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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K/A

AMENDMENT NO. 1

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2003	Commission File Number 1-5313

Potlatch Corporation

A Delaware Corporation	(IRS Employer Identification Number 82-0156045)

601 West Riverside Ave., Suite 1100

Spokane, Washington 99201

Telephone (509) 835-1500

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

Title of each class	Name of each exchange on which registered
Common Stock ($1 par value)	New York Stock Exchange Pacific Exchange

Chicago Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
Title of each class

None

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 registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ü No __

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ü No __

The aggregate market value of the voting stock held by non-affiliates of the registrant at June 30, 2003, was approximately $695.9 million, based on the closing price of $25.75, as reported on the New York Stock Exchange Composite Transactions.

The number of shares of common stock outstanding as of January 31, 2004: 28,956,554 shares of Common Stock, par value of $1 per share.

Documents Incorporated by Reference

Portions of the definitive proxy statement for the 2004 annual meeting of stockholders are incorporated by reference in Part III hereof.

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Introductory Note

This Form 10-K/A is the result of discussions between Potlatch Corporation s management and the Securities and Exchange Commission (SEC) during a normal review of Potlatch Corporation s SEC filings. In addition to changes that supplement or revise textual information as well as footnotes, this Form 10-K/A also contains reclassifications in certain of the consolidated financial statements as previously reported. The information contained in this Form 10-K/A has not been updated to reflect events and circumstances occurring since its original filing. Such matters have been or will be addressed in subsequent reports filed with the SEC.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

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PART I

ITEM 1. BUSINESS

General

Potlatch Corporation (herein referred to as the company, us, we, and our), incorporated in 1903, is a vertically integrated and diversified forest products company. We own and manage approximately 1.5 million acres of timberlands and operate 15 manufacturing facilities. Our timberlands and all of our manufacturing facilities are located within the continental United States, primarily in Arkansas, Idaho and Minnesota. We are engaged principally in growing and harvesting timber and converting wood fiber into two broad product lines: (a) commodity and specialty wood products; and (b) bleached pulp products. Our business is organized into four operating segments: Resource; Wood Products; Pulp and Paperboard; and Consumer Products.

Information relating to the amounts of net sales, operating income (loss) and identifiable assets attributable to each of our operating segments for 2001-2003 is included in Note 15 to the financial statements on pages 60-62 of this report.

Interested parties may access our periodic and current reports filed with the Securities and Exchange Commission, at no charge, by visiting our website: www.potlatchcorp.com. In the menu choose: Corporate Governance, then choose: SEC Filings. Information on our website is not part of this report.

Cautionary Statement Regarding Forward-Looking Information

This report contains, in addition to historical information, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including without limitation, statements regarding future revenues, costs, manufacturing output, capital expenditures and timber supply issues. These forward-looking statements reflect management s current views regarding future events based on estimates and assumptions, and are therefore subject to known and unknown risks and uncertainties and are not guarantees of future performance. Our actual results of operations could differ materially from those expressed or implied by forward-looking statements contained in this report. Factors that could cause or contribute to such differences include, but are not limited to, changes in the United States and international economies; changes in exchange rates between the U.S. dollar and other currencies; changes in the level of construction activity; changes in worldwide demand for our products; changes in worldwide production and production capacity in the forest products industry; competitive pricing pressures for our products; unanticipated manufacturing disruptions; changes in general and industry-specific environmental laws and regulations; unforeseen environmental liabilities or expenditures; weather conditions; and changes in raw material, energy and other costs. Other potential factors that could affect our financial position or results of operations include, but are not limited to, our ability to extend or replace our current bank credit facility. Forward-looking statements contained in this report present management s views only as of the date of this report. Except as required under applicable law, we do not intend to issue updates concerning any future revisions of management s views to reflect events or circumstances occurring after the date of this report.

Raw Materials

The principal raw material used by our manufacturing operations is wood fiber, which is obtained from our own timberlands and purchased on the open market. During 2003, we harvested approximately 783,000 tons of sawtimber from our Arkansas timberlands and purchased an additional 1,330,000 tons. Of the 2,113,000 tons of sawtimber harvested and purchased, we sold 390,000 tons

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to third parties during the year. We also harvested 603,000 tons of pulpwood from our Arkansas timberlands and purchased an additional 944,000 tons. We sold 492,000 tons of the harvested and purchased pulpwood to third parties. In 2003 we harvested approximately 1,214,000 tons of sawtimber from our Idaho timberlands and purchased an additional 414,000 tons. From these amounts we sold 488,000 tons to third parties. We also harvested 245,000 tons of pulpwood from our timberlands in Idaho and purchased 54,000 tons. Of the 299,000 tons of pulpwood harvested and purchased, we sold 59,000 tons to third parties. We harvested from our Minnesota timberlands in 2003 approximately 366,000 tons of both sawtimber and logs used in the manufacture of oriented strand board (OSB). We also purchased an additional 2,312,000 tons of sawtimber and OSB logs and, from the total of 2,678,000 tons, sold 266,000 tons to third parties. We harvested 17,000 tons of pulpwood from our Minnesota timberlands, purchased 7,000 tons and sold all 24,000 tons to third parties.

In 2003, 500,022 tons of the total 5,061,000 tons of purchased sawtimber, OSB logs and pulpwood were acquired directly from timberlands owned by federal, state and local governments. Wood fiber acquisitions from these sources occur in market transactions at current market prices. We generally do not maintain long-term supply contracts for a significant volume of timber.

Our Resource segment supplies fiber from our timberlands, as well as some purchased fiber, to our manufacturing facilities. In addition, each of our manufacturing segments procures fiber directly from third parties for use in their respective operations. Our Wood Products segment purchases a portion of its sawtimber and OSB log needs; our Pulp and Paperboard segment purchases a substantial amount of wood chips and sawdust from third parties for use in the production of pulp; and the Consumer Products segment purchases several varieties of pulp, used in manufacturing tissue products in addition to pulp provided by our Pulp and Paperboard segment.

Timber from our lands, together with outside purchases, is presently adequate to support our manufacturing operations. For more than a decade, the timber supply from federal lands has been increasingly curtailed, largely due to environmental pressures that are expected to continue for the foreseeable future. This trend has had a favorable effect on earnings, but the long-term effect of this trend on earnings cannot be predicted.

The volume and value of timber that can be harvested from our lands may be affected by natural disasters such as fire, insect infestation, disease, ice storms, wind storms, floods and other weather conditions and causes. We assume substantially all risk of loss from fire and other hazards on the standing timber we own, as do most owners of timber tracts in the United States.

Resource Segment

The Resource segment manages our 1.5 million acres of timberlands located in Arkansas, Idaho and Minnesota, and a 17,000 acre hybrid poplar plantation in Oregon. The timberlands include a wide diversity of softwood and hardwood species. In Arkansas we own approximately 478,000 acres of timberlands. Primary species on these lands include southern yellow pine, red oak, white oak and other hardwoods. We own approximately 668,000 acres of timberlands in the northern portion of the state of Idaho. Primary species on these lands include grand fir, inland red cedar, Douglas fir, ponderosa pine, western larch, Engelmann spruce and western white pine. We own approximately 326,000 acres of timberlands in Minnesota, comprised primarily of aspen and red pine.

The segment sells wood fiber to our manufacturing facilities at market prices, as well as to third parties. We believe this maximizes our timber value and motivates management of our manufacturing segments to optimize operating efficiencies and identify profitable markets in which to compete. The Resource segment also provides some fiber procurement services to our manufacturing facilities and uses its expertise for regional timber and log acquisitions and sales.

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In addition to sales to our manufacturing facilities, which accounted for 62% of the segment s net sales in 2003, the Resource segment sells wood fiber to a variety of paper and forest products companies situated within economically viable transportation distance of our timberlands. These customers range in size from small operators to multinational corporations. The segment competes with owners of timberlands that operate in areas adjacent to or near our timberlands, ranging from private owners of small tracts of land to some of the largest timberland companies in the United States. The segment competes principally on the basis of log quality, customer service and price.

The segment also sells land in the normal course of business, the majority of which is comprised of small parcels of timberland. We have intensified our efforts to manage our timberlands, which include sales of non-strategic land. Non-strategic land sales occur because the parcels do not fit our strategic plan or the parcels may be more valuable to others. As part of our strategic plan for timber, we also purchase new parcels.

We own 17,000 acres of agricultural land located in northeastern Oregon, which is being developed for the production of hybrid poplar. In 2001, these development efforts were re-directed from the production of an alternate source of wood chips for pulping, with a harvest rotation of seven years, to the production of high-quality solid wood logs, with a harvest rotation of approximately 11 years. Stable production of high quality logs is expected to begin in 2006. We intend to sell hardwood sawlogs from the plantation for conversion into plywood and lumber for furniture manufacturing and other non-structural uses. Our success in the project will depend upon our ability to market hybrid poplar as a cost-competitive, viable alternative to other regional hardwood species, mainly red alder, which are currently used to supply the raw material needs for these activities. The supply of available red alder is declining due to increased environmental restrictions in riparian areas throughout the Pacific Northwest. We believe our operation in Oregon and the positive characteristics of hybrid poplar logs produced there will enable us to compete effectively with producers of other hardwood species.

The amount of timber harvested in any year from company-owned lands varies according to the requirements of sustainable forest management. By continually improving silvicultural techniques and other forest management practices, we have been able to increase the volume of wood fiber produced per acre from our timberlands. Due to a low cost basis, on average, the cost of timber from company-owned land is substantially below the cost of timber obtained on the open market. Our overall results of operations are favorably affected to the extent we can supply wood fiber from our own timberlands, due to its low cost basis relative to wood fiber purchased on the open market. Our annual harvest plans and requirements of our manufacturing facilities influence the volume harvested from our own lands. We manage long-term harvest levels on our timberlands in a manner that assures sustainable yields consistent with the Sustainable Forestry Initiative® (SFI) Program. The SFI Program was initially developed by the American Forest & Paper Association (AF&PA) to establish principles and objectives for program participants committed to sustainable forestry and to provide measures by which the public can monitor and evaluate this commitment. The SFI Program is currently managed by an independent board (The Sustainable Forestry Board) whose members include representatives of the forest products industry as well as representatives of diversified stakeholders. As a member of AF&PA and a participant in the SFI Program, we have implemented the principles of the SFI Program: sustainable forestry, responsible practices, forest health and productivity, and protection of special sites. During 2002, an independent third party certified that management practices on our timberlands in Arkansas, Idaho and Minnesota met the requirements for SFI certification, as well as the International Organization on Standardization (ISO) 14001 standard for environmental management systems. In 2003, our management practices on all 1.5 million acres of timberlands were re-certified under these programs. Our Boardman, Oregon, hybrid poplar plantation was certified as well managed in 2001 under the Forest Stewardship Council® (FSC) standards, and was also certified under the ISO standard in 2003. The SFI and ISO certifications should aid us in marketing our products to customers who require that products they purchase for resale have such certification.

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In 2003, the Idaho region elected to be the sole industry participant in a certification system comparison project conducted by the Pinchot Institute, initiated to understand and document similarities and differences between the SFI and FSC standards of performance, the two primary North American programs. Participation required that our Idaho timberlands undergo third party audits under both programs. Results of the audits and comparisons will be made public and reported by the Pinchot Institute during the first half of 2004.

In late 2002, we reached agreement with the Trust for Public Lands to establish working-forest conservation easements to be held by the Idaho Department of Lands on up to 600,000 acres of our Idaho timberlands in phases over a period of years. The first phase was completed in the third quarter of 2003, covering over 2,700 acres. The next phase, comprising approximately 25,000 acres, is expected to be completed by September 2004. We expect that additional conservation easements will be developed and established in phases over the next several years. The easements require us to accept certain restrictions on the use of the property over which the easements are granted, such as a prohibition on converting land to residential or commercial uses. The easement terms permit the continued use of the land as a working, managed forest. Our compensation for accepting restrictions is based upon a fair-market appraisal of the rights foregone. In 2003 we recognized approximately $0.5 million in Idaho easement revenues. In December 2003, we announced another agreement with the Trust for Public Land to pursue conservation easements in the Brainerd Lakes region of Minnesota. The first phase of that agreement will involve easements on 4,700 acres of land to be held by the Minnesota Department of Natural Resources. Similar easements are being considered on other portions of our Minnesota timberlands and on our Arkansas timberlands.

Wood Products Segment

The Wood Products segment manufactures and markets oriented strand board (OSB), lumber, plywood and particleboard. These products are sold through our sales offices primarily to wholesalers for nationwide distribution.

To produce these solid wood products, we own and operate ten manufacturing facilities in Arkansas, Idaho and Minnesota. A description of these facilities is included under Item 2 of this report.

