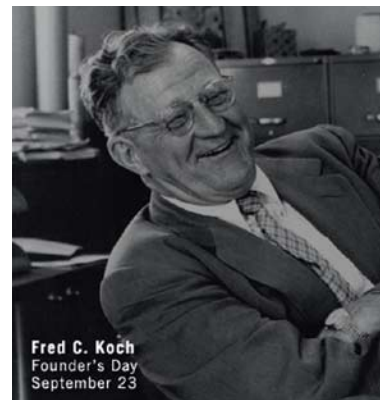
Tanja Kronic
London, Ontario
Canada

The Augusta County Board of Supervisors would like to extend their sincere appreciation for your sponsorship of our recent Household Hazardous Waste Collection Day here at the Government Center.

INVISTA collected pesticides, paint, solvents, fuels, anti-freeze, acids and even tar.

Please accept our thanks for INVISTA's participation in providing this important service to our citizens for so many years.

John C. McGehee
Asst. administrator
Augusta, Va.



I LOVE this year's Founder's Day picture of Fred C. Koch. What character it shows!

Janie Campbell
Office manager
Matador Cattle Co.
Matador, Texas

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Editorial Board
Philip Ellender Mary Beth Jarvis
Rich Fink Charles Koch
Jeff Gentry Jim Mahoney
Dale Gibbens Dave Robertson
Allen Wright

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

Publication design:
Deanna Bauman
Koch Creative Group

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K KOCH INDUSTRIES INC

★Hampshire – An affiliate of Koch Nitrogen has acquired fertilizer terminal assets in Southampton, one of Britain’s most famous port cities and one of the largest commercial ports in Europe.

The assets were purchased in September from Osborne Fertiliser Ltd., an English importing and marketing firm.

Just last year, affiliates of Koch Nitrogen acquired French fertilizer marketing assets in Paris and opened an office in Geneva.

“This acquisition of Osborne’s terminal assets is another significant step forward for us,” said Steve Packebush, president of Koch Nitrogen Co.

“It compliments our global supply and production network and enhances our ability to serve the U.K. and European fertilizer markets.”

With operations that can produce 9 million metric tons of nitrogen products per year and offices ranging from Canada and the Caribbean to Venezuela and France, Koch’s fertilizer businesses are, collectively, among the largest producers and marketers of fertilizer in the world.

★Kerkrade – “Praktisch MBM®” may not mean much to most Koch company employees, but for those who speak Dutch at work, it’s the first step in learning about Market-Based Management® in their own language.

Leo Arets, an MBM consultant for INVISTA who lives in the Netherlands, is adapting a “Practical MBM” training program for Dutch-speaking employees. He also has plans for a German translation.

“Having this one-day course available in their local language will help shop floor employees apply our MBM philosophy in a practical way during their day-to-day operations,” said Arets.

“Something that has become quite clear to me as I received my own training, is that MBM brings together the company’s interest and the personal interest.



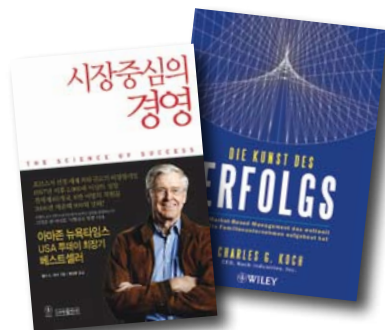
Leo Arets, MBM consultant for INVISTA in Europe.

“The more closely aligned the objectives of the company and those of the employee, the more they will benefit from each other.

“The result for both sides is then Fulfillment – MBM Guiding Principle number 10.”

Efforts to help employees and interested readers learn more about MBM have “gone global” in recent months.

Korean and Portuguese translations of Charles Koch’s book, *The Science of Success*, were published earlier this year. A German translation will be published in November. Chinese (Mandarin) and Vietnamese versions are expected within a few months.



Korean and German translations of Charles Koch’s book on MBM®. Coming soon: Chinese and Vietnamese.

★London – Georgia-Pacific’s Nouvelle brand of toilet tissue, made from 100 percent recycled paper, has launched a major new ad campaign in Europe.



TV ads for this 100 percent recycled tissue end on a lighthearted note: “New Nouvelle is so soft that doing your bit needn’t be a pain in the bum.”

The campaign, valued at £2 million (about \$3.6 million), positions Nouvelle as a “modern and easy choice in environmentally conscious times.”

TV ads for the product end on a decidedly lighthearted note: “New Nouvelle is so soft that doing your bit needn’t be a pain in the bum.”

Like Nouvelle toilet tissue, Nouvelle paper towels are made from 100 percent recycled content. GP estimates 160,000 metric tons of recyclable paper are used per year to make these two products.

As Nouvelle’s Web site explains, this is paper that would otherwise end up in landfill sites.

“We,” says the site, “believe it’s everyone’s responsibility to recycle. However, there is little point in recycling if there is no demand for recycled products.

“By choosing Nouvelle Soft, you are effectively closing the recycling loop.” ■

 www.nouvellerecycling.co.uk

Crisis in the Making by Steve Feilmeier

Back in January, when our chairman and CEO, Charles Koch, was sharing his thoughts about what to expect in 2008, he warned us that “we could be facing the greatest loss of liberty and prosperity since the 1930s.”

If anyone doubted the wisdom of his words then, there should be little room for doubt now.

The upheaval in global financial markets has reached a point where all of us are going to be affected in one way or another.

Tough questions

Many Koch company employees have raised questions and concerns about the growing credit crisis, federal takeovers of Fannie Mae, Freddie Mac, AIG and the \$700 billion bailout bill.

Did the markets fail? Is the financial system really distressed? Is the U.S. government doing the right thing? What are the short-term and long-term implications of these actions? Should we support the U.S. government’s actions or not? Is our company at risk?

In an effort to answer those questions, here is a summary of our point of view on all this.

Root cause

Almost all of these problems (and much of the current chaos) are, at their root, the result of political failure.

The U.S. government attempted to stimulate more home ownership than the market would have created on its own. It encouraged the over-development of homes, particularly homes for first-time buyers financed with sub-prime mortgages.

Today’s crisis was caused by government pressure to erode lending standards, coupled with a lowering of the cost of funds to such a low level that lenders (and borrowers) were encouraged to build, even when many borrowers could not afford the monthly payment.

To make matters worse, these subsidies caused other borrowers to begin building with the intent to resell. They believed home values would only go up, allowing them to make a quick profit.

This caused housing prices to rise to unsustainable levels. When the market became glutted with much more construction than it needed (or that homeowners could afford), the

result was poor quality mortgages and excess homes throughout the country.

The U.S. government kept this false economy moving for a number of years through its indirect support and regulation of Fannie Mae and Freddie Mac, which purchased many of those “toxic” mortgages.

Ironically, many of the politicians who now claim that the markets have failed are the very same politicians who pressured for unsustainable lending practices a decade ago.

The cost

U.S. taxpayers are now on the hook for at least \$200 billion which may or may not be recoverable in the future, and the dominoes are still falling.

Add in the \$150 billion economic stimulus package that ended this summer, the \$700 billion bailout (plus another \$150 in earmarks), and the cost of this failure easily exceeds one trillion dollars! That’s close to 7 percent of the U.S. economy.

Of course, the real cost of this most recent failure is that billions of dollars of capital were funneled into unsustainable housing projects instead of more productive assets.

Chain reactions

As investors grew cautious of the deterioration in asset quality, three large financial institutions, Bear Stearns, Lehman Brothers and AIG, failed. Three others, Merrill Lynch, Washington Mutual and Wachovia, are being merged out of existence with other more solvent institutions.

These failures have caused fear and panic in the U.S. financial system. Capital has literally stopped flowing between savers and borrowers, and even between banks.

Credit is largely based on trust, and this trust has been severely compromised. Without equity and debt capital flowing to entrepreneurs and credit-worthy companies or consumers, any economy can slow dramatically.

We have watched the U.S.



Steve Feilmeier is chief financial officer of Koch Industries. He also serves on the boards of KII, Georgia-Pacific, INVISTA and Koch’s ChemTech Group.

financial markets closely for several months. Without hesitation, we can confirm that the system really has seized up. Reports of this are not exaggerated, and are not limited to the U.S. World financial markets are also in a crisis.

Given these dire circumstances, the U.S. government is stepping in to support the system in hopes that capital will start flowing again, giving entrepreneurs the capital to invest and allowing loans to be made to support them.

Consequences

A market economy functions best when governments do not attempt to influence outcomes with a political agenda. It is regrettable that our government is stepping in again to do just that.

These bailouts, buyouts and “supports” are poor policy that will likely cause far more long-term harm than good. Why? Because each government intervention tends to lead to new problems, prompting calls for even more government intervention.