The forest products industry is highly competitive, and we compete with both smaller and substantially larger forest products companies as well as companies that manufacture substitutes for wood and wood fiber products. Although we are a relatively large OSB manufacturer, we believe we make less than ten percent of the OSB manufactured in the United States and less than seven percent of the OSB manufactured in North America. Our share of the market for lumber, plywood and particleboard is not significant compared to the total United States market for these products. We believe that competitiveness in this industry is largely based on individual mill efficiency and on the availability of competitively priced resources on a facility-by-facility basis, rather than the number of mills operated. This is due to the fact that it is generally not economical to transfer wood between or among facilities, which would permit a greater degree of specialization and operating efficiencies. Instead, each facility must utilize the raw materials that are available to it in a relatively limited geographic area. For these reasons, we believe we are able to compete effectively with companies that have a larger number of mills. In addition, we are developing and marketing a series of specialty OSB products designed to provide a radiant heat barrier, moisture resistance, insect resistance or fungal resistance. Initial market acceptance has been positive and we believe these value-added products will become a significant portion of our total OSB sales. We also have a number of other specialty products under development. We compete based on product quality, customer service and price.

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Pulp and Paperboard Segment

The Pulp and Paperboard segment produces and markets bleached paperboard and bleached pulp. A description of the facilities used to produce these products is included under Item 2 of this report.

As a result of management changes effective in January 2003, the former Pulp and Paper segment was split into two separate business segments, the Pulp and Paperboard segment and the Consumer Products segment. Beginning in the first quarter of 2003, results for these two segments were reported separately, with prior year amounts reclassified for comparative purposes.

We are a major producer of bleached paperboard in the United States, where we compete with at least six other domestic pulp and paperboard producers. We believe we are the third largest domestic producer of bleached paperboard, with approximately 10% of the available capacity. The business is capital intensive, which leads to high fixed costs. As a result, production generally continues as long as selling prices cover variable costs. As part of our ongoing effort to increase manufacturing efficiency and lower costs, we have allocated production of various paperboard products between our two facilities.

Bleached paperboard is a product used in the high-end segment of the packaging industry due to its strength, brightness and favorable printing and graphic surface features. Our bleached paperboard is processed by our customers into a variety of end products, including packaging for liquids and other food products, pharmaceuticals, toiletries and other consumable goods as well as paper cups and paper plates.

We also produce and sell bleached softwood market pulp, which is used as the basis for many paper products. We do not consider ourselves among the larger manufacturers of softwood market pulp in the United States.

We utilize various methods of sale and distribution for our paperboard and softwood pulp. In general, we sell paperboard to packaging converters domestically through sales offices located throughout the United States. The majority of our international paperboard sales are made in Japan, Korea, China and other Southeast Asian countries through sales representative offices. The majority of softwood market pulp sales are generally made through agents. Our principal methods of competing are product quality, customer service and price.

Consumer Products Segment

The Consumer Products segment produces and markets household tissue products. A description of the facilities used to produce these products is included under Item 2 of this report. During 2002 we began construction of a new 102-inch trim through-air-dried tissue machine next to our existing tissue converting facility in Las Vegas, Nevada. The machine began production in early 2004.

During 2003 our tissue products were manufactured on three machines at our Lewiston, Idaho, facility and then converted into packaged tissue products at three converting facilities in Lewiston, Las Vegas, and Benton Harbor, Michigan. Approximately 70%

of the pulp we used to make our tissue products was obtained from our Lewiston pulp mill. The remaining portion was purchased on the open market and consisted primarily of hardwood pulp, which enhances the quality of certain grades of tissue.

We are a leading North American producer of private label household tissue products, and we produce most of the private label tissue products sold in grocery stores in the western U.S. We compete with at least three companies that are much larger than Potlatch who sell national brand

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tissue products, as well as commercial, industrial and private label products. We also compete with smaller companies who sell regional brand products, commercial, industrial and private label products. Our household tissue products (facial and bathroom tissues, paper towels and napkins) are packaged to order for retail chains, wholesalers and cooperative buying organizations throughout the United States and to a lesser extent Canada. These products are sold to consumers under our customers own brand names. We sell a majority of our tissue products to three national grocery store chains. We do not have long-term supply contracts with any of these national chains and the loss of one or more of these customers could potentially have a material adverse effect upon the operating results of the segment.

We sell tissue products to major retail outlets through brokers. Our principal methods of competing are product quality, customer service and price.

Discontinued Operations

On March 18, 2002, we announced that we had signed a definitive agreement with a domestic subsidiary of Sappi Limited for the sale of our Cloquet, Minnesota, pulp and printing papers facilities and certain associated assets for $485.5 million in cash, after closing adjustments. The sale was completed in May 2002. In conjunction with the sale, we closed our Brainerd, Minnesota, printing papers mill and exited the coated printing papers business. As a result, we recorded an after-tax charge of $149.8 million in the first quarter of 2002. The charge represented estimated costs associated with the write-down of the carrying value of the assets involved in the sale and the closure of the Brainerd facility, as well as other costs associated with our exit of the coated paper business. In December 2002, we recorded an additional after-tax charge of $14.6 million to adjust employee severance costs, the carrying value of the remaining Brainerd assets and other exit costs. We sold the Brainerd facility in February 2003 for $4.44 million in cash. In December 2003, we recorded an after-tax charge of $1.6 million for a continuing contractual obligation related to the Brainerd facility. Our exit from the printing papers business reflects a strategic realignment to focus on our natural resources, wood products and consumer tissue businesses, which we believe have the greatest potential for growth.

On June 3, 2002, we announced that we would close our Bradley hardwood sawmill in Warren, Arkansas, and exit the hardwood lumber business. An after-tax charge of $5.7 million was recorded for estimated asset write-down and closure costs. We sold the facility in August 2002. In December 2002, we reversed $1.6 million of the after-tax charge to reflect the actual costs incurred for the closure and sale.

Environment

Information regarding environmental matters is included under Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations on pages 35-36 of this report.

Employees

As of December 31, 2003, we had approximately 4,300 full time employees. The workforce consisted of approximately 1,000 salaried, 3,300 hourly and 100 temporary or part-time employees. As of December 31, 2003, approximately 54% of the workforce was covered under collective bargaining agreements.

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Hourly union labor contracts expiring in 2004 are set forth below.

Contract Expiration Date	Location	Union	Approximate Number of Hourly Employees
May 31	Wood Products Division & Resource Management Division Lewiston, Idaho	International Association of Machinists & Aerospace Workers	310
May 31	Idaho Pulp & Paperboard Division No. 4 Power Boiler Lewiston, Idaho	International Association of Machinists & Aerospace Workers	50
June 30	Nursery Operations Lewiston, Idaho	Paper, Allied-Industrial, Chemical and Energy Workers International Union	10
October 14	Wood Products Division Grand Rapids, Minnesota	Paper, Allied-Industrial, Chemical and Energy Workers International Union	130

ITEM 2. PROPERTIES

For information regarding our timberlands, see the discussion under the heading Resource Segment on pages 3-5 of this report. Our principal manufacturing facilities at December 31, 2003, which are all owned by us except as noted, together with their respective 2003 annual capacities and production, are as follows:

	Capacity(A)	Production(A)
Wood Products		
Oriented Strand Board Mills(B):		
Bemidji, Minnesota	535,000 msf	529,000 msf
Cook, Minnesota	440,000 msf	436,000 msf
Grand Rapids, Minnesota	375,000 msf	372,000 msf
Sawmills:		
Prescott, Arkansas	225,000 mbf	222,000 mbf
Warren, Arkansas	225,000 mbf	219,000 mbf
Lewiston, Idaho	170,000 mbf	168,000 mbf
St. Maries, Idaho	105,000 mbf	104,000 mbf
Bemidji, Minnesota	95,000 mbf	94,000 mbf
Plywood Mill(B):		
St. Maries, Idaho	145,000 msf	141,000 msf
Particleboard Mill(C):		
Post Falls, Idaho	71,000 msf	71,000 msf
Pulp and Paperboard		
Pulp Mills:		
Cypress Bend, Arkansas	270,000 tons	268,000 tons
Lewiston, Idaho	530,000 tons	522,000 tons
Bleached Paperboard Mills:		

Cypress Bend, Arkansas	290,000 tons	289,000 tons
Lewiston, Idaho	390,000 tons	371,000 tons
Consumer Products		
Tissue Mills:		
Lewiston, Idaho	180,000 tons	176,000 tons
Las Vegas, Nevada(D)	30,000 tons	tons
Tissue Converting Facilities:		
Lewiston, Idaho	115,000 tons	112,000 tons
Benton Harbor, Michigan(E)	10,000 tons	5,000 tons
Las Vegas, Nevada	55,000 tons	46,000 tons

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(A) msf stands for thousand square feet; mbf stands for thousand board feet.
(B) $^{3}/8$ inch panel thickness basis.
(C) $^{3}/4$ inch panel thickness basis.
(D) Commenced operations in 2004. Capacity shown is rated capacity.
(E) Operated as a leased facility. Lease expires in May 2005.

ITEM 3. LEGAL PROCEEDINGS

In late January 2004, we voluntarily reported to the Minnesota Pollution Control Agency (MPCA) a potential air permit violation at our oriented strand board facility in Bemidji, Minnesota, relating to the non-operation of equipment used to control nitrous oxide emissions from a wood-fired boiler for a period of approximately 29 months. Corrective action has been taken, and we are cooperating with the MPCA in its investigation. As the investigation is ongoing, we have not been advised as to what action the MPCA may take. Because we discovered the violation, took corrective action and voluntarily reported it to the MPCA, we do not believe any potential penalty will be material.

Taking into consideration the possible consequences of the above described matter, we believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

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

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2003.

EXECUTIVE OFFICERS OF THE REGISTRANT

Information as of March 1, 2004, and for the past five years concerning the executive officers of the company is as follows:

L. Pendleton Siegel (age 61), first elected an officer in 1983, has served as Chairman of the Board and Chief Executive Officer since May 1999. From May 1994 to May 1999, he was President and Chief Operating Officer. Mr. Siegel was elected a director of the company effective November 1997. He is a member of the Finance Committee of the Board of Directors.

Richard L. Paulson (age 62), first elected an officer in 1992, has served as President and Chief Operating Officer since May 1999. From May 1996 through April 1999, he was Vice President, Minnesota Pulp and Paper Division. Mr. Paulson will retire from the company on March 31, 2004.

Richard K. Kelly (age 56), first elected an officer in 1999, has served as Vice President, Wood Products Division, since July 1999. From May 1999 to July 1999, he was Vice President, Western Wood Products Division. From April 1993 to May 1999, he was an appointed officer and served as Vice President, Western Wood Products Division.

Craig H. Nelson (age 47), first elected an officer in 1996, has served as Vice President, Consumer Products Division since January 2003. From May 2000 through December 2002 he was Vice President, Consumer Products and Paperboard Division. From May 1996 through May 2000, he was Vice President, Consumer Products Division.

John R. Olson (age 55), first elected an officer in 1999, has served as Vice President, Resource Management Division, since May 1999. From August 1998 through May 1999 he was an appointed officer serving as Vice President, Resource Management Division.

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Harry D. Seamans (age 50), first elected an officer in 2003, has served as Vice President, Pulp and Paperboard Division, since January 2003. From March 2000 through December 2002, he was Arkansas Pulp and Paperboard Mill Manager. From January 1993 through February 2000, he was an appointed officer serving as Vice President, Arkansas Pulp and Paperboard Division.

Gerald L. Zuehlke (age 55), first elected an officer in 1994, has served as Vice President, Finance, Chief Financial Officer and Treasurer since June 2000. From June 1994 to June 2000, he was Treasurer.

NOTE: **The aforementioned officers of the company are elected to hold office until the officer s successor has been duly elected and has qualified or until the earlier of the officer s death, resignation, retirement or removal by the board.**

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PART II

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

The company s common stock is traded on the New York, Chicago and Pacific Stock Exchanges. The quarterly and yearly high and low sales price per share of our common stock, as reported in the New York Stock Exchange Composite Transactions for 2003 and 2002 were as follows:

	2003		2002	
Quarter	**High**	**Low**	**High**	**Low**
1st	$ 25.10	$ 18.75	$ 34.44	$ 27.85
2nd	26.10	20.00	36.13	32.32
3rd	31.90	25.35	33.69	28.35
4th	35.95	29.90	29.88	23.88
Year	35.95	18.75	36.13	23.88

In general, all holders of Potlatch common stock who own shares 48 consecutive calendar months or longer (long-term holders) are entitled to exercise four votes per share of stock so held, while stockholders who are not long-term holders are entitled to one vote per share. All stockholders are entitled to only one vote per share on matters arising under certain provisions of the company s charter. There were approximately 1,800 common stockholders of record at December 31, 2003.