Very soon, U.S. citizens will be faced with higher taxes to pay for bailouts, even more regulation and a weaker currency. The value of the U.S. dollar will be driven down by ever-increasing debt.

Interest rates (for entities other than the federal government) will rise, too, making it all the more difficult to be competitive in a world economy.

In the short run, government intervention might help restart these markets, but whether it will or not simply isn't clear because we have rarely faced market disruptions this severe.

In the long run, however, these steps are likely to cost us far more than any benefits we might gain in the short run.

Learning the hard way

If we learn anything from crises such as this, it should be that government intervention – no matter how well-intended – tends to cause more harm than good.

This crisis also underscores the importance of personal responsibility, including living within our means.

What we are witnessing is not a failure of markets, but a failure of certain individuals, corporations and our own government. Many of our core principles – especially integrity and humility – have been alarmingly absent.

We do not support government interference in the market; however, the fact that our monetary system is a government system is undeniable. Thus, the government determines the health of the financial system.

Consequently, some form of action to restore confidence in financial markets is necessary, but only so long as the government does not continue overreaching, attaching political and policy agendas to its actions, and picking the winners and losers.

The bailout package that was approved by the U.S. Congress and signed by the President violated all of these tenets.

What to do?

There are at least three things the U.S. government can do to improve this situation.

The first is to put a stop to the creation of new government institutions and programs intended to “solve” the problem. As mentioned earlier, such actions will probably create even more problems.

Instead, we should be systematically eliminating the programs and perverse incentives that created this crisis.

Second, the government should put an immediate halt to its spending spree. Here in the U.S., we are already facing \$79 trillion in unfunded liabilities. These are promises made by the government that we don't have the money to pay for.

Any nation that allows its government to incessantly overspend is headed for bankruptcy. This is also true for individuals. There are always dire consequences when we



overload ourselves with debt.

Third, the Federal Reserve needs to re-evaluate its role. Providing a reasonable amount of liquidity in the markets is a legitimate role for the Fed. Subsidizing people who've made bad decisions is not.

In short, what we need is a return to sound economic principles.

The good news

The question of whether or not Koch Industries is at risk is much easier to answer.

Because we interact with financial markets in so many different ways, there is no question that Koch companies are affected by this financial crisis.

The good news is that neither KII nor its affiliates have made major investments in the types of assets that got so many financial institutions in trouble. What's more, we see the potential for growth opportunities as a result of these tough times.

We are confident in our ability to continue growing and investing in our businesses. Our goal is unchanged: the creation of real, long-term value by the economic, not political, means. ■

This article is based on a recent e-mail sent by Steve Feilmeier to all Koch company employees. We encourage you to share it with your friends and family.

An electronic version of this article is available at www.kochind.com. Click on newsroom, then publications, then Discovery.

Wheels Up



A Beech 18, built in Wichita, was the company's first corporate aircraft.

On Oct. 6, the National Business Aviation Association presented Koch Industries with a special award recognizing Koch Aviation's 60-year history of accident-free flying.

The NBAA commissioned a special trophy, presented at a business aviation convention in Orlando, Fla., that included a customized sculpture of a Beech 18, the company's first airplane.

Koch Aviation employees K.C. Carlson, director of aviation, and David Schinstock, director

of maintenance, were on hand to accept the award.

"This is not just an accomplishment for our current team," said Carlson. "This is something that reflects decades of effort by dozens of people.

"It started with Si McDonald back when our company was called Wood River, and it has continued for more than 105,000 hours of flight time in a variety of aircraft ever since."

This is not the first time Koch Aviation has been recognized for its exceptional safety performance.

On Nov. 16, 2006, Koch Aviation's Wichita hangar became the first corporate aviation site in the nation to earn the U.S. Occupational Safety and Health Administration's highest safety certification: VPP STAR status.

Work is underway to certify Koch Aviation's Atlanta site, next to Fulton County Airport. That facility has been accident-free for 27 years.

A VPP application for the Atlanta site was submitted last month. OSHA's response is expected next summer. ■

Good Company

Every year, the publishers of *Occupational Hazards* magazine seek out the safest companies in the U.S.

They look for employers with below-average injury and illness rates and comprehensive safety training programs.

A clear commitment to safety processes, great communication, full support from management and total employee involvement are also required.

This year, Koch Pipeline Co., LP was one of only 18 firms to demonstrate those qualities and earn the distinction of being one of the nation's safest employers.

The company, which owns or operates about 4,000 miles of pipeline, is relatively small compared to others on this year's list, which average about 15,000 employees. But there is nothing small about KPL's



safety accomplishments.