The board of directors annually reviews and approves the dividend policy. The board considers a variety of factors in determining whether to pay a dividend and the dividend rate, including, among other things, conditions in the forest products industry and the economy generally, dividend pay rates in the forest products industry, our operating results and cash flows, anticipated capital expenditures and compliance with the terms of any debt instrument that limit the payment of dividends on our common stock. The quarterly dividend rate is subject to change from time to time based on the board s business judgment with respect to these and other relevant factors. Quarterly dividend payments per common share for 2003 and 2002 were:

Quarter	**2003**	**2002**
1st	$ .15	$ .15
2nd	.15	.15
3rd	.15	.15
4th	.15	.15
	$ .60	$ .60

ITEMS 6, 7, 7A and 8

The information called for by Items 6, 7, 7A and 8, inclusive, of Part II of this form is contained in the following sections of this report at the pages indicated below:

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ITEM 6	Selected Financial Data	19
ITEM 7	Management s Discussion and Analysis of Financial Condition and Results of Operations	19-37
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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Potlatch maintains disclosure controls and procedures, as such term is defined in Rule 13a-14(c) under the Securities and Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by Potlatch in reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to Potlatch s management, including its Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating Potlatch s disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, Potlatch s management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Subject to the limitations noted above, our management, with the participation of our CEO and CFO, has evaluated the effectiveness of the design and operation of Potlatch s disclosure controls and procedures as of the end of the fiscal year covered by the annual report on this Form 10-K. Based on that evaluation, the CEO and CFO have concluded that Potlatch s disclosure controls and procedures were effective to meet the objective for which they were designed.

There were no changes in Potlatch s internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonable likely to materially affect, Potlatch s internal control over financial reporting.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information regarding the directors of our company is set forth under the heading Board of Directors on pages 7-8 of our definitive proxy statement, dated April 5, 2004, for the 2004 annual meeting of stockholders (the 2004 Proxy Statement), which information is incorporated herein by reference. Information concerning Executive Officers is included in Part I of this report following Item 4. Information regarding reporting compliance with Section 16(a) for directors, officers or other parties is set forth under the heading Section 16(a) Beneficial Ownership Reporting Compliance on page 21 of the 2004 Proxy Statement and is incorporated herein by reference.

We have adopted a Corporate Conduct and Ethics Code that applies to all directors, officers and employees. You can find our Corporate Conduct and Ethics Code on our website by going to the following address: www.potlatchcorp.com, clicking on Corporate Governance, and then clicking on the link for Corporate Conduct and Ethics Code. We will post any amendments, as well as any waivers that are required to be disclosed by the rules of either the Securities and Exchange Commission or the New York Stock Exchange, on our website.

Our board of directors has adopted Corporate Governance Guidelines and charters for the board of directors Audit Committee, Executive Compensation and Personnel Policies Committee, and Nominating and Corporate Governance Committee. You can find these documents on our website by going to the following address: www.potlatchcorp.com, clicking on Corporate Governance, and then clicking on the appropriate link.

You can also obtain a printed copy of any of the materials referred to above by contacting us at the following address:

Potlatch Corporation

Attention: Mac Ryerse, Corporate Secretary

601 West Riverside Ave., Suite 1100

Spokane, Washington 99201

Telephone: (509) 835-1500

The Audit Committee of our board of directors is an audit committee for purposes of Section 3(a)(58) of the Securities Exchange Act of 1934. As of December 31, 2003, the members of that committee were: Boh A. Dickey (Chair), Jerome C. Knoll, and Gregory L. Quesnel. The board of directors has determined that Mr. Dickey is an audit committee financial expert and that he and all of our Audit Committee members are independent as defined under the applicable rules and regulations of the Securities and Exchange Commission.

ITEM 11. EXECUTIVE COMPENSATION

Information set forth under the heading Compensation of the Named Executive Officers on pages 16-19 of the 2004 Proxy Statement is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information regarding any person or group known by us to be the beneficial owner of more than five percent of our common stock as well as the security ownership of management set forth under the heading Stock Ownership on pages 9-10 of the 2004 Proxy Statement is incorporated herein by reference.

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The following table provides certain information as of December 31, 2003, with respect to our equity compensation plans:

Plan category	Number of securities to be issued upon exercise of outstanding options (1)	Weighted average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	2,804,975	$ 36.19	569,042
Equity compensation plans not approved by security holders			
Total	2,804,975	$ 36.19	569,042

(1) Includes 88,155 performance shares granted in December 2003, which amount includes the maximum number of shares that could be awarded under the grant, but does not include future dividend equivalents. Performance shares are not included in the weighted average exercise price calculation.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Not applicable.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information set forth under the heading Fees Paid to Independent Auditor in 2003 and 2002 on page 21 of the 2004 Proxy Statement is incorporated herein by reference.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

Consolidated Financial Statements

Our consolidated financial statements are listed in the Index to Consolidated Financial Statements and Schedules on page 18 of this Form 10-K.

Financial Statement Schedules

Our financial statement schedules are listed in the Index to Consolidated Financial Statements and Schedules on page 18 of this Form 10-K.

Reports on Form 8-K

A current report on Form 8-K was filed on October 24, 2003. Under Item 5, Other Events, we announced the election of Ruth Ann M. Gillis to our Board of Directors, effective November 1, 2003.

A current report on Form 8-K was filed on November 10, 2003. Under Item 5, Other Events, we reported the details of remarks made by company officials at an industry analysts meeting that day.

A current report on Form 8-K was filed on December 19, 2003. Under Item 5, Other Events, we announced the election of William L. Driscoll to our Board of Directors, effective January 1, 2004.

A current report on Form 8-K was filed on December 29, 2003. Under Item 5, Other Events, we disclosed that Richard L. Paulson, our President and Chief Operating Officer, will retire at the end of March 2004. We had previously disclosed that Mr. Paulson planned to retire at the end of 2003.

Exhibits

Exhibits are listed in the Exhibit Index on pages 75-78 of this Form 10-K.

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SIGNATURES

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

POTLATCH CORPORATION

(Registrant)

By: /s/ L. PENDLETON SIEGEL

L. Pendleton Siegel

Chairman of the Board and Chief Executive Officer

Date: March 12, 2004

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on March 12, 2004, by the following persons on behalf of the company in the capacities indicated.

By	/s/ L. PENDLETON SIEGEL **L. Pendleton Siegel**	Director and Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
By	/s/ RICHARD L. PAULSON **Richard L. Paulson**	President and Chief Operating Officer (Principal Operating Officer)
By	/s/ GERALD L. ZUEHLKE **Gerald L. Zuehlke**	Vice President, Finance, Chief Financial Officer and Treasurer (Principal Financial Officer)
By	/s/ TERRY L. CARTER **Terry L. Carter**	Controller (Principal Accounting Officer)
	* **Boh A. Dickey**	Director
	* **Ruth Ann M. Gillis**	Director

	*	Director
	Jerome C. Knoll	
	*	Director
	Lawrence S. Peiros	

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*		Director
Michael T. Riordan		
*		Director
Judith M. Runstad		
*		Director
Dr. William T. Weyerhaeuser		

*By /s/ MALCOLM A. RYERSE

Malcolm A. Ryerse

(Attorney-in-fact)

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POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

Index to Consolidated Financial Statements and Schedules

The following documents are filed as part of this report:

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Management s Discussion and Analysis of Financial Condition and Results of Operations	19-37
Consolidated Financial Statements:	
Consolidated Statements of Operations and Comprehensive Income for the years ended December 31, 2003, 2002 and 2001	39
Consolidated Balance Sheets at December 31, 2003 and 2002	40
Consolidated Statements of Cash Flows for the years ended December 31, 2003, 2002 and 2001	41
Consolidated Statements of Stockholders Equity for the years ended December 31, 2003, 2002 and 2001	42
Summary of Principal Accounting Policies	43-46
Notes to Consolidated Financial Statements	47-72
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Schedules:	
II. Valuation and Qualifying Accounts	74

All other schedules are omitted because they are not required, not applicable or the required information is given in the consolidated financial statements.

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Potlatch Corporation and Consolidated Subsidiaries

Selected Financial Data

(Dollars in thousands except per-share amounts)

	2003	2002	2001	2000	1999
Net sales	$ 1,506,634	$ 1,293,546	$ 1,278,864	$ 1,295,810	$ 1,347,533
Earnings (loss) from continuing operations	53,221	(50,933)	(56,566)	(33,393)	52,210
Net earnings (loss)	50,727	(234,381)	(79,445)	(33,214)	40,947
Net cash provided by (used for) operations	163,402	(38,619)	25,530	78,899	199,541
Working capital	160,802	102,693	612,384	745,052	780,003
Current ratio	1.9 to 1	1.4 to 1	2.1 to 1	2.7 to 1	3.1 to 1
Long-term debt (including current portion)	$ 618,785	$ 638,252	$ 1,150,125	$ 801,874	$ 712,121
Stockholders equity	470,851	430,791	707,304	813,236	921,039
Long-term debt to stockholders equity ratio	1.3 to 1	1.5 to 1	1.6 to 1	.99 to 1	.77 to 1
Capital expenditures	$ 79,686	$ 51,614	$ 42,679	$ 142,812	$ 65,277
Total assets	1,597,377	1,624,817	2,488,439	2,542,445	2,446,500
Basic net earnings (loss) from continuing operations per common share	$ 1.85	$ (1.79)	$ (2.00)	$ (1.17)	$ 1.80
Basic net earnings (loss) per common share	1.77	(8.23)	(2.81)	(1.16)	1.41
Average common shares outstanding (in thousands)	28,706	28,462	28,282	28,523	28,947
Diluted net earnings (loss) from continuing operations per common share	$ 1.85	$ (1.79)	$ (2.00)	$ (1.17)	$ 1.80
Diluted net earnings (loss) per common share	1.77	(8.23)	(2.81)	(1.16)	1.41
Average common shares outstanding, assuming dilution (in thousands)	28,718	28,462	28,282	28,523	28,967
Cash dividends per common share	$ .60	$ .60	$ 1.17	$ 1.74	$ 1.74

Certain amounts for 1999-2002 have been reclassified to conform to the 2003 presentation.

Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are a vertically integrated and diversified forest products company. We own approximately 1.5 million acres of timberland and operate 15 manufacturing facilities, located primarily in Arkansas, Idaho and Minnesota. Our business is organized into four segments:

The Resource segment manages our timberlands, which supply logs, wood chips, pulpwood and other wood fiber to our manufacturing segments, as well as to third parties. Intersegment sales are based on prevailing market prices for wood fiber. In 2003, Resource segment net sales were $252.6 million, representing approximately 15% of our net sales, before elimination of intersegment sales. Intersegment sales were $157.2 million in 2003.

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The Wood Products segment manufactures oriented strand board (OSB), lumber, plywood and particleboard at ten mills located in Arkansas, Idaho and Minnesota. These products are largely commodity products, which are sold to wholesalers primarily for use in home building and other construction activity. Wood Products segment net sales were $683.1 million in 2003, representing approximately 40% of our net sales, before elimination of intersegment sales. Intersegment sales were $11.7 million in 2003.

The Pulp and Paperboard segment manufactures bleached paperboard used in packaging and bleached softwood market pulp. The Pulp and Paperboard segment operates two pulp mills and two paperboard mills located in Arkansas and Idaho. Pulp and Paperboard segment net sales were $482.0 million in 2003, representing approximately 28% of our net sales, before elimination of intersegment sales. Intersegment sales were $43.0 million in 2003.

The Consumer Products segment manufactures tissue products primarily sold on a private label basis by major grocery store chains. In 2003 the Consumer Products segment operated one tissue mill and three tissue converting facilities located in Idaho, Michigan and Nevada. The segment began operating a newly constructed tissue machine in Las Vegas in 2004. Consumer Products segment net sales were $300.9 million in 2003, representing approximately 17% of our net sales, before elimination of intersegment sales. Intersegment sales were $0.1 million in 2003.

As a result of management changes effective in January 2003, the former Pulp and Paper segment was split into two separate business segments, the Consumer Products segment and the Pulp and Paperboard segment. Because the restructuring of the former Pulp and Paper segment into the Pulp and Paperboard segment and the Consumer Products segment was the result of changes in management structure and did not affect the day-to-day operations of the facilities included in the business segments, there was no effect on our results of operations, liquidity and sources and uses of capital resources as a result of this change. Segment data for 2002 and 2001 related to the two segments has been reclassified to be comparative with 2003 data.

In May 2002, we exited our Printing Papers segment, which produced primarily high-grade coated printing papers and bleached hardwood market pulp. We sold our Cloquet, Minnesota, pulp and printing papers facilities and certain associated assets to a domestic subsidiary of Sappi Limited for $485.5 million in cash, after closing adjustments. We closed our Brainerd, Minnesota, printing papers mill at the same time. That facility was sold in February 2003 for $4.44 million in cash. The sale of the printing papers business reflects a strategic realignment to focus on our natural resources, wood products and consumer tissue businesses, which we believe have the greatest potential for growth.

In June 2002, we announced that we would close our Bradley hardwood mill in Warren, Arkansas, and exit the hardwood lumber business. We sold the facility in August 2002.

Our consolidated financial statements and this discussion reflect the classification of the Printing Papers segment and the Bradley hardwood mill as discontinued operations for all periods presented. Our discontinued operations generated operating losses of $1.3 million, $24.5 million and $37.5 million for the years ended December 31, 2003, 2002 and 2001, respectively. Cash flows generated by discontinued operations (without consideration of sale proceeds) totaled $(.8) million, $3.4 million and $42.9 million for the years ended December 31, 2003, 2002 and 2001, respectively. The majority of the proceeds from the sale of the discontinued operations were used to retire over $400 million of debt. The retirement of this debt has decreased our interest expense in subsequent years and improved the measurement of financial maintenance covenants contained in our bank credit facility.

Certifications with respect to this annual report on Form 10-K by our Chief Executive Officer and Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002, are included as exhibits to this report. Certifications as required by Section 906 of the Sarbanes-Oxley Act are furnished as exhibits to this report.

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Factors Influencing Our Results of Operations

Our operating results have been and will continue to be influenced by a variety of factors, including the cyclical nature of the forest products industry, competition, the efficiency and level of capacity utilization of our manufacturing operations, changes in our principal expenses, such as wood fiber and energy costs, changes in the production capacity of our manufacturing operations as a result of major capital spending projects, asset dispositions or acquisitions and other factors.

Our operating results generally reflect the cyclical pattern of the forest products industry. Historical prices for our products have been volatile, and we, like other manufacturers in the forest products industry, have limited direct influence over the timing and extent of price changes for our products. Product pricing is significantly affected by the relationship between supply and demand. Product supply is influenced primarily by fluctuations in available manufacturing capacity. Demand is affected by the state of the economy in general and a variety of other factors. The demand for our timber resources and wood products is affected by the level of new residential construction activity and, to a lesser extent, home repair and remodeling activity, which are subject to fluctuations due to changes in economic conditions, interest rates, population growth, weather conditions and other factors. The demand for most of our pulp and paperboard products is primarily affected by the general state of the global economy, and the economies in North America and east Asia in particular. The demand for our tissue products is primarily affected by the state of the United States economy.

The markets for our products are highly competitive and companies that have substantially greater financial resources than we do compete with us in each of our markets. Logs and other fiber from our timberlands, as well as our wood products, are subject to competition from timberland owners and wood products manufacturers in North America and to a lesser extent in South America, Europe, Australia and New Zealand. Our pulp-based products, other than tissue products, are globally-traded commodity products. Because our competitors in these segments are located throughout the world, variations in exchange rates between the U.S. dollar and other currencies can significantly affect our competitive position compared to our international competitors. As it is generally not profitable to sell tissue products overseas due to high transportation costs, currency exchange rates do not have a major effect on our ability to compete in our tissue business.

Tariffs, quotas or trade agreements can also affect the markets for our products, particularly our wood products. In 2002, the United States imposed duties on imported lumber from Canada in response to a dispute over the stumpage policies of some provincial governments. The two countries are currently in negotiations to resolve the dispute, and any resulting agreement could have a significant effect on lumber markets in the United States.

In addition, our industry is capital intensive, which leads to high fixed costs and generally results in continued production as long as prices are sufficient to cover variable costs. These conditions have contributed to substantial price competition, particularly during periods of reduced demand. Some of our competitors are currently lower-cost producers in some of the businesses in which we operate, and accordingly these competitors may be less adversely affected than we are by price decreases. During the fourth quarter of 2001, downtime was taken at most of the Wood Products segment facilities as well as the paperboard facility in Lewiston, Idaho, due to our inability to cover our variable costs. The fixed costs incurred at these facilities during the downtime were expensed as period costs. For all other periods presented, no downtime was taken for market related conditions.

Energy has become one of our most volatile operating expenses over the past several years. Substantial price increases commenced in late 2000 and continued in the first half of 2001, before moderating in the second half of 2001. These price increases were substantial and contributed to the net losses we incurred during these periods. Energy prices returned to more normal historical levels in

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2002, which had a favorable effect on our results compared to 2001. Energy costs rose overall in 2003, but the effects varied among our operating regions; from modest increases at our facilities in Idaho to a significant increase at our pulp and paperboard facility in Arkansas. In periods of high energy prices, market conditions may prevent us from passing higher energy costs on to our customers through price increases and therefore could adversely affect our operating results. We have taken steps through conservation and electrical production to reduce our exposure to the volatile spot market for energy. Our energy costs in future periods will depend principally on our ability to continue to produce internally a substantial portion of our electricity needs and on changes in market prices for natural gas. From time to time we have entered into derivative financial instruments as a hedge against potential increases in the cost of natural gas. We entered into several such contracts in the third quarter of 2003, covering a portion of our expected natural gas purchases from November 2003 through March 2004.

Another significant expense is the cost of wood fiber needed to supply our manufacturing facilities. The percentage of our wood fiber requirements supplied by our timberlands will fluctuate based on a variety of factors, including changes in our timber harvest levels, changes in our manufacturing capacity and changes in the amount of timber sales to third parties. The cost of various types of wood fiber that we purchase in the market has at times fluctuated greatly because of economic or industry conditions. Selling prices of our products have not always increased in response to wood fiber price increases nor have wood fiber prices always decreased in conjunction with declining product prices. On occasion, our results of operations have been and may in the future be adversely affected if we are unable to pass cost increases through to our customers.

The disparity between cost of fee timber harvested and the cost of timber purchased is caused by the fact that the capitalized costs to establish the fee timber were expended many years ago. The initial stand establishment costs remain as a capitalized asset until the timber reaches maturity (becomes merchantable), which typically ranges from 30 to 60 years. On-going forest management costs include recurring items necessary to the ownership and administration of timber producing property and are expensed as incurred. The cost of purchased timber is significantly higher due to the fact that the timber being purchased from third parties is mature and is sold by them at the current market price.

The cost of timber harvested in 2003, as noted in Footnote No. 5, decreased $1.4 million. Also disclosed in the footnote is the fact that cost of timber harvested increased $1.7 million in 2002 from 2001. Because timber growing is a long-term business, the variation between these amounts is not unusual. Such variances are caused by factors that we have discussed in the preceding paragraphs. The tons of timber purchased have increased progressively in each of the three years presented in the statements of operations. In addition, our harvested tons as well as the tons sold have increased progressively in each of the years presented. Harvested tons as a percentage of total harvested and purchased tons for each year was 37%, 37% and 40% for 2003, 2002 and 2001, respectively. The tons sold for each of the years presented compared to total harvested and purchased tons was 18%, 10% and 8%, respectively.

Finally, changes in our manufacturing capacity, primarily as a result of capital spending programs or asset dispositions, have significantly affected our results of operations in recent periods. In January 2001, we completed a modernization and expansion of our OSB mill in Cook, Minnesota, which resulted in an increase in annual production capacity from 250 million square feet to 440 million square feet. In May 2002, we sold a majority of our Printing Papers segment assets to a domestic subsidiary of Sappi Limited and exited the printing papers business. In August 2002, we sold a hardwood sawmill in Arkansas. We are currently in the process of bringing a newly constructed tissue machine in Las Vegas, Nevada, up to full operating production, which we anticipate will produce 30,000 tons a year. Each of these changes has affected or will affect our levels of net sales and expenses, as well as the

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comparability of our operating results from period to period. Additionally, the profitability of our manufacturing segments depends largely on our ability to operate our manufacturing facilities efficiently and at or near full capacity. Our operating results would be adversely affected if market demand does not justify operating at these levels or if our operations are inefficient or suffer significant interruption for any reason.

Critical Accounting Policies

Our principal accounting policies are discussed on pages 43-46 of this Form 10-K. The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported financial position and operating results of the company. Management believes the accounting policies discussed below represent the most complex, difficult and subjective judgments it makes in this regard.

Long-lived assets. Due to the capital-intensive nature of our industry, a significant portion of our total assets are invested in our manufacturing facilities. Also, the cyclical patterns of our businesses cause cash flows to fluctuate by varying degrees from period to period. As a result, long-lived assets are a material component of our financial position with the potential for material change in valuation if assets are determined to be impaired. We account for impairment of long-lived assets in accordance with Financial Accounting Standards Board (FASB) Statement No. 144. The statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, as measured by its undiscounted estimated future cash flows. We use our operational budgets to estimate future cash flows. Budgets are inherently uncertain estimates of future performance due to the fact that all inputs (revenues, costs, capital spending) are subject to frequent change for many different reasons, as previously described in Factors Affecting Our Results of Operations. Because of the number of variables involved, the interrelationship between the variables and the long-term nature of the impairment measurement, sensitivity analysis of individual variables is not practical. Budget estimates are adjusted periodically to reflect changing business conditions and operations are reviewed, as appropriate, for impairment using the most current data available. To date, this process has not resulted in an impairment charge for any of our assets.

Timber and timberlands. Timber and timberlands are recorded at cost, net of fee timber harvested. Expenditures for reforestation, including all costs related to stand establishment, such as site preparation, costs of seeds or seedlings and tree planting, are capitalized. Expenditures for forest management, consisting of regularly recurring items necessary to the ownership and administration of our timber and timberlands, are accounted for as current operating expense. Our cost of timber harvested is determined based on costs capitalized and the related current estimated recoverable timber volume. Recoverable volume does not include anticipated future growth, nor are anticipated future costs considered.

There are currently no authoritative accounting rules relating to costs to be capitalized in timber and timberlands. We have used relevant portions of current accounting rules, industry practices and our judgment in determining costs to be capitalized or expensed. Alternate interpretations and judgments could significantly affect the amounts capitalized. Additionally, models and observations used to estimate the current recoverable timber volume on our lands are subject to judgments that could significantly affect volume estimates. For example, harvest cycles can vary by geographic region and by species of timber, weather patterns can affect harvest cycles, environmental regulations and restrictions may limit the company s ability to harvest certain timberlands, changes in harvest plans may occur, or scientific advancement in seedlings and timber growing technology may affect future harvests. Different assumptions for either the cost or volume estimates, or both, could have a

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significant effect upon amounts reported in our statements of operations and financial condition. Because of the number of variables involved and the interrelationship between the variables, sensitivity analysis of individual variables is not practical.

Restructuring charges and discontinued operations. In 2001 and 2002 we recorded charges for the reduction of the hourly workforce at a manufacturing site and a reduction of our salaried workforce, respectively. In May 2002 we completed the sale of a majority of the assets of our Printing Papers segment and closed a printing papers facility in Brainerd, Minnesota, which was subsequently sold in 2003. In July 2002 we closed a hardwood lumber mill in Warren, Arkansas. The mill was sold in August 2002. In January 2004, we recorded a charge for a workforce reduction in our Consumer Products segment. These events required us to record estimates of liabilities for employee benefits, environmental clean-up and other costs at the time of the event. In making these judgments, we considered contractual obligations, legal liabilities, and possible incremental costs incurred as a result of restructuring plans to determine the liability. Our estimated liabilities could differ materially from actual costs incurred, with resulting adjustments to future period earnings for any differences, although no material adjustments to our original estimates have occurred for the events described above.

Environmental liabilities. We record accruals for estimated environmental liabilities in accordance with FASB Statement No. 5, Accounting for Commitments and Contingencies. These estimates reflect assumptions and judgments as to the probable nature, magnitude and timing of required investigation, remediation and monitoring activities. In making these estimates, we consider, among other things, the activities we have conducted at any particular site, information obtained through consultation with applicable regulatory authorities and third-parties, and our historical experience at other sites that are judged to be comparable. We must also consider the likelihood of changes in governmental regulations, advancements in environmental technologies, and changing legal standards regarding liability. Due to the numerous uncertainties and variables associated with these assumptions and judgments, and changes in governmental regulations and environmental technologies, our accruals are subject to substantial uncertainties and our actual costs could be materially more or less than the estimated amounts.

Pension and postretirement benefits. The determination of pension plan expense and the requirements for funding our pension plans are based on a number of actuarial assumptions. Two critical assumptions are the discount rate applied to pension plan obligations and the rate of return on plan assets. For other postretirement employee benefit (OPEB) plans, which provide certain health care and life insurance benefits to qualified retired employees, critical assumptions in determining OPEB expense are the discount rate applied to benefit obligations and the assumed health care cost trend rates used in the calculation of benefit obligations.

Note 12 to the consolidated financial statements on pages 54-58 includes information for the three years ending December 31, 2003, on the components of pension and OPEB expense, the underlying actuarial assumptions used to calculate periodic expense, as well as the funded status for our pension and OPEB plans as of December 31, 2003 and 2002.

The discount rate used in the determination of pension benefit obligations and pension expense is based on high-quality fixed income investment interest rates. At December 31, 2003, we calculated obligations using a 6.25% discount rate. The discount rates used at December 31, 2002 and 2001 were 6.75% and 7.25%, respectively. To determine the expected long-term rate of return on pension assets, we employ a process that analyzes historical long-term returns for various investment categories, as measured by appropriate indexes. These indexes are weighted based upon the extent to which plan assets are invested in the particular categories in arriving at our determination of a composite expected return. The assumed long-term rate of return on pension plan assets used for 2003-2001 was 9.5%.