KPL employees were injury-free for all of 2005 and have worked more than one million hours without an OSHA recordable. All of KPL's sites in Texas have earned VPP STAR status.

KPL is not the first Koch company to earn this distinction. Koch-Glitsch was recognized as one of America's safest companies in 2006. ■



Noteworthy

Climate Confusion

by Roy W. Spencer

If you think all the bright folks at NASA are alarmed about global warming, think again.

Spencer, who has a Ph.D. in Meteorology, was a senior scientist for climate studies at NASA before moving to his current role as a university research scientist. He has frequently testified before the U.S. Congress on the subject of global warming.

His book, subtitled "how global warming hysteria leads to bad science, pandering politicians and misguided policies that hurt the poor," has become a *New York Times* bestseller.

For Spencer, the road to economic and environmental ruin is paved with good intentions.

"Modern environmentalism in general," he writes, "is couched in buzz words and terms that sound noble, but end up being hypocritical attempts to keep humanity from prospering."

Spencer suggests asking two fundamental questions whenever we are presented with far-reaching environmental proposals.

First, "How much will the proposed solution cost?"

And second, "How much global warming will it alleviate?"

Knowing the answers might convince us it's better to save millions of people from malaria rather than spending hundreds of billions in hopes of helping a few polar bears.



Too True

"Excessive debt is a means by which governments oppress the people and waste their substance."

– Thomas Jefferson

History by the Mile



A refinery without any crude oil to process is not much of an asset. That's why, in 1953, a trio of businessmen decided to create the Minnesota Pipe Line Company.



1953 – An original MPL stock certificate. Today, the company is co-owned by Marathon Oil, the Marshall family and a subsidiary of FHR.

Their vision was to build a common carrier (a pipeline treated much like a public utility) for transporting Canadian crude oil from Clearbrook, in northern Minnesota, to a site just south of St. Paul.

J. Howard Marshall II, secretary-treasurer of the new company, was also a co-founder of the Great Northern Oil Company, developer of Pine Bend Refinery.

Specs

The MPL's 256.4-mile route crossed the Mississippi River (twice) and required 18 railroad and 32 highway crossings.

Construction crews and engineers had to deal with terrain that ranged from bogs and swamps to timberland and pasture.

In addition to hundreds of miles of 16-inch diameter pipe, the project also required pumping stations, storage tanks, rail spurs, monitoring facilities and office space.

After six months of approvals, right-of-way purchases and design work, construction began

in August 1954 and was completed by the end of October. The total cost of the project was \$12.5 million.

Up and running

The first Canadian crude oil to make the journey from Clearbrook to Pine Bend arrived on July 18, 1955.

Although the system was designed with an ultimate capacity of 90,000 barrels per day, it was many years before throughput volumes came close to meeting that target.

During its first year of operation, the MPL averaged 13,967 bpd. The following year, the average rose to 27,240 – quite an increase, but still far below projections.

In 1963, \$1.1 million was spent to build additional crude storage and two new pumping stations. At the time, this was considered "a major expansion."

Several highway projects – including U.S. Interstate 35E in Anoka County and State Highways 2, 169 and 212 in Clearwater, Sherburne and Washington Counties – required the relocation of some pipeline sections.



2008 – The final weld by a crew from the same company that helped expand the MPL in 1983.

In 1967, owners of the system undertook the most ambitious building program since its original construction. New pumping stations, storage tanks and an updated monitoring system were installed at a cost of \$1.8 million.

For almost 20 years, the MPL managed to increase its capacity by using improved technology.

Stronger, more efficient pumps, for example, helped boost system throughput to an average of 126,000 bpd in 1972.

MinnCan project

Expansions during the mid-1980s were the last significant changes to the system for almost 20 years. Meanwhile, consumer demand for petroleum products in the Twin Cities region continued to grow.

This demand prompted the owners of MPL to plan its biggest-ever expansion, dubbed the MinnCan project.

MinnCan called for 24-inch diameter pipe installed alongside the original pipeline system for much of its original route. (To avoid urban development and comply with state environmental regulations, pipeline construction was diverted to the south and west of the original route at the southern end of the line.)

Larry Van Horn, team leader for the MinnCan project, has spent most of the last three years working to make MinnCan a reality.

"This was a major undertaking," said Van Horn, "and not just because of its size, cost and regulatory compliance."

"We had to compete with 75 other pipeline projects in the U.S. for about half that many available crews."