An increase in the discount rate or the expected return on plan assets, all other assumptions remaining the same, would reduce pension plan expense, and conversely, a decrease in either of these measures would increase plan expense. Total periodic pension plan income in 2003 was $13.3 million. As an indication of the sensitivity that pension expense has to the discount rate assumption, a 25 basis point change in the discount rate would affect plan expense by approximately $1.1 million. A 25 basis point change in the assumption for expected return on plan assets would affect plan expense by approximately $1.5 million. The actual rates on plan assets may vary significantly from the assumption used because of unanticipated changes in financial markets.

We estimate contributions to our pension plan will total approximately $1.2 million in 2004.

For our OPEB plans, expense for 2003 was $23.4 million. The discount rate used to calculate OPEB obligations was also 6.25% at December 31, 2003, and 6.75% and 7.25% at December 31, 2002 and 2001, respectively. The assumed health care cost trend rate used to calculate OPEB obligations and expense at December 31, 2003, was an 8% increase over the previous year, declining 1 percent annually to a long-term ultimate rate increase assumption of 6% for 2005 and thereafter.

As an indication of the sensitivity that OPEB expense has to the discount rate assumption, a 25 basis point change in the discount rate would affect plan expense by approximately $0.8 million. A 1% change in the assumption for health care cost trend rates would have affected 2003 plan expense by approximately $2.2-$2.6 million and the total postretirement obligation by approximately $27.0-$31.7 million, as reported in Note 12 on page 56. The actual rates of health care cost increases may vary significantly from the assumption used because of unanticipated changes in health care costs.

Periodic pension and OPEB expense are included in Materials, labor and other operating expenses and Selling, general and administrative expenses in the statements of operations. The expense is allocated to all business segments. Depending upon the funded status of the different plans, either a long-term asset or long-term liability is recorded for plans with overfunding or underfunding, respectively. Any unfunded accumulated pension benefit obligation in excess of recorded liabilities is accounted for in Accumulated other comprehensive income . See Note 12 on pages 54-58 for related balance sheet effects at December 31, 2003 and 2002.

Results of Operations

At December 31, 2003, our business was organized into four reporting segments: Resource, Wood Products, Pulp and Paperboard, and Consumer Products. Sales or transfers between segments are recorded as intersegment sales based on prevailing market prices. Because of the role of the Resource segment in supplying our manufacturing segments with wood fiber, intersegment sales represent a significant portion of the Resource segment s total net sales. Beginning in the third quarter of 2002, our Wood Products and Pulp and Paperboard operating segments transitioned to a fiber procurement system where a portion of third party fiber purchases are made directly by each of these segments, rather than from the Resource segment. The change in the fiber procurement system has significantly decreased intersegment sales for the Resource segment and decreased fiber purchases by the Resource segment from third parties. Intersegment sales represent a substantially smaller percentage of net sales for our other segments.

In the period-to-period discussion of our results of operations below, when we discuss our consolidated net sales, contributions by each of the segments to our net sales are reported after elimination of intersegment sales. In the Discussion of Business Segments sections below, each segment s net sales are set forth before elimination of intersegment sales.

As a result of our decisions to sell our Printing Papers segment assets and to close the Bradley hardwood sawmill, those operations have been classified as discontinued operations and assets held for sale in the financial statements. The discussion below addresses our continuing businesses.

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In addition, revenues and expenses associated with land sales have been reclassified, for periods prior to the second quarter of 2003, in our Statements of Operations and Comprehensive Income. Revenues from land sales are included in net sales and the associated expense is included in materials, labor and other operating expenses. Revenues and expenses from land sales are attributable to the Resource segment. The change in presentation reflects the Resource segment s ongoing commitment to actively manage timberland assets, which includes land sales for higher and better use, in the normal course of business.

Certain 2002 and 2001 period amounts presented below have been conformed to 2003 classifications.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Net sales of $1.51 billion for the year ended December 31, 2003, increased 16% compared to net sales of $1.29 billion recorded for the year ended December 31, 2002. Increases in net sales for the Wood Products, Pulp and Paperboard and Resource segments of $174.7 million, $30.5 million and $22.7 million, respectively, more than offset a decline in Consumer Products net sales of $14.8 million. Increased shipments and higher sales prices for oriented strand board in the Wood Products segment and increased paperboard shipments in the Pulp and Paperboard segment were largely responsible for the increase in net sales for these segments. The Resource segment net sales were higher due to increased land sales. A decrease in sales prices resulted in lower net sales for the Consumer Products segment.

Expenses for depreciation, amortization and cost of fee timber harvested were $104.9 million for the year ended December 31, 2003, a decrease of $10.6 million from the prior year total of $115.5 million. For the year ended December 31, 2003, the major components constituting the decrease in depreciation, amortization and the cost of fee timber harvested were permit timber harvest expenses, which were $4.4 million lower in Minnesota than in the prior year, and depreciation expense, which was $1.7 million lower in the Pulp and Paperboard segment and $1.5 million lower in the Wood Products segment than in the prior year.

For the year ended December 31, 2003, materials, labor and other operating expenses rose to $1.21 billion from $1.10 billion in 2002. The higher costs were due primarily to increased shipments of oriented strand board, lumber and paperboard.

Selling, general and administrative expenses were $80.3 million for the year ended December 31, 2003, a slight increase from 2002 s expense of $79.6 million, due principally to a small increase in selling expense.

The following items were included in the Restructuring charges line in the Statements of Operations:

In 2002, we recorded a $9.0 million pre-tax charge for costs associated with the elimination of 106 salaried production and administrative positions. As of December 31, 2002, 82 employees had been terminated, three had assumed other positions within the company as a result of job openings and 21 were scheduled for termination in the first half of 2003. We recorded $3.8 million against the accrued liability associated with the charge at December 31, 2002.

In the first quarter of 2003, we recorded additional charges totaling $0.2 million for costs related to terminated employees whose service had been retained beyond the initial 60-day period following the announced job eliminations in 2002. In

December 2003 we recorded a $0.7 million credit, reflecting final cost determinations for pension and medical benefits. As of December 31, 2003, 100 employees had been terminated, four had assumed other positions

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within the company as a result of job openings and two individuals have been retained until mid-2004. As of December 31, 2003, all costs except immaterial amounts related to the retained individuals, associated with the salaried workforce reduction had been incurred.

Interest expense, net of capitalized interest, was $48.2 million for the year ended December 31, 2003, substantially less compared to the $59.9 million charged against income in 2002. The decrease reflected the lower amount of average debt outstanding during 2003 compared to 2002, as well as an increase of $2.6 million in the amount of interest capitalized from major construction projects in 2003 versus 2002. Capitalized interest increased in 2003 due to the construction of a new tissue machine in Las Vegas, Nevada. It is our policy to calculate and capitalize interest on capital projects with a construction period exceeding 12 months, based upon management s discretion in consideration of the requirements of SFAS No. 34, Capitalization of Interest Costs. These factors were partially offset by increased interest expense of approximately $2.8 million on our $100 million credit sensitive debentures, due to the lowering of our debt ratings in January 2003.

In 2003, we incurred one-time, pre-tax costs of $0.2 million for the early retirement of $3.1 million of outstanding debt. During 2002, we incurred one-time, pre-tax costs of $15.4 million related to our early retirement of over $380 million of outstanding debt.

Interest income for the year ended December 31, 2003, was $14.1 million, compared to $1.9 million recorded in 2002. The increase was primarily due to the receipt of $13.2 million of interest income in conjunction with a settlement with the Internal Revenue Service for tax years 1989 through 1994.

For the year ended December 31, 2003, we recorded an income tax provision of $27.3 million on income from continuing operations, based on an estimated effective tax rate of 34%. During the third quarter of 2003 we revised our estimated tax rate from 39% to 34% as a result of applying anticipated tax credits to our income tax provision. For the year ended December 31, 2002, we recorded an income tax benefit of $32.6 million, reflecting our net loss from continuing operations before taxes, based on an estimated effective tax rate of 39%.

Our earnings from continuing operations for the year ended December 31, 2003, were $53.2 million, compared to our net loss from continuing operations of $50.9 million for the year ended December 31, 2002.

We incurred a pre-tax loss on our discontinued operations of $4.1 million in 2003, compared to a pre-tax loss of $300.7 million in 2002. Discontinued operations include our former Printing Papers segment and a hardwood sawmill. The 2003 loss represents costs we incurred related to maintaining the Brainerd facility before its sale in February 2003, an additional loss on the sale and recognition of a continuing contractual obligation relating to the Brainerd facility. Included in the 2002 amount was $276.2 million for loss on disposition of these properties and $24.5 million in operational losses.

Our net earnings, including discontinued operations, for 2003 were $50.7 million, compared to a net loss of $234.4 million in 2002.

Items recorded in Other comprehensive loss, net of tax for 2003 include a $0.4 million, after-tax increase to our minimum pension liability partially offset by cash flow hedge derivative gains of $0.1 million, after tax, related to our natural gas hedging activities. The increase to the minimum pension liability is the result of a change in the discount rate from 6.75% to 6.25%, partially offset by market increases in our pension assets. In 2002 we recorded a minimum pension liability increase totaling $33.2 million, after-tax, as a result of market declines in our pension assets and a reduction in the discount rate from 7.25% to 6.75%.

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Discussion of business segments

See Note 15, Segment Information, on pages 60-62 for tabular presentation of sales, operating income (loss), depreciation and amortization, assets and capital expenditures attributable to our business segments.

The Resource segment reported operating income of $65.5 million for the year ended December 31, 2003, slightly higher than the $62.6 million reported in 2002. Higher income from land sales in 2003 offset lower earnings from wood fiber sales. In 2003, income from land sales was 38% of the Resource segment operating income due primarily to the sale of 15,300 acres of non-strategic hardwood timberland in Arkansas. This sale of a large parcel was historically unusual as most sales consist of small parcels of less than 100 acres each. The sale occurred because the buyer placed greater value on the large parcel of hardwood timberland than we did, as it was no longer strategic for future use in our business in view of the fact that we had previously sold our hardwood lumber mill in Arkansas and exited the hardwood lumber business. In 2002 and 2001, income from land sales was 11% and 7%, respectively, of the Resource segment operating income. These two years are more representative of the percentage of income from land sales for the segment as land sale revenue amounts can and usually do vary between reporting periods, sometimes significantly as was the case in 2003. The period-to-period fluctuations are due to the unique characteristics of each transaction such as location, size, accessibility, parcel attributes and the value to certain buyers. The sale of timberland is just one aspect of managing our timber and timberland assets to maximize shareholder value within this segment. Segment net sales decreased to $252.6 million in 2003, compared to $411.8 million in 2002. The decrease in net sales was due to decreased wood fiber sales to our Wood Products and Pulp and Paperboard operating segments in Arkansas, Idaho and Minnesota. In the third quarter of 2002, these operating segments began the transition to a fiber procurement system where portions of third party fiber purchases are made directly by each segment. The changes in the fiber procurement system have resulted in lower intersegment sales for the Resource segment and, consequently, lower wood fiber purchases by the Resource segment from third parties. Intersegment sales declined $181.9 million in 2003 compared to 2002. Increased land sales partially offset the decline in wood fiber sales. Land sales revenue totaled $26.5 million in 2003 compared to $7.3 million in 2002. Expenses for the Resource segment were $187.1 million in 2003, significantly lower than the $349.3 million recorded in 2002, due to reduced outside wood purchases by the Resource segment.

The Wood Products segment s operating income of $97.6 million for the year ended December 31, 2003, was a significant improvement over the operating loss of $27.0 million incurred in 2002. Net sales for the segment were $683.1 million, compared to $509.2 million reported in 2002. Low interest rates during 2003 helped to sustain a high level of new home construction, and by mid-year panel inventory levels and, to a lesser extent, dimension lumber began to recover from their oversupplied position, with a corresponding rise in sales prices. The effect was particularly favorable for oriented strand board. OSB net sales increased 68% in 2003, to $314.2 million, largely due to a 61% increase in 2003 versus 2002 average sales prices. Sales prices peaked at record high levels early in the fourth quarter and declined towards year end. Shipments of OSB were 4% higher in 2003 due to production efficiencies at our three facilities in Minnesota. The upturn in OSB markets also aided the markets for certain grades of plywood. Our plywood facility in Idaho adjusted its product mix and temporarily operated some additional shifts during the year to take advantage of market conditions. The resulting added production allowed a 27% increase in shipments, and, combined with increased sales prices, accounted for plywood net sales of $46.4 million, compared to $34.9 million in 2002. Lumber net sales increased to $279.2 million in 2003, compared to $249.8 million in 2002, due to a 17% increase in shipments that was partially offset by a 5% decline in sales prices. The increase in shipments was due to higher production at our lumber mills, largely as a result of adding a shift at each of our Arkansas facilities. Particleboard shipments increased 14% in 2003, due to the absence of market-related downtime taken in 2002. Net sales of particleboard were $15.2 million in 2003, compared to

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$14.1 million in 2002. Expenses were $585.5 million for the segment in 2003, compared to $536.2 million in 2002. Higher product shipments and resin costs were primarily responsible for the increase.