Now that MinnCan's construction is complete, Van Horn is especially proud of the performance of the employees and contractors who worked on the project.

Although MPL is not the only company with an interest in growing pipeline capacity in Minnesota, it has the distinction of being the first to succeed in doing so.

"This," said Van Horn, "is a very big step forward in meeting the energy demands for this region. Now our focus is on making sure it is operated safely, reliably and efficiently."



In 1983 and again in 1985, the MPL system expanded by constructing "loops." These new sections and extensions added nearly 100 miles of pipeline to the system.



By Philip Ellender
Koch Companies
Public Sector

I was raised on a sugarcane farm in South Louisiana, where elections usually came in the middle of harvest.

After a long day in the field, we would often gather at the dinner table and have a lively discussion about politics, history and public policy. It made for an interesting gumbo.

Those discussions (some of them heated) often centered around presidents and presidential candidates.

Washington, America's first president, is credited with some strong words of caution regarding the role of government. They are words worth remembering during this unusually heated presidential election in the U.S.

"Government is not reason," said Washington. "It is not eloquence; it is force! Like fire, it is a dangerous servant and a fearful master. Never for a moment should it be left to irresponsible action."

"Government is not reason; it is not eloquence; it is force!"
- George Washington

To me, the thought of a fearful master gaining ground is not a pleasant one.

The world is watching

Just as we operate in a global economic world, we are also in a very global political economy.

The actions of prime minister Vladimir Putin in Russia, France's president Nicholas Sarkozy, and Hu Jintao, president of the People's Republic of China, affect the economies and prosperity of other countries around the world.

Similarly, the actions of a new President and Congress will have global repercussions.

Regardless of which candidates win, the ramifications – or what we at Koch call second- and third-order effects – are likely to be enormous.

Unbalanced and unfair

Regardless of our political affiliations, we need to realize there are some political situations where everyone loses.

In the U.S. Senate, for example, it is imperative that the minority

party have at least 41 votes. Otherwise, the majority party can prevent debate and steamroll any opposition to the majority's legislation.

It is also beneficial to have the White House in the hands of a different party than the Congressional majority. Historically, one-party control of Washington D.C. has been quite costly, both in the economic sense, and in terms of personal liberty.

Presidents Clinton and George W. Bush were both guilty of promoting egregious policies when their respective parties had a majority in Congress. Ill-conceived legislation is much easier to force through when power is unchecked.

On the other hand, divided control often results in a more robust challenge process and certainly a much slower rate of government growth and reduced risk of overreaching.

Overreaching is not just a risk at the Federal level (which is already facing \$79 trillion in unfunded liabilities). More and more, we are seeing state and local governments – such as those in California, Minnesota, New England and even Kansas – try to "lead the nation" with ill-conceived policies that often have disastrous effects.

Reminders

As we were reminded on Founder's Day, employees need "to be educated and active citizens, especially when governments consider issues that shape our societies and the markets in which we operate."

Senators McCain and Obama, for example, have both proposed massive environmental policies that are likely to have little if any effect on global temperatures. Rushing to meet such goals could create setbacks to our prosperity and freedom that far exceed our current financial threats.

The huge sums associated with our current financial crisis will seem small compared to the potential costs and setbacks to our global society caused by

One-party control of Washington is costly, regardless of which party is in power.

drastic, government-dictated changes in how we live and how businesses can create value.

Discussions about how to fuel our societies or manage climate change are exactly the sorts of debates that should take place in a reasoned, informed environment, not a polarized, political one.

Predictions

Regardless of who wins the White House in November, we can take great comfort in knowing that our business philosophy will remain consistent.

We will continue to work for an environment where Principled Entrepreneurship™ sets the standard by creating real, long-term value by the economic (not political) means.

We will continue to push for free markets and a rule of law that fosters real value creation, because we know these lead to greater prosperity for society, companies and individuals.

We will continue to take a long-term point of view, because we know the only way a company can survive – let alone prosper – is by creating real, long-term value in society through principled behavior.

Charles Koch has endured nine different presidents (four Democrats, five Republicans) while helping Koch Industries grow 2,500-fold in value. He insists that our success would have been impossible without a commitment to MBM® and our Guiding Principles.

For those of you who are U.S. citizens, I cannot overemphasize the importance of keeping our principles in mind and being an informed voter in this election.

For those of you who are watching America's election from a distance, imagine what our world could be like if every candidate for public office was measured by the standards of our MBM® Guiding Principles. ■