The Pulp and Paperboard segment incurred an operating loss of $15.1 million in 2003, versus a loss of $42.8 million in 2002. Segment net sales increased to $482.0 million for 2003, compared to $443.6 million in 2002. Paperboard net sales were $420.8 million in 2003, compared to $395.1 million in 2002. Paperboard shipments increased 9% compared to 2002, more than offsetting a 2% decline in sales prices. Pulp sales (including intersegment sales) were higher in 2003, rising to $61.2 million, compared to $48.5 million for 2002. The increase in pulp and paperboard sales was due to higher production at our Lewiston, Idaho, facility, which allowed increased pulp shipments internally and increased paperboard and pulp shipments to external customers. Pulp sales prices to external customers increased 12% in 2003. Segment expenses for 2003 totaled $497.1 million, compared to $486.4 million in 2002. The increase reflects greater volumes of product shipments in 2003 compared to 2002, as well as higher energy and wood fiber costs at our McGehee, Arkansas, facility. However, increased paperboard and pulp production at the Lewiston facility has resulted in lower unit production costs compared to 2002.

The Consumer Products segment reported operating income of $1.3 million in 2003, significantly less than the $42.8 million earned in 2002. Very competitive markets during the year resulted in a 5% decline in net sales, to $300.9 million, compared to $315.7 million in 2002. The effect of a sales price decline of 7% for 2003 was only partially offset by a 2% increase in product shipments. Segment expenses were $299.6 million in 2003, compared to $272.9 million in 2002. Higher per unit costs due to downtime taken on some converting lines during the year to reduce finished goods inventory levels, higher pulp costs, higher selling and administration costs in anticipation of the start-up of the new tissue machine in Las Vegas, and increased product shipments contributed to the increase in expenses.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Net sales of $1.29 billion for the year ended December 31, 2002, were slightly higher compared to net sales of $1.28 billion recorded for the year ended December 31, 2001. Increases in Resource and Wood Product segment net sales in 2002 of $30.3 million and $11.8 million, respectively, were partially offset by decreases in net sales for the Pulp and Paperboard segment of $25.4 million and $2.0 million for the Consumer Products segment. In 2002 Resource sales were greater due to increased sales to external customers, while Wood Products net sales increased as a result of an increase in OSB shipments. The decrease in net sales for Pulp and Paperboard was primarily due to lower sales prices for paperboard. In the Consumer Products segment, the effect of lower sales prices for tissue products was partially offset by higher product shipments in 2002.

Expenses for depreciation, amortization and cost of fee timber harvested were $115.5 million for the year ended December 31, 2002, an increase of $.5 million from the prior year amount of $115.0 million.

For the year ended December 31, 2002, materials, labor and other operating expenses were $1.10 billion, compared to $1.10 billion in 2001. Repair and maintenance expense and wood fiber costs were higher in 2002, but were offset by lower energy costs.

Selling, general and administrative expenses totaled $79.6 million for the year ended December 31, 2002, compared to 2001 s expense of $82.8 million. The change was primarily due to bad debt expense incurred in 2001 as a result of a $2.2 million charge related to the insolvency of a pulp broker. In 2002, we expensed the remaining balance due from the pulp broker, totaling $.8 million, after it was determined that collection was not reasonably likely to occur. In addition, bank fees were lower in 2002 versus

2001.

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The following three charges were included in the Restructuring charges line in the Statements of Operations:

In 2002 we recorded a $9.0 million pre-tax charge for costs associated with the elimination of 106 salaried production and administrative positions. We recorded an additional $.2 million during the first half of 2003 for costs related to terminated employees whose services have been retained beyond the initial 60-day period following the announced job elimination, as required by Statement of Financial Accounting Standards (SFAS) No. 146. As of December 31, 2002, 82 employees had been terminated, three had assumed other positions within the company as a result of job openings, and 21 were scheduled for termination at a later date.

In March 2001, we recorded a $4.2 million pre-tax charge associated with a workforce reduction plan at our pulp, paperboard and consumer products operations in Idaho. In September 2001, an additional $0.4 million pre-tax charge was recorded as a result of final cost determinations for pension and medical benefits. The plan permanently reduced the workforce by 124 hourly production and maintenance positions. As of December 31, 2001, all material costs associated with the plan had been incurred.

In December 2001, we reversed $1.8 million of an $18.5 million pre-tax charge, taken in September 2000, for costs associated with the closure of a plywood mill. Our initial estimate of the cost to close the mill included expected costs for some aspects of maintenance and demolition that were not incurred.

Interest expense was $59.9 million for the year ended December 31, 2002, substantially less than the $77.9 million charged against income in 2001. The decrease reflected our net reduction of over $470 million of debt during 2002.

We incurred one-time, pre-tax costs of $15.4 million during 2002 related to our early retirement of over $380 million of outstanding debt. These costs included cash fees and premiums of $10.6 million and the non-cash write-off of related debt financing costs totaling $4.8 million.

Interest income for 2002 totaled $1.9 million, slightly less than the $2.6 million recorded in 2001.

For the year ended December 31, 2002, we recorded an income tax benefit of $32.6 million, reflecting our net loss from continuing operations before taxes, based on an estimated effective tax rate of 39%. For the year ended December 31, 2001, we recorded an income tax benefit of $36.2 million, also reflecting an estimated effective tax rate of 39%.

We recorded a net loss from continuing operations of $50.9 million for the year ended December 31, 2002, compared to a net loss from continuing operations of $56.6 million for the year ended December 31, 2001.

We incurred a pre-tax loss on our discontinued operations of $300.7 million in 2002. The discontinued operations included our former Printing Papers segment and a hardwood sawmill. Included in the amount was $276.2 million for loss on the disposition of these properties and $24.5 million from operational losses. In 2001 these operations incurred pre-tax losses of $37.5 million.

Our net loss for 2002 was $234.4 million, compared to a net loss of $79.4 million in 2001. The unfavorable comparison was due to recognition of the substantial charge for our discontinued operations.

In December 2002, as a result of market declines in our pension assets in the second half of 2002 and a reduction in the discount rate from 7.25% to 6.75%, we recorded in Other comprehensive loss, net of tax an adjustment for a minimum pension liability totaling $33.2 million, after tax.

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Discussion of business segments

The Resource segment reported operating income of $62.6 million for the year ended December 31, 2002, up from $55.3 million reported in 2001. Segment net sales were $411.8 million, compared to $410.1 million in 2001. Increased sales prices and higher sales volumes to third parties in Idaho, Minnesota and Arkansas in 2002, as well as slightly higher land sales, were largely offset by a decrease in internal net sales. Resource segment expenses decreased 2% to $349.3 million in 2002, compared to $354.8 million in 2001. Decreased purchases of residual fiber reduced costs but were partially offset by increased logging costs.

The Wood Products segment incurred an operating loss of $27.0 million for the year ended December 31, 2002, compared to an operating loss of $26.6 million incurred in 2001. Market conditions were difficult for our wood products due to the industry s oversupply position, which persisted throughout 2002, despite a positive new home construction environment. Foreign imports continued to affect pricing during all of 2002, even after imposition of a U.S. duty on Canadian products beginning in May. Net sales for the segment were $509.2 million, slightly higher compared to $502.3 million reported in 2001. Net sales of oriented strand board increased 12% in 2002, to $187.3 million, due to a 13% increase in shipments. A small decrease in lumber shipments, combined with slightly lower sales prices, resulted in a net sales decrease to $249.8 million from $251.9 million in 2001. Net sales of plywood decreased 14% to $34.9 million. Plywood shipments were down 17%, due in large part to lower production in 2002 compared to 2001. Production was higher in 2001 due to extra shifts above the normal operating schedule at our St. Maries, Idaho, mill. Net sales of particleboard were $14.1 million, compared to $15.8 million in 2001. Expenses were $536.2 million for the segment in 2002, compared to $528.9 million in 2001. Higher wood fiber costs were partially offset by small declines in energy and labor costs. Wood fiber costs were higher due in large part to the full year s operation of the Cook, Minnesota, oriented strand board mill. The mill was shut down for a portion of the first quarter of 2001 to complete a modernization and expansion project.

The Pulp and Paperboard segment incurred an operating loss of $42.8 million in 2002, compared to a loss of $56.0 million in 2001. Segment net sales decreased to $443.6 million for 2002, compared to $464.7 million in 2001. The decrease was due to lower sales prices and shipments for paperboard. Paperboard net sales declined 6% to $395.1 million from $420.6 million in 2001 due to a 5% decrease in sales prices and a 1% decline in shipments. The markets for paperboard reflected the difficult general economic conditions in 2002, as well as increased competition from international producers of paperboard. A $4.4 million increase in pulp net sales, due to a 12% increase in shipments, partially offset the decrease in paperboard net sales. Segment expenses were $486.4 million in 2002, compared to $520.7 million in 2001. Energy expense was significantly lower in 2002 but was partially offset by higher repair and maintenance expense and wood fiber costs. Repair and maintenance expense was higher due to a scheduled major maintenance shutdown at the Cypress Bend, Arkansas, pulp and paperboard mill and some equipment improvements at the Lewiston, Idaho, pulp and paperboard mill. Included in expenses for 2001 was an $11.1 million charge related to a lawsuit against a vendor and bad debt expense of $2.2 million related to the insolvency of a pulp broker.

The Consumer Products segment reported operating income of $42.8 million in 2002, slightly higher than 2001 s operating income of $41.6 million. Sales prices for consumer tissue products were down 3%, resulting in a decline in 2002 net sales to $315.7 million from $317.7 million in 2001. Segment expenses were $272.9 million in 2002, compared to $276.2 million in 2001. Lower energy expense in 2002 was primarily responsible for the favorable comparison.

Liquidity and Capital Resources

At December 31, 2003, our financial position included long-term debt of $618.8 million, including current installments on long-term debt of $0.5 million. Long-term debt at December 31, 2003 (including current installments) declined $19.5 million from the December 2002 balance due to normal

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payments on maturing debt of $15.5 million and the early retirement of $4.0 million of long-term debt. The majority of the repayments on maturing debt were made using $15.0 million placed in an interest-bearing escrow account in September 2002 that was restricted to the repayment of $15 million of our medium-term notes, which matured on April 4, 2003. Early retirements of long-term debt consisted of a bond associated with our Brainerd facility totaling $0.9 million and medium-term notes of $3.1 million. The Brainerd bond was called as a result of the sale of the facility in February 2003, and the medium-term notes (whose maturity date was 2018) were repurchased on the open market. Stockholders equity increased $40.1 million, largely due to net earnings of $50.7 million for 2003 and treasury stock issuances of $6.9 million, partially offset by dividend payments of $17.2 million. The ratio of long-term debt (including current installments) to stockholders equity was 1.31 to 1 at December 31, 2003, compared to 1.48 to 1 at December 31, 2002.

Scheduled payments due on long-term debt during each of the five years subsequent to December 31, 2003, are as follows:

	(Dollars in thousands)
2004	$ 507
2005	1,508
2006	2,758
2007	6,559
2008	609

Working capital totaled $160.8 million at December 31, 2003, an increase of $58.1 million from December 31, 2002. The significant changes in the components of working capital are as follows:

Restricted cash declined $15.1 million due to its use for the repayment of medium term notes, which matured in April 2003.

Short-term investments increased $38.1 million. We invested positive cash flow from increased operating earnings not immediately needed for operations or capital expenditures into short-term bank instruments. The increase also reflects our investment in Euro, which will be used to pay the remaining balance due to the supplier of our tissue machine in Las Vegas.

Receivables declined $14.6 million as a result of the receipt of an income tax settlement from the Internal Revenue Service totaling approximately $22.3 million. Increased sales and the corresponding increase in customer receivables partially offset the effect of the tax settlement receipt.

Prepaid expenses declined $20.7 million largely as a result of a $10.4 million reduction in our current deferred tax asset and a reimbursement for a deposit on production equipment of approximately $10.0 million.

During 2003 we repaid $40.0 million of notes payable outstanding at December 31, 2002, under our bank credit facility.

Current installments on long-term debt declined $15.1 million. We made $15.5 million of scheduled debt payments, which were partially offset by approximately $0.5 million of debt scheduled for payment in 2004.

Accounts payable and accrued liabilities declined $22.2 million, largely due to accrued taxes declining $9.4 million and declines in reserves for insurance, property taxes and employee benefits.

Net cash provided by operations in 2003 totaled $163.4 million, compared with cash used for operations of $38.6 million in 2002 and cash provided by operations of $25.5 million in 2001. Net earnings from continuing operations, versus a net loss in 2002, combined with cash generated from

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working capital changes were largely responsible for the favorable comparison in 2003. The net earnings were generally due to significantly higher sales, lower interest expense and higher interest income, as previously discussed. In 2003 we contributed $19.5 million to our two qualified hourly defined benefit pension plans, representing the maximum contribution allowed for tax deduction purposes. The contribution should eliminate the requirement for any material contributions to the plans for the next two years, in the absence of a significant drop in our discount rate assumption. An increase in cash used for working capital items in 2002 accounted for a majority of the unfavorable comparison to 2001.

Net cash used for investing was $111.9 million in 2003, while net cash provided by investing was $46.5 million in 2002 and net cash used for investing was $175.9 million in 2001. In 2003 we used $79.7 million for capital spending and $38.1 million to increase our short-term investments. These activities were partially offset by the use of $15.1 million of restricted cash to repay debt. A significant portion of 2003 capital spending was used for construction of a new tissue machine in North Las Vegas, Nevada. Total spending on this project was $44.4 million during the year. The balance of capital spending in 2003 was focused on forest resources and various small projects designed to improve product quality and manufacturing efficiency. Cash provided by investing in 2002 was largely from the use of restricted cash and the liquidation of short-term investments. The funds were used to repay long-term debt. Capital spending of $51.6 million in 2002 was modestly higher than the $42.7 million spent in 2001. In September 2002, we announced plans to spend $66 million to construct a new tissue machine in Las Vegas, Nevada. Of that amount, $19.2 million was spent on the project in 2002. The balance of capital spending in 2002 focused on routine general replacement, safety, forest resource and environmental projects.

At December 31, 2003, our authorized capital spending budget, including $11.4 million carried over from prior years, totaled $68.2 million. We expect to spend $67.7 million of this amount in 2004. Spending in 2004 will consist of the completion of the new tissue machine in Las Vegas as well as various routine general replacement and forest resource projects. Spending on projects may be delayed due to the acquisition of environmental permits, acquisition of equipment, engineering, weather and other factors.

Net cash used for financing totaled $56.9 million in 2003, compared to cash used for financing of $495.3 million in 2002 and cash provided by financing of $104.3 million in 2001. The majority of cash used for financing in 2003 was to repay borrowings under our bank credit facility totaling $40.0 million and to retire long-term debt in the amount of $19.5 million. Cash was also used to pay dividends of $17.2 million. The majority of cash used for financing in 2002 was for the retirement of $511.9 million of long-term debt. During 2002 we used restricted cash to repay our $100 million 6.25% Debentures, and we retired other debt using proceeds from asset sales. Notes payable increased $40.0 million in 2002, partially offsetting cash used for debt payments.

Cash generated from discontinued operations in 2003 totaled $3.6 million, which is the net result of the sale of the Brainerd facility in February for $4.44 million. Cash from discontinued operations in 2002 totaled $488.9 million, most of which was cash received from the sale of our Printing Papers segment assets and the sale of our hardwood sawmill in Arkansas. In connection with the sale of our Printing Papers segment assets in May 2002, we were required under the terms of our bank credit facility to use the proceeds to repay $198.5 million under the term loan portion of our bank credit facility, and all outstanding debt under our revolving credit line at the date of sale, totaling $33.2 million. We also used a portion of the proceeds to retire approximately $164.9 million of additional debt.

Our current bank credit facility, which expires June 28, 2004, is comprised of a revolving line of credit of up to $150.0 million, including a $70.0 million subfacility for letters of credit, usage of which reduces availability under the revolving line of credit. Our obligations under the bank credit facility are

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secured by our accounts receivable and inventory. As of December 31, 2003, there were no borrowings outstanding under the revolving line of credit; however, approximately $14.7 million of the revolving line of credit was used to support outstanding letters of credit. Prior to the expiration of our current bank credit facility, we expect to either extend the current credit facility or enter into a new credit facility.

Both the agreement governing our bank credit facility and the indenture governing our $250 million 10% senior subordinated notes contain certain covenants that, among other things, restrict our ability and our subsidiaries ability to create liens, merge or consolidate, dispose of assets, incur indebtedness and guarantees, pay dividends, repurchase or redeem capital stock and indebtedness, make certain investments or acquisitions, enter into certain transactions with affiliates, make capital expenditures, or change the nature of our business. The bank credit facility also contains financial maintenance covenants establishing a maximum funded indebtedness to capitalization ratio, a minimum consolidated net worth requirement, and a minimum interest coverage ratio. Events of default under the bank credit facility and the indenture include, but are not limited to, payment defaults, covenant defaults, breaches of representations and warranties, cross defaults to certain other material agreements and indebtedness, bankruptcy and other insolvency events, material adverse judgments, actual or asserted invalidity of security interests or loan documentation, and certain change of control events involving our company. As of December 31, 2003, we were in compliance with the covenants of our bank credit facility and the $250 million 10% senior subordinated notes.

We believe that our cash, cash flows from operations and available borrowings under our current bank credit facility (including our anticipated extension or replacement of the bank credit facility) will be sufficient to fund our operations, capital expenditures and debt service obligations for the next twelve months. We cannot assure, however, that our business will generate sufficient cash flow from operations or that we will be able to extend or replace our current bank credit facility, or that we will be in compliance with the financial covenants in our bank credit facility so that future borrowings thereunder will be available to us. Thus, our ability to fund our operations will be dependent upon our future financial performance, which will be affected by general economic, competitive and other factors, including those discussed above under Factors Influencing Our Results of Operations, many of which are beyond our control.

On January 30, 2003, Standard & Poor s Ratings Services (S&P) announced that it had lowered our senior unsecured debt rating to BB+ and affirmed our senior secured bank loan rating at BBB-. The ratings downgrade by S&P caused the interest rate on our $100 million Credit Sensitive Debentures to increase from 9.425% to 12.5%, effective January 30, 2003. Also during the first quarter of 2003, Fitch, Inc. downgraded our senior unsecured debt to BB+ with a negative outlook and affirmed our senior secured bank loan rating at BBB-. Moody s Investors Service Inc. s rating of our debt remains unchanged at Baa3 with a negative outlook.

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The following table summarizes our contractual obligations as of December 31, 2003. Portions of the amounts shown are reflected in our consolidated financial statements and accompanying footnotes, as required by generally accepted accounting principles. See the footnotes following the table for information regarding the amounts presented and for references to appropriate financial statement footnotes, which include a detailed discussion of the item.

	Payments due by period				
	Total	1 Year	2-3 Years	4-5 Years	Over 5 Years
	(Dollars in thousands)				
Long-term debt(1)	$ 618,785	$ 507	$ 4,266	$ 7,168	$ 606,844
Operating leases(2)	87,907	12,391	21,524	16,779	37,213
Purchase obligations	144,355	110,994	24,850	8,416	95
Other long-term obligations(3)	266,514	21,858	46,541	74,801	123,314
Total	$ 1,117,561	$ 145,750	$ 97,181	$ 107,164	$ 767,466

(1) See Note 8, Debt, in the notes to financial statements.
(2) See Note 13, Commitments and Contingencies, in the notes to financial statements.
(3) Payments on qualified pension plans are based on estimated minimum required contributions for years 1-5. Payments on postretirement benefit plans are based on expected future benefit payments as disclosed in Note 12 to the financial statements for years 1-5.

Since December 1999, we have been authorized under a stock repurchase program to repurchase up to two million shares of our common stock. Under the plan, purchases of common stock may be made from time to time through open market and privately negotiated transactions at prices deemed appropriate by management. Through December 31, 2001, a total of 910,900 shares had been acquired under the stock repurchase program. No shares were acquired in 2002 or 2003, and we do not expect to repurchase additional common stock in the near future.

It is our practice to periodically review strategic and operational alternatives to improve our operating results and financial position. In this regard, we consider and plan to continue to consider, among other things, adjustments to our capital expenditures and overall spending, the restructuring of our operations to achieve greater efficiencies, and the disposition of assets that may have greater value to others. There can be no assurance that we will be successful in implementing any new strategic or operational initiatives or, if implemented, that they will have the effect of improving our operating results and financial position.

Off-Balance Sheet Arrangements

We currently are not a party to off-balance sheet arrangements that would require disclosure under this section.

Environment

We are subject to extensive federal and state environmental regulations at our operating facilities and timberlands, particularly with respect to air emissions, wastewater discharges, solid and hazardous waste management, site remediation, forestry operations and endangered species. We endeavor to comply with all environmental regulations and regularly monitor our activities for such compliance. Compliance with environmental regulations is a significant factor in our business and requires capital expenditures as well as additional operating costs. Capital expenditures specifically designated for environmental compliance totaled approximately $0.4 million during 2003 and are budgeted to be approximately $4.8 million in 2004.

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As previously discussed in Item I, Business, our timberlands in Idaho, Arkansas and Minnesota are certified by third parties to be in compliance with the Sustainable Forestry Initiative (SFI) Program and the International Organization on Standardization (ISO) 14001 standard for environmental management systems. Participation in the SFI and ISO programs is voluntary, can require operating processes which are more stringent than existing federal or state requirements, and can increase our operating costs to maintain certification. Such operating costs have not had a material adverse effect on our competitive position, nor do we expect that they will in the future.

In early 1998 the Environmental Protection Agency (EPA) published the Cluster Rule regulations specifically applicable to the pulp and paper industry. These extensive regulations govern both air and water emissions. During 2001, we completed modifications to process equipment and operating procedures to comply with Phase I of the regulations. Phase II of the regulations relates to control of high volume, low concentration emissions at kraft pulp mills, and our compliance efforts are scheduled to be completed in 2006 at an expected cost of approximately $6 million. We do not expect that such compliance costs will have a material adverse effect on our competitive position.

Our pulp mill at Lewiston, Idaho, discharges treated mill effluent into the nearby Snake River. Federal law requires that we comply with provisions of a National Pollution Discharge Elimination System (NPDES) permit. As allowed by federal regulations, we are operating under an NPDES permit that expired in 1997, but which continues to be in force until the effective date of a new NPDES permit. The EPA published a revised draft NPDES permit in June 2003, which among other matters requires a significant reduction in biochemical oxygen demand over the five year period of the new permit and also requires within two years of the effective date of the new permit a reduction in the temperature of the effluent during the months of July, August and September each year. Meeting these requirements would require modifications of operating practices that will increase operating costs. Physical modifications to the effluent system over the next several years may be required at a cost of up to $5 million. We do not expect that such compliance costs will have a material adverse effect on our competitive position.

The EPA is currently developing additional Maximum Achievable Control Technology (MACT) standards, which will affect wood products panel facilities. The effective date of these standards is expected to be in early 2004, with compliance required by early 2007. We have studied the proposed MACT standards for power boiler operations and for wood products operations, and estimate the capital expenditures necessary for compliance will be approximately $11 million. We do not expect such compliance costs to have a material adverse effect on our competitive position.

We believe that our facilities are currently in substantial compliance with applicable environmental laws and regulations. We cannot assure, however, that situations that may give rise to material environmental liabilities will not be discovered or that the enactment of new environmental laws or regulations or changes in existing laws or regulations will not require significant expenditures by us. In that regard, in late January 2004, we voluntarily reported to the Minnesota Pollution Control Agency (MPCA) a potential air permit violation at our oriented strand board facility in Bemidji, Minnesota, relating to the non-operation of equipment used to control nitrous oxide emissions from a wood-fired boiler for a period of approximately 29 months. Corrective action has been taken, and we are cooperating with the MPCA in its investigation. As the investigation is ongoing, we have not been advised as to what action the MPCA may take.

Taking into consideration the possible consequences of the above described matter, we believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

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Income Taxes

Our effective tax rate for 2003 was 34%, compared to 39% for 2002 and 2001. The effective rate for 2003 differs from the one used for 2002 and 2001 as a result of applying anticipated tax credits to our tax provision.

Subsequent Event

In late January 2004, we implemented a plan to reduce the hourly and salaried workforces at our Consumer Products manufacturing facilities in Lewiston and Las Vegas. A total of 8 salaried and 60 hourly positions were eliminated. Costs for the workforce reduction, consisting of severance benefits, are expected to be approximately $1.0 million to $1.5 million and will be incurred during the first quarter of 2004.

Quantitative and Qualitative Disclosures About Market Risks

Our exposure to market risks on financial instruments includes interest rate risk on our bank credit facility and long-term debt, credit rate risk on our credit sensitive debentures, foreign currency exchange rates that affect the value of our investment in Euro and commodity price risk on collars we use to hedge a portion of our short-term natural gas purchases.

As of December 31, 2003, we had no borrowings outstanding under our bank credit facility. The interest rates applied to borrowings under the bank credit facility are adjusted often and therefore react quickly to any movement in the general trend of market interest rates. We do not attempt to mitigate the effects of short-term interest rate fluctuations on our bank credit facility borrowings through the use of derivative financial instruments.

All of our long-term debt is fixed-rate and therefore changes in market interest rates do not expose us to interest rate risk for these financial instruments. However, in August 2003 we entered into a fixed-to-variable interest rate swap to hedge a portion of our 10% senior subordinated debentures. The swap was designated as a fair value hedge and calls for the company to pay a variable interest amount, determined semi-annually in arrears and equal to LIBOR plus 4.80%, and receive a fixed-rate payment from a financial institution, calculated on $165.0 million of our 10% senior subordinated debentures. The terms of the swap allow us to assume there is no ineffectiveness in the hedge. A previous swap, with essentially the same terms, was terminated in June 2003. We have received cash settlements totaling $20.0 million for the previous swap, representing the value of the swap at the time of termination as well as for a repricing of the swap in August 2002. The cash received will be accreted to earnings until the 10% senior subordinated debentures are retired.

We currently have $100 million of credit sensitive debentures outstanding which pay interest to the debt holder based upon our credit ratings as established by Standard & Poor s Ratings Services (S&P) or Moody s Investors Services, Inc. The following table denotes the interest rate applicable based on various credit ratings:

Ratings		
Moody s	S&P	Applicable Rate(%)
Aaa	AAA	8.825
Aa1 - Aa3	AA+-AA-	8.925
A1 - Baa2	A+- BBB	9.125
Baa3	BBB-	9.425
Ba1	BB+	12.500
Ba2	BB	13.000
Ba3	BB-	13.500
B1 or lower	B+ or lower	14.000

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On January 30, 2003, S&P announced that it had lowered our senior unsecured debt rating to BB+ from BBB -. The ratings downgrade caused the interest rate on our credit sensitive debentures to increase from 9.425% to 12.5%, effective January 30, 2003.

In the first half of 2003 we entered into forward purchase contracts to acquire Euro, with the settlement of these forward contracts timed to coincide with our required Euro payments to the supplier of our new tissue machine under construction in North Las Vegas, Nevada. As of December 31, 2003, we had no forward purchase contracts outstanding, however, we held 3.9 million Euro to be used to pay the remainder of the amount due to the supplier upon completion of the project. The Euro are valued on our Balance Sheet at the exchange rate quoted at December 31, 2003.

During the third quarter of 2003, we entered into several derivative financial instruments designated as cash flow hedges for a portion of our expected natural gas purchases during November 2003 through March 2004. The financial instruments are in the form of collars, with a ceiling of $6.35 per mmBtu and floors ranging from $4.44 to $5.30 per mmBtu, indexed to the NYMEX, Rocky Mountain and Canadian Border indices. The collars apply to 13,200 mmBtu of natural gas purchased per day for the five-month period beginning November 1, which represents approximately 60% of our expected daily usage during that period. As designated cash flow hedges, changes in the fair value of the financial instruments are recognized in Other comprehensive loss, net of tax to the extent the hedges are deemed effective, until the hedged item is recognized in the statement of operations.

Quantitative Information About Market Risks

	Expected Maturity Date						
	2004	**2005**	**2006**	**2007**	**2008**	**Thereafter**	**Total**
				(Dollars in thousands)			
Long-term debt:							
Fixed rate	$ 507	$ 1,508	$ 2,758	$ 6,559	$ 609	$ 606,844	$ 618,785
Average interest rate	6.0%	6.2%	6.4%	6.1%	6.8%	8.0%	8.0%
Fair value at 12/31/03							$ 651,905
Interest rate swap:							
Fixed to variable						$ 165,000	$ 165,000
Average pay rate						6-month LIBOR in arrears + 4.8%	
Average receive rate						10.0%	10.0%
Fair value at 12/31/03							$ 2,386

	Maturity-2004	**Fair Value**
Natural gas futures contracts:		
Puts		$ 7
Contract volume (mmbtu)	1,027,600	
Weighted average price (mmbtu)	$ 4.82	
Calls		$ 105
Contract volume (mmbtu)	1,027,600	
Weighted average price (mmbtu)	$ 6.35	

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POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Dollars in thousands except per-share amounts)

	For the years ended December 31		
	2003	**2002**	**2001**
Net sales	$ 1,506,634	$ 1,293,546	$ 1,278,864
Costs and expenses:			
Depreciation, amortization and cost of fee timber harvested	104,859	115,469	115,033
Materials, labor and other operating expenses	1,207,086	1,099,690	1,095,686
Selling, general and administrative expenses	80,280	79,618	82,842
Restructuring charges (Note 16)	(476)	8,963	2,750
	1,391,749	1,303,740	1,296,311
Earnings (loss) from operations	114,885	(10,194)	(17,447)
Interest expense, net of capitalized interest of $2,907 ($300 in 2002 and $1,032 in 2001)	(48,172)	(59,882)	(77,853)
Debt retirement costs	(248)	(15,360)	
Interest income	14,090	1,939	2,569
Earnings (loss) before taxes	80,555	(83,497)	(92,731)
Provision (benefit) for taxes (Note 7)	27,334	(32,564)	(36,165)
Earnings (loss) from continuing operations	53,221	(50,933)	(56,566)
Discontinued operations (Note 17):			
Loss from discontinued operations (including loss on disposal of $2,745, $276,218 and $0)	(4,089)	(300,734)	(37,507)
Income tax benefit	(1,595)	(117,286)	(14,628)
Net earnings (loss)	$ 50,727	$ (234,381)	$ (79,445)
Other comprehensive loss, net of tax:			
Cash flow hedges:			
Net derivative gains, net of income tax provision of $44, $0 and $0	68		
Minimum pension liability adjustment, net of income tax benefit of $239, $21,231 and $0	(374)	(33,207)	
Comprehensive income (loss)	$ 50,421	$ (267,588)	$ (79,445)
Net earnings (loss) per common share from continuing operations:			
Basic	$ 1.85	$ (1.79)	$ (2.00)
Diluted	1.85	(1.79)	(2.00)
Net earnings (loss) per common share:			
Basic	1.77	(8.23)	(2.81)

Diluted	1.77	(8.23)	(2.81)

Certain amounts for 2002 and 2001 have been reclassified to conform to the 2003 presentation.

The accompanying notes and summary of principal accounting policies are

an integral part of these financial statements.

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POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except per-share amounts)

	At December 31	
	2003	**2002**
ASSETS		
Current assets:		
Cash (Note 11)	$ 7,190	$ 8,973
Restricted cash (Notes 1, 8 and 11)		15,069
Short-term investments (Note 11)	40,091	2,000
Receivables, net of allowance for doubtful accounts of $1,285 ($1,624 in 2002) (Notes 2 and 8)	105,345	119,964
Inventories (Notes 3 and 8)	159,678	159,798
Prepaid expenses (Note 7)	18,315	39,005
Assets held for sale (Note 17)		5,000
Total current assets	330,619	349,809
Land, other than timberlands	8,831	8,750
Plant and equipment, at cost less accumulated depreciation of $1,334,918 ($1,260,487 in 2002) (Note 4)	740,342	758,168
Timber, timberlands and related logging facilities, net (Note 5)	398,899	396,426
Other assets (Note 6)	118,686	111,664
	$ 1,597,377	$ 1,624,817
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable (Notes 8 and 11)	$	$ 40,000
Current installments on long-term debt (Notes 8 and 11)	507	15,607
Accounts payable and accrued liabilities (Note 9)	169,310	191,497
Liabilities related to assets held for sale (Note 17)		12
Total current liabilities	169,817	247,116
Long-term debt (Notes 8 and 11)	618,278	622,645
Other long-term obligations (Note 10)	266,514	267,611
Deferred taxes (Note 7)	71,917	56,654
Stockholders equity:		
Preferred stock, Authorized 4,000,000 shares		
Common stock, $1 par value Authorized 40,000,000 shares, issued 32,721,980 shares	32,722	32,722
Additional paid-in capital	130,996	131,065
Retained earnings	443,202	409,692
Accumulated other comprehensive loss:		

Minimum pension liability adjustment	(33,581)	(33,207)
Cash flow hedges	68	
Common shares in treasury 3,881,217 (4,143,329 in 2002)	(102,556)	(109,481)
Total stockholders equity	470,851	430,791
	$ 1,597,377	$ 1,624,817

Certain amounts for 2002 have been reclassified to conform to the 2003 presentation.

The accompanying notes and summary of principal accounting policies are an integral part of these financial statements.

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POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	For the years ended December 31		
	2003	**2002**	**2001**
CASH FLOWS FROM CONTINUING OPERATIONS			
Net earnings (loss)	$ 50,727	$ (234,381)	$ (79,445)
Adjustments to reconcile net earnings (loss) to net operating cash flows:			
Loss from discontinued operations	820	14,955	22,879
Loss on disposal of discontinued operations	60	229,023	
Depreciation, amortization and cost of fee timber harvested	104,859	115,469	115,033
Debt retirement costs	248	15,360	
Deferred taxes	15,503	(132,725)	(83,351)
Employee benefit plans	1,514	3,295	(2,365)
Decrease in receivables	14,619	(1,333)	27,499
Decrease (increase) in inventories	120	(52,085)	19,077
Decrease (increase) in prepaid expenses	20,690	(7,731)	29,879
Increase (decrease) in accounts payable and accrued liabilities	(26,297)	11,534	(22,211)
Funding of qualified pension plans	(19,461)		(1,465)
Net cash provided by (used for) operations	163,402	(38,619)	25,530
CASH FLOWS FROM INVESTING			
Decrease (increase) in restricted cash	15,069	83,131	(98,200)
Decrease (increase) in short-term investments	(38,091)	28,500	(30,500)
Additions to plant and equipment, and to land other than timberlands	(64,991)	(36,956)	(29,063)
Additions to timber, timberlands and related logging facilities	(14,695)	(14,658)	(13,616)
Disposition of plant and properties	709	2,099	15,695
Other, net	(9,927)	(15,629)	(20,244)
Net cash provided by (used for) investing	(111,926)	46,487	(175,928)
CASH FLOWS FROM FINANCING			
Change in book overdrafts	4,610	(9,952)	(2,366)
Increase (decrease) in notes payable	(40,000)	40,000	(188,943)
Proceeds from long-term debt			450,000
Retirement of long-term debt	(19,467)	(511,873)	(101,749)
Premiums and fees on debt retirement	(248)	(10,584)	
Long-term debt issuance fees			(15,553)
Issuance of treasury stock	6,799	8,146	6,620
Purchase of treasury stock			(10,453)
Dividends on common stock	(17,217)	(17,071)	(33,108)
Other, net	8,656	6,054	(112)
Net cash provided by (used for) financing	(56,867)	(495,280)	104,336

Cash from continuing operations	(5,391)	(487,412)	(46,062)
Cash from discontinued operations	3,608	488,910	42,880
Increase (decrease) in cash	(1,783)	1,498	(3,182)
Balance at beginning of year	8,973	7,475	10,657
Balance at end of year	$ 7,190	$ 8,973	$ 7,475

Net interest paid (net of amounts capitalized) in 2003, 2002 and 2001 was $46.2 million, $65.1 million and $66.1 million, respectively. Net income tax payments (refunds) in 2003, 2002 and 2001 were $(13.1) million, $(16.0) million and $.3 million, respectively.

Certain amounts for 2002 and 2001 have been reclassified to conform to the 2003 presentation.

The accompanying notes and summary of principal accounting policies are

an integral part of these financial statements.

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POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(Dollars in thousands except per-share amounts)

	Common Stock Issued				Accumulated	Treasury Stock		
	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Other Comprehensive Loss	Shares	Amount	Total Stockholders Equity
Balance, December 31, 2000	32,721,980	$ 32,722	$ 128,984	$ 773,697	$	4,375,546	$ (122,167)	$ 813,236
Exercise of stock options and stock awards			5			(750)	19	24
Shares purchased at cost*						250,000		
Issuance of treasury stock			989			(214,268)	5,608	6,597
Net loss				(79,445)				(79,445)
Common dividends, $1.17 per share				(33,108)				(33,108)
Balance, December 31, 2001	32,721,980	$ 32,722	$ 129,978	$ 661,144	$	4,410,528	$ (116,540)	$ 707,304
Exercise of stock options and stock awards			141			(25,050)	662	803
Issuance of treasury stock			946			(242,149)	6,397	7,343
Net loss				(234,381)				(234,381)
Minimum pension liability adjustment					(33,207)			(33,207)
Common dividends, $.60 per share				(17,071)				(17,071)
Balance, December 31, 2002	32,721,980	$ 32,722	$ 131,065	$ 409,692	$ (33,207)	4,143,329	$ (109,481)	$ 430,791
Exercise of stock options and stock awards			47			(49,925)	1,319	1,366
Issuance of treasury stock			(173)			(212,187)	5,606	5,433
Performance share awards			57					57
Net earnings				50,727				50,727
Cash flow hedges					68			68
Minimum pension liability adjustment					(374)